

Insights: Publications

A Recipe for Bad Tax Policy: False Claims Acts and Class Action Lawsuits in the World of State Taxation

December 4, 2024

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Perfection is often an admirable goal, but rarely achieved. However, in the current environment, failure to collect, report and remit your taxes perfectly, particularly in the sales and use tax arena, can leave a taxpayer open to litigation for the smallest of errors. There have been thousands of lawsuits filed in the last few years where a taxpayer has been sued via a *qui tam* action for under collection of taxes or in a class action lawsuit for over collection of taxes. While nobody likes a tax cheat, the stark increase of these cases begs widespread consideration of the laws and policies allegedly furthered by them. Most notably, the recent settlement of the *Tributum, LLC v. Saylor* illustrates the often-tenuous relationship between a well-intentioned law and exploitative application.

Qui tam actions are not new. The United States Congress enacted the Informer's Act, now known as the False Claims Act ("FCA"), to root out fraud in government contracting during the Civil War. ^[2] The most important component of the Act was the *qui tam* provision that allowed a private individual (a 'relator') to bring an action on behalf of the government in exchange for a substantial percentage of any awards or settlements. ^[3] After the Civil War, the Act lay relatively dormant for many years.

States adopt FCAs.

In 1987, California became the first state to pass its own False Claims Act. ^[4] Today, approximately thirty states and the District of Columbia all have FCAs. ^[5] The wholesale adoption of FCA's has led to thousands of lawsuits across the country accusing good intentioned taxpayers of failing to be perfect with their tax obligations. Often times, there are no violations of the *qui tam* laws associated with these suits. Unfortunately, because many of these taxpayers were small businesses and the costs of litigating these cases far exceeded the costs of settling, the majority of these cases settled out of court and the relator obtained their much-desired windfall.

Class Action Suits

Success begets success. Because of the lucrative nature of these exploitive *qui tam* suits, relators looked for additional ways to harass taxpayers and produced the class action tax lawsuit. Here, the "relator" claims that a business is over-collecting a tax rather than under-collecting as commonly found in a traditional *qui tam* lawsuit.

Relator motivation to bring class action lawsuits can be even greater, as the potential payout is potentially even more lucrative than traditional *qui tam* lawsuits. However, due to their nature as class actions, this increased monetary incentive is accompanied by a slightly higher bar for recovery to compensate.

Defenses and Current Cases

Taxpayers are not powerless to fight back against these types of parasitic lawsuits. While settlement remains the quickest, and sometimes cheapest, means of ending the dispute, defenses have been emerging to ward off this new category of suits. One popular defense is to argue that the transaction at issue was taxed correctly. On a fundamental level, if the tax was properly collected and remitted, there can be no “false claim.” Thus, there is no basis for the cause of action, and the suit will be dismissed. Some defendants have challenged these suits procedurally, arguing that the relevant state tax agency has exclusive and/or primary jurisdiction over the claim. If exclusive, *qui tam* and class action suits would be precluded by law because such agency is the only party which may launch an action related to the matter. If primary, any *qui tam* or class action suit would be forced to wait on the sideline while the tax agency reviews the case file and determines whether to proceed with the case.

Illinois has long been a battleground for *qui tam* litigation. There, suits can be categorized by waves of litigation, often striking certain industries with each wave. For example, while the “first wave” of litigation focused on out-of-state internet retailers not collecting sales tax, the most recent wave (2017 and forward) has largely focused on foreign and domestic tailors and bespoke clothing companies. Since 2017, more than fifty cases have been launched against companies of this type in Illinois alone.

While Illinois has been a leader in both *qui tam* and class action tax lawsuits, the problem is national. For example, in Washington D.C. a relator brought a *qui tam* action regarding a business owner's state of residency. In *Tributum, LLC v. Michael J. Saylor*, Tributum, acting as relator, accused Saylor of violating the False Claims Act by living in Washington D.C. but claiming residency in Florida for tax purposes. The relator highlighted the fact that the taxpayer's company filed his personal income tax returns, which claimed Florida residency, was in violation of the FCA. Because the company did so under Saylor's direction. Thus, this corporate action constituted a violation of the FCA by Saylor himself. Saylor ultimately settled with the relator for over \$30 million. While significant, it pales in comparison to another case from New York, *People of New York v. Sprint*, where the telecommunications company settled for roughly \$330 million after the New York Court of Appeals found the sales tax statute at issue unambiguous as applied to wireless voice services.

Another case involving a Florida taxpayer is *Stevens v. State of Florida*. This suit involved several financial institutions and associated mortgage electronic registrations systems. The relator alleged that these institutions failed to collect and remit sales tax on the assignment of mortgage notes within the state. However, unlike *Tributum*, the Florida court dismissed this action, stating that the Florida Tax Act, not the Florida False Claims Act, provided the exclusive remedy for this matter at hand. Another similar victory emerged in *People of New York v. Vanguard*, where the court dismissed the *qui tam* suit brought by an in-house tax attorney against the taxpayer because an ethical exception to attorney-client confidentiality was not met. This suit relied on information obtained from the relator's employment within Vanguard, and therefore required such exemption to be meaningfully actionable. As evidenced by these two cases, defenses to suits of these kinds are possible, but require a degree of creativity and the willingness to challenge the relator on the merits and procedural posture of their case.

Finally, a growing and concerning trend has emerged involving *qui tam* and False Claims suits in the Unclaimed Property space. Two recent examples include *State ex rel. French v. Card Compliant* and *State ex rel. French v. Overstock.com*. Each of these cases arises out of Delaware. Both taxpayers are large retailers with significant out-of-state gift card operations. Each company did not file Delaware unclaimed property reports for the years at issue. After navigating a long series of litigation and appeals, the suits landed in the Delaware Supreme Court. This Court ruled that the companies' failure to file reports did not equate to making or using a false statement for the purpose of the Delaware False Claims Act. These rulings represent major victories for taxpayers in the growing landscape of *qui tam* lawsuits involving unclaimed property.

Future Developments

Looking to the future, it is apparent that other complicated legal areas will be ripe targets for opportunistic *qui tam* relators. By all indications, the relators in these cases will again dramatically over- or under-calculate what these companies owe and will continue to supplant the traditional authorities that are tasked with ensuring compliance with each state's laws.

Qui tam relators tend to focus on areas where compliance with the law is a sophisticated and imprecise art. These are areas for which there have typically been undeniable public disclosures, most often in the form of audits and in the media, and state agencies continue to debate the best solutions in addressing them. Allowing these relators to move forward with such actions will not only further the injustice of allowing private individuals to reap the benefits of statutes that were not intended to apply to them, but will also allow these often unsophisticated and opportunistic individuals to set policy in very difficult and sensitive areas of the law, divorced entirely from seasoned policymakers striving to implement sound resolutions to these complex areas of law. Hence, states should begin to rethink their characterization of proper relators. A proper relator should be a true whistleblower with actual insider knowledge of violations of the FCA. More important, given the complexity of state tax issues and the need for such issues to be uniformly applied by state departments of revenue, states should unequivocally reject the application of FCAs to state and local taxes. [6]

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[2] See False Claims Act, ch. 67, 12 Stat. 696 (1863) (current version codified at [31 USC §§3729](#) and [3730](#))

[3] The shorthand term *qui tam* derives from 'the Latin phrase *qui tam pro domino rege quam pro se ipso in hac parte sequitur*, which means 'who pursues this action on our Lord the King's behalf as well as his own.'" See [State ex rel. McCann v. Bank of America, N.A., 191 Cal. App. 4th 897, 120 Cal. Rptr. 3d 204 \(1st Dist., 2011\)](#), fn. 4 (internal citation and quotation marks omitted). That private individual, or 'relator,' who pursues the action has become known also as a 'whistleblower.'

[4] [Cal. Gov't Code §§12650](#) to [12656](#).

[5] See the website of the Taxpayers Against Fraud Educational Fund (TAFEF), at www.taf.org (select 'Resources by Topic' and, under 'FCA,' click on 'State FCAs'). Most states have adopted their FCAs since 2000. As described on the website, TAFEF is 'a nonprofit, public interest organization dedicated to combating fraud against the government and protecting public resources through public-private

partnerships.' Taxpayers Against Fraud (TAF, the [IRC §501\(c\)\(4\)](#) arm of the TAFEF) advocates for 'legislation, rules and regulations creating and enhancing whistleblower reward and private enforcement provisions in federal and state laws.'

[6] For a contrary view, see, e.g., Bruegger, 'Tax Whistleblower Proceedings at the State Level: Common Themes and a Call to Action,' 19 JMT 12 (May 2009).

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