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Court of Appeals

Of the

State of New York

PEOPLE OF THE STATE OF NEW YORK, by Eric T. Schneiderman, Attorney General for the State of New York, and STATE OF NEW YORK, ex rel. EMPIRE STATE VENTURES, LLC,

Plaintiffs-Respondents,

against

Sprint Nextel Corp., Sprint Spectrum L.P., Nextel of New York, Inc., and Nextel Partners of Upstate New York, Inc.,

Defendants-Appellants.

BRIEF FOR *AMICUS CURIAE* THE BUSINESS COUNCIL OF NEW YORK STATE, INC. IN SUPPORT OF DEFENDANTS-APPELLANTS

Date Completed: July 21, 2015

DISCLOSURE STATEMENT OF THE
BUSINESS COUNCIL OF NEW YORK STATE, INC.
PURSUANT TO 20 NYCRR 500.1(f)

Pursuant to Rule 500.1(f) of the Court of Appeals of New York Rules of Practice, the Business Council of New York State, Inc. advises the Court that it is a non-profit corporation organized under section 501(c)(3) of the Internal Revenue Code and that it has no parent corporation, subsidiary, or corporate affiliate.

TABLE OF CONTENTS

TABLE OF CONTENTS
(Continued)

Page

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES
(Continued)

Page

TABLE OF AUTHORITIES
(Continued)

Page

STATUTES & RULES

TABLE OF AUTHORITIES
(Continued)

Page

TABLE OF AUTHORITIES
(Continued)

Page

OTHER AUTHORITIES

INTEREST OF AMICUS CURIAE

The Business Council of New York State, Inc. ("Business Council") is a leading business organization in New York, representing the interests of more than 2,500 member businesses statewide. Its membership is comprised of both large and small businesses, with varying degrees of sophistication in state and local tax matters. The Business Council's primary function is to serve as an advocate for its members to promote a healthier climate for business and economic development.

The Business Council's members frequently have to determine whether to collect tax from their customers. These determinations involve interpreting and applying the Tax Law, often in novel and constantly evolving situations. The evolution of business often causes uncertainty in the application of tax laws, which requires businesses to constantly analyze and determine how to apply such laws.

These tax determinations have become extremely precarious for the Business Council's members because of class-action litigation against retailers for *collecting* sales tax that may not have been due, and the prosecution of False Claims Act litigation against retailers for *not collecting* sales tax that may have been due. Businesses have also been subject to derivative securities litigation because of the impact of such non-traditional administration of the Tax Law on a public company's stock price. The proper administration of the Tax Law must be entrusted to the administrative agency responsible for administering the tax laws,

the New York State Department of Taxation and Finance ("Department"), and the resolution of tax disputes to the agency responsible for adjudicating tax controversy, the New York State Division of Tax Appeals ("DTA").

Although the pre-filing resolution of uncertainty in the Tax Law may be a gallant endeavor, it is infeasible for the Business Council's thousands of members to wait for an advisory opinion or for a legislative clarification of law before making the decisions to collect or not to collect tax.

The Business Council recognizes that its members would be impacted negatively if the New York State Attorney General ("Attorney General") were permitted to use the False Claims Act to prosecute tax positions that are based on business judgment applied to arrive at a reasonable interpretation of the Tax Law.

SUMMARY OF THE ARGUMENT

The New York False Claims Act ("NYFCA") cannot be used to prosecute a taxpayer's reasonable interpretation of an unclear tax statute. The Plaintiff seeks to use the NYFCA, an atypical measure recently amended to combat tax fraud, to circumvent the established and effective administrative process in place to resolve taxpayer disputes. The Business Council asks the Court to grant the motion to dismiss filed by Defendants-Appellants, Sprint Nextel Corp. and its affiliates (collectively "Sprint").

The NYFCA is an extraordinary measure, imposing treble damages for unpaid tax. To state a cause of action under the NYFCA, the Plaintiff was required to plead with factual detail each element of its claim. Vitally, the Plaintiff was required to allege that Sprint acted with "knowing" intent—that is, that the company had actual knowledge, reckless disregard, or deliberate ignorance—to violate the Tax Law when it filed its sales tax returns. *See* N.Y. State Fin. Law §§ 188(3)(a), 189(4). In addition, unlike an ordinary tax dispute, where the burden is on the taxpayer to prove the Department issued an incorrect assessment, the NYFCA places the burden of proof squarely on the State to allege its prima facie case. The NYFCA claim is not entitled to a presumption of correctness.

The Complaint failed to plead the requisite scienter. The Plaintiff conceded that Sprint analyzed the Tax Law and made a determination that its position was

reasonable. If the Court allows the Plaintiff to proceed under this standard, any taxpayer acting under an unclear tax statute would have a "knowing" intent to violate that statute. Such a result would eviscerate the statutory scienter requirement.

The Complaint further contains no factual allegations to support a violation of the Tax Law. Rather than a specific provision of the Tax Law, the Plaintiff's primary allegation is that Sprint violated a state agency's interpretation issued in a guidance, a technical memorandum. But the Department's informal interpretation is *not the law*, is regularly overturned at both the administrative and appellate levels, and may be withdrawn or even reversed by the Department at any time. Further, the Department's interpretation does not impact the foundational premise that ambiguous tax imposition statutes must be construed strictly in favor of the taxpayer. Nor can an NYFCA claim be pled for an alleged violation of an ambiguous taxing statute unless the taxpayer's interpretation is unreasonable. Again, tax disputes concerning the interpretation of the Tax Law are properly adjudicated using the established administrative process—not the NYFCA.

The Plaintiff's proposed alternatives for taxpayers navigating ambiguous tax statutes are infeasible, expensive, and impractical for businesses making decisions in real time. A taxpayer may have to wait years to receive an advisory opinion, which will apply only to the specific facts and law in the taxpayer's petition. A

taxpayer who chooses to collect sales tax and seek a refund later—rather than not collect and go through audit—opens itself up to consumer protection class action liability. And a taxpayer cannot reasonably expect the Legislature to amend every unclear tax provision. The Plaintiff's suggestions are even more absurd when compounded by the Business Council's thousands of member businesses.

The Business Council asks the Court to dismiss the Plaintiff's Complaint so disputes over reasonable tax law interpretation can properly return to the administrative process.

ARGUMENT

I. THE FALSE CLAIMS ACT IS AN EXTRAORDINARY MEASURE THAT REQUIRES KNOWING, RECKLESS, OR DELIBERATELY IGNORANT INTENT

The NYFCA is an extraordinary remedy—which is intended to apply to tax fraud—that places the burden on the State or relator to prove every element of its claim, including the taxpayer's "knowing" intent to make a false statement or record. N.Y. State Fin. Law § 192(2). Tax disputes, including disputes over the correct interpretation of the Tax Law, are properly settled through the established administrative process in which the Department audits the taxpayer's position and either agrees or assesses a deficiency. The Legislature did not intend for the NYFCA, and its immense penalties, to be used as a response to a taxpayer's reasonable interpretation of unclear Tax Law, which is properly resolved using normal administrative procedures.

In 2010, the Legislature amended the NYFCA to apply only to tax claims specifically "alleging tax fraud." Assembly Mem. in Support, Bill No. A11568, *reprinted in* Bill Jacket for Ch. 379 (2010). The extraordinary remedy under the NYFCA is thus reserved to punish egregious, fraudulent acts. The NYFCA penalty is exceedingly punitive: a successful NYFCA claim imposes mandatory treble damages, causing the taxpayer to owe three times the actual liability. Further, the NYFCA extends the statute of limitations for bringing a claim against

a taxpayer from the ordinary three years to ten years. N.Y. State Fin. Law §§ 189(1), 192(1); N.Y. Tax Law § 1147(b). Because of the extended statute of limitations and treble damages, a taxpayer could theoretically owe ten times the amount that would be due under the standard administrative procedures.[1]

Because the Legislature intended that the NYFCA apply only in extraordinary circumstances—tax fraud—and recognized the draconian penalty provisions, the Legislature intentionally imposed several safeguards to limit the NYFCA. These safeguards evidence the Legislature's understanding that the NYFCA is an exceptional remedy applicable only in limited circumstances. Notably, the NYFCA carries a heightened pleading requirement, under which the Plaintiff was required to allege in detail facts demonstrating that Sprint acted "knowingly" in violation of the Tax Law.

A claim under the NYFCA must be stated "with particularity." *State of New York ex rel. Seiden v. Utica First Ins. Co.*, 96 A.D.3d 67, 72 (1st Dep't 2012). Under the federal False Claims Act ("FCA"), on which the NYFCA is modeled,[2] the complaint must meet "the heightened pleading requirements" in Federal Rule of Civil Procedure 9(b), which requires the plaintiff to "state with particularity the

[1] For example, if a taxpayer had a $1 million deficiency each year, it would owe $3 million total under the standard administrative procedure. However, under the NYFCA, the taxpayer would owe $30 million total—ten times more than would ordinarily be due.

[2] *Utica*, 96 A.D. 3d at 71 ("The NYFCA follows the federal False Claims Act (31 USC § 3729 *et seq.*) . . . and therefore it is appropriate to look toward federal law when interpreting the New York act . . . .") (internal citations omitted).

circumstances constituting fraud." *United States ex rel. Gross v. AIDS Research Alliance-Chicago*, 415 F.3d 601, 604 (7th Cir. 2005); Fed. R. Civ. P. 9(b). Rule 9(b) requires an FCA complaint to allege "'facts as to time, place, and substance of the defendant's alleged fraud,' specifically 'the details of the defendant['s] allegedly fraudulent acts, when they occurred, and who engaged in them.'" *Hopper v. Solvay Pharms.*, 588 F.3d 1318, 1324 (11th Cir. 2009) (quoting *United States ex rel. Clausen v. Lab. Corp. of Am.*, 290 F.3d 1301, 1308 (11th Cir. 2002)). New York's equivalent of Rule 9(b), CPLR 3016(b), similarly requires that in a complaint alleging a cause of action based upon misrepresentation, fraud, or mistake, "the circumstances constituting the wrong shall be stated in detail."

The Plaintiff was thus required to plead each element, including the defendant's scienter, in substantial factual detail. The Complaint fails to state a claim because: (1) an NYFCA complaint can challenge only the disregard of settled, clear legal precedent; and (2) the Complaint concedes that Sprint did not act with a scienter of knowing, reckless, or deliberately ignorant intent.

A. Plaintiff Fails to Plead that Sprint Acted in Contravention of the Tax Law

Plaintiff fails to plead that Sprint violated settled, clear Tax Law. In fact, Plaintiff alleges only that Sprint disregarded the Department's informal, non-precedential guidance.

1. The False Claims Act is Properly Used Only to Combat a Violation of Settled Tax Law

An NYFCA complaint can establish the required "knowing" scienter only where the defendant disregarded settled, clear legal precedent. Courts have repeatedly refused to find that a defendant acted "knowingly" where the defendant merely took "advantage of a disputed legal question." *Hagood v. Sonoma Cnty. Water Agency*, 81 F.3d 1465, 1477 (9th Cir. 1996) (internal citations omitted); *see also United States ex rel. Hixson v. Health Mgmt. Sys., Inc.*, 613 F.3d 1186, 1191 (8th Cir. 2010) ("[The plaintiff] must show that there is no reasonable interpretation of the law that would make the allegedly false statement true"); *United States ex rel. Siewick v. Jamieson Science & Eng'g, Inc.*, 214 F.3d 1372, 1378 (D.C. Cir. 2000) ("it is hard to see how [the plaintiffs] could . . . have satisfied even the loosest standard of knowledge, i.e., acting in reckless disregard of the truth or falsity of the information" when the relevant legal question was unsettled) (internal citations omitted).

Thus, a plaintiff cannot properly allege that a defendant interpreting an unclear tax imposition statute, which is construed in favor of the taxpayer, acted "knowingly" as required by the NYFCA. Conclusory statements that a defendant's conduct was knowing, without more, are grounds to dismiss the complaint. *Utica*, 96 A.D.3d at 72.

2. Department Administrative Guidance Is Not Tax Law

The Complaint fails to properly plead all the requirements of the NYFCA. Specifically, the Plaintiff fails to specify factual allegations that Sprint violated any provision of the Tax Law. Rather, the Plaintiff conflates a violation of the Tax Law with a disagreement over the Department's interpretative guidance, which is not law.

The Plaintiff was required to specifically allege the provisions of the Tax Law that Sprint violated. The Complaint fails to plead that Sprint knowingly acted in contravention of a specific section of the Tax Law. Instead, the Complaint merely quotes a Tax Law provision and makes the conclusory statement that the provision and the Tax Law as a whole are clear. R66 (¶¶ 32-33). The only specific allegation in the Complaint alleged that Sprint's tax returns violated agency guidance interpreting the Tax Law. In other words, the only well-pled allegation in the Complaint is that Sprint did not comply with the Department's *interpretation* of the law—Technical Memorandum No. TSB-M-02(4)C, (6)S (July 30, 2002)—rather than any actual law.

The Department's technical memorandum, however, is not law. The Department's own regulations acknowledge that technical memoranda are "advisory in nature," "have no legal effect but are merely explanatory," and therefore "do not have legal force or effect, do not set precedent and are not

binding." N.Y. Comp. Codes R. & Regs. tit. 20, § 2375.6(c). Further, because technical memoranda are not the law, the Department is excused from the formal rulemaking procedures in the State Administrative Procedure Act.[3] *Id.* The Department is not required to comply with the rigors of formal rulemaking (i.e., notification to the public and public comment). In addition, any instructions or statements by a Department auditor are likewise not law.[4]

The Complaint fails to plead the required elements of an NYFCA violation because there is no well-pled, specific allegation that Sprint violated the *law*.

B. Plaintiff Concedes that Sprint Did Not Act With the Requisite "Knowing" Scienter

The Complaint fails to plead that Sprint actually knew that the law unequivocally stated that Sprint could not unbundle, and that Sprint did it anyway. Rather, the Complaint concedes that Sprint analyzed the Tax Law, and determined that it was not clear and that a reasonable interpretation was that Sprint could unbundle. Therefore, the Complaint fails to plead the requisite scienter.

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[3] Conversely, formally promulgated agency regulations have the force and effect of law. *General Elec. Capital Corp. v. New York St. Div. of Tax Appeals*, 2 N.Y.3d 249, 254 (N.Y. 2004).

[4] *See, e.g., Matter of Pelham Manor Associates*, DTA No. 802152, 1989 WL 127312, at *2-3 (N.Y. Tax App. Trib. 1989); *Matter of Adirondack Alternate Energy and Edinburg Marina*, DTA No. 803950, 1988 WL 167821, at *1-3 (N.Y. Div. Tax App. 1988); *Matter of Winners Garage, Inc.*, DTA No. 823285, 2010 WL 2490909, at *6 (N.Y. Tax App. Trib. 2010).

1. The False Claims Act Requires a Scienter of Knowing, Reckless, or Deliberately Ignorant Intent

The NYFCA requires the defendant to have acted with a scienter of "knowing" intent. N.Y. State Fin. Law § 189(1)(g). A plaintiff filing an NYFCA complaint must therefore allege—and ultimately be able to prove— this "essential element[]" of the cause of action. *Id.* § 192(2). The NYFCA provides that a person has "knowing or knowingly" intent when "a person, with respect to information:

(i) has actual knowledge of the information;
(ii) acts in deliberate ignorance of the truth or falsity of the information; or
(iii) acts in reckless disregard of the truth or falsity of the information."

Id. § 188(3)(a). Thus, an NYFCA complaint must allege, with particularity, facts to establish a defendant's actual knowledge, deliberate ignorance, or reckless disregard when making a false claim. Conclusory statements that a defendant's conduct was knowing, without more, require dismissal of the Complaint. *Utica*, 96 A.D.3d at 72.

2. The Plaintiff Must Plead That Sprint Acted Knowingly

The Plaintiff's NYFCA Superseding Complaint ("Complaint") was required to plead, in factual detail, that Sprint had a "knowing" intent to violate the Tax Law. The Plaintiff's allegations that Sprint did not follow the Department's informal guidance are not sufficient.

The Plaintiff's Complaint and the original *qui tam* Complaint fail to state a cause of action under section 189(1)(g) of the NYFCA. *See* R85 (¶ 112). Section 189(1)(g) requires the Plaintiff to prove that the person "knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the state or a local government." N.Y. State Fin. Law § 189(1)(g). Section 189(4) makes the NYFCA applicable to claims against taxpayers only insofar as it can be alleged that there are "claims, records or statements made under the *tax law*." *Id.* § 189(4)(a) (emphasis added).

To survive Sprint's motion to dismiss, the Plaintiff was required to plead, in detail, facts supporting that:

(i) Sprint actually knew when it filed its tax returns that the law clearly stated that Sprint could not unbundle, and Sprint did it anyway ("knowingly");
(ii) Sprint purposely did not analyze the Tax Law to determine if unbundling was permitted ("deliberate ignorance"); or
(iii) Sprint failed to perform an analysis of the Tax Law to determine if unbundling was permitted ("reckless disregard").

The Complaint failed to do so.

3. Plaintiff Concedes that Sprint Did Not Act With the Requisite "Knowing" Scienter

The Complaint fails to plead the scienter requirement because the Complaint affirmatively concedes that Sprint analyzed the Tax Law and that Sprint made a determination that its tax position was a permissible interpretation of the law.

The Plaintiff's Complaint fails to plead that Sprint actually knew that the law unequivocally stated that Sprint could not unbundle, and Sprint did it anyway. Rather, the Complaint concedes that Sprint analyzed the Tax Law, and determined that it was not clear and that a reasonable interpretation was that Sprint could unbundle. In fact, whether the law is objectively clear or not is irrelevant; Sprint did not have the requisite scienter because Sprint believed the law to be unclear and to permit unbundling. Sprint could not have "knowingly" violated the law if it determined that its position reflected a reasonable interpretation of the Tax Law.

Additionally, the Complaint fails to plead "deliberate ignorance" or "reckless disregard" because the Complaint concedes that Sprint did, in fact, perform a careful analysis of the ability to unbundle under the Tax Law.

The Complaint acknowledges that Sprint put a great deal of time and analysis into its tax position. For example, the Plaintiff states,

> Before 2002, Sprint began to consider unbundling its flat-rate plans that included wireless voice services. Responsibility for implementing the plan fell to Sprint's business unit called the State and Local Tax Group . . . . [The Group] had resources that gave it ready access to tax laws, guidance and other materials to aid in the analysis and understanding of Sprint's state and local tax obligations, including its obligations under the New York Tax Law.

R71 (¶ 48). Further, the specific allegations in the Complaint recognize that Sprint contemplated the Tax Law for over three years to make a determination regarding its interpretation of the Tax Law, including:

- In 2002, "[A] member of Sprint's State and Local Tax Group prepared Sprint's 'business case' for component taxation." R71 (¶ 51)
- Illustrating that Sprint considered the Tax Law unclear, "in 2002, the head of Sprint's State and Local Tax Group warned other companies at a Communications Tax Executive Conference at Vail, Colorado that unbundling posed risks of audits by taxing authorities and litigation, and that they should protect themselves from these risks by entering into agreements with taxing authorities or by seeking clarifying legislation before they began to unbundle." R72 (¶ 52)
- "By September 2004, Sprint was refining its consideration of how to approach unbundling and component taxation." R72 (¶ 56)
- "Another approach, which Sprint viewed as aggressive and risky . . . involved unbundling . . . ." R73 (¶ 57)
- "Sprint began to implement a nationwide program of unbundling its wireless offerings for sales tax purposes" in 2005. R70 (¶ 44)
- "An internal Sprint analysis from January 2005 showed . . . ." R73 (¶ 59)
- Sprint's "refining its consideration" as well as the "internal Sprint analysis" before unbundling any of its services. R72-73 (¶¶ 56-59)
- "Sprint acknowledged that its approach to unbundling in this way was aggressive and risky because tax authorities throughout the country could object to the practice." R70 (¶ 45)
- "Sprint employees met and decided to recommend" the unbundling tax position. R73-74 (¶ 60)

The allegations in the Complaint illustrate that Sprint performed an analysis, and determined that unbundling was not a clear violation of the Tax Law.

The Complaint fails to plead that Sprint acted with actual knowledge, deliberate ignorance, or reckless disregard. Therefore, the Complaint fails to plead the requisite scienter element, and must be dismissed.

II. THE PLAINTIFF'S ASSERTED POSITION TURNS THE FALSE CLAIMS ACT ON ITS HEAD

The Plaintiff asks the Court to read the scienter requirement out of the NYFCA and sanction a new, significantly lowered bar for bringing NYFCA claims, thereby disregarding the heightened pleading requirements imposed by law. In the Plaintiff's view, a taxpayer's reasonable interpretation of an unclear tax statute results in sufficient scienter of "knowingly" violating a law. Further, the Plaintiff asks the Court to ignore the long-standing rule that ambiguous taxing statutes must be interpreted strictly against the taxing authority and in favor of the taxpayer. An NYFCA claim based on an unclear taxing provision not only construes the provision against the taxpayer, it would impose draconian penalties to punish the taxpayer for taking its reasonable interpretation.

A. Standard Tax Disputes are Properly Adjudicated through the Administrative Process

The Legislature created a robust administrative process for tax administration. This process ensures that any tax properly due under the Tax Law will be collected. The established administrative process also allows taxpayers to make reasonable interpretations of unclear tax law without the threat of remarkably punitive damages.

The Department's broad information gathering powers and experience administering the Tax Law put it in the best position to evaluate a taxpayer's

interpretation of the Tax Law. By law, taxpayers are required to "keep records of every sale" and to make such records available to the Department for examination on demand. N.Y. Tax Law § 1135(a) & (g). The Department further has the power to subpoena production of missing books and records and can question the taxpayer regarding its position under oath. *Id.* § 1143(a). After gathering the information supporting a taxpayer's position, if the Department disagrees with the taxpayer's interpretation, and calculates additional tax owed, the Department is authorized to assess a tax deficiency plus interest and penalties on the amounts due. *Id.* §§ 1138, 1142, 1145. If a taxpayer does not provide sufficient documentation to support its position, the Department can estimate the tax owed. *Id.* § 1138(a)(1).

The Department's assessment under the administrative process is presumed correct. *See, e.g.*, *Suburban Carting Corp. v. Tax Appeals Tribunal*, 263 A.D.2d 793,794 (3d Dep't 1999); *Kourakos v. Tully*, 92 A.D.2d 1051, 1051-52 (3d Dep't 1983). The taxpayer's intent is irrelevant to this presumption. But a taxpayer is not required to accept the Department's interpretation as a final declaration of the Tax Law.

Taxpayers have the right to appeal the Department's proposed assessment to the DTA. N.Y. Tax Law §§ 1138(a)(4), 2008(1); N.Y. Comp. Codes R. & Regs. tit. 20, § 535.5. The Legislature created the DTA as an "independent and impartial

body for the resolution of tax and licensing disputes." *Division of Tax Appeals*, NEW YORK STATE DIVISION OF TAX APPEALS AND TAX TRIBUNAL, http://www.dta.ny.gov/about/ (last visited July 14, 2015). In fact, the DTA was established for the very purpose of "providing the public with a just system of resolving controversies" and "to ensure that the elements of due process are present with regard to such resolution of controversies." N.Y. Tax Law § 2000. Additionally, the DTA procedure preserves the requisite taxpayer confidentiality. The DTA is the proper forum for adjudicating tax disputes.

Because an assessment is presumed to be correct, taxpayers challenging the Department's assessment at the DTA carry the burden to prove the assessment was improper or incorrect. N.Y. Comp. Codes R. & Regs. tit. 20, § 3000.15(d)(5). The burden increases if the taxpayer failed to keep adequate records. *See Hwang v. Tax Appeals Tribunal*, 105 A.D.3d 1151, 1153 (3d Dep't 2013) (quoting *Matter of Lombard v. Comm'r of Tax. & Fin.*, 197 A.D.2d 799, 800 (3d Dep't 1993)). A taxpayer unable to meet its burden is strictly liable for the amounts assessed. *See, e.g.*, N.Y. Tax Law §§ 1138(a)(1) (stating that an unappealed assessment becomes final after 90 days of mailing a notice of determination), 1141(a) (allowing a suit to enforce payment of a tax against a person required to collect tax that fails to collect or remit the tax). The administrative process provides the Department the necessary enforcement tools to enforce the Tax Law.

B. The Plaintiff's Position Would Eviscerate the Scienter Requirement

The Complaint fails to plead that Sprint had the requisite scienter, a "knowingly" false claim in violation of the Tax Law. If the Plaintiff's position is adopted, any ambiguity in the Tax Law will be construed against the taxpayer such that it would have the requisite scienter under the NYFCA any time the law is not entirely clear.

1. The Plaintiff Has the Burden to Prove and Must Specifically Plead a False Claims Act Violation, Including the Requisite Scienter

Administrative tax proceedings place the burden of proof on the taxpayer, which makes sense. *See* N.Y. Comp. Codes R. & Regs. tit. 20, § 3000.15(d)(5). When a tax statute is not clear, the taxpayer can take a reasonable position and is then given the opportunity to substantiate its tax position at audit and through the administrative appeals process. The taxpayer is rightfully not exposed to severe punitive measures for making reasonable determinations in the face of uncertainty in the Tax Law. Further, the taxpayer's intent is not relevant whatsoever to whether the Department's assessment is correct; an assessment is presumed correct, and it is up to the taxpayer to prove otherwise. The NYFCA is, in contrast, an extraordinary measure with exceedingly punitive results, including treble damages. As such, the Legislature built in important safeguards to limit the NYFCA's application to only the most egregious cases, such as tax fraud.

The Legislature expressly placed the burden of proof on the State or relator bringing the NYFCA complaint. A plaintiff bringing a claim under the NYFCA is "required to prove all essential elements of the cause of action, including damages, by a preponderance of the evidence." N.Y. State Fin. Law § 192(2). In other words, there is no presumption that a plaintiff bringing a NYFCA claim is correct.

One essential element the plaintiff must specifically plead and must ultimately prove is scienter. *See id.* § 189(1)(g); *Utica*, 96 A.D.3d at 71-72. The plaintiff *must* allege in detail that the taxpayer acted with "knowing" intent to violate the Tax Law. The Plaintiff's complaint fails to properly plead the "knowing" requirement.

2. The Plaintiff Alleges that Ambiguity in the Tax Law is Construed Against the Taxpayer for Purposes of a False Claims Act Action

The Plaintiff's Complaint does not meet the high bar for pleadings under the NYFCA. The Complaint fails to properly plead the scienter requirement, even conceding that Sprint analyzed and determined its tax position pursuant to the Tax Law. If the Court ignores the strict pleading requirement for NYFCA claims, the Attorney General and *qui tam* plaintiffs will be able to bring NYFCA actions against any taxpayer taking a reasonable position when the Tax Law is not entirely clear. Such a result would eviscerate the scienter requirement entirely. If this Court permits this case to move forward, the requisite "knowing" intent will be

presumed any time a tax statute is not crystal clear. This result turns New York law on its head. Decades of judicial decisions, including from this Court, have held that any ambiguity in a tax imposition statute must be strictly construed against the State and in favor of the taxpayer.

C. Ambiguities in the Tax Law are Construed Against the State

An ambiguous taxing statute—or one that is susceptible to multiple reasonable interpretations—is construed against the taxing authority and in favor of the taxpayer. *Debevoise & Plimpton v. New York St. Dep't of Tax. & Fin.*, 80 N.Y.2d 657, 661 (N.Y. 1993) (stating that a statute imposing tax "must be narrowly construed and that any doubts concerning its scope and application are to be resolved in favor of the taxpayer"); *accord, e.g.*, *Expedia, Inc. v. City of New York Dep't of Fin.*, 22 N.Y.3d 121, 127 (N.Y. 2013). Under this established rule of construction, a taxpayer adopting a reasonable interpretation of an unclear tax imposition statute is entitled to have the rule interpreted in the taxpayer's favor. The NYFCA, which applies only when a taxpayer has disregarded established legal precedent, is thus inapplicable.

1. If the Tax Law Can Be Subject to Multiple Interpretations, Taxpayers Cannot Face False Claims Act Liability if They Act in Accordance with Any of those Interpretations

A claim under the NYFCA must allege that a taxpayer violated a provision of the Tax Law. N.Y. State Fin. Law § 189(4). An ambiguous tax imposition

statute, which is construed in the taxpayer's favor, cannot form the basis of an NYFCA violation. Under established New York precedent, when a taxing statute is unclear, a court will uphold a taxpayer's reasonable determination that a transaction is subject to tax or is not taxed at all. *Matter of Grace v. New York State Tax Commission*, 37 N.Y.2d 193,196 (N.Y 1975) ("The government takes nothing except what is given by the clear import of the words used, and a well-founded doubt as to the meaning of the act defeats the tax") (internal quotations omitted). For this reason, courts interpreting the federal FCA have held that there can be no FCA claim unless the plaintiff can "show that there is no reasonable interpretation of the law that would make the allegedly false statement true." *Hixson*, 613 F.3d at 1191. This Court must dismiss an NYFCA complaint under long-standing New York precedent unless the Plaintiff alleges that the taxpayer's position could not have stemmed from a reasonable interpretation of the Tax Law.

The Department has broad authority when it disagrees with a taxpayer's interpretation of unclear taxing statutes. The Department can audit the taxpayer, who can then challenge the Department's assessment at the DTA. A dispute over the correct interpretation of the Tax Law is properly adjudicated through the administrative process.

2. Courts Often Strike Down the Department's Interpretation of the Tax Law.

The Department may issue informal guidance interpreting ambiguous taxing statutes. But the Department's interpretation of tax law is not always correct. For example, the Department "may not extend the meaning of legislation so as to permit the imposition of a tax in situations not embraced within the statute." *Debevoise*, 80 N.Y.2d at 661; *see also American Locket Co. v. City of New York*, 308 N.Y. 264, 269 (N.Y. 1955).

Courts regularly strike down the Department's erroneous interpretation of the Tax Law. In fact, this Court just recently rejected the Department's interpretation of the Tax Law. *See Gaied v. New York St. Tax Appeals Trib.*, 22 N.Y.3d 592, 598 (N.Y. 2014) (stating that "there is no rational basis for that interpretation."). Further, taxpayers appealing to the DTA regularly prove that their interpretation of the Tax Law is the correct interpretation.[5] *See, e.g.*, *Matter of Expedia, Inc.*, DTA Nos. 825025 & 825026 (consolidated), 2015 WL 667467, at *7 (N.Y. Div. Tax App. Feb. 5, 2015) (finding that "[t]he Division's interpretation of the regulation, in this case, however, appears to be an impermissible expansion of Tax Law . . . ."). The Tax Appeals Tribunal often overturns the Department's

[5] During fiscal year 2013-2014, the DTA issued 57 determinations (of 441 formal hearings requested in that year). ANNUAL REPORT, FISCAL YEARS 2013-2014, NEW YORK STATE TAX APPEALS TRIBUNAL 6 (Jan. 20, 2015), *available at* http://www.dta.ny.gov/pdf/reports/Annual%20Report%2013%2014.pdf. The DTA modified or cancelled the assessment in 21% of those cases. *Id.* at 8. Some taxpayers asked the Tax Appeals Tribunal to review the DTA's determination. *See* N.Y. Tax Law §§ 1138(a)(4), 2006. The Tax Appeals Tribunal issued 24 decisions, in which another 13% granted the taxpayer's exception to the DTA ruling. ANNUAL REPORT, at 17.

interpretation as well. *See, e.g.*, *Matter of Baum*, DTA Nos. 820387 & 820838, 2009 WL 427425, at *7 (N.Y. Tax App. Trib. Feb. 12, 2009); *Matter of Bausch & Lomb, Inc.*, DTA No. 819883, 2007 WL 4559302, at *13 (N.Y. Tax App. Trib. Dec. 20, 2007).

The mere fact that the Department does not agree with a taxpayer's position does not render the Department's position correct or solidify its interpretation as the decisive statement on the Tax Law. The Department's interpretations are far from a settled statement of law.

3. The Department Often Changes its Own Position on Administrative Guidance

The Department's frequently changing administrative guidance cannot be a basis for an NYFCA claim. The Department's regulations announce, "Regardless of the method by which a tax policy or interpretation is communicated, the [Department] may, *at any time*, reassess a matter and change its policy or an interpretation by amending the vehicle by which such policy or interpretation was communicated or by a pronouncement having a greater force and effect." N.Y. Comp. Codes R. & Regs., tit. 20, § 2375.1(a)(1). In fact, the Department reverses its *own* guidance regularly.[6]

[6] For example, the Department disregarded a longstanding advisory opinion, stating simply that it "no longer reflects the Department's position on this subject." Technical Memorandum No. TSB-A-11(1)C (Dec. 28, 2010). Additionally, the Department reversed its established

The Department even disclaims technical memoranda, such as the one on which the Plaintiff's Complaint exclusively relies, as indicative of the Department's "policies at the time of issuance." N.Y. Comp. Codes R. & Regs., tit. 20, § 2375.6(c). Otherwise, their effectiveness is subject to later "judicial decisions, Tax Appeals Tribunal decisions, or changes in law, regulations, or [Department] policies." *Id.*

Again, under the NYFCA the Complaint must plead a violation of the Tax Law, not of the Department's non-precedential, often shifting informal guidance. The Complaint failed to do so.

III. THE ATTORNEY GENERAL'S POSITION IS INFEASIBLE

The Attorney General's position is infeasible, impractical, and cost prohibitive. The Attorney General suggests taxpayers follow one of three approaches when the Tax Law is not completely clear to them: (1) seek an advisory opinion or declaratory ruling; (2) collect and remit sales tax, and later seek refunds if they overcollected; or (3) seek legislative amendment. Brief for the Respondents at 60. None of these approaches are practical for taxpayers that must

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interpretation of the Tax Law concerning whether information services were subject to sales tax. Technical Memorandum No. TSB-M-10(7)S (July 19, 2010). And the Department issued a TSB-M that expressly overruled its longstanding interpretation of the New York insurance tax provisions, which it had set forth in several TSB-As over the course of the prior nine years. The Department justified its completely reversed interpretation simply by stating, "the Department believes [it] is a better interpretation . . . ." Technical Memorandum No. TSB-M-12(4)C (Feb. 17, 2012).

make thousands of such business decisions. Further, the Attorney General's position illustrates that it seeks to shift the burden for clarifying unclear tax laws to the taxpayer, contrary to well-settled New York law.

Advisory opinions can take years to receive, apply only to the specific facts and law at the time of the petition, and are provided at the Commissioner's discretion. Collecting and remitting sales tax and seeking refunds later exposes companies to a significant risk of class action or derivative litigation. And seeking legislative amendment for each instance of an unclear Tax Law provision is time consuming, burdensome, and unrealistic.

A. The Advisory Opinion Process is Too Slow and Limited in Scope

The Attorney General suggests that a taxpayer must seek an advisory opinion or declaratory ruling if the Tax Law is not completely clear. Aside from the fact that the suggestion is premised on a misunderstanding of ambiguous tax law, seeking an advisory opinion each time the Tax Law is not entirely clear is infeasible and impractical.

The advisory opinion process can take years, and the Department may decline to even address the issue. Businesses in today's economy need to make taxability determinations immediately, and reevaluate that determination each time a business model evolves or changes in any material manner. The advisory opinion process grants the Department long stretches of time, initially 90 days,

with several opportunities for 30 day extensions, as the Department and taxpayer go back and forth regarding the specific factual assumptions and basis for their interpretations. N.Y. Comp. Codes R. & Regs., tit. 20, §§ 2376.3(a), 2376.5(a). Ultimately, the Audit Division does not have any express time limit to prepare its comments on the petition, and the Commissioner has the authority to extend the response deadline even when the petition is complete. *Id.* §§ 2376.3(b), 2376.5.

Thus, despite the initial 90-day time limit, in practice the process of requesting and receiving an advisory opinion often takes many months, if not years. It is common for taxpayers to receive responses to petitions that they filed more than two years earlier.[7] For taxpayers that need to make day-to-day business decisions, waiting months or years for an advisory opinion to clarify a reasonable interpretation of an unclear Tax Law provision is impractical.

Because advisory opinions are binding only on the specific taxpayer seeking the petition, the Attorney General's suggestion is impractical and infeasible for the Department itself. The Department is already struggling to address the advisory opinion petitions in its current inventory. If every taxpayer had to seek an advisory opinion every time it had to interpret unclear Tax Law provisions, there is no way

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[7] *See, e.g.*, *Matter of Nerac, Inc.*, DTA Nos. 822568 & 822651, 2010 WL 2888529, at *7 (N.Y. Div. Tax App. July 15, 2010) (taxpayer requested an advisory opinion on March 25, 2005, and a *draft* opinion was issued in November 2007); *Matter of the Petition of Orvis, Inc.*, DTA No. 805391, 1991 WL 218620, at *5 (N.Y. Div. Tax. App. Oct. 17, 1991) (taxpayer requested an advisory opinion on January 4, 1983, and the opinion was issued October 8, 1985).

in which the Department could address even a fraction of the petitions. And it would take the Department even longer to issue advisory opinions, which is already prohibitive.

Again, even if a taxpayer receives an advisory opinion, it is binding only for that specific taxpayer and upon the specific facts presented in the petition. N.Y. Comp. Codes R. & Regs., tit. 20, §§ 2376.1(a), 2376.4(a). If any of the facts or law upon which the opinion is based change while the taxpayer is waiting for the Department to render an opinion, or after the Department renders its opinion, the taxpayer loses all certainty. *See id.* § 2376.4(b). Under the Attorney General's approach, a taxpayer would be required to restart the entire advisory opinion process each time there was a factual or legal change—a regular occurrence.

Importantly, declaratory rulings are wholly discretionary for the Commissioner. *Id.* § 2375.3. Even if a taxpayer followed the Attorney General's approach and sought an advisory opinion on an unclear interpretation of the Tax Law, the Department may decline to provide a response.

Finally, as discussed in detail above, the Department's interpretation of the Tax Law is not equivalent to the Tax Law itself. In fact, the Department's interpretation of the Tax Law is often overturned through the administrative appeals process.

B. Taxpayers Face Potential Class Action Lawsuits if they Collect Sales Tax when There is a Reasonable Interpretation that it was

not Required

The Attorney General suggests that a taxpayer should simply collect and remit the tax, and later seek a refund of any amount overcollected. The Attorney General ignores the very real threat of a class action lawsuit brought by consumers against the collecting business. Contrary to the Attorney General's suggestion, there is no "conservative" approach regarding sales tax collection. Rather, businesses must endeavor to follow what they deem to be a reasonable interpretation of the Tax Law to minimize the threat of a class action suit on one hand, and now the threat of an improper False Claims Act suit on the other.

Businesses are facing class action suits with growing frequency. Consumers, often through plaintiff's attorneys, have filed an overwhelming number of class action suits alleging sales tax overcollection recently.[8] In New York and many other states, consumers have filed class action suits against leading businesses, particularly in the telecommunications industry.[9] Class action suits

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[8] At least thirteen class action lawsuits have been filed against vendors for alleged overcollection of sales tax since 2010.

[9] *See, e.g.*, *Hesse v. Sprint Corp.*, 598 F.3d 581 (9th Cir. 2010); *Brandewie v. Wal-Mart Stores, Inc.*, No. 1:14-cv-00965, 2015 WL 418157 (N.D. Ohio Feb. 2, 2015); *Schojan v. Papa John's Int'l Inc.*, No. 8:14-cv-1218-T-33MAP, 303 F.R.D. 659 (M.D. Fla. 2014); *In re AT&T Mobility Wireless Data Servs. Sales Tax Litig.*, 789 F. Supp. 2d 935 (N.D. Ill. 2011); *Rasschaert v. Frontier Commc'ns. Corp.*, No. 0:11-cv-02963, 2013 WL 1149549 (D. Minn. Mar. 19, 2011); *Hobbs v. Verizon Cal. Inc.*, No. B249131, 2014 WL 722038 (Cal. Ct. App. Feb. 26, 2014); *Long v. Dell, Inc.*, 93 A.3d 988 (R.I. 2014); *McGonagle v. Home Depot, U.S.A., Inc.*, 75 Mass. App. Ct. 593, 915 N.E.2d 1083 (Mass. 2009); *Bassolino et al. v. Whole Foods Inc.*, case number not yet available (N.Y. Sup. Ct. Bronx Cnty 2015); *Ferrie v. DirecTV LLC*, No. 3:15-cv-00409 (D.

subject companies to significant litigation costs, or force them to make preemptive settlement offers to protect their brands and reputations, even if they reasonably interpreted the Tax Law—possibly even a position supported by the respective tax authority.

The Attorney General's suggested approach would subject business to vast potential class action liability, and is thus entirely unworkable.

C. Achieving Legislative Clarification for Every Provision of the Tax Law that is not Entirely Clear is Infeasible

It is even more infeasible, impractical, and cost prohibitive for taxpayers to seek and ultimately achieve legislative clarity for every unclear Tax Law provision. Like seeking an advisory opinion, seeking a legislative amendment is extremely burdensome and time consuming. And the Legislature has no obligation to enact a legislative amendment, if it is even possible. The Attorney General's suggestion that taxpayers seek a legislative amendment to unclear Tax Law provisions is unrealistic.

The Plaintiff's suggestions above illustrate the Plaintiff's naivety regarding tax administration. It is well-settled in New York law that ambiguous taxing statutes are construed against the Department and in favor of the taxpayer.

Conn. 2015); *Wong v. Whole Foods Market Group, Inc.*, No. 1:15-CV-00848 (N.D. Ill. 2015); *Wong v. Target Corp.*, No. 1:15-cv-01985 (N.D. Ill. 2015); *Tucker v. Papa John's Int'l, Inc.*, No. 3:14-cv-00618 (S.D. Ill. 2014).

Likewise, the burden to clarify ambiguous tax law rests with the Department, not the taxpayer. Furthermore, seeking advisory opinions and legislative amendments are slow and impractical, and overcollecting sales tax is absurd given the current class action landscape.

CONCLUSION

For the reasons set forth above, the Business Council respectfully requests that this Court reverse the Appellate Division's decision and grant Sprint's motion to dismiss.

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Respectfully submitted,

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