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Let the Shakedowns Begin: Tax False Claims Legislation in California

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Legislators in Sacramento, California, are mulling over one of the most (if not *the* most) troubling state and local tax bills of the past decade.

Senate Bill (SB) 799, introduced earlier this year and recently amended, would expand the California False Claims Act (CFCA) by removing the "tax bar," a prohibition that exists in the federal False Claims Act (FCA) and the vast majority of states with similar laws.

If enacted, SB 799 will open the floodgates for a cottage industry of financially driven plaintiffs' lawyers to act as bounty hunters in the state and local tax arena. California taxpayers would be forced to defend themselves in high-stakes civil investigations and/or litigation – even when the California Attorney General's Office declines to intervene. As seen in other states, this racket leads to abusive practices and undermines the goal of voluntary compliance in tax administration.

While the CFCA is intended to promote the discovery and prosecution of fraudulent behavior, Senator Ben Allen introduced the bill specifically to "protect public dollars and combat fraud." The enumerated list of acts that lead to a CFCA violation does *not* require a finding of civil fraud. In fact, a taxpayer who "knowingly and improperly avoids, or decreases an obligation to pay or transmit money or property to the state or to any political subdivision" would be in violation of the CFCA (*See* Cal. Gov't Code § 12651(a)(7)).

This standard is particularly inappropriate in the tax context and is tantamount to allowing vague accusations of noncompliance with the law, leading to taxpayers being hauled into court. Once there, taxpayers would be held hostage between an expensive legal battle and paying an extortion fee to settle. The CFCA is extremely punitive: Violators would be subject to (1) *treble* damages (*i.e.*, three times the amount of the underreported tax, interest, and penalties), (2) an additional civil penalty of $5,500 to $11,000 for *each violation*, plus (3) the costs of the civil action to recover the damages and penalties (attorneys' fees).

To the extent the action was raised by a private plaintiff (or relator) in a *qui tam* action, the recovered damages or settlement proceeds would be divided between the state and the relator, with the relator permitted to recover *up to 50%* of the proceeds (Cal. Gov't Code § 12652(g)(3)). If the state attorney general or a local government attorney initiates the investigation or suit, a fixed 33% of the damages or settlement proceeds would be allotted to their office to support the ongoing investigation and prosecution of false claims (Cal. Gov't Code § 12652(g)(1)).

Adding further insult to injury, the CFCA has its own statute of limitations independent of the tax laws. Specifically, the CFCA allows claims to be pursued for *up to 10 years* after the date the violation was committed (Cal. Gov't Code § 12654(a)). A *qui tam* bounty hunter's claim would supersede the tax statutes of limitations.

Next, the elements of a CFCA violation must only be shown "by a preponderance of the evidence" (Cal. Gov't Code § 12654(c)). The common law burden of proof for fraud is by "clear and convincing evidence," a much higher bar.

Absent amendments, SB 799 would put every significant California taxpayer in jeopardy when the taxpayer takes a legitimate tax return position on a gray area of the state or local tax law, even when the position was resolved through the California Department of Tax and Fee Administration, the California State Board of Equalization, the California Franchise Tax Board, or a local government. Settlement agreements, voluntary disclosure agreements, and audit closing agreements all would be disrupted if the attorney general or a plaintiff's lawyer believes the underlying tax dispute or uncertainty is worth pursuing under the CFCA.

In countless cases in Illinois and New York, we have seen companies face False Claims Act shakedowns after the company already had been audited, had entered into a settlement with the state, or when the tax statute of limitations had long closed. SB 799 would bring the horrors experienced in Illinois and New York to taxpayers doing business in California.

Fundamentally, SB 799 threatens to open the litigation floodgates and undermine the authority of California tax administrators, putting tax administration in the hands of profit-seeking "whistleblower" bounty hunters. The goal of motivating whistleblowers and addressing tax fraud can be accomplished by simply adopting (and funding) a tax whistleblower program similar to the very successful programs offered by the Internal Revenue Service and many other states.

Ideally, SB 799 will be rejected in full or deferred for further consideration by an interim/study committee. With this in mind, the following amendments are essential to prevent the most severe abuses that stem from the CFCA's application to tax.

1. **Bring *qui tam* suits without government involvement.** Eliminating the ability of private plaintiffs to bring *qui tam* suits without the involvement of the attorney general would significantly reduce the number of frivolous claims and give the state its sovereign right to decide whether a claim should be pursued under the CFCA. If this amendment is not accepted, companies that introduce new technology and innovative products will be at the greatest risk of being targeted for *qui tam* It is always the case that tax law does not keep up with technological advances. Thus, the gray areas of tax law will be most present for high-tech taxpayers.
2. **Protect reasonable, good-faith tax positions.** Companies should not be liable under the CFCA merely for taking a reasonable return position or otherwise attempting to comply with a reasonable interpretation of law. CFCA exposure should be limited to cases of specific intent

to evade tax, proven by clear and convincing evidence. Tax law is notoriously murky, and good-faith disputes are what keep lawyers and accountants employed worldwide.

3. **Defer to existing tax statutes.** The CFCA should not override the California Revenue and Taxation Code provisions governing statutes of limitation or burden of proof.
4. **Apply prospectively only.** The CFCA should be limited in application to prospective matters (*i.e.*, claims for taxable years beginning on or after January 1, 2026) to avoid retroactive liability and constitutional risk.

Additionally, there is an emerging body of caselaw involving the federal FCA, holding it violates the separation of powers under the US Constitution. Justice Thomas, in a dissent, suggested that the federal FCA might be unconstitutional because it transfers executive power to the private sector. A district court in Florida recently dismissed a *qui tam* action brought under the federal FCA on similar grounds. The California Constitution is structured like the US Constitution in this regard, with executive power vested in the governor and the attorney general serving as the chief law enforcement officer (*See* Cal. Const. art. V, §§ 1, 13). The *qui tam* provisions of the existing CFCA transfer these powers to private actors with no political accountability. It is likely these *qui tam* provisions of the CFCA similarly violate the California Constitution.

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