

# Today's GENERAL COUNSEL

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## Compliance

# Defending a New York FCA Tax Investigation

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Since 2010, the New York False Claims Act (FCA) has included tax as a potential basis for false claims, allowing private plaintiffs and the New York Attorney General to seek treble damages from individuals and businesses for underpaying New York tax. The statute of limitations is 10 years.

In theory, the FCA unearths fraud by allowing whistleblowers to come forward with information the government would not otherwise receive through the tax administration process. In practice, however, the standards for civil fraud under the FCA don't line up with the standards for tax compliance, and the FCA leads to costly and complicated investigations over issues that are better suited to an audit by a tax authority. Under the FCA, a standard but uncertain tax position can trigger a sprawling investigation into who knew what when, rather than a straight-forward analysis of the merits of the underlying tax issues.

This article explains the first steps you should take to put yourself and your company in the best position to manage an FCA tax investigation effectively and efficiently.

### **1** *Take a deep breath.*

An FCA investigation likely means that someone with intimate knowledge of your company has accused it of wrongdoing in a complaint filed under seal. If you have received a subpoena, it means the government is taking the allegations seriously, and you should, too. In these cases, the government essentially conducts two inquiries at the same time. It examines whether your

tax position was correct, and whether you took that position knowingly.

Some cases involve “cooking the books” or reporting fake numbers —

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these should be the real FCA cases — but others involve a tax reporting position that the government challenges under the FCA. In this situation, the government may not wait to decide whether it thinks you have gotten the tax right. If there is any possibility you got the tax wrong, it may forge ahead with its investigation to try and determine whether you acted knowingly (i.e., with the recklessness or intent required to state a claim). It may seem unfair that the government would take an ambiguous position to court under the FCA, but it will do so if it determines that, in its view, you intended to flout the law or buried your head in the sand.

### **2** *Strictly limit knowledge of the investigation.*

The allegations against your company remain under seal until the government decides whether to intervene. During that time, the government keeps the complaint and claims confidential, and

you should approach the investigation on the same basis.

News of your FCA investigation should be kept on a strict need-to-know-basis, especially within your company. Among other things, you could have a whistleblower in your company who may be looking to gain insight into your response, including your review of documents or, even worse, opinions about bad facts or bad documents. You also don't want the investigation to mushroom, which can happen if others come forward, either seeking a financial reward or an opportunity to act on a grudge. As the circle expands, your company will become more exposed.

Equally important, you want the ability to learn what happened before staff and advisors begin to get defensive themselves — after all, someone has accused the company of doing something wrong — and retreat in a way that hampers your company's ability to identify and document key facts and advice that support its defense and positions. The investigations team, run by your outside counsel, will want to talk to each key person before their recollections are tainted or colored by the thoughts of others and self-preservation.

### **3** *Form a small internal team.*

After deciding who to initially inform, the general counsel should create a small team to organize response efforts. This team will gather information within the company, handle communication within the company, make decisions with respect to the investigation, oversee and liaise with the outside advisors (discussed in the next step), and make recommen-



dations to the ultimate decision makers. Third parties will handle most of the day-to-day work, and you should keep the internal group as small and nimble as you can for now. The team should consist of an attorney from the general counsel's office, someone from tax, someone from accounting and someone from IT.

Once the team has been selected, the general counsel should draft a brief memo or email that "creates" this group for the purpose of the investigation and in anticipation of litigation. You will want to ensure a healthy paper trail to protect this group's dialogue from disclosure under attorney work-product protection. Additionally, let this small group know that knowledge of the investigation may only be shared on a need-to-know basis and on the general counsel's express per-

mission, and that the investigation may seek emails created all the way through the production period. This team should be very aware of everything they put in writing to preserve privilege and avoid unnecessary or unintentional disclosures.

**4 Hire Outside Counsel.** Do not rush into hiring a law firm even if your subpoena requests a response in a really short period of time (it can usually be extended). Take your time and talk to a few firms. The tax aspect of the FCA is relatively new, and not that many firms have gone through the investigative process before. It is important that your legal team not only understand the New York FCA but also the process.

The investigation potentially involves

the New York Attorney General's office, the New York State Department of Taxation and Finance, the New York City Department of Finance and a relator. You therefore need help both navigating the underlying tax issues and developing a strategy that accounts for parties that have different interests, different perspectives and different chains of command within an evolving process. In this regard, advisors who have relationships with the government will not make the investigation go away more quickly. But they should give you insight into the government's perspective, the issues you face and the arguments you need to make.

As you might guess, your team will also need state and local tax expertise and investigations expertise. The tax counsel helps you understand the issues,

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vet the tax positions and develop arguments that support your defense. The investigations counsel helps you respond to the subpoenas, manage privilege issues, evaluate questions of intent, deal with investigators and generally handle the setting of an investigation. The critical consideration here is that you will need tax and investigations experts who can work closely together. You don't want to miss a key document because the tax experts weren't integrated with the document review, for example.

While you're hiring counsel, remember that you may not be able to predict how serious the investigation will be. You will likely have to wait and see the core documents, which may have their own surprises.

### 5 *Ask the government what this is all about.*

You won't be able to see the complaint filed against your company — unless and until you reach court — and you will therefore need to ask the government for a description of the issue or issues its investigators are reviewing. You may be able to figure out their focus from the subpoenas, but the government can and should give you more clarity.

You will likely have millions of records that are technically responsive to the subpoena, and you and the government both have an interest in finding the information that is truly pertinent. This conversation should lead to prioritizing categories of documents to produce and developing search terms and time frames that narrow the overall scope of the production. It should also lead to discussions about the core issues, which are helpful to both the government and your company.

Some assistant attorneys general are willing to engage in conversations at this early stage, but be cautious. Have your outside counsel make this early contact and report back to you.

### 6 *Slowly build a story.*

Committing to a specific narrative and building a strategy around it too early can be one of the biggest mistakes you make. The narrative will color the

investigation for your team, perhaps send you down unproductive or unpersuasive paths, and obscure the relevance of key documents or information. You need to understand the facts, documents, history and key decisions before building a definitive strategy and defense — or making any presentations. You will lose credibility if the documents contradict you. A detailed chronology of the key events, memos, people and emails will help you determine your path and build the true story of the company's knowledge, intent and decisions.

### 7 *Get in touch with your advisors.*

Your outside counsel will need to not only reconstruct events but also gain access to prior work product that may exonerate your company, or at least show that it approached its tax position with care. You will also need to know if your advisors have received subpoenas so that you can conduct privilege reviews of their materials before they send them to the New York Attorney General. If you are lucky, your advisors will give you copies of the materials they send and allow you to interview them or their staff. This access is invaluable. You want to be able to anticipate and understand the New York Attorney General's positions, and you cannot do that unless you see what they see. You also want to confirm that your prior advisors continue to stand by their advice.

### 8 *Don't forget New York City.*

You may think that the FCA only applies to New York State tax. After all, New York City has its own FCA. That's incorrect. The New York Attorney General and New York City treat the FCA as allowing claims based upon any New York City tax type, not just those that New York State administers. New York City tax issues will involve different law, different considerations — and potentially different strategy. Therefore, you cannot focus exclusively on New York State or assume that you can solve your New York City issue if you solve your New York State issue. Each jurisdiction requires careful, separate thought and consideration, whether you are reviewing

documents or considering legal arguments.

There are a myriad of additional considerations that you will have to think through, and some of them deserve consideration early on, like whether or not to request a Voluntary Disclosure Agreement or use a "Kovel" arrangement to hire an accounting firm that will assist the legal team under privilege. But the eight steps above will set you on the right path.



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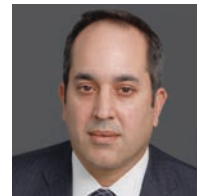
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