

4 Takeaways From Sprint's \$330M Tax FCA Settlement

By **Randall Fox** (January 9, 2019, 4:55 PM EST)

In late December, the New York Attorney General's Office announced that it had settled the long-running New York False Claims Act whistleblower case against cell phone giant Sprint Nextel Corporation for \$330 million. It was the largest ever settlement under any state false claims act, and it invoked a provision on tax violations that other states have yet to enact.

The Sprint settlement raises several important points about whistleblower cases under the New York False Claims Act.

The Eight-Year Marathon of Sprint

The genesis of the Sprint case lies in a 2010 amendment to the New York False Claims Act that extended the act to apply to knowing tax law violations and provided incentive for whistleblowers to bring tax-related cases.[1]

In March 2011, a whistleblower filed the Sprint case just as the Attorney General set up a new bureau — the Taxpayer Protection Bureau — to handle such cases. The whistleblower alleged that Sprint had violated the False Claims Act by knowingly submitting false sales tax returns as a result of its failure to collect and remit to the government millions of dollars in sales taxes on its cell phone monthly access charges.

Within just over a year, the state conducted its investigation, confirmed the whistleblower's claims and intervened in the case.[2] In its superseding complaint, the state raised not only causes of action under the New York False Claims Act, but also causes of action under the New York Tax Law — based on a referral from the New York State Department of Taxation and Finance.

The fast pace of the case then slowed to a crawl as Sprint moved to dismiss the case, lost, appealed, lost again, appealed again, lost again and then had its petition for certiorari to the United States Supreme Court denied.[3] By the end of motion practice, New York's highest court had concluded that the failure to pay the sales taxes at issue was an unambiguous tax violation. The only factual issue that remained realistically in dispute was whether Sprint had acted with knowledge, for scienter is an element of a False Claims Act violation. The state had alleged that Sprint knew its tax obligations at the time it violated them, but Sprint denied the allegation.

After the motion practice, discovery proceeded for several years more. One of the most contentious issues involved tax secrecy. Sprint unsuccessfully challenged the application of tax secrecy to tax department documents concerning other mobile carriers' taxes.[4]

Sprint finally settled in late December 2018 for an amount that appears to be full treble damages. The state had alleged that Sprint underpaid about \$100 million in taxes, and the settlement for \$330 million seems to be about three times that amount plus interest and penalties. Sprint did not explicitly admit liability.[5]

Sprint settled the case just as it was facing a Dec. 27, 2018, deadline for invoking an advice of counsel defense, which would have waived its attorney-client privilege on key issues. By settling, Sprint has maintained the privilege. It also has left unanswered for the public an intriguing question of whether Sprint had foreknowledge from its own lawyers that its tax practices were illegal. In its complaint, the state alleged that Sprint's in-house senior state and local tax counsel had testified he reviewed the relevant tax law provision a "hundred or more" times before Sprint stopped paying the tax, but Sprint did not disclose his advice about the law's meaning.

The question of Sprint's knowledge was, in any event, answered in a different way. On Feb. 29, 2016, the state publicly filed correspondence that Sprint's internal lobbyist had sent to New York tax authorities in 2002, which was before any of the conduct at issue in the case. In the correspondence, Sprint explained that it understood the relevant tax provision to mean exactly what the state had alleged it meant. That correspondence was filed with the explanation that it evidenced Sprint's knowledge of its tax obligation before violating it.

Takeaway 1: Other States Will Benefit Their Citizens by Incentivizing Tax Whistleblowers

Most states have no mechanism to reward people who come forward to report on tax violations. In fact, nearly every state with a false claims act specifically bars its application to tax cases.[6]

The Sprint settlement, together with other successful New York cases, demonstrates what is at stake for other states. They are losing significant amounts of tax revenues, and they are thus placing an extra tax burden on their citizens who honestly pay their taxes. The Sprint case and other New York False Claims Act tax cases show that there are tax frauds that will not be caught by traditional methods of tax enforcement. Whistleblowers are often uniquely situated to provide direct and focused evidence of violations, including violations that would otherwise avoid detection.

To date, New York has recovered \$459 million in tax-related False Claims Act matters. Whistleblowers were rewarded with about 18.5 percent of those sums, leaving \$374 million for the state and local governments. The state's investment to get this recovery has been modest, consisting largely of the costs of personnel and services for the AG's Taxpayer Protection Bureau. From a purely financial point of view, the government's return on that investment has been an impressive 3,600 percent.

The financial recoveries tell only part of the story because New York has also benefitted from greater tax compliance. It has been reported anecdotally that businesses and individuals have changed their practices to pay their tax obligations because they understand that when whistleblowers are incentivized to report on fraud, the odds of getting caught for violations are much higher.



Randall Fox

Other states can benefit their own citizens by following suit.

Takeaway 2: The Government Can, and Will, Persist

The length of conduct of the Sprint case may suggest that Sprint thought it would wear down the government, perhaps leading to a cheap settlement. If that was the thinking, it was mistaken. The government was undoubtedly forced to tap its resources, but the end result was not a cheap settlement. After eight years, Sprint finally paid essentially full damages and, in the process, developed law that substantially hurt its litigation position. It also undoubtedly incurred its own litigation costs in the process. The settlement teaches that no one should presume that the government has no backbone.

The New York False Claims Act specifically imposes a dollar threshold for tax cases so that the government can focus its resources on the larger tax matters. For the act to apply in tax cases, it must be alleged that the defendant had net income or sales of at least \$1 million in any year at issue and that damages are at least \$350,000.[7] The Sprint case, of course, greatly exceeded the threshold. For New York citizens it was well worth the expenditure of government resources.

Takeaway 3: Do Not Just Assume Any Taxpayer Is Well Meaning

During the Sprint case, some Sprint allies jumped to Sprint's defense in amicus briefs and in the press. They argued that Sprint's well-intentioned difference of opinion about the meaning of the relevant tax provision could not, as a matter of law, form the basis for alleging the knowledge element of a False Claims Act violation. They did not point to any facts suggesting that Sprint and the government had a difference of opinion during the period at issue, nor that any such opinion was well-intentioned.

In fact, the evidence now in the public domain suggests that Sprint and the government did not have different interpretations of Sprint's tax obligations. Even before starting the conduct at issue, Sprint told the New York tax authorities that it understood its obligations to be exactly as the government has consistently understood them. The assumption that Sprint had a well-intentioned difference of opinion was unsupported by the facts.

Takeaway 4: New York Protects and Rewards Whistleblowers

With the Sprint settlement, the New York Attorney General built upon its existing track record for fairly rewarding and protecting whistleblowers. And such fair treatment serves to encourage more persons with strong cases to come forward, ultimately to the benefit of the state and its citizens.

In the Sprint case, the whistleblower received a 19 percent whistleblower award, which is a higher percentage than the average awards under the federal False Claims Act. While the factors supporting that award are not public, we can infer from the size of the award that the whistleblower provided useful information that led to the successful prosecution of the case. To date, New York's whistleblower awards in tax False Claims Act cases have averaged 19.53 percent, and 21.5 percent if we remove the Sprint settlement from the calculation.

Fairly rewarding whistleblowers is only part of the equation. New York has also acted to protect whistleblowers, which is particularly important because whistleblowers can face threats, retaliation and severe disruptions in their personal and professional lives. In the Sprint case, the State accorded that protection by allowing the whistleblower to proceed in the form of a limited liability company whose member or members were not disclosed publicly. New York has similarly protected the identity of whistleblowers in other cases as well.

Whistleblowers who bring false claims act cases should not assume at the start of a case that their identities will never be publicly revealed, but government enforcers clearly invite strong whistleblower cases by showing that they will do their best to offer protection.

At its most basic level, the Sprint settlement demonstrates that the False Claims Act is one of the government's most important and effective fraud-fighting tools and that the tool works just as effectively in the tax arena as it has worked for years in healthcare, procurement and other cases.





Randall M. Fox is a partner at Kirby McInerney LLP. Prior to joining the firm, he was the first bureau chief of the New York attorney general's Taxpayer Protection Bureau.

Disclosure: While at the Office of the New York Attorney General, the author was one of the prosecutors on the case discussed in the article.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Ch. 379, 2010 McKinney's N.Y. Laws 1160  ; N.Y. State Fin. Law Sections 187  , et seq.

[2] See Press Release, Office of the New York Attorney General, "A.G. Schneiderman Files Groundbreaking Tax Fraud Lawsuit Against Sprint For Over \$300 Million," Apr. 19, 2012.

[3] See *Sprint Nextel Corp. v. New York*, 136 S.Ct. 2387 (2016)  ; *People v. Sprint Nextel Corp.*, 26 N.Y.3d 98 (2015)  ; *People v. Sprint Nextel Corp.*, 114 A.D.3d 622 (2014)  ; *People v. Sprint Nextel Corp.*, 41 Misc.3d 511 (2013)  .

[4] See *People v. Sprint Communications Inc.*, 148 A.D.3d 471 (1st Dep't 2017)  .

[5] See Press Release, Office of the New York Attorney General, "A.G. Underwood And Acting Tax Commissioner Manion Announce Record \$330 Million Settlement With Sprint In Groundbreaking False Claims Act Litigation Involving Unpaid Sales Tax," Dec. 21, 2018.

[6] While most states explicitly bar tax-related cases under their false claims acts, a small number have no explicit bar and no explicit invitation. In addition, Illinois, Indiana and Rhode Island have false claims acts that allow for cases about only certain types of tax violations.

[7] See [N.Y. State Fin. Law § 189\(4\)\(a\)](#) .

All Content © 2003-2019, Portfolio Media, Inc.