



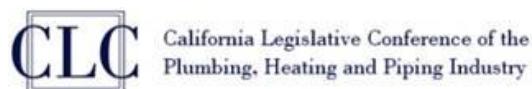
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CIVIL JUSTICE
ASSOCIATION OF CALIFORNIA



Associated General
Contractors (AGC)



"FLOOR ALERT"

June 5, 2020

TO: Members, California State Assembly
**SUBJECT: AB 2570 (STONE) FALSE CLAIMS ACT
OPPOSE – AS AMENDED MAY 4, 2020**

The California Chamber of Commerce, the Civil Justice Association of California and the listed organizations **OPPOSE AB 2570 (Stone)** because it will bring nuisance lawsuits into tax enforcement, create conflicts with existing tax law, and lead to double jeopardy for taxpayers.

Importantly, we do not condone tax fraud, nor do we oppose this bill in order to defend such bad faith actions by individuals or businesses. Our opposition stems from serious concerns about the drastic changes that **AB 2570** would bring to California by introducing conflicting standards into tax law and allowing private attorneys to bring tax lawsuits against taxpayers.

Moreover, we are concerned that this bill will require approximately \$1.45 million for new staff at a time when our state is struggling to even fund basic priorities, such as education, due to COVID-19. Because of its unclear benefits, added costs, and negative implications for tax enforcement, we are strongly opposed.

Background on the False Claims Act & AB 2570

Because this bill hinges on changing California's False Claims Act (Gov. Code §§ 12650 et seq., "FCA"), some explanation of that legal tool is necessary. The California False Claims Act is a legal tool that allows the Attorney General, public entities, or individual plaintiffs to recover considerable penalties against companies that, while contracting with the government, commit some form of fraud related to the contract. For example – if a company had contracted to maintain school buses for the state but failed to comply with the contract terms or state law regarding maintenance – and billed the public entity for maintenance it did not perform – that could generate a False Claims Act action.¹

The FCA provides extreme penalties, including: (1) up to 300% of the amount in dispute, (2) per-instance penalties, and (3) attorney's fees. For comparison, present tax law imposes a 75% penalty for tax fraud.²

California's FCA has been in existence for more than 30 years and has always explicitly excluded tax-related statements.³ In fact, all but two states in the United States have similar False Claims Act laws, and similarly exclude tax-related statements. Instead, tax filings are reviewed by taxing agencies that have expertise in tax, strong auditing powers, and an efficient dispute resolution process.

What Would AB 2570 Change About the FCA?

AB 2570 makes a host of changes to the FCA. Many of these changes are focused on expanding the FCA to cover tax-related claims, but some changes would affect the standards governing *all* FCA suits. A short list of the Coalition's concerns is below:

1) AB 2570 Will Allow Plaintiff's Attorneys to Bring Nuisance Suits Based on Tax Disputes

Tax-related issues are simply different than other forms of litigation. Taxes are a powerful tool that we reserve for government – the ability to reach directly into the pockets of every citizen and business and claim a portion to support necessary government functions. Taxes are so unique that Ben Franklin allegedly compared them to death as the only certainty in life, and Albert Einstein allegedly exclaimed that his income tax form was “too difficult a question for a mathematician. It should be asked of a philosopher.”

At a philosophical level, the business community has grave concerns about allowing for-profit attorneys into tax enforcement. This is particularly true when discussing a tool like the FCA, which provides massive penalties for the taxpayer and massive rewards for the private litigant. California's FCA provides the following penalties:

- \$5,000-\$11,000 per violation, adjusted for inflation.
- Two-to-three times the amount of actual damage to the public entity, as an added penalty.
- Attorney's fees if the plaintiff is successful, adding potentially hundreds of thousands of dollars.

Based on these strong penalties, a \$200,000 tax dispute under the FCA could quickly balloon into a potential million-dollar dispute. We are gravely concerned that plaintiff's attorneys will be incentivized to threaten lawsuits without any merit to scare businesses into paying settlements and, facing such steep penalties, businesses will be compelled to pay to settle meritless claims.

Illinois' similar law⁴ provides an example of the potential abuse. There, one attorney filed hundreds of False Claims Act suits by simply ordering products online and alleging that the out-of-state company had improperly complied with Illinois state tax law. Though the products purchased were not expensive, the resulting per-incident penalties and attorney's fees provisions allowed the attorney to pressure businesses

¹ Facts here are slightly modified from a prominent California case, SAN FRANCISCO UNIFIED SCHOOL DIST. EX REL. CONTRERAS v. FIRST STUDENT, INC. 224 Cal.App.4th 627 (2014). General information is available at: <https://oag.ca.gov/cfs/falseclaims>.

² Rev & Tax Code § 19164.

³ See Gov. Code § 12651(f)- “This section does not apply to claims, records, or statements made under the Revenue and Taxation Code.”

⁴ Illinois is one of two states to presently allow tax-related False Claims Act suits.

to pay large settlements – even where no wrongdoing had occurred. The absurdity and abuse under Illinois law led to national media attention and ongoing criticism.⁵

2) AB 2570 Will Create Uncertainty for Taxpayers Because the FCA Conflicts with Existing Tax Law

AB 2570 would also create conflicting standards in tax law by ignoring differences between the standards in California's Rev & Tax Code and the standards applied under the FCA. We are gravely concerned that these conflicts will make it even easier for plaintiff's attorneys to bring nuisance suits against taxpayers because the ambiguity of conflicting law will make it difficult for businesses to determine whether they are in compliance. As a result, businesses will be uncertain as to whether they will win or lose if the case proceeds and will pay to avoid the cataclysmic consequences that the FCA provides.

A short list of these differences includes:

- Different standards of what constitutes "fraud"⁶
- Different burdens of proof of fraud
- Lack of protection for good faith mistakes from FCA lawsuits
- Different statutes of limitations between the FCA (10 years) and tax claims (ranging from 3-8 years by area)

Presently, **AB 2570** does nothing to bring the FCA's standards in line with existing tax standards, or to prevent plaintiff's attorneys from abusing these ambiguities to harass businesses.

3) AB 2570 Will Create Double Jeopardy Because FCA Suits Can Be Brought Even If the Taxpayer Has Completed an Audit or Signed an Agreement with a Taxing Agency

We strongly believe that a taxpayer, as with a defendant in a court of law, should not face prosecution for the same issue twice. For example: if a taxpayer is audited on a statement in a taxable year, and the tax agency finds that all documents are in order, then that taxpayer should be able to rely on that finding. Without such reliance, what is the role of the tax agency?

In contrast, **AB 2570** fails to include any protection for a taxpayer who has already handled a transaction with the taxing agencies. Focusing on that same example: if a taxpayer is audited and no issues are found, the taxpayer could still face an FCA lawsuit years later under **AB 2570**. Moreover, even if the taxpayer had affirmatively flagged an issue for review by the taxing agency (bringing that issue forward specifically for review), and was found to have correctly filed, they could still face the treble damages and attorney's fees of an FCA lawsuit.

This double jeopardy issue makes concerns about profit-driven plaintiff's attorneys all the more apparent – regardless of whether the taxing agencies have signed off on a taxpayer's documents, that taxpayer is still at risk of a lawsuit.

4) AB 2570 Incorrectly Codifies Existing Case Law Regarding Materiality Under the FCA – Which Will Lead to Litigation and Uncertainty for Businesses.

Outside of the new tax-related provisions of the FCA, **AB 2570** also attempts to codify caselaw on another part of the FCA: materiality. By way of background, the FCA requires that an alleged misstatement be "material" for a lawsuit to be brought. Generally speaking, this "materiality" test asks whether the alleged

⁵ See the following news articles discussing Illinois' FCA and the resulting nuisance lawsuits.

<https://www.forbes.com/sites/wlf/2016/07/27/will-illinois-state-ag-s-action-put-an-end-to-unabashed-abuse-of-states-false-claims-law/#6dba7b676f06>; <https://www.natlawreview.com/article/scary-stuff-illinois-sales-tax-whistleblower-update-first-e-tailers-and-now-custom>; <https://madisonrecord.com/stories/510899027-judge-dismisses-201-lawsuits-in-latest-chapter-of-businesses-battle-against-illinois-false-claims-act>

⁶ California Tax law requires intent to defraud, whereas the FCA does not require that the party intend to commit fraud. See CA Gov't Code § 12650(b)(2); *Marichica v. State Bd. Of Equalization*, 107 Cal.App. 2d 501, 509 (1951) ("The fraud meant by the statute is actual, intentional wrongdoing, and the intent required is the specific purpose to evade a tax believed to be owed.")

misstatement mattered to the public entity. If it was a small typo or unimportant point, the courts have concluded that it doesn't make sense to impose the FCA's strict penalties because the misstatement did not matter (or was not "material") to the payment.

Problemsatically, **AB 2570** attempts to codify a California case⁷ (which is already far more forgiving for plaintiffs than federal law) but, to make matters worse, incorrectly summarizes the California caselaw and goes far beyond its actual rule.⁸ Though this letter is not the proper vehicle to fully explain the distinction inherent in the language or compare California's jurisprudence to federal law, we are gravely concerned that mis-characterizing present law caselaw will lead to uncertainty and litigation for anyone facing a FCA lawsuit in the future.

5) **AB 2570 Will Not Close California's "Tax Gap" Because the Author is Relying on Out-dated and Baseless Assumptions.**

The Author and others have claimed that this bill will address California's "Tax Gap" - the difference between the state's theoretical tax revenue and what is actually received - which they claim is valued at \$20 billion. However, a closer look at the data reveals the falsehood of this claim. As aptly pointed out by CalTax,⁹ California's Franchise Tax Board (FTB) did publish an estimate of California's tax gap of \$20 billion, but it subsequently withdrew that estimate after acknowledging it had no basis! And the FTB was right to do so. This estimate was based on assuming that federal data from 2008-2010 from the IRS could be used to analogize to California's present tax gap. This kind of analogy poses a host of concerns. First, California's tax agencies are well-known for their aggressive pursuit of tax cheats and nationally-recognized for their effectiveness. That is not necessarily the case with the federal IRS, which means that any comparison and assumptions about alleged fraud must take into account California's more robust agencies. Moreover, analogizing to 2008-2010 data ignores the considerable improvements made in tax enforcement since that time. Notably, this includes the Enterprise Data to Revenue Project, which generated approximately \$3.7 billion in revenue from 2011-2016, and \$1 billion thereafter.

Moreover, there is no evidence that AB 2570 will actually increase tax revenue in California at all. Fiscal analysis of **AB 2570's** substantively identical precursor, **AB 1270 (Stone-2019)** did not identify any estimated increase in revenue to California from expanding the FCA to allow tax-related suits. It is our belief that this is because there is not any present lack of anti-fraud statutes or mechanisms in state tax law. Notably, though all of the Author's discussion of this bill's benefits relate to events in New York from a decade ago, California's tax enforcement system has *already* been significantly reworked in that time (see above). Moreover, thankfully, California already applies civil and criminal liability for fraud under California Rev & Tax Code Section 19706¹⁰ (tax fraud) and Penal Code Section 72¹¹ (false statement to public entities may constitute a felony). And there is certainly no reporting of rampant tax fraud in California that would justify new tools such as the FCA being utilized or would suggest additional income if FCA lawsuits could be brought.

In short – this bill's negative effects on tax enforcement in California cannot be justified by citation to a \$20 billion tax gap . . . because that statistic is simply baseless and there is no evidence of any resulting income.

Conclusion

There has been no recent report of failure by California's taxing agencies – instead, **AB 2570** appears to be a solution without a problem. Moreover, as discussed above, **AB 2570** is more than a small change. It would introduce plaintiff's attorneys into tax enforcement, create ambiguity with existing tax law, and leave taxpayers in uncertainty as they faced conflicting standards and potential double jeopardy, even after a

⁷ The so-called "Contreras" case – full citation: SAN FRANCISCO UNIFIED SCHOOL DIST. EX REL. CONTRERAS v. FIRST STUDENT, INC. 224 Cal.App.4th 627 (2014).

⁸ The *Contreras* case provided that a court, in deciding whether a misstatement was material to the public entity, held that a court could look to whether the public entity actually paid the claim, and also, even if the public entity paid, look to how important the misstatement was to the public entity. (224 Cal.App.4th at 642-645). In conflict with *Contreras*, **AB 2570** states that a court should look to the "potential effect" of the misstatement (how important the misstatement was), and not the actual effect (whether the public entity paid).

⁹ <http://www.foxandhoundsdaily.com/2020/05/backers-of-false-claims-act-bill-make-false-claims-of-their-own/>

¹⁰ Rev & Tax Code § 19706 provides that offenders face imprisonment of one year and a fine up to \$20,000.

¹¹ Penal Code Section 72 provides that offenders face imprisonment of up to one year and a fine of up to \$10,000.

clean audit. Furthermore, it codifies a misreading of existing law (and thereby changes California law unintentionally). Simply put, **AB 2570** creates a host of concerns because the FCA was simply not designed to enforce tax law. The complexity and ambiguity of tax law is better suited to the present system – where it can be handled by taxing agencies with expertise in taxes, well-developed procedures, and no profit-motive.

For these reasons, we **OPPOSE AB 2570**.

Sincerely,



Robert Moutrie, Policy Advocate
California Chamber of Commerce

Sincerely,



Mike Belote on behalf of
Civil Justice Association of California

Acclamation Insurance Management Services
Allied Managed Care
American Beverage Association
Associated General Contractors
Brea Chamber of Commerce
California Association of Sheet Metal and Air Conditioning Contractors National Association
California Bankers Association
California Building Industry Association
California Business Properties Association
California Business Roundtable
California Construction and Industrial Materials Association
California Legislative Conference of the Plumbing, Heating and Piping Industry (CLC)
California Manufacturers & Technology Association
California Medical Association
California Restaurant Association
California Retailers Association
California Taxpayers Association
Cellular Telecommunications and Internet Association (CTIA)
Computing Technology Industry Association (CompTIA)
Construction Employers Association
Family Business Association of California
Flasher Barricade Association
Greater Coachella Valley Chamber of Commerce
Job Creators for Workplace Fairness
Motion Picture Association
National Electric Contractors Association – California Chapters (NECA)
National Federation of Independent Business
Oxnard Chamber of Commerce
Pleasanton Chamber of Commerce
Silicon Valley Leadership Group
United Contractors
Western Electrical Contractors Association

cc: Legislative Affairs, Office of the Governor
Office of Assemblymember Stone
Jith Meganathan, Assembly Judiciary Committee
Daryl Thomas, Assembly Republican Caucus