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Oh Captive! My Captive! New York's *Qui Tam* Provision for Tax Is Validated in the Captive Insurance Context

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OH CAPTIVE! MY CAPTIVE! NEW YORK'S *QUI TAM* PROVISION FOR TAX IS VALIDATED IN THE CAPTIVE INSURANCE CONTEXT

Abstract: On August 30, 2018, in *Anonymous v. Anonymous*, the Appellate Division of the New York Supreme Court, First Judicial Department held, for the first time, that a plaintiff-relator had sufficiently alleged that the defendants had violated the New York False Claims Act by using a captive insurance company for the sole purpose of evading taxes. The tax evasion scheme was brought to light by a former employee who utilized the New York False Claims Act's *qui tam* provision. A *qui tam* provision allows a private citizen to stand in the shoes of the government when bringing an action. This Comment argues that *Anonymous* is an example of how beneficial a tax *qui tam* provision can be in uncovering complex and clandestine tax avoidance schemes.

INTRODUCTION

Tax fraud is a problem that can deprive governments of hundreds of millions of dollars in much needed revenue.¹ Accordingly, governments take a variety of steps to identify and prevent tax evasion.² The New York False Claims Act (NYFCA) attaches liability to those who knowingly attempt to defraud the State.³ The *qui tam* provision of the NYFCA largely mirrors the whistleblower provisions contained in the federal False Claims Act (FCA).⁴ In

¹ See Deddeh A. Jones, *Much Ado About Qui Tam for State Taxes*, TAX ANALYSTS (Apr. 3, 2014) <http://www.taxhistory.org/www/features.nsf/Articles/4E0BBBC30A84AA2785257E1B004F094B?OpenDocument> [<https://perma.cc/RGJ6-KH92>] (noting that the difference in taxes owed and taxes actually paid by citizens amounts to millions of dollars in lost revenue for state governments).

² See, e.g., N.Y. STATE FIN. LAW § 189 (McKinney 2019) (allowing tax fraud to be enforced by private citizens); N.Y. STATE DEP'T OF TAXATION & FINANCE, CRIMINAL INVESTIGATIONS AND PROSECUTIONS OF TAX FRAUD CASES: GUIDELINES 1–2 (2013), https://www.tax.ny.gov/pdf/enforcement/cid_guidelines.pdf [<https://perma.cc/JVA8-NE45>] (explaining criminal enforcement of tax fraud).

³ N.Y. STATE FIN. LAW § 189. The New York False Claims Act (NYFCA) does not define fraud, but rather attaches liability for knowingly submitting claims that are false or fraudulent. See *id.* § 188(2) (defining false claims).

⁴ See Peter L. Faber, *New York State False Claims Act: Background*, in 2018 N.Y.U. INST. ON ST. & LOC. TAX'N § 2.03 (2018) (explaining that the NYFCA is modeled after the federal False Claims Act (FCA), and that prior to the 2010 tax amendment to the NYFCA, the two were nearly identical). Compare N.Y. STATE FIN. LAW § 189(a)–(b) (attaching liability to those who knowingly present a false statement to the government, or knowingly create a false record used to make a false claim), with FCA, 31 U.S.C. § 3729(a), (b) (2018) (same). A *qui tam* provision allows a private citizen to bring suit in the place of the state. See N.Y. STATE FIN. LAW § 190(2) (allowing citizens to bring suit for violation of the NYFCA “on behalf of the . . . state of New York or local government”); *Qui Tam Action*, BLACK'S LAW DICTIONARY (11th ed. 2019). *Qui tam* plaintiffs are often referred to as relators or, colloquially, “whistleblowers” because they draw attention to the fraud. See, e.g., Michael T. Fa-

2010, however, New York deviated from the FCA by including within the NYFCA's scope statements made under state tax law.⁵ Before New York amended the NYFCA, Congress had explicitly rejected the inclusion of tax statements within the scope of the FCA, and no state had departed from the FCA model.⁶ Since amending the NYFCA, New York courts have heard many cases dealing with this provision.⁷

In 2018, in *Anonymous v. Anonymous*, the Appellate Division of the N.Y. Supreme Court, First Judicial Department (Appellate Division) rendered a landmark decision regarding the NYFCA.⁸ It was the first time that the court ruled on a claim brought under the NYFCA relating to a defendant's abuse of tax incentives tied to captive insurance companies.⁹ In *Anonymous*, the Appellate Division found that a plaintiff-relator sufficiently pleaded that a corporation knowingly submitted a false tax return by treating its captive insurance company as legitimate in order to reap substantial tax benefits.¹⁰ The decision

tale et al., *False Claims Act Litigation*, in 2016 N.Y.U. INST. ON ST. & LOC. TAX'N § 6.04 (2016) (referring to relators as whistleblowers). *Qui tam* provisions are also often described as a form of private enforcement because they place the enforcement of the law in the hands of private citizens rather than the government. See Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX L. 357, 363 (2008) (referring to whistleblower provisions in the FCA as means of "private enforcement").

⁵ N.Y. STATE FIN. LAW § 189(4) This provision attaches liability to one who "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." *Id.* § 189(1)(g) This provision applies to "claims, records, or statements made under the tax law" so long as the defendant's net income surpasses \$1 million in a taxable year and the damages exceed \$350,000. *Id.* § 189(4); see also Faber, *supra* note 4, § 2.03 (providing context about the legislative history of the NYFCA).

⁶ See 31 U.S.C. § 3729(d) (excluding statements made under federal tax law from the scope of the FCA). This exclusion has been explained as a recognition of the Internal Revenue Service's (IRS) exclusive authority to enforce the Tax Code. United States *ex rel.* Lissack v. Sakura Glob. Capital Mkts., 377 F.3d 145, 152–53 (2d Cir. 2004).

⁷ See Fatale et al., *supra* note 4, § 6.04 (describing New York as having experienced a rash of FCA lawsuits dealing with state taxes); see, e.g., *People v. Sprint Nextel Corp.*, 42 N.E.3d 655, 657 (N.Y. 2015) (ruling on a NYFCA claim brought against Sprint for failing to charge taxes on certain types of calls).

⁸ See 83 N.Y.S.3d 472, 474 (App. Div. 2018).

⁹ See *id.* at 478–79 (evaluating the plaintiff-relator's allegations regarding the defendant's use of its captive insurance company to avoid paying taxes). A captive insurance company is defined by N.Y. Insurance Law to be a subsidiary that only insures risks for its parent company. N.Y. INS. LAW § 7003(a)(1) (McKinney 2019). Ultimately, *Anonymous* explains New York's decision to bring tax fraud within the scope of the NYFCA. See Jones, *supra* note 1 (describing the benefits of tax *qui tam* provisions as expanding enforcement capabilities and allowing more information to be discovered by insiders).

¹⁰ See *Anonymous*, 83 N.Y.S.3d at 474 (holding that plaintiff-relator sufficiently alleged that Moody's treatment of Moody's Assurance Company (MAC) was improper and that Moody's knowingly took this position to avoid paying taxes). The tax benefits of captives are two-fold. See I.R.C. § 162 (2018) (allowing a tax deduction for ordinary & necessary business expenses); N.Y. TAX LAW § 1502-b(a) (McKinney 2019) (establishing a favorable tax rate for captive insurance companies). First, the parent company can deduct its premium payments as a trade or business expense for federal tax purposes. I.R.C. § 162. Second, the captive pays an extremely low tax rate on only its premium

highlights the policy advantages of enforcing certain types of tax fraud through private enforcement mechanisms.¹¹ Specifically, the NYFCA allows government agencies to pursue other enforcement actions, enables *qui tam* plaintiffs to plead claims more easily, and brings tax avoidance practices into the view of the general public.¹²

Part I of this Comment gives an overview of the statutory framework established by New York's tax, insurance, and whistleblower laws.¹³ It then explains the facts at issue in *Anonymous* and the court's decision.¹⁴ Part II of this Comment examines the law the Appellate Division relied on in reaching its decision.¹⁵ Part II also discusses other notable examples of cases brought under the NYFCA's tax provision.¹⁶ Finally, Part III argues that the NYFCA's private enforcement mechanisms provide significant benefits to society because tax evasion through the means of captive insurance companies can be complex and involve layers of secrecy, which these mechanisms help to unravel.¹⁷

I. NEW YORK'S STATUTORY FRAMEWORK AND FACTUAL BACKGROUND OF *ANONYMOUS*

Anonymous derives its novelty in part from New York's unique statutory scheme.¹⁸ Section A of this Part details the statutes that governed the Appellate Division's analysis in *Anonymous*.¹⁹ Section B of this Part explains the facts of *Anonymous* and the Appellate Division's ruling.²⁰

A. New York's Captive Insurance Company Tax Framework and the New York False Claims Act

Since the invention of captive insurance companies, businesses realized that they could be valuable risk management tools; however, states were

income. *See infra* note 25 and accompanying text (describing the progressive tax structure for captive insurance companies). Plaintiff alleges that these practices deprived New York of \$120 million in tax revenue. *State ex rel. Banerjee v. Moody's Corp.*, No. 103997/2012, 2016 WL 7252487, at *4 (N.Y. Sup. Ct. Dec. 8, 2016).

¹¹ *See infra* notes 134–153 and accompanying text (discussing the various policy benefits of tax *qui tam* provisions).

¹² *See infra* notes 134–153 and accompanying text.

¹³ *See infra* notes 23–50 and accompanying text.

¹⁴ *See infra* notes 50–86 and accompanying text.

¹⁵ *See infra* notes 87–109 and accompanying text.

¹⁶ *See infra* notes 110–123 and accompanying text.

¹⁷ *See infra* notes 124–156 and accompanying text.

¹⁸ *See* N.Y. STATE FIN. LAW § 189(4)(a) (permitting the NYFCA to apply to tax statements). *See generally Anonymous*, 83 N.Y.S.3d 472 (dealing with an alleged false claim arising out of Moody's tax treatment of a captive insurance company for the first time under the tax provision of the NYFCA).

¹⁹ *See infra* notes 21–50 and accompanying text.

²⁰ *See infra* notes 51–86 and accompanying text.

somewhat delayed in realizing that they could share in the benefits as well.²¹ Once states realized that attracting captives to the state could lead to revenue and job creation, they began passing legislation to that effect.²² In 1997, the N.Y. State Legislature enacted legislation authorizing entities conducting business within the state to create captive insurance companies.²³ A captive insurance company is a subsidiary company that is created by a parent company solely for the purpose of providing insurance to the parent company.²⁴ Under N.Y. insurance law, these captive insurance companies are given favorable tax treatment so long as they meet certain requirements.²⁵ Since 2009, at least fifty percent of the captive's revenue must consist of premiums from insurance arrangements.²⁶ If a captive's premiums meet this threshold, the captive may file

²¹ Joseph W. Tucciarone & Louis Biscotti, *Captive Insurance Companies: A Common Sense Approach to Improved Risk Management*, CPA J. (Dec. 2018), <https://www.cpajournal.com/2018/12/19/captive-insurance-companies/> [<https://perma.cc/K4MH-6QAL>].

²² *See id.* Captive insurance companies can be valuable job creators through hiring and by creating a need for other businesses to service the captive industry. *Id.* They can also create revenue for state governments as their income is taxed. *Id.*

²³ N.Y. INS. LAW §§ 7001(a), 7002(h) (McKinney 2019).

²⁴ *See id.* § 7002(c), (h). Since the 1950s, major companies have utilized captive insurance companies as risk management tools. Tucciarone & Biscotti, *supra* note 21. In 2019, the vast majority of Fortune 500 corporations had captive insurance companies. *Id.* Like all insurance companies, captives serve to transfer risk from the insured to the insurer. *Id.* In traditional insurance, the insured enters into a contract with the insurer and pays a premium to the insurer. Julia Kagan, *Insurance*, INVESTOPEDIA, <https://www.investopedia.com/terms/i/insurance.asp> [<https://perma.cc/5JJ9-62SZ>]. The insurer collects premium payments from a pool of insureds who face similar risks, and in the event that one of the insureds makes a claim, the insurance company can pay the claim from the pool of premiums. *Id.* Where captive insurance differs is that the insured owns the insurance company, and therefore is the only entity that is paying premiums. Julia Kagan, *Captive Insurance Company*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/captive-insurance-company.asp> [<https://perma.cc/YLX6-QNRQ>]. In this way, captives are a form of self-insurance because the insured is effectively setting money aside to offset the risk of future harm. *Id.*

²⁵ N.Y. INS. LAW § 7003; N.Y. TAX LAW § 1502-b (McKinney 2019); *Anonymous*, 83 N.Y.S.3d at 475. Captives need to pay taxes only on their gross premium income, minus payments made on those premiums for risks in New York State. N.Y. TAX LAW § 1502-b; *Anonymous*, 83 N.Y.S.3d at 475. Premiums include any payment for insurance coverage received by a captive. N.Y. TAX LAW § 1502-b(c). Accordingly, premium income is the captive's income derived from premium payments. *See id.* The tax rate on the captive's premium income is small and decreases as the captive earns more premium income. *Id.* § 1502-b(a). For the first \$20 million, the tax rate is 0.4%; for the second, the tax rate is 0.3%; for the third, the tax rate is 0.2%; and, for each dollar of premium income over \$60 million, the captive pays 0.075%. *Id.* Captives must be licensed by the Department of Financial Services. N.Y. INS. LAW § 7003(c)(1). To be licensed, captives must submit a copy of their charters, bylaws, financial statements, plans of operations, and independent actuarial reports. *Id.* Additionally, captives are required to maintain a principal office and records in the State and to hold board meetings within the State. *Id.* § 7003(b)(1). Further, captives are prohibited from providing certain types of insurance, such as workers' compensation, employers' liability, and motor vehicle liability insurance. *Id.* § 7003(a)(4)(A), (B). These exceptions aside, captives can provide any other type of insurance allowed under N.Y. law. *See id.* §§ 1113–1114 (listing the types of insurance authorized by the State of New York).

²⁶ N.Y. TAX LAW § 2(11)(d) (McKinney 2019). In 2009, the N.Y. State Legislature was concerned that captive insurance companies were causing the state to lose revenue by sheltering property unrelated to insurance policies from taxation. *Anonymous*, 83 N.Y.S.3d at 475. As a result, the legisla-

a separate tax return and need only pay a special franchise tax rate on its premium income.²⁷ If, however, the captive's premium revenue does not reach the minimum threshold, it must file a combined tax return with the parent company and pay a higher corporate income tax rate.²⁸

Through the NYFCA, the Legislature brought tax treatment of captive insurance companies—and tax avoidance more generally—within reach of both private lawsuits and enforcement actions by the N.Y. Attorney General.²⁹ Like false claims laws in other states, the NYFCA closely mirrors the federal FCA.³⁰ The NYFCA attaches liability to any person who knowingly submits a false record or statement to the state to avoid an obligation to pay the government.³¹ The term “knowingly” encompasses actual knowledge, willful ignorance³², and reckless disregard³³ of the veracity or inaccuracy of statements.³⁴

ture amended Section 2(11) of the tax code to require that captive insurance companies earn at least half of their income from insurance premiums. *Id.* Any captive that derived more than half of its income from sources other than insurance premiums were deemed overcapitalized insurance companies. *Id.* Section 2(11) was then updated again in 2014 to change the terminology from overcapitalized captive insurance company (OCCIC) to combinable captive insurance company (CCIC). N.Y. TAX LAW § 2(11)(d); *Anonymous*, 83 N.Y.S.3d at 475. An insurance arrangement is an insurance relationship in which the risk falls on the insurer rather than on the insured. *See* *Securitas Holdings, Inc. v. Comm’r, T.C. Memo 2014-225*, at 18 (2014) (outlining the standard for what constitutes an insurance arrangement).

²⁷ N.Y. TAX LAW § 1502-b(a)(2); *Anonymous*, 83 N.Y.S.3d at 475. If a captive's premiums do not exceed the 50% threshold, the captive files a joint tax return with the parent company, hence the term “combinable captive insurance company.” *See Anonymous*, 83 N.Y.S.3d at 475. If the captive is able to file a separate tax return, it pays only a fraction of one percent in taxes on its premium income, depending on how much premium income the captive has in a given year. N.Y. TAX LAW § 1502-b(a)(2); *see supra* note 25 and accompanying text (explaining the special franchise tax on captive insurance companies).

²⁸ *See Anonymous*, 83 N.Y.S.3d at 475 (noting the consequences of being classified as an OCCIC, such as requiring the captive to file a combined tax return with the parent company and paying the corporate income tax rate). New York's corporate tax rate for years before 2016 was seven and one-tenth percent of the business income base. N.Y. TAX LAW § 210(1)(a) (McKinney 2019). A taxpayer's business income base is the “portion of the taxpayer's business income apportioned within the state” according to the rules set forth in Section 210 of the State tax law. *Id.*

²⁹ *See* N.Y. STATE FIN. LAW §§ 189–190 (permitting false tax statements to be the subject of false claims act litigation from *qui tam* plaintiffs and the government). Although the government always had the ability to enforce tax fraud, the expansion of private enforcement to uncovering tax fraud makes it possible to uncover clandestine avoidance schemes. *See infra* notes 85–122 (noting the benefits of *qui tam* enforcement, which include a greater ability to uncover tax fraud). Once fraudulent tax statements come to light, the government can then transform the private enforcement action into a public one by superseding the relator's complaint. N.Y. STATE FIN. LAW § 190(5).

³⁰ *See* Faber, *supra* note 4, § 2.03 (noting the similarities between the NYFCA and the FCA prior to the 2010 amendment).

³¹ N.Y. STATE FIN. LAW § 189.

³² *Voluntary Ignorance*, BLACK'S LAW DICTIONARY, *supra* note 4 (“an unknowing or unaware state resulting from the neglect to take reasonable steps to acquire important knowledge”).

³³ *Disregard*, BLACK'S LAW DICTIONARY, *supra* note 4 (“conscious indifference to the consequences of an act”).

³⁴ N.Y. STATE FIN. LAW § 188(3).

The law applies both to the typical false claim and the reverse false claim.³⁵ Like the federal FCA, the NYFCA contains a *qui tam* provision.³⁶ A *qui tam* provision allows private citizens, known as relators, to bring an action on behalf of the government.³⁷ Once a *qui tam* action is filed in New York, the state Attorney General then chooses whether to participate in the action.³⁸ Such provisions incentivize whistleblowers to bring their concerns to the courts with a promise of fifteen to thirty percent of the damage award or settlement, depending on whether the state or city deprived of revenue decides to intervene.³⁹ *Qui tam* provisions have several policy benefits.⁴⁰ They expand the extent the government can pursue enforcement, thus alleviating the strain on agencies typically tasked with such enforcement.⁴¹ Further, *qui tam* actions often reveal details about defendants, in particular corporate defendants, that might be otherwise difficult or impossible to uncover with a conventional agency investigation.⁴² Lastly, *qui tam* actions increase corporate accountability by removing

³⁵ See *Anonymous*, 83 N.Y.S.3d at 478 (noting the difference between the traditional false claim and the reverse false claim). The typical false claim involves making a false statement that causes the government to pay out money, whereas the reverse false claim occurs when a person or entity makes a false statement which deprives the government of money that it is owed. *Id.*

³⁶ N.Y. STATE FIN. LAW § 190(2).

³⁷ *Qui Tam Action*, BLACK'S LAW DICTIONARY, *supra* note 4. Relators are often informally referred to as "whistleblowers" because they draw attention to fraud. See, e.g., Fatale et al., *supra* note 4, § 6.04 (referring to relators as whistleblowers).

³⁸ N.Y. STATE FIN. LAW § 190(5). *Qui tam* complaints must be served on the State. *Id.* § 190(2)(b). Upon notice of such complaints, the Attorney General may investigate the conduct alleged in the complaint. *Id.* After an investigation, the Attorney General must decide upon one of three possible courses of action: (1) to file a complaint against the defendant which will supersede the existing *qui tam* complaint; (2) intervene in the existing action and assist the plaintiff-relator; or, (3) decline to participate, allowing the plaintiff-relator to proceed alone. *Id.* § 190(c)–(f).

³⁹ *Id.* § 190(6)(a)–(b). If the N.Y. Attorney General decides to initiate a proceeding, or the State or City elects to intervene, the plaintiff-relator is entitled to between 15–20% of the proceeds or settlement of the action. *Id.* § 190(6)(a). If, however, the plaintiff-relator is left to pursue the claim alone, the plaintiff-relator is entitled to 25–30%. *Id.* § 190(6)(b). This structure, again, is similar to the FCA. 31 U.S.C. § 3729; see Kathleen Clark & Nancy J. Moore, *Financial Rewards for Whistleblowing Lawyers*, 56 B.C. L. REV. 1697, 1704 (2015) (discussing the FCA and noting the government's option to intervene). Under both the NYFCA and the FCA, the government chooses whether to intervene, and this may have a dramatic impact on the outcome. See Clark & Moore, *supra*, at 1704 (noting that the government chooses to intervene in less than one third of *qui tam* actions, but that in nearly all *qui tam* actions resulting in a reward, the government did choose to intervene).

⁴⁰ See *infra* notes 41–43 and accompanying text (discussing that *qui tam* provisions can relieve strain on government agencies, provide more information, and increase corporate accountability).

⁴¹ Ventry, *supra* note 4, at 363. Revenue services suffer from a lack of resources that prevents them from pursuing many enforcement actions. *Id.*

⁴² See Press Release, N.Y. State Office of the Attorney Gen., A.G. Schneiderman Announces \$40 Million Settlement with Investment Management Company for Tax Abuses, Marking Largest Tax Whistleblower Recovery in Office's History (Apr. 18, 2017), <https://ag.ny.gov/press-release/ag-schneiderman-announces-40-million-settlement-investment-management-company-tax> [<https://perma.cc/6AX3-MBA5>] [hereinafter *A.G. Memo*] (noting that without the whistleblower these issues would likely have remained invisible).

the shroud of secrecy provided by agency investigations and allowing the public to see how certain companies are manipulating the law for financial gain.⁴³ In 2010, New York expanded the NYFCA beyond the scope of the federal standard to include any submissions of tax returns made under the state tax law so long as the defendant meets the minimum income threshold, and the damages exceed the required amount.⁴⁴

Since 1986, Congress has explicitly refused to extend the FCA to income tax statements.⁴⁵ This refusal is codified in § 3729(d) of the United States Code, which states that the FCA does not apply to false statements made under the Internal Revenue Code (Tax Code).⁴⁶ Federal courts have interpreted this exclusion to be an official recognition of the Internal Revenue Service's (IRS) exclusive jurisdiction over the enforcement of the Tax Code.⁴⁷ The vast majority of states have followed the federal government's lead.⁴⁸ Indeed, when New York brought tax statements within the purview of the NYFCA, it became the first and only state with such a provision.⁴⁹ Courts interpret Congress's rejection of the approach eventually adopted by New York to reflect Congress's belief in institutional competence.⁵⁰

⁴³ See Ventry, *supra* note 4 (explaining that any privacy concerns must be balanced against the public benefit of exposing taxpayers who seek to cheat the tax system); see also Franziska Hertel, Note, *Qui Tam for Tax?: Lessons from the States*, 113 COLUM. L. REV. 1919–21 (2013) (discussing how taxpayer privacy contributes to the smooth functioning of the U.S. tax system because it requires taxpayers to voluntarily surrender personal information, and if taxpayers believed that information would not be kept private, they would be less willing to surrender it); Amy Hamilton, *Qui Tam Troubles, Part IV: Does New York Have the Answer?*, TAX ANALYSTS (July 7, 2014), <http://www.taxhistory.org/www/features.nsf/Articles/F44AA8EA9E28521585257D0F00702F25?OpenDocument> [<https://perma.cc/ET42-VBG2>] (noting that *qui tam* provisions can encourage corporate responsibility and increase legal compliance by publicizing illegal behavior and martialing public opinion against those who commit fraud).

⁴⁴ N.Y. STATE FIN. LAW § 189(4)(a)(i)–(ii). The NYFCA limits actions arising out of tax statements to instances in which damages exceed \$350,000 and defendants earn more than \$1 million in annual net income. *Id.*

⁴⁵ 31 U.S.C. § 3729(d); see *Lissack*, 377 F.3d at 152–53 (noting that Congress added the provision excluding statements made under federal tax law, known as the “Tax Bar,” to the FCA in 1986).

⁴⁶ 31 U.S.C. § 3729(d).

⁴⁷ See *Lissack*, 377 F.3d at 152–53. The court in *Lissack* concluded that the Tax Bar is a codification of the existing common law, and the reservation of the IRS's exclusive jurisdiction is derived from § 7401 of the Tax Code. *Id.* Section 7401 states that all civil actions brought for the collection of taxes are prohibited unless brought at the direction of the Secretary of the IRS or the Attorney General directs it. I.R.C. § 7401; *Lissack*, 377 F.3d at 152–53.

⁴⁸ Akin Gump, LLP, *New York False Claims Act*, STATE FCA RESOURCE CTR. (Mar. 4, 2013), <https://www.akingump.com/en/experience/practices/litigation/false-claims-act-qui-tam-defense/state-fca-resource-center/new-york-false-claims-act.html> [<https://perma.cc/RCY8-6V9H>].

⁴⁹ See Hertel, *supra* note 43, at 1915 (explaining that, as of 2013, New York was the only state explicitly to bring fraudulent tax statements within the reach of its false claims act). Some states, like Illinois, have implicitly allowed actions arising out of tax statements to be brought under the FCA, but do not have a statute that explicitly authorizes it. *Id.*

⁵⁰ *Lissack*, 377 F.3d at 152–53; see also Hertel, *supra* note 43, at 1918–20 (explaining that the decision to grant the IRS the exclusive jurisdiction to enforce internal revenue code (Tax Code) re-

*B. Factual Setting of Anonymous v. Anonymous and the
Appellate Division's Decision*

In the realm of corporate tax evasion, captive insurance companies have become a well-known means for avoiding taxes.⁵¹ Though many captives provide legitimate insurance for their parent companies, some do not.⁵² In 2002, Moody's Corporation (Moody's), a financial service holding company, formed Moody's Assurance Company (MAC) as a captive insurance company.⁵³ MAC provides insurance coverage to Moody's Investors Service, a credit agency subsidiary of Moody's, for instances of terrorism, excess commercial liability coverage,⁵⁴ and harm to reputation.⁵⁵ From 2002 to 2009, MAC took advantage of the favorable tax structure provided by New York State by filing separate tax returns and paying the lower franchise tax rate on only its premium income.⁵⁶ Moody's then deducted its premium payments to MAC from its taxable income.⁵⁷

flects the belief that by virtue of its expertise, the IRS, partnered with the Department of Justice, is in the best position to determine when to bring enforcement proceedings). Another benefit of this approach is the privacy of the taxpayer. *See* Ventry, *supra* note 4 (explaining that the U.S. system of taxation depends on voluntary participation of taxpayers; therefore, taxpayers must believe that their information will be kept private because otherwise they would not willingly provide sensitive financial information).

⁵¹ *See* Tucciarone & Biscotti, *supra* note 21 (noting that captive insurance companies were placed on an IRS watch-list for tax evasion schemes).

⁵² *Id.*

⁵³ *Anonymous*, 83 N.Y.S.3d at 475. Moody's Corporation primarily issues credit ratings, performs market research and risk analysis, and provides analytics tools for businesses. *About Moody's*, MOODY'S, <https://about.moody's.io/about-us> [<https://perma.cc/GQ94-2LPU>]. Its two largest subsidiaries are Moody's Investors Service and Moody's Analytics. *Id.* In 2018, Moody's reported over \$4 billion in total annual revenue. *Id.*

⁵⁴ Excess liability insurance policies extend the coverage of an underlying insurance policy so that the policy will cover more expensive losses, which might otherwise exhaust the original policy. *What Is Excess Liability Insurance?*, COVERWALLET, <https://www.coverwallet.com/general/excess-liability-insurance> [<https://perma.cc/Z7WA-6BZ2>].

⁵⁵ *Anonymous*, 83 N.Y.S.3d at 475. The N.Y. state legislature specifically contemplated the use of captive insurance companies by cities to provide coverage for the effects of the September 11, 2001, terrorist attacks. N.Y. INS. LAW § 7003(5). It is possible that Moody's decision to insure against terrorism flowed out of this same concern. *See Background on: Terrorism Risk and Insurance*, INS. INFO. INST. (Dec. 16, 2019), <https://www.iii.org/article/background-on-terrorism-risk-and-insurance> [<https://perma.cc/4HSK-C9WN>] (explaining the impact that terrorism has had on the insurance industry and insurance policies). There has also been some question about whether companies, especially financial services companies, should be able to self-insure against reputational damage. *See* Jay Adkinson, *Whistleblower Yanks Back Rug to Expose Alleged Dirt of Moody's Captive Insurance Company*, FORBES (Sept. 5, 2018), <https://www.forbes.com/sites/jayadkinson/2018/09/05/whistleblower-yanks-back-rug-to-expose-alleged-dirt-of-moodys-captive-insurance-company/#489483086cae> [<https://perma.cc/KQ7G-FU3L>] (explaining that the concern arises out of the company's ability to trigger the policy with its own actions, thus creating a significant moral hazard).

⁵⁶ *Anonymous*, 83 N.Y.S.3d at 475.

⁵⁷ *Id.* Premium payments are payments made to MAC as consideration for insurance coverage. *See* N.Y. TAX LAW § 1502-b(c) (defining premiums). A New York corporation must pay an annual

This situation was forced to change when the New York legislature became concerned that companies were using captives to shield income from taxation.⁵⁸ In 2009, New York amended section 2 of its tax law to place more restrictions on the favorable tax treatments of captives.⁵⁹ In response to the 2009 amendment, Moody's treated MAC as an overcapitalized captive insurance company (OCCIC) because MAC's insurance premiums did not make up the majority of MAC's revenue.⁶⁰ An OCCIC is any captive insurance company that derives more than half of its revenue from bona fide insurance premiums.⁶¹ As an OCCIC, MAC was required to file a combined tax return with Moody's and was not subject to the low tax rate on its premium income, and instead had to pay a higher corporate tax rate on all taxable income.⁶² To avoid paying the higher corporate tax rate on MAC's income in following years, Moody's hired Marsh & McLennan Companies, Inc. (Marsh & McLennan), a professional services firm, to restructure MAC.⁶³ This restructuring allowed Moody's to return to treating MAC as a non-OCCIC and to continue taking advantage of the favorable tax rates.⁶⁴

Moody's restructuring sparked concerns from within the company itself.⁶⁵ In 2012, an anonymous former Moody's employee-turned-relator filed his first *qui tam* suit on behalf of New York State.⁶⁶ On August 9, 2013, the plaintiff-

franchise tax on its business income, which is the business's net income minus any income deriving from investments and other exempted income, so long as the exempted incomes do not amount to more than net income. *Id.* § 208(8).

⁵⁸ *Anonymous*, 83 N.Y.S.3d at 475.

⁵⁹ *Id.* The amendment required captives to earn at least half of their income from insurance premiums in order to qualify for favorable tax treatment. *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* The court explained that, to be bona fide premium income, the income must come from insurance arrangements that qualify as insurance for federal income tax purposes. *Id.* at 478–79. The court relied on *Securitas Holdings, Inc. v. Commissioner*, T.C. Memo 2014-225, to supply the multi factor test for when an arrangement qualifies as insurance for federal income tax purposes. *Id.*; *see supra* notes 91–92 (discussing the federal tax standard for an insurance arrangement).⁶² *See supra* notes 25–23 and accompanying text (explaining how OCCIC classification impacts the tax treatment of a captive).

⁶² *See supra* notes 25–23 and accompanying text (explaining how OCCIC classification impacts the tax treatment of a captive).

⁶³ *Anonymous*, 83 N.Y.S.3d at 475 (noting that Marsh & McLennan moved many of MAC's profitable intellectual property assets to a newly created subsidiary so that MAC's premium income would constitute the majority of its revenue). As a professional services firm, Marsh & McLennan, through its many subsidiaries, provides risk management, insurance broking, and strategic consulting services. MARSH & MACLENNAN COS., AT A GLANCE, https://www.mmc.com/content/dam/mmc-web/Files/MMC_AtAGlance_02022020_web.pdf [<https://perma.cc/794M-TD2P>].

⁶⁴ *Anonymous*, 83 N.Y.S.3d at 475. For the first \$20 million of premium income, the tax rate for captives is 0.4%; for the second, the tax rate is 0.3%; for the third, the tax rate is 0.2%; and for each dollar of premium income over \$60 million, the captive pays 0.075%. N.Y. INS. LAW § 1502-b(c).

⁶⁵ *Anonymous*, 83 N.Y.S.3d at 476.

⁶⁶ *Id.* Plaintiff-relator worked for Moody's as a treasury manager in the company's Treasury Department. *Banerjee*, 2016 WL 7252487, at *4. He was instructed by supervisors to perform a cost-

relator filed an amended complaint to include both the State and New York City.⁶⁷ In his complaint, the plaintiff-relator alleged that MAC is a “sham” that Moody’s and co-defendant Marsh & McLennan created for the sole purpose of allowing Moody’s to avoid paying more than \$120 million in corporate taxes to the State and the City.⁶⁸ Both Moody’s and Marsh & McLennan moved to dismiss the plaintiff-relator’s claims on the basis that the plaintiff-relator failed to state a claim.⁶⁹ Moody’s primarily asserted that its tax treatment of MAC was proper as a matter of law, while Marsh & McLennan argued that the plaintiff-relator had sued the incorrect corporate entity.⁷⁰

On November 30, 2016, the Supreme Court of New York, which is the state’s trial-level court, granted Marsh & McLennan’s motion to dismiss.⁷¹ The Supreme Court dismissed the plaintiff-relator’s complaint with prejudice and denied the plaintiff-relator’s request to amend the complaint to correct the name of the Marsh corporate entity.⁷² The plaintiff-relator appealed from this decision to the Appellate Division.⁷³

On appeal, the plaintiff-relator argued that the Supreme Court of New York abused its discretion by dismissing his complaint against Marsh & McLennan and by denying his request to amend it.⁷⁴ Specifically, the plaintiff-relator argued that the Supreme Court of New York should have granted leave to amend because amendment would not be futile and would not unduly prejudice the defendant.⁷⁵ The Appellate Division agreed with the plaintiff-relator’s argument and held that the Supreme Court of New York had abused its discretion.⁷⁶

benefit analysis of MAC in April 2011. *Id.* It was this project that caused the plaintiff-relator to become concerned about the legality of MAC. *Id.*

⁶⁷ *Anonymous*, 83 N.Y.S.3d at 476. New York City had the option to join the lawsuit as a plaintiff because Moody’s dealings also deprived the City of tax revenue. *Banerjee*, 2016 WL 7252487, at *4.

⁶⁸ *Banerjee*, 2016 WL 7252487, at *2, *4 (alleging that MAC did not actually provide insurance for Moody’s, but rather, was simply a vehicle used to avoid paying taxes through a scheme of overvaluing policies, circling back premium payments to Moody’s in the form of unsecured loans, and utilizing subsidiaries to shield income, thereby allowing MAC to qualify for the extremely low captive tax rates).

⁶⁹ *Anonymous*, 83 N.Y.S.3d at 476, 480–81. Marsh & McLennan’s motion to dismiss hinged on the fact that the wrong corporate entity was named in the original complaint. *Id.* at 31–32.

⁷⁰ *Id.* at 476, 480–81.

⁷¹ *Id.* at 481. It appears that this dismissal was based on the fact that the plaintiff had named the wrong corporate entity as a defendant. *Id.*

⁷² *Id.* The court denied plaintiff-relator’s request to amend the complaint to include the proper corporate entity defendant because the plaintiff-relator failed to file a formal motion as the court had instructed. *Id.*

⁷³ *Id.* at 474. Despite its name, the Supreme Court of New York is the trial-level court in the state. *Structure of the Courts*, NYCOURTS.GOV, <https://www.nycourts.gov/courts/structure.shtml> [<https://perma.cc/M7P6-L5QH>]. The Appellate Division is the state’s intermediate appellate court, and the N.Y. Court of Appeals is the state’s highest court. *Id.*

⁷⁴ *Anonymous*, 83 N.Y.S.3d at 481.

⁷⁵ *Id.* A party’s leave to amend is subject to the discretion of the court, but may be denied if the amendment would be completely meritless or ineffective. 1 WEINSTEIN, KORN & MILLER CPLR

With respect to the allegations against Moody's, on December 8, 2016, the Supreme Court of New York denied in part Moody's motion to dismiss the complaint against it, but granted the motion with respect to tax year 2009.⁷⁷ The court ruled that the plaintiff-relator's allegations sufficiently alleged that MAC should have been treated as an OCCIC.⁷⁸ The court also determined that Moody's knowingly submitted false claims by filing tax returns treating MAC as a legitimate captive.⁷⁹ In reaching this decision, the court credited the plaintiff-relator's allegations about MAC's inability to pay claims.⁸⁰ The court also noted that no claims had been made despite reputational harm that could have triggered coverage.⁸¹ Moody's subsequently appealed this decision to the Appellate Division.⁸²

On appeal, Moody's raised the same arguments that it raised in the Supreme Court of New York.⁸³ Specifically, Moody's argued that MAC's licensing and oversight by the Department of Financial Services indicated that Moody's was complying with applicable regulations and that the plaintiff-relator's claims should be barred by past settlements with the State and the City.⁸⁴ Moody's also argued that the Supreme Court of New York should have relied on state law definitions of insurance, and therefore that it erred by ana-

MANUAL § 19.14 (David L. Ferstendig ed., 3d ed. 2020). Similarly, leave to amend may be denied if the amendment would prejudice the party opposing the amendment. Prejudice must stem from the delay. *Id.* A common example of prejudice would be that the opposing party has no remedy because the statute of limitations has run. *Id.*

⁷⁶ *Anonymous*, 83 N.Y.S.3d at 480–81. The Appellate Division spent no more than one paragraph addressing plaintiff-relator's appeal of the Marsh & McLennan dismissal. *See id.* (lacking robust explanation for the reversal of the Marsh & McLennan dismissal).

⁷⁷ *Banerjee*, 2016 WL 7252487, at *1. In 2009, Moody's treated MAC as an OCCIC, as it should have. *Id.* For this reason, the court granted Moody's motion with respect to that year. *Id.*

⁷⁸ *Id.* at *11.

⁷⁹ *See id.* at *12 (explaining that plaintiff-relator met the pleading standards with allegations that sufficiently demonstrated that Moody's had knowingly engaged in a scheme to avoid paying taxes). To state a claim under the NYFCA, a plaintiff-relator must show that "(1) defendants filed the tax records at issue, (2) that those records were actually false . . . , and (3) that defendants acted knowingly in doing so." *Id.* at 7.

⁸⁰ *Anonymous*, 83 N.Y.S.3d at 478, 478 n.2. The court also noted the allegations that MAC did not pay claims, and that any claims that were paid were on smaller policies added later only to give the impression that MAC was legitimate. *Id.*

⁸¹ *See Banerjee*, 2016 WL 7252487, at *2 (noting that although Moody's suffered considerable reputational damage during the 2008 financial crisis, Moody's never made a claim under its reputational damage policy).

⁸² *Anonymous*, 83 N.Y.S.3d at 474, 476.

⁸³ *See id.* at 479–80 (noting that Moody's argued on appeal that the tax treatment of MAC was proper, the suit was barred by settlements with the State and the City, and MAC was a legitimate insurance company because it was licensed by the N.Y. Department of Financial Services).

⁸⁴ *Id.* at 479. Despite Moody's reliance on the settlements, the settlements were not signed by the N.Y. Attorney General, did not contain release language, and explicitly contained exceptions for future actions arising out of fraud. *Id.* at 477, 480.

lyzing federal case law.⁸⁵ The Appellate Division rejected each of these arguments, ultimately affirming the decision of the Supreme Court of New York.⁸⁶

II. LEGAL CONTEXT OF *ANONYMOUS*

The Appellate Division's decision in *Anonymous v. Anonymous* is a matter of first impression because it is the first time that a parent company's classification of its captive insurance company triggered an action under the NYFCA.⁸⁷ This case, however, sits in the much larger and well-litigated context of tax law, which provided the Appellate Division with familiar standards to decide that the plaintiff-relator sufficiently pleaded a cause of action under the NYFCA.⁸⁸

Section A of this Part discusses how the plaintiff's inside knowledge of Moody's actions and the existing authority on tax enforcement shaped the Supreme Court of New York's decision.⁸⁹ Section B of this Part then explains how *Anonymous* represents a narrow subset of tax enforcement under the expansive NYFCA.⁹⁰

A. *The Anonymous Framework and the Role of a Relator's Inside Knowledge*

The crux of the question for the Supreme Court of New York was whether Moody's and MAC had reached an insurance arrangement under federal law.⁹¹ The standard for what constitutes an insurance arrangement is a matter of common law.⁹² Ultimately, the standard focuses on whether the arrangement

⁸⁵ *Id.* at 478–79. (rejecting this argument entirely while noting that Moody's did not suggest why the law was wrong, how state law definitions of insurance differed from the federal standard, or suggest an alternative).

⁸⁶ *Id.* at 481.

⁸⁷ 83 N.Y.S.3d 472, 474 (App. Div. 2018).

⁸⁸ See *State ex rel. Banerjee v. Moody's Corp.*, No. 103997/2012, 2016 WL 7252487, at *8–10 (N.Y. Sup. Ct. Dec. 8, 2016) (relying on federal tax enforcement cases); see also *People v. Sprint Nextel Corp.*, 42 N.E.3d 655, 662 (N.Y. 2015) (interpreting the knowledge requirement and noting that it can be difficult to prove). Specifically, the issues in *Anonymous* depended on cases that determined what constitutes insurance under federal law and the general scienter element of the NYFCA. *Banerjee*, 2016 WL 7252487, at *8–10.

⁸⁹ See *infra* notes 91–109 and accompanying text.

⁹⁰ See *infra* notes 110–123 and accompanying text.

⁹¹ See *Banerjee*, 2016 WL 7252487, at *11–12 (analyzing whether the tax treatment of MAC was appropriate through the federal insurance arrangement framework).

⁹² See *Securitas Holdings, Inc. v. Comm'r, T.C. Memo. 2014-225*, at 18 (2014) (Although insurance is not defined by statute, courts have established the standard for an arrangement to qualify as insurance for federal income tax purposes: (1) the arrangement needs to concern insurable risks; (2) risk must be shifted to the insurance provider; (3) risk must be distributed amongst policyholders; and (4) the relationship must satisfy commonly accepted notions of insurance. See *Anonymous*, 83 N.Y.S.3d at 479 (citing *In re In re Stewart's Shops Corp.*, No. 825745, 2016 WL 1086062, at *24

shifts risk and fits in with the common understanding of insurance.⁹³ To determine whether an insurance arrangement fits with the common understanding of insurance, courts consider several factors.⁹⁴ First, whether the insurer is an organized insurance company.⁹⁵ Second, whether the insurer could afford to cover claims.⁹⁶ Third, whether the premiums paid were reasonable in relation to the market.⁹⁷ Last, whether both premiums and claims were actually paid.⁹⁸ The Supreme Court of New York evaluated each of these factors and determined that the plaintiff-relator's allegations did not meet the common understanding of insurance.⁹⁹

In so concluding, the Supreme Court of New York looked to the well-pleaded allegations in the plaintiff-relator's complaint.¹⁰⁰ As a treasury manager in Moody's Treasury Department, the plaintiff-relator had an expansive amount of information at his disposal.¹⁰¹ Specifically, the circular nature of the payments to and from MAC evidenced that risk was not truly shifting from Moody's to MAC.¹⁰² Further, the plaintiff-relator provided examples of specific premium payments made to MAC that far outpaced market rates.¹⁰³ He also provided statements allegedly made by Moody's executives to him that such high premiums would never be paid to third-party providers.¹⁰⁴ The plaintiff-

(N.Y. Div. Tax App. Mar. 10, 2016), *aff'd* 102 N.Y.S.3d 732 (App. Div. 2019)) (noting that courts have rejected the argument that the federal tax standard for insurance was inapplicable prior to 2014).

⁹³ *Anonymous*, 83 N.Y.S.3d at 479 (describing risk-shifting as the essential element of insurance); *Securitas*, T.C. Memo. 2014-225, at 18–19 (recognizing the fundamental nature of risk-shifting within the insurance context and giving substantial weight to the common understanding element of the test).

⁹⁴ *Securitas*, T.C. Memo 2014-225, at 18–19.

⁹⁵ *Id.* at 18. Courts look to see whether the insurer is “organized, operated, and regulated as an insurance company.” *Id.* at 27. In doing so, the courts look to the corporate structure and management of the insurer, their financial records, and whether they were subject to the laws of the insurer's state of incorporation. *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *See Banerjee*, 2016 WL 7252487, at *12 (holding that the allegations suggest that the arrangement between Moody's and MAC does not qualify as an insurance arrangement because the allegations suggest that (1) claims were not made; (2) could not have been paid; and (3) the risk did not actually shift from the insured to the insurer).

¹⁰⁰ *Id.*

¹⁰¹ *See id.* (describing the plaintiff-relator's allegations, based on his knowledge of the inner-workings of the Moody's-MAC arrangement).

¹⁰² *See id.* at *10 (citing *Stewart's Shops Corp.*, 2016 WL 1086062, at *22) (noting that the premium payments made to MAC were circled back to Moody's in the form of unsecured intercompany loans, and that because of this circular payment, the risk of loss never actually left the parent company). A security interest is a “property interest created by agreement or operation of law to secure performance of an obligation.” *Security Interest*, BLACK'S LAW DICTIONARY, *supra* note 4. Accordingly, an unsecured loan is a loan where the lender does not take a security interest in any of the borrower's assets. *See id.*

¹⁰³ *Banerjee*, 2016 WL 7252487, at *10.

¹⁰⁴ *See id.* at *10–11 (noting that plaintiff-relator alleged that the premiums were valued in an arbitrary manner above market rates). The N.Y. Supreme Court relied on *Rent-A-Center v. Commis-*

relator's in-depth knowledge of Moody's conduct was similarly important in the court's determination on the element of scienter.¹⁰⁵ The knowledge requirement of the NYFCA has been previously evaluated in tax avoidance cases.¹⁰⁶ Many of the plaintiff-relator's claims stemmed from statements allegedly made by Moody's executives.¹⁰⁷ Beyond those statements, the plaintiff-relator alleged that because Moody's had never made a claim under MAC's policies and did not state MAC's liabilities in investor reports,¹⁰⁸ Moody's did not treat MAC as a legitimate insurance provider.¹⁰⁹

B. Larger Context of Tax Enforcement Under the NYFCA

The expansion of the NYFCA led to a significant increase in the number of private tax enforcement actions.¹¹⁰ These actions vary in detail, but settlements and favorable decisions have substantially benefitted New York State by recapturing revenue.¹¹¹ The 2015 decision in *People v. Sprint Nextel Corp.* is particularly influential.¹¹² In that decision, the N.Y. Court of Appeals affirmed

tioner to show that premium rates should be independently determined. *See id.* (citing *Rent-A-Center*, 142 T.C. 1, 27 (2014) (Buch, J., concurring)).

¹⁰⁵ *See id.* at *12. The Supreme Court discussed that the complaint contained several allegations that sufficiently showed knowledge and highlighted the plaintiff-relator's allegation that a Moody's executive stated that Moody's did not want MAC to provide certain types of insurance because MAC would not have been able to pay out claims. *See id.*; *Scienter*, BLACK'S LAW DICTIONARY, *supra* note 4 ("A degree of knowledge that makes a person legally responsible for the consequences of his or her act or omission.").

¹⁰⁶ *See, e.g., Sprint*, 42 N.E.3d at 662 (explaining that the knowledge requirement is crucial because the NYFCA is not meant to apply to every case of unpaid taxes, but only those where the defendant acted knowingly).

¹⁰⁷ *Banerjee*, 2016 WL 7252487, at *12. The plaintiff-relator alleged that a Moody's executive told him that Moody's would never pay such high premiums to outside insurance providers. *Id.* The executive also allegedly said that MAC was undercapitalized and could not pay out claims. *Id.*

¹⁰⁸ All publicly traded companies are required to publish financial reports that inform investors on the company's performance and outlook. *See* Sham Gad, *How to Efficiently Read an Annual Report*, INVESTOPEDIA (Apr. 11, 2019), <https://www.investopedia.com/articles/basics/10/efficiently-read-annual-report.asp> [<https://perma.cc/M347-5YAZ>].

¹⁰⁹ *Banerjee*, 2016 WL 7252487, at *12.

¹¹⁰ *See* Fatale et al., *supra* note 4, § 6.04 (noting that New York has experienced a surge of FCA lawsuits dealing with state taxes).

¹¹¹ *See, e.g., A.G. Memo*, *supra* note 42 (noting that New York received \$40 million in unpaid taxes).

¹¹² *See* Fatale et al., *supra* note 4, § 6.04 (describing *People v. Sprint Nextel Corp.* as the most significant case in this fairly new field of law). In *Sprint*, Empire State Ventures, LLC (Empire) filed a *qui tam* complaint against Sprint Nextel Corporation (Sprint). 42 N.E.3d at 658–59. Empire alleged that Sprint knowingly failed to collect sales tax on a portion of its phone services by separating out, or "unbundling," the percentage of the monthly charge that it attributed to interstate and international calls. *Id.* at 659. The N.Y. Attorney General filed a superseding complaint and converted the plaintiff's action into a civil enforcement action. *Id.* at 658. In the Attorney General's complaint, the government argued that the relevant tax law required collection on the full amount of fixed charges for voice services sold to New York customers, and that Sprint was aware of the interpretation and chose to pursue its "unbundling" scheme to lower prices and gain a competitive advantage in the market. *Id.*

the denial of the defendant's motion to dismiss and determined that the N.Y. Attorney General had sufficiently pleaded a claim.¹¹³ The N.Y. Court of Appeals relied on allegations that Sprint had initially complied with the tax law, but later deliberately chose not to comply despite warnings from the New York State Tax Department that the unbundling practice was illegal.¹¹⁴ In reaching this conclusion, the Court of Appeals noted the importance of allowing the Attorney General to engage in further discovery to bolster the allegations.¹¹⁵

The Attorney General of New York has also been successful in extracting large settlements from claims initially brought by whistleblowers under the NYFCA.¹¹⁶ In 2017, the Office of the Attorney General announced a record forty million dollar settlement with Harbert Management Corporation, an Alabama-based investment management company.¹¹⁷ The settlement was heralded as a great victory by then-Attorney General Eric Schneiderman, who touted New York's enforcement capabilities.¹¹⁸ Schneiderman also credited the anonymous whistleblower for his contributions, a sentiment that was echoed by the relator's lawyers who insisted that these types of cases would be unseen by regulators without the relator's help.¹¹⁹

Tax enforcement under the NYFCA has, however, not always resulted in a victory for plaintiffs and the state.¹²⁰ In April 2018, the Supreme Court of New York granted a motion to dismiss for defendant Starbucks Corporation

at 659. Sprint moved to dismiss the complaint on the grounds that the government did not state a claim because, among other things, Sprint lacked the requisite knowledge and instead acted according to its own reasonable interpretation of the statute. *Id.* at 661. Sprint also argued that the Ex Post Facto Clause in Article 1, Section 10 of the U.S. Constitution, which operates to prevent states from passing laws that apply retroactively, prohibited such a retroactive application of the NYFCA. *Id.* at 662. The N.Y. Court of Appeals affirmed the denial of Sprint's motion on all counts. *Id.* at 663.

¹¹³ *Sprint*, 42 N.E.3d at 657. The court affirmed the denial of the motion to dismiss because (1) the language of the relevant tax law was unambiguous and therefore not open to any alternate interpretation; (2) federal law did not preempt the statute; (3) the application of the NYFCA was not barred by the Ex Post Facto Clause; and (4) the Attorney General sufficiently pleaded a cause of action under the NYFCA. *Id.*

¹¹⁴ *Id.* at 663.

¹¹⁵ *Id.* at 662. The court stated that, in light of the serious allegations and the factual disputes surrounding those allegations, the N.Y. Attorney General was entitled to further discovery to support the allegations in the complaint.

¹¹⁶ *A.G. Memo*, *supra* note 42.

¹¹⁷ *Id.* In bringing a case against Harbert Management Corporation, the State alleged that Harbert's New York-based subsidiary and its executives knowingly took the fraudulent position that all of its income was from Alabama, the location of Harbert's headquarters. *Id.* The case was originally brought by an anonymous relator who continued to provide information to the Attorney General's office after the case was converted to a civil enforcement action. *See id.* (referring to the cooperation between private citizens and the government).

¹¹⁸ *Id.* Schneiderman, as a state senator, sponsored the bill to amend the NYFCA to bring statements made under tax law within its scope. *Id.*

¹¹⁹ *Id.*

¹²⁰ *See, e.g., People ex rel. Hunter v. Starbucks Corp.*, 74 N.Y.S.3d 717, 728 (Sup. Ct. 2018) (dismissing a NYFCA claim brought against Starbucks).

(Starbucks).¹²¹ In that case, the plaintiff-relator created a survey of eighty Starbucks locations around the state and, based on the results of that survey, alleged that Starbucks had a practice of knowingly failing to charge sales tax for pastries that were either warmed by servers or prepared for on-premises consumption.¹²² In evaluating the complaint, the Supreme Court of New York concluded that the survey was non-scientific and amounted to little more than anecdotal evidence.¹²³

III. CAPTIVE INSURANCE TREATMENT HIGHLIGHTS THE IMPORTANCE OF APPLYING THE NYFCA TO FRAUDULENT TAX STATEMENTS

The Appellate Division reached the correct decision in *Anonymous v. Anonymous* by holding that the plaintiff-relator had sufficiently alleged that Moody's tax treatment of MAC was unlawful.¹²⁴ It properly used the settled federal law to determine that the Moody's-MAC arrangement was not insurance in the commonly accepted sense.¹²⁵ The plaintiff-relator's allegations demonstrated that MAC was not providing insurance coverage to Moody's, but rather, MAC was a vehicle to conceal assets from corporate taxation.¹²⁶ Further, the Appellate Division properly determined that the plaintiff-relator's complaint sufficiently alleged that Moody's violations of the tax law were made knowingly.¹²⁷ The Moody's executives' statements contained in the

¹²¹ *Id.*

¹²² *Id.* at 719–721. Starbucks did not employ the relators in this case. *Id.* at 719. Rather, the relators were both attorneys and partners in a law firm, and they represented themselves. *Id.* They likely are not the type of relators that the New York legislature had in mind when crafting the NYFCA. See Timothy P. Noonan & William Cominsky, *Calling All Tax Whistleblowers—New York Wants You!*, 59 ST. TAX NOTES 349, 350–51 (2011), https://www.hodgsonruss.com/media/publication/128_01_2011%20Calling%20All%20Tax%20Whistleblowers.pdf [<https://perma.cc/DFB2-PQN2>] (opining that New York is looking for trustworthy whistleblowers with intimate knowledge and documentary evidence of a business's fraudulent tax practices).

¹²³ See *Starbucks*, 74 N.Y.S.3d at 728 (discounting the merits of the plaintiffs' survey methods by comparing them to the accepted standards of scientific surveys, which require expert endorsement). The court also dismissed the complaint because the plaintiff-relators could not meet the \$350,000 threshold damages requirement of the NYFCA, presumably in part because the plaintiff-relators' survey could not support the amount of damages they claimed. See *id.* at 728–29 (ruling that plaintiffs' claims were unsupported by their survey and did not meet the statutory requirements).

¹²⁴ See *Anonymous v. Anonymous*, 83 N.Y.S.3d 472, 478 (App. Div. 2018) (determining that the allegations in plaintiff-relator's complaint tended to show that Moody's treatment of MAC was unlawful).

¹²⁵ See *id.* (applying the federal standard for insurance arrangements to Moody's relationship with MAC).

¹²⁶ See *id.* at 476–478 (outlining facts that showed MAC was used for the purpose of avoiding taxes).

¹²⁷ See *State ex rel. Banerjee v. Moody's Corp.*, No. 103997/2012, 2016 WL 7252487, at *12, *24 (N.Y. Sup. Ct. Dec. 8, 2016) (evaluating plaintiff-relator's allegations of inculpatory statements made by Moody's executives). Inculpatory means implying or imputing guilt. *Inculpatory*, MERRIAM-WEBSTER DICTIONARY (11th ed. 2003).

plaintiff-relator's complaint demonstrated that the executives knew that MAC was not providing insurance to Moody's and implied that this structure was intentional.¹²⁸ Moreover, the Appellate Division's decision to allow this claim to proceed under the NYFCA fully effectuated the intent of the legislature.¹²⁹ The Appellate Division's analysis was a straightforward application of the law.¹³⁰ Yet, *Anonymous* is still significant because it provides an excellent representation of the policy goals that underlie the NYFCA.¹³¹

Tax *qui tam* provisions offer several benefits.¹³² *Anonymous* magnifies the importance of each of these benefits in the context of captive insurance company treatment.¹³³ First, such provisions help alleviate the strain on agency resources by locating potential violators without using governmental funds.¹³⁴ Whereas enforcement agencies ordinarily must prioritize their collections, thereby allowing some violators to escape sanction, *qui tam* provisions allow whistleblowers to pursue enforcement in such cases.¹³⁵ Relatedly, when companies knowingly violate the New York tax code, the companies will seek to hide their evasion.¹³⁶ This is especially true in the context of tax evasion through captive insurance companies, as exhibited by Moody's conduct in *Anonymous*.¹³⁷ Moody's knowingly manipulated MAC's structure to extract the greatest tax benefits and avoid detection.¹³⁸ If not for the plaintiff-relator, this conduct likely would have been undetected by enforcement agencies.¹³⁹

¹²⁸ See *Banerjee*, 2016 WL 7252487, at *12 (describing the allegations of Moody's executives' incriminating statements).

¹²⁹ See *Senate Bill S. S7169B*, N.Y. ST. SENATE, <https://www.nysenate.gov/legislation/bills/2009/s7169/amendment/b> [<https://perma.cc/U3RT-SRWG>] (explaining that the amendments would enhance the ability to recover funds withheld from the government).

¹³⁰ See *Anonymous*, 83 N.Y.S.3d at 478–79 (applying existing law to a new set of facts without modifying the standards).

¹³¹ See *id.* at 476 (discussing a complex system of tax evasion, using a third-party restructuring and circular payments that primarily relied on a whistleblower to uncover).

¹³² See *infra* notes 133–156 (noting several policy benefits of tax *qui tam* provisions).

¹³³ See *Anonymous*, 83 N.Y.S.3d at 476–78 (describing a complex system designed to avoid taxes that was previously undisturbed by audits conducted by the State and New York City).

¹³⁴ Hertel, *supra* note 43, at 1922–23 (explaining that tax whistleblower programs decrease information costs and expand the scope of enforcement beyond government enforcement agency limitations).

¹³⁵ *Id.* (noting that agencies prioritize certain enforcement actions at the expense of others).

¹³⁶ See, e.g., *Banerjee*, 2016 WL 7252487, at *10–12 (noting that Moody's enlisted Marsh & McLennan to restructure MAC to give the government the impression that MAC qualified for captive insurance tax treatment). The court also noted that Marsh & McLennan acknowledged that the MAC restructuring was very aggressive, and Moody's executives made statements to the plaintiff-relator to discourage him from raising concerns over MAC's treatment. *Id.* at 5; see also Hamilton, *supra* note 43 (noting that complex tax evasion requires private citizens to assist in enforcement because companies seek to hide their behavior).

¹³⁷ See *Banerjee*, 2016 WL 7252487, at *10–12 (detailing the complex scheme of restructuring to give the appearance that MAC was properly capitalized).

¹³⁸ See *Anonymous*, 83 N.Y.S.3d at 478, 481 (noting that the allegations of knowledge were sufficient to avoid summary judgment); *Banerjee*, 2016 WL 7252487, at *12 (same). The State and the

Second, claims brought under the NYFCA's tax provision are very difficult for plaintiffs to prove because of the scienter requirement.¹⁴⁰ This is illustrated by both the Harbert settlement announcement and the *People ex rel. Hunter v. Starbucks Corp.* dismissal.¹⁴¹ In the Harbert settlement announcement, the Attorney General of New York and private attorneys recognized the necessity of public-private cooperation in bringing suspected NYFCA violations to light.¹⁴² *Starbucks* illustrates how much information *qui tam* plaintiffs need to survive a motion to dismiss.¹⁴³ *Anonymous* demonstrates that, in the context of captive insurance companies, the case becomes only harder to make.¹⁴⁴ Moody's allegedly engaged in a complex scheme of circular payments, asset shifting, and arbitrary valuation of premiums.¹⁴⁵ Unquestionably, the party in the best position to identify this information and understand the motivations of the actors involved is an insider, like the plaintiff-relator.¹⁴⁶ The Supreme Court of New York appropriately credited this system by giving significant weight to the statements allegedly made by Moody's executives to the plaintiff-relator.¹⁴⁷ Such statements were significant in surviving the defend-

City had audited Moody's actions, resulting in settlement agreements. *Anonymous*, 83 N.Y.S.3d at 475, 479; *Banerjee*, 2016 WL 7252487, at *18. These agreements, however, did not note any fraud, otherwise they would not have contained the exception that allowed future actions to be brought against Moody's for fraud. *Anonymous*, 83 N.Y.S.3d at 479.

¹³⁹ Hamilton, *supra* note 43; see *A.G. Memo*, *supra* note 42 (noting that, generally, these issues would likely have remained invisible without the whistleblower).

¹⁴⁰ See, e.g., *People ex rel. Hunter v. Starbucks Corp.*, 74 N.Y.S.3d 717, 729 (Sup. Ct. 2018) (discounting a survey about failure to collect taxes on certain food items that examined eighty locations); *A.G. Memo*, *supra* note 42 (noting that whistleblowers often have information that is not uncovered by the government).

¹⁴¹ See *Starbucks*, 74 N.Y.S.3d at 728–29 (holding that a self-conducted survey did not have enough scientific merit to support plaintiffs' claims of tax avoidance); *A.G. Memo*, *supra* note 42 (commenting that the plaintiff's inside information was crucial in uncovering unlawful tax practices).

¹⁴² See *A.G. Memo*, *supra* note 42 (crediting the relator for shedding light on Harbert's fraudulent reporting).

¹⁴³ See *Starbucks*, 74 N.Y.S.3d at 728–29 (explaining how the survey that the plaintiffs put together was insufficient because it did not meet scientific standards for compiling surveys).

¹⁴⁴ See *Anonymous*, 83 N.Y.S.3d at 476–77 (noting that Moody's tax avoidance was multi-layered and involved unreasonable valuation of assets, circular payments, and illegitimate insurance policies); *Banerjee*, 2016 WL 7252487, at *10–12 (discussing the complexity of Moody's actions).

¹⁴⁵ *Anonymous*, 83 N.Y.S.3d at 476–77.

¹⁴⁶ See Noonan & Cominsky, *supra* note 107, at 351 (contending that New York is looking for whistleblowers with intimate knowledge and documentary evidence of a business's fraudulent tax practices); Hamilton, *supra* note 43 (noting that whistleblowers can help enforcement agencies eliminate the complexity associated with tax avoidance schemes by providing inside information).

¹⁴⁷ See *Banerjee*, 2016 WL 7252487, at *12 (describing the statements from Moody's executives that implied knowledge of wrongdoing). In each step of the court's analysis, the court considered the statements allegedly made by Moody's executives first, before the allegations of any actions that might have given rise to similar inferences. See *id.* (reviewing inculpatory statements before wrongful conduct).

ant's motion to dismiss.¹⁴⁸ Notably, these statements contain the type of information that an enforcement agency acting alone would be unlikely to obtain.¹⁴⁹

Lastly, the NYFCA exposes the public to the questionable tax practices of major corporations.¹⁵⁰ This is a good thing.¹⁵¹ The benefit of this feature might not be so apparent in cases like *People v. Sprint Nextel Corp.*, *Starbucks*, or the Harbert settlement announcement, where the evasion is simple and amounts to little more than filing a fraudulent tax return.¹⁵² To the general public, however, tax evasion through captive insurance companies is likely a fundamentally different type of issue.¹⁵³ The sheer complexity of these schemes is what separates them and raises the importance of public awareness.¹⁵⁴ The multi-faceted schemes, like the one Moody's was allegedly engaged, should raise the ire of the public and trigger a call for increased corporate responsibility.¹⁵⁵ In this way, the NYFCA can encourage lawful behavior of corporations both directly and indirectly through its *qui tam* provision.¹⁵⁶

CONCLUSION

In *Anonymous v. Anonymous*, the N.Y. Appellate Division, First Judicial Department, affirmed the denial of Moody's motion to dismiss and reversed the granting of Marsh & McLennan's motion to dismiss. In doing so, the court allowed a NYFCA claim alleging tax evasion through the use of a captive insurance company to proceed for the first time. The case stands as a major victory for New York's unique *qui tam* provision for tax fraud because it high-

¹⁴⁸ See *id.* (noting the alleged statements of the executives' motivations before any actions that give rise to inferences of knowledge).

¹⁴⁹ See Hamilton, *supra* note 43 (highlighting how complex tax evasion schemes are obscured from federal agencies and that insiders are extremely important in uncovering them).

¹⁵⁰ See *id.* (noting that *qui tam* provisions can encourage lawful activity and hold corporations accountable).

¹⁵¹ See *id.* (noting that the publication of *qui tam* claims informs citizens and incentivizes corporations to abide by the law).

¹⁵² See *Sprint*, 42 N.E.3d at 658 (failing to collect sales tax on certain services); *Starbucks*, 74 N.Y.S.3d at 721 (failing to collect sales tax on certain items); *A.G. Memo*, *supra* note 42 (reporting income from a different state); Hamilton, *supra* note 43 ("There is no real complexity, for example, when a retailer collects sales tax and pockets the money rather than passing it along to the government.").

¹⁵³ See Hamilton, *supra* note 43. Some cases of tax evasion are simple and involve nothing more than withholding tax money from the government; however, others are more complex in that they involve layers of deception. *Id.*

¹⁵⁴ See *id.* (noting that publicizing tax avoidance cases can encourage lawful behavior).

¹⁵⁵ See *Anonymous*, 83 N.Y.S.3d at 476-77 (noting that Moody's tax avoidance was multi-layered and involved unreasonable valuation of assets, circular payments, and illegitimate insurance policies); Hamilton, *supra* note 43. (highlighting the benefits of publicizing tax *qui tam* actions).

¹⁵⁶ See N.Y. STATE FIN. LAW § 189(4)(a) (McKinney 2019) (setting forth the tax *qui tam* provision of the NYFCA); Hamilton, *supra* note 43 (explaining that *qui tam* enforcement increases lawful behavior by making an example out of bad actors).

lights the benefits of pursuing tax enforcement through such a provision. *Anonymous*, which dealt with tax avoidance through a captive insurance company, presented an opportunity to evaluate the strengths and weaknesses of the NYFCA's whistleblower provision. Specifically, these instances of fraud will likely go undetected by enforcement agencies acting alone. Further, private whistleblowers are privy to information that is often crucial to allowing these cases to survive a motion to dismiss. Finally, the whistleblower lawsuits shine a spotlight on the deceptive tax practices of corporations that might otherwise be kept secret, thus bringing to the public's attention information that may prove useful in holding companies accountable.

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