

DC Taxpayers Face More Scrutiny Under New False Claims Act

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Published in [Law360](#) on February 18, 2021. Reprinted here with permission.

On Jan. 13, 2021, District of Columbia Mayor Muriel Bowser signed the False Claims Amendment Act,[1] which expanded liability under the Washington, D.C., False Claims Act, or FCA, to encompass tax-related claims.

The amendment is effective unless Congress jointly disapproves it during a 30-day review period currently underway.[2] It enables the D.C. attorney general to bring a new category of D.C. FCA cases and incentivizes private citizen whistleblowers to file more qui tam complaints.

D.C. now joins New York and Illinois in taking the novel step of expanding its FCA to apply to tax fraud — an expansion that, if successful, could become a wave of the future and create heightened exposure for many businesses and individuals.

This change to the existing D.C. FCA arises out of the context of the District of Columbia's large revenue losses[3] — \$721 million in 2020 and an additional projected \$774 million in 2021 — due primarily to COVID-19's depletion of revenue streams, such as a decrease in sales tax intake.

Similar shortfalls impacted federal, state and local governments across the country. In the District of Columbia, the shortfalls were exacerbated over the past year as a result of civil unrest that increased expenditures.[4]

As previously predicted,[5] states and local governments will likely look to an uptick in certain enforcement actions to recover funds from the private sector to augment state and local budgets.

Against this backdrop, the District of Columbia added a tool to its arsenal with the amendment, which drew upon a parallel New York state statute. The New York 2010 Fraud Enforcement and Recovery Act resulted in the state generating more than \$460 million in tax-related false claims act settlements.[6]

Indeed, New York's largest False Claims Act settlement of \$330 million originated from a whistleblower's tax fraud claim made possible by the 2010 amendment to the New York False Claims Act.[7]

Overview of the D.C. False Claims Act

The D.C. FCA, modeled after the federal False Claims Act, creates civil and criminal penalties for anyone who

knowingly presents a false claim to D.C. government.[8] Knowingly, in this context, means deliberate ignorance or reckless disregard. The D.C. FCA allows both the D.C. attorney general and private citizens to file suit to enforce the statute's provisions.[9]

Moreover, like the federal False Claims Act, in order to incentivize whistleblowers to file qui tam suits, the D.C. FCA allows individual qui tam plaintiffs to recover anywhere between 15% and 30% of the proceeds of the District of Columbia's recovery, if successful.

Previously, the D.C. FCA, like the federal False Claims Act, did not apply to tax fraud cases.

The amendment, however, partially removes that bar and allows whistleblowers or the D.C. attorney general to file a claim under the D.C. FCA against persons or entities that (1) have more than \$1 million in district taxable income, district sales or district revenue for any taxable year brought into question by the action; and (2) where the claim asserted alleges damages to the district of at least \$350,000.[10]

The D.C. False Claims Act Amendment and Its Legislative Intent

The D.C. Council committee report has specifically stated that the goal of the amendment is to generate revenue through an increase of tax fraud enforcement and by "crack[ing] down on tax fraudsters." As such, the amendment seeks to accomplish these goals as follows:

- Allowing enforcement of tax fraud by private citizens through qui tam lawsuits: Private citizens may now file qui tam complaints against taxpayers alleging tax fraud.
- Financially incentivizing whistleblowers: Successful qui tam plaintiffs can recover between 15% and 25% of any monetary reward or penalty if the D.C. attorney general intervenes and between 25% and 30% if the D.C. attorney general does not intervene. This additional incentive will likely result in plaintiffs' attorneys bringing more cases than before, given the additional expected payout.
- Increasing damages to deter potential tax fraudsters: Courts may impose treble damages for violations of the D.C. FCA, in addition to civil penalties of between \$5,500 and \$11,000 for each D.C. FCA violation.[11]

Supporters of the amendment estimated that D.C. has recovered at least \$21 million through enforcement of the D.C. FCA since 2014. Thus, the expansion of the D.C. FCA to encompass tax fraud is projected to help close the district's revenue shortfall.

But not everyone supported the amendment's enactment. Many, including Bowser, expressed concerns about a proliferation of spurious whistleblower lawsuits based on the results seen following a similar expansion of Illinois' False Claims Act.

The D.C. Council nonetheless decided that the amendment differed from the similarly expanded Illinois law in several ways.

First, the amendment sets an income threshold for tax fraud suits, unlike the Illinois law.

Second, it allows defendants to request that the court "limit or restrict the participation of a plaintiff upon showing that unrestricted participation would be repetitious, irrelevant, or constitut[ing] harassment" and to award the

defendant attorney fees and expenses if the court finds the lawsuit frivolous.

Third, the D.C. FCA requires qui tam plaintiffs to serve the D.C. attorney general when the plaintiff files, which theoretically should spur the D.C. attorney general to intervene and dismiss frivolous cases, a procedural requirement absent in Illinois.

Finally, the D.C. Council noted that New York has not witnessed a flood of frivolous claims after lifting its tax bar.

Likewise, the D.C. Council dismissed the concerns surrounding privacy because the D.C. FCA already included several protections for personal tax information. For example, qui tam complaints are filed in camera and remain under seal for up to 180 days.

Additionally, the D.C. FCA contains restrictions on who may examine evidence and allows for additional privacy protections, including the ability of the court to issue a protective order and allow for in camera review of certain sensitive materials.

Finally, all acknowledged the possibility for conflicts between the D.C. attorney general and the D.C. Office of the Chief Financial Officer, especially with respect to whether to settle a given case.

In tax-related cases, the D.C. attorney general's office asserted in its memo to the D.C. Council that it believed it should generally yield to the CFO for tax claims brought under the D.C. FCA because the CFO is ultimately responsible for all tax matters.[12]

That deferential position ultimately quelled this concern. For all of these reasons, the D.C. Council elected to pass the amendment.

Consequences for Business and Certain High-Income Earners

Changes, like this one, do not come without a price to the individuals and businesses who operate in Washington or service Washington residents.

Specifically, any person or business who currently has or projects to have taxable district income, district sales, or district revenue in excess of \$1 million dollars in a given tax year must be aware of these developments and take steps to protect themselves. Such discipline is critical because the penalties for a D.C. FCA judgment are steep and the defense of any such action costly.

Some of the major consequences that anyone potentially subject to the D.C. FCA should contemplate are as follows.

The amendment essentially extends the statute of limitations for tax fraud claims from three years to 10 years. Typically, D.C. must file any claims against a taxpayer within three years of the tax return at issue. But the D.C. FCA imposes a statute of limitations of 10 years from the date of the alleged violation.

Therefore, the D.C. FCA enables the D.C. attorney general and whistleblowers to examine tax filings much farther

back in time. During the first few years of its enactment, this potential for retroactive application may result in cases involving tax periods that are currently closed under the law.

The amendment stiffens the penalties for anyone who meets the thresholds and underreports their tax liability to D.C. A tax-related violation of the D.C. FCA will result not only in repaying the underreported tax liability but also in a trebling of that amount plus a statutory penalty of \$5,500 to \$11,000 for each such violation.

If the case is initiated by a qui tam whistleblower plaintiff and D.C. recovers any funds, the business will also likely be responsible for paying the plaintiff's costs, expenses and attorney fees.

The amendment incentivizes business employees or former employees to blow the whistle on tax fraud. Because the amendment makes the D.C. FCA whistleblower provision fully applicable to tax fraud claims and also increases the percentage recovery for whistleblowers, businesses should be aware that there will be additional eyes on the handling of their tax returns beyond only the D.C. government, which correspondingly increases businesses' risk of litigation.

Put differently, this amendment will increase D.C.'s investigatory resources to ferret out and prosecute tax fraud beyond its current capabilities.

There are several risk-mitigation measures that businesses can take in light of this change in the law.

- Keep tax returns and related documentation for a minimum of 10 years instead of three years. This change is necessary as a result of the D.C. FCA's 10-year statute of limitations.
- Recognize how the amendment reshapes your liability. Businesses should understand that there will be increased scrutiny by both the D.C. attorney general and any private citizens who have knowledge about how the business handles its tax returns.
- Document all decisions in detail. Record the reasoning behind your choices and overall tax plan. When you seek outside advice, keep records of your communications and any recommendations from that professional.
- Ensure that all relevant stakeholders in your organization are up-to-date on tax issues. Provide training for employees so they understand their role in filing your tax returns. Develop compliance programs for employees. For higher-level employees and management, consider providing training that addresses how to handle a D.C. FCA investigation.
- Exercise caution if you are subject to a D.C. FCA investigation. The D.C. FCA has an anti-retaliation clause for whistleblowers or qui tam litigants.[13]
- Monitor trends across states. States around the country have taken notice of the D.C. FCA amendment's enactment and have already been closely monitoring the results of the similar new laws in New York and Illinois. In fact, California and Michigan are currently considering legislative proposals similar to D.C.'s amendment. Other states may soon follow suit to close their similar revenue shortfalls induced by COVID-19.

[1] B23-0035, Council of the District of Columbia, <https://lims.dccouncil.us/Legislation/B23-0035>.

[2] Although the mayor signed the legislation, the bill is not yet law. Per the District of Columbia Home Rule Act, a federal statute, all legislation must be hand delivered separately to the U.S. Senate and U.S. House of Representatives in paper form for their approval before taking effect. If Congress takes no action for 30 days on

the new proposed law (or 60 days for changes to the D.C. Criminal Code), then the law takes effect automatically. But if Congress passes a joint resolution against any new D.C. law and the president signs it, the new law is overridden.

This process was slowed by the erection of a large fence erected around the Capitol following the violent protests there on January 6, 2021, which barred the D.C. Council access to Congress to effectuate the requisite hand-delivery. Accordingly, the 30-day review period could not begin to run for any recently enacted D.C. legislation, including for the Amendment. The D.C. Council finally succeeded in circumventing that barrier on February 1, 2021, when it hand-delivered paper copies of all new laws, including the Amendment, to a member of the House of Representatives on an offsite location. Thus, the 30-day review period has commenced. The D.C. Council's website currently projects that the effective date for this legislation will be March 19, 2021.

[3] A. Koma, Bowser Cuts Affordable Housing Spending, Avoids Mass Layoff in New Budget Proposal, BizJournals, May 18, 2020, <https://www.bizjournals.com/washington/news/2020/05/18/bowser-pitches-a-new-dc-budget-slashing-affordab.html>.

[4] M. Barthel, Mayor Bowser Wants to Move \$43 Million from D.C. Budget to Cover Police Overtime from Protests This Summer, WAMU 88.5, Oct. 22, 2020, <https://wamu.org/story/20/10/22/bowser-move-43-million-cover-police-overtime-during-racial-justice-protests/>.

[5] M. Hooker et al., The Coming Tsunami: Anticipated Regulatory And Enforcement Trends in the Wake of COVID-19 and the Unique Role of State Attorneys General, Am. Bar Ass'n Bus. L. Section, June 9, 2020, <https://businesslawtoday.org/2020/06/coming-tsunami-anticipated-regulatory-enforcement-trends-wake-covid-19-unique-role-state-attorneys-general/>.

[6] Senate Bill S8378, The New York State Senate (June 28, 2010), <https://www.nysenate.gov/legislation/bills/2009/s8378>.

[7] S. Krouse, Sprint to Pay \$330 Million to Settle N.Y. Tax Probe, The Wall Street J., Dec. 21, 2018, <https://www.wsj.com/articles/sprint-to-pay-330-million-to-settle-n-y-tax-probe-11545414196>.

[8] D.C. Code Ann. § 2-381.02-.03 (2020).

[9] § 2-381.03.

[10] False Claims Act of 2020, 68 D.C. Reg. 1019 § 2(a) (amending § 2.381.02(d)).

[11] D.C. Code Ann. § 2-381.02(a).

[12] See Nov. 13, 2020 Report.

[13] § 2-381.04.

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