



MULTISTATE TAX COMMISSION

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To: Sales and Use Tax Uniformity Subcommittee

From: Sheldon H. Laskin

Date: November 21, 2012

Subject: Transaction Tax Over-collection Class Actions and False Claims Act Claims for Failure to Collect

The purpose of this memo is to summarize two requests that the Commission has received from members of the public, which ask the Commission for assistance in addressing the issue of transaction tax collector liability to purchasers for over-collection on the one hand and for failure to collect on the other

Summary of the Issues

Sellers that are required to collect state and local transaction taxes face two potential risks of liability to purchasers arising from sellers' statutory obligation to collect transaction tax on behalf of the state or locality. On the one hand, sellers have a risk of exposure to litigation (including class action litigation) under state consumer protection laws for over-collection of tax. The Commission has had occasion to address the issue of class action lawsuits for overpayment of transaction tax. In *AT&T Corp. v. Bobby Gene Allen, et al.*, United States Supreme Court No. 03 – 1046, the Commission filed an amicus brief at the U.S. Supreme Court in support of AT&T's petition for writ of certiorari to the Oklahoma Court of Civil Appeals.¹ The Oklahoma trial court had certified a national class action of AT&T customers seeking a refund of allegedly improperly collected municipal taxes. In doing so, the trial court ignored various state laws that require exhaustion of administrative remedies prior to filing suit for a tax refund. Exhaustion of administrative remedies requires taxpayers to initially protest the denial of a claim for refund by following whatever administrative procedures the taxing authority has established to challenge the denial. A taxpayer ordinarily cannot file a court action challenging the denial until he has

¹ The Commission's amicus brief is available here:
http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Resources/Amicus_Briefs/MTC%20Amicus%20Brief%20in%20ATT%20v.%20Allen%20Final.pdf

exhausted those administrative procedures. The Court denied AT&T's petition for certiorari. Nevertheless, the *Allen* case illustrates some aspects of the problem.

On the other hand, sellers have a risk of exposure to litigation under state qui tam laws for failure to collect tax. Originally a creation of English common law, a *qui tam* action is a means by which private individuals can act on behalf of the government in seeking judicial enforcement of a duty owed by the defendant to the state. Currently, the common law *qui tam* action has been codified in federal and state False Claims Acts, under which a "private attorney general" can seek to recover part of any penalty imposed for violation of regulatory laws (i.e., environmental laws, Blue Sky laws, etc.). These suits are typically brought on behalf of whistleblowers, often government employees, who assert that the government has failed to enforce the law. Whether formally denominated as class actions or not, the nature of these claims is such that the private attorney general is seeking relief on behalf of the general public, or some discrete segment of the public (i.e., investors in an action to compel compliance with Blue Sky laws). Typically, the False Claims Act will allow – but will not require – the applicable state enforcement officer to choose to prosecute the action instead of the private party.²

Requests for Action by the Public

1. Class Actions

Deborah Bierbaum, Executive Director of Tax Policy for AT&T, has suggested that the Commission could assist vendors' efforts to reduce exposure to class action lawsuits by endorsing the American Bar Association Model Transactional Tax Overpayment Act (February 2011) ("Model Act"), a copy of which can be found at

http://www.americanbar.org/content/dam/aba/administrative/taxation/policy_resolution_with_report_model_transactional_tax_overpayment_act.authcheckdam.pdf

In its Report to the ABA House of Delegates recommending adoption of the Model Act, the ABA Section of Taxation explained the need for the Model Act.

"Sellers collecting state and local transactional taxes face two main liability risks. First, if sellers fail to collect sufficient tax, they face liability risks attributable to audit assessments. Second, if sellers over-collect or collect for the wrong jurisdiction, they face potential actions and lawsuits filed on behalf of purchasers or pursuant to consumer protection statutes." The Report goes on to note that, while sellers are often successful in defending against such suits, nevertheless sellers

² Class action attorneys have filed False Claims Act (FCA) claims involving state taxation in a number of contexts. *State ex. Rel. Beeler, Schad & Diamond, PC v. Ritz Camera Ctr., Inc.*, 878 N.E. 2d at 1158 (court rules that FCA cannot be asserted against Internet retailers for failure to collect use tax when it was unsettled that such retailers have nexus); *California ex. rel. Grayson v. Pac. Bell Tel. Co.*, 142 Cal. App. 4th 741, *review denied*, 2006 Cal. LEXIS 14195 (2006) (FCA complaint that Pacific Bell Telephone failed to remit, as unclaimed property, unused amounts on prepaid calling cards dismissed as it was unclear whether such unclaimed balances were actually unclaimed property under state law); *Grayson v. AT&T Corp.*, 980 A. 2d 1137 (D.C. 2009), *reh'g granted en bank*, 989 A. 2d 709 (DC 2010) (similar unclaimed property FCA complaint dismissed but allowed to proceed under Consumer Protection and Procedures Act). The plaintiff law firm in *Ritz Camera, Schad & Diamond*, has also filed FCA actions alleging fraudulent failure to charge tax on shipping charges to Illinois customers.

incur substantial costs in defending against the suits. As the Report notes, “[e]xposure to lawsuits will increase the cost of collection and will discourage some retailers from voluntarily collecting state and local transaction taxes.”

The Model Act addresses the problem of suits for over-collection by barring the purchaser, the taxing jurisdiction or any other party from naming the seller as a party in any action that arises from or relates to an overpayment. The Act makes clear that a government agency may exercise its powers to take action to prevent continuing over-payment of tax by a seller. The Model Act also sets forth alternative refund procedures for purchasers seeking a refund of overpayment, under which the purchaser can either file a refund claim with the seller or with the taxing jurisdiction, establishes time limits for filing such claims, and specifies the procedures to be followed in processing the refund claims. There are also provisions that govern when a seller may seek a refund of overpayments from the taxing jurisdiction, provided the seller has either previously refunded the overpayment to the purchaser or will do so within a period agreed to by the taxing jurisdiction.

In considering whether to endorse the ABA Model Act, there are a number of issues the Commission might first explore. Those issues include, at a minimum, the following:

1. Are current state laws adequate to address the issue of class action lawsuits against sellers that seek to recover damages for alleged overpayment of transaction tax?³
2. If not, why not? What are the shortcomings in existing law that need to be addressed?
3. Is the Model Act an appropriate and effective response to the problem?
4. If the Model Act were to be adopted, what if any implications would there be for current state sales and use tax refund procedures? For example, the Model Act allows purchasers to file refund claims alternatively with the seller or with the taxing jurisdiction. While the Model Act does not allow for duplicate refund claims, is it clear under the Model Act that there would be mechanisms in place to assure that such duplicate claims are not in fact filed? Otherwise, the taxing jurisdiction would at the least incur unnecessary costs in processing a duplicate claim and at worst, might pay a duplicate claim that the seller has already paid.
5. Should the Commission encourage the adoption of the Model Act?
6. If so, what form(s) should the Commission’s encouragement take? A resolution? Written testimony? Oral testimony?⁴

³ Many states have laws that prohibit class actions in tax cases. However, these laws do not necessarily address the issue that led to the Model Act. First, these statutes generally are designed to prevent class actions against the taxing authority and are silent regarding class actions against third parties, such as sellers. In addition, class actions against sellers for overcollection typically are filed under state consumer protection statutes and/or as common law breach of contract suits. It is sometimes unclear whether the prohibition against class actions in tax suits apply when the cause of action is grounded, not in the tax statutes, but in other sources of law.

⁴ The ABA Section on Taxation should be able to assist the committee in gathering the information necessary to address these and other questions, as the Taxation Section prepared the Model Act.

2. False Claims Act

Todd Lard, Vice President and General Counsel for the Council on State Taxation, has requested that the Commission add the consideration of the False Claim Act issue to any project this committee should initiate in reference to the class action issue. A copy of his email to Joe Huddleston dated July 23, 2012, is attached as an exhibit.⁵

Issues that this committee might consider in evaluating COST's request include at a minimum, the following:

1. Is there a problem with FCA lawsuits in relation to state and local taxation of such magnitude that legislation is required?
2. Is the Commission the appropriate body to draft model qui tam legislation for tax issues?
3. What is the appropriate scope for any such legislation? For example, should a carve out from state FCAs encompass all cases that relate to state taxation? Or only cases where liability for tax is unclear? Is such a distinction – clear liability vs. uncertain liability – administrable? Alternatively, should FCA claims related to state taxation be allowed only in cases where it is asserted that the defendants have acted knowingly or committed malfeasance in avoiding state taxes? Should the carve out include cases where the state has elected to pursue the FCA in lieu of the private attorney general? Or should it be limited to FCAs that are in fact prosecuted by the private attorney general?⁶ Should the carve out encompass all state taxes? Or should FCA claims be allowed in cases of failure to collect transaction tax, at least under some circumstances?

Conclusion

At this time, this committee is asked to:

1. Decide whether the Commission should endorse the ABA Model Act and if so, what the form of that endorsement should be, and
2. Study whether to draft a model statute to exclude tax claims from state FCAs.

⁵ It should be noted that, unlike the class action issue, the FCA issue would require the committee to draft a model statute. Ms. Bierbaum has instead asked the Commission to endorse an existing product; the ABA model act.

⁶ Limiting the carve out to cases prosecuted by the private attorney general present additional issues. For example, there is generally no limitation under state law as to the timing of the state's decision to take over the case. Since most FCA cases begin as private attorney general cases, at what point in time should it be determined that the carve out applies?

It should be noted that the Litigation Committee has requested that it be included in any project that this committee should undertake. The Litigation Committee will not be meeting until March, at which time the Committee will consider this issue during its open session, including any input from this committee.

Sheldon H. Laskin

From: Todd Lard <TLard@cost.org>
Sent: Tuesday, November 20, 2012 10:38 AM
To: Sheldon H. Laskin
Subject: FW: Possible MTC Uniformity Project on Qui Tam Actions

Here you go.

From: Joe Huddleston [<mailto:jhuddleston@MTC.gov>]
Sent: Monday, July 23, 2012 1:27 PM
To: Todd Lard
Subject: Re: Possible MTC Uniformity Project on Qui Tam Actions

Todd,
Thanks for the suggestion. I will be glad to raise this important issue with our Executive Committee.
Joe

-----Original message-----

From: Todd Lard <TLard@cost.org>
To: "jhuddleston@mtc.gov" <jhuddleston@mtc.gov>
Cc: Doug Lindholm <dlindholm@cost.org>
Sent: Mon, Jul 23, 2012 17:12:05 GMT+00:00
Subject: Possible MTC Uniformity Project on Qui Tam Actions

Joe,

I wanted to follow up on a conversation you had with Doug Lindholm at SEATA. We have seen a recent spike in *qui tam* sales tax cases brought against vendors, and believe the area would benefit from uniform guidance. Many states have adopted new false claims acts (FCAs) since 2005 in order to comply with federal law, and many of the FCAs are silent on whether they apply to uncollected sales taxes. As result, vendors navigating the nuances of sales tax collection can get caught between class actions for improperly collecting tax and *qui tam* actions for not collecting. Tax administrators are often relegated to the sidelines in these suits, and have limited input as to how the tax law is applied. We think the administration of sales tax is best left to the tax administrators, and would welcome a discussion of how to make sure that happens.

We noticed that the Sales Tax Uniformity Subcommittee is starting a new project on limiting class actions against telecoms, and think that perhaps a discussion of qui tams would fit well within that project. Accordingly, we ask that you consider presenting the potential new project to the MTC Executive Committee. Let us know if you need any additional background or any help from us in presenting the issue.

Thanks,
Todd

Todd A. Lard
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Council On State Taxation
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