Vendor Liability Risks

National Conference of State Legislatures
Executive Committee Task Force on State and Local Taxation
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Overview

- Background on liability risks faced by vendors from administering and collecting sales taxes on behalf of state and local governments.
  - Qui Tam Actions
  - Class Action Law Suits

- Overview of protections currently in State statutes.

- Review of current efforts to develop vendor liability protections.
Part I: Background
Vendor Liability Risks

- Unclear statutes and lack of guidance create two main liability risks for vendors.
  - Collect Too Little
    - Audit Risk
    - Qui Tam
  - Collect Too Much
    - Class Action Law Suits

Between a Rock and a Hard Place
Qui Tam Actions

- Typically brought under a state’s False Claims Act.
- Are brought by an informer or other “whistleblower.”
- Establishes a penalty for the commission or omission of certain acts.
- Awards part of the penalty to the “whistleblower.”
Qui Tam Actions

- Federal False Claims Act provides for private enforcement actions against those alleged to have defrauded the federal government. Does not apply to taxes collected by the IRS.

- State False Claim Acts:
  - Some restrict the Act to Medicaid and/or contractor-type frauds.
  - Some explicitly bar “tax” actions: CA, DC, HI, MA, NM, NYC, NC, TN, VA. Some states only apply limitations for income taxes: IL, IN, RI.
  - Some have no restrictions: DE, FL, NV, NH, NJ.
  - In 2010, NY became the first state to explicitly authorize the application of the FCA to tax claims.
Qui Tam Actions

Should False Claims Act be applied to tax?

- Removes tax administration decisions from taxing authorities.
- Leads to disparate tax treatment among taxpayers.
- Contravenes well-established procedures designed to ensure efficient resolution of tax disputes.
- Upends protections for taxpayer rights, including historical right to privacy in tax matters.
- Meant to combat fraud by incentivizing true whistle blowers (i.e. insiders) to bring suits on the government’s behalf. In reality, a breeding ground for parasitic lawsuits.
Class Action Law Suits

- Customer liability actions fall under three main categories:
  - Jurisdiction rate assignments
  - Sourcing conventions
  - Product/Service taxability

- Vendors often can defend against the actions because they used due diligence and remitted funds to the jurisdiction but not without costs.

- State and local governments can also face class action lawsuits.
Tax Collection Liability Litigation

- Class actions can be brought against the government jurisdiction –
  - Arizona Department of Revenue v. Bernard J. Dougherty (29 P.3d 862) class action lawsuits against the State were permitted in Tax Court.
  - Granados v. County of Los Angeles, Court of Appeal of California, Second District, No. B200812, March 28, 2012 a taxpayer can file a class action claim for refund of CA local telephone users taxes paid. Before filing the claim the plaintiff must first file a claim that contains the information required by the Government.
Part II: Current Protections
Streamlined Agreement Provisions

- Customer Remedy Procedures – § 325
  - First course of remedy
  - Reasonable business practice to use state provided data.

- Taxability Matrix – § 328

- Definitions and sourcing rules -- §§ 314, 315 & Library of Definitions

- Database requirements – § 307

- Local rate and boundary changes – § 302
American Bar Association Model Act

Major provisions:

- Section 4 sets forth Purchaser Recourse provisions
  - Purchaser’s relief is limited to a refund claim pursuant to §5
  - Seller should not be party to any action

- Section 5 sets forth Refund Procedures
  - Purchaser may file a claim with the seller with time limits (90 days) for response
  - Purchaser may under certain circumstances file a claim with the taxing jurisdiction
Part III: Current Projects
Multistate Tax Commission

- Sales and Use Tax Uniformity Subcommittee Working group.
  - Includes participation for tax administrators, Attorney General staff, practitioners and taxpayers.
  - Developed resolution encouraging states to consider adopting the ABA model Act. Currently pending before the Executive Committee for vote at their December meeting.
  - Discussing issues and proposals for addressing False Claim Actions for tax. Goal to develop a model Act for states to consider.
Potential Action

- Develop principles for states to consider when developing vendor liability protections.
- ABA developed principles that can form a starting point for consideration:
  - Balance the needs of the State, vendors and consumers.
  - Vendors are acting as agents of the state and should not be subject to claims from collecting the taxes and remitting them to the state.
  - Consumers should be entitled to refunds of overpaid taxes.