SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

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THE PEOPLE OF THE STATE OF NEW YORK, by BARBARA D. UNDERWOOD, Attorney General of the State of New York;

THE CITY OF NEW YORK;

STATE OF NEW YORK, *ex rel.* CROSSROADS ANALYTIC LLC,

Plaintiffs,

v.

HARBINGER CAPITAL PARTNERS OFFSHORE MANAGER, L.L.C.,

Defendant.

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Index No. 100416/15

SUPERSEDING COMPLAINT

Pursuant to N.Y. State Finance Law § 190(2)(c)

JURY TRIAL DEMANDED

Plaintiffs Barbara D. Underwood, Attorney General of the State of New York (the "State"), and Zachary W. Carter, Corporation Counsel of the City of New York (the "City"), allege upon information and belief:

NATURE OF THE ACTION

1. In this case, a company that managed hedge funds from an office in midtown Manhattan paid little to no tax to New York City or State on the incentive fees it earned from spectacularly successful trading on behalf of a hedge fund, during the years 2004 through 2008. The hedge fund manager—Harbinger Capital Partners Offshore Manager, L.L.C., a Delaware limited liability company ("Offshore Manager")—knew that it should have been paying New York taxes. Instead of doing so, however, Offshore Manager ignored professional advice that it should pay City taxes and that its members who were not New York State residents should pay State taxes. Rather, Offshore Manager took the position, which its own chief administrative officer described as "unsupportable," that Offshore Manager should report

incomes in Alabama, where it performed minor back-office functions for the hedge funds, but where taxes were far lower.

2. To ensure that New York never realized that Offshore Manager was carrying on business in New York, its officers and agents embarked on a scheme of concealment and deception in order, as one Offshore Manager agent put it, to stay "under NY's radar screen for future investigation." They did so because, as one of Offshore Manager's members who lived in Alabama wrote: "ugh…. I hate paying taxes especially having to support some place I don't live. Another one of those high class problems."

3. Defendant Offshore Manager was the investment manager for a hedge fund that aggregated investment capital from onshore and offshore funding vehicles (collectively, the "Harbinger Funds"). The Senior Managing Director of Offshore Manager was Offshore Manager's principal investment officer. Under the Senior Managing Director's management, the Harbinger Funds achieved one of the most brilliant successes to arise from the financial crisis of 2008: the Funds bet against subprime mortgages and reaped billions in profits as a result.

4. Twenty percent of those profits went to Offshore Manager as compensation for its services. The compensation took the form of "incentive fees" totaling hundreds of millions of dollars, which were then distributed to the Senior Managing Director and Offshore Manager's other members.

5. Because it carried on its business in New York, Offshore Manager had a clear obligation under New York State Tax Law to apportion and allocate income as taxable in New York State, but instead apportioned 100% of its income to the State of Alabama, which had lower tax rates than New York.

6. As a result of Offshore Manager's improper apportionment of no income to New York, Offshore Manager's nonresident members avoided paying the New York State income tax they owed and Offshore Manager failed to pay millions of dollars in estimated taxes to New York State for those nonresident members, as it was required to do.

7. Further, Offshore Manager's members who were New York residents (in particular, the Senior Managing Director) also paid less New York tax because of the zero allocation. New York State residents must pay tax on their worldwide income, but are entitled to a credit for taxes paid to another state on income derived from sources in the other state. By apportioning 100% of its income to Alabama, Offshore Manager caused its New York resident members to overstate their resident credit and thereby reduce the amount they paid to New York State.

8. Because it carried on its business within New York City, Offshore Manager was also required to file returns and pay New York City Unincorporated Business Tax ("UBT"). It failed to do so for several years.

9. In March 2005, shortly before Offshore Manager first made the decision not to apportion any income to the State and the City, an international accounting firm (hereinafter "International Accounting Firm A") advised Offshore Manager that its nonresidents would have to pay New York State tax on their incentive fee income and that Offshore Manager would have to pay City taxes on this income as well.

10. Shortly thereafter, Offshore Manager's Chief Administrative Officer made notes that compared four different apportionments as between New York and Alabama: (a) 100% to New York (and therefore 0% to Alabama); (b) 50% to New York and 50% to Alabama; (c) 25% to New York and 75% to Alabama; and (d) 100% to Alabama (and therefore 0% to New York).

He concluded that apportioning 100% to Alabama, and therefore 0% to New York, was an "unsupportable" position.

11. A week later, Offshore Manager signed tax returns for the 2004 tax year that took the "unsupportable" position apportioning 0% to New York. Offshore Manager also failed to file a UBT return with the City for tax year 2004 and failed to pay any UBT on its income for that year. Offshore Manager continued to fail to apportion income to New York State and New York City for tax years 2005, 2006, and 2007.

12. Offshore Manager feared that New York tax authorities might discover its "unsupportable" tax position. So it took steps to conceal that decision, by pretending that it had left New York. Offshore Manager systematically camouflaged its New York presence by making false statements on tax returns, failing to file tax returns, altering corporate documents, surrendering its authority to do business within the State, and misleading New York tax authorities about its operations. It did these things in order to stay "under NY's radar screen."

13. On the returns it filed with the State for 2004 through 2008 (the years relevant to this action), Offshore Manager was required to identify "***all*** places, both in and out of New York State, where the partnership carries on business." In response, on each return, Offshore Manager falsely listed only an address in Birmingham, Alabama. It did so despite these facts: (a) the Senior Managing Director and his entire trading team worked in a New York City office on Madison Avenue; (b) in prior years, when no tax was due, Offshore Manager had listed New York City as the place where it carried on its business; and (c) Offshore Manager's operating agreement and investment management agreement listed New York City as its business address for several years.

14. After it filed its tax returns for tax year 2004, Offshore Manager purported to surrender its authority to do business in New York by signing a certificate to that effect. However, in practice, Offshore Manager continued, for the next four years, to operate from the office in Manhattan, even listing the New York address as the place to contact the supposedly absent company.

15. In 2008, Offshore Manager went even further. During an audit of the Senior Managing Director's personal income tax returns, an auditor from the New York State Department of Taxation and Finance ("DTF") repeatedly asked for information from the Senior Managing Director about the source of the income for Offshore Manager. During the audit, Offshore Manager's Controller prepared responses to these questions that highlighted Offshore Manager's connections with Alabama and entirely omitted any mention of the work that the Senior Managing Director and his team were performing in their New York City office, and the Senior Managing Director's representatives provided these responses to DTF.

16. During that same audit, Offshore Manager rushed through a singular amendment to its operating agreement, changing the principal office listed in the agreement from New York, New York to Birmingham, Alabama. When DTF asked for Offshore Manager's operating agreement in order to learn more about the source of the Senior Managing Director's income from Offshore Manager, its Controller provided the newly-created version of the agreement even though, for the entire period under audit, "New York, NY" had been listed as the location of the company's principal office. When DTF asked for agreements from the audit period, Offshore Manager simply did not respond.

17. In 2009, tax professionals again warned Offshore Manager that it should have been paying State and City taxes. Despite these warnings, in August 2009, Offshore Manager

filed a return for tax year 2008 that apportioned no income to New York State even as it paid UBT for that tax year. Thus, for this tax year, Offshore Manager took the absurd position that it earned income in New York City but not New York State.

18. For years, Offshore Manager enjoyed the advantages and services of New York State and City, without paying its fair share in tax. While others followed the rules and paid taxes that supported the schools, roads, mass transit, and other government services that helped New York attract top financial talent and make it one of the world's foremost financial centers, Offshore Manager did not. Offshore Manager made profits remarkable even by Wall Street standards, but failed to pay what should have been paid to the City and State where it made those profits, and misled the tax authorities to ensure that it would not have to pay its fair share.

19. Offshore Manager's misconduct, for a time, solved the "high class problem" one of its Alabama members faced with such disgust: Offshore Manager's nonresident members escaped the requirement of supporting a place where they did not live. In addition, Offshore Manager's resident members -- in particular, the Senior Managing Director -- improperly reduced their tax liabilities to New York State. Finally, all of Offshore Manager's members escaped paying New York City tax on Offshore Manager's income, notwithstanding the massive financial benefits New York City conferred on them.

20. The City and State bring this action to redress violations of the New York False Claims Act. Offshore Manager knowingly made false statements and omissions to the State that understated tax owed to New York and concealed the work it performed in New York. Offshore Manager also had possession or control of money that was owed to New York State and New York City and knowingly delivered, or caused to be delivered, less than all of that money

because of its unsupportable apportionment position. Plaintiffs seek treble damages, penalties and interest resulting from these violations.

WHISTLEBLOWER ACTION

21. This action was filed on or about March 13, 2015 by whistleblower, or *qui tam* plaintiff, Crossroads Analytic LLC ("Relator") under the New York False Claims Act and was amended on or about June 12, 2017. The New York False Claims Act permits whistleblowers who know of information concerning false or fraudulent conduct that victimizes the government through the failure to pay taxes to bring an action on behalf of the government. The government then has the opportunity to investigate the matter and decide whether to take over the action.

22. Following the filing of Relator's complaint, the Office of the Attorney General conducted an investigation of Relator's allegations. The Office of the Attorney General then settled False Claims Act claims with the Alabama members of Offshore Manager and affiliated entities. On September 26, 2018, the Attorney General notified the Court of its decision to supersede the Relator's complaint with respect to Offshore Manager and to decline to proceed with the allegations against certain other named individuals and entities.

23. The People of the State of New York have thus been substituted as the plaintiff with respect to claims against Offshore Manager, and the action with respect to Offshore Manager has been converted in all respects from a *qui tam* civil suit brought by a private person into a civil enforcement action by the Attorney General.

24. This superseding complaint arises out of the conduct, transactions and occurrences set forth in the prior complaint by the Relator.

JURISDICTION AND PARTIES

25. Plaintiff the State of New York, through the Attorney General, brings this action in its sovereign capacity and pursuant to the New York False Claims Act, New York State Fin. Law § 187, *et. seq.* It sues to redress injury to the State, general economy and citizens, and seeks injunctive relief, damages, costs, penalties and other relief with respect to Offshore Manager's fraudulent and otherwise unlawful conduct.

26. Plaintiff the City of New York, a municipal corporation organized under the laws of the State of New York, brings this action pursuant to the New York False Claims Act.

27. Defendant Offshore Manager is a Delaware limited liability company. Previously, Offshore Manager had been known as HMC Distressed Investment Offshore Manager, L.L.C.

28. This Court has subject matter jurisdiction over the claims asserted in this action under N.Y. State Finance Law § 190(2)(b).

29. This Court has personal jurisdiction over Offshore Manager because Offshore Manager can be found, resides, and/or transacts business in New York State and New York County.

30. Venue is proper in this Court pursuant to CPLR § 503.

FACTUAL ALLEGATIONS

I. The Harbinger Funds and Offshore Manager

A. The Harbinger Funds

31. In 2001, Harbert Management Company ("HMC"), an investment management company headquartered in Birmingham, Alabama, sponsored and organized the hedge fund now known as Harbinger Capital Partners Master Fund I Limited (the "Master Fund").[1] In or about June 2001, HMC hired an investment professional, who was located in New York, to be the Senior Managing Director of the Master Fund.

32. Consistent with the Senior Managing Director's experience, the Master Fund focused on "distressed investments," a term that generally refers to investments in companies that are in financial trouble or undergoing bankruptcy.

33. The Master Fund enjoyed dramatic growth between 2004 and 2008. The peak of the Senior Managing Director's investment success was in 2007, when he doubled his investors' money, largely as a result of a high-profile investment shorting the subprime mortgage market.

34. In March 2009, the Senior Managing Director purchased Offshore Manager and related entities from affiliates of HMC and other sellers. In effect, HMC and the Senior Managing Director separated at this time.

B. Offshore Manager

35. Like other hedge funds, the entities at issue here were part of a "master fund/feeder fund" structure. Under this structure, investors invest capital in vehicles described as feeder funds, the feeder funds invest in a master fund, and the master fund then invests in the market.

[1] This entity was formerly known as Harbert Distressed Investment Master Fund, Ltd.

36. The Master Fund in this case had two feeder funds, an onshore entity known as Harbinger Capital Partners Fund I, L.P. (the "Onshore Feeder Fund"), and an offshore entity known as Harbinger Capital Partners Offshore Fund I, Ltd. (the "Offshore Feeder Fund").[2] The Master Fund and Offshore Feeder Fund are the primary focus of this Complaint.

37. From 2003 to 2009, Offshore Manager was the investment manager of the Master Fund and the Offshore Feeder Fund.[3]

38. As the investment manager, Offshore Manager was responsible for investing and reinvesting all of the capital of the Master Fund and the Offshore Feeder Fund.

39. No other entity had authority to invest or reinvest capital of the Master Fund or Offshore Feeder Fund. Offshore Manager had exclusive control and discretion over this function.

40. Offshore Manager's responsibilities were governed by the Investment Management Agreement between and among the Master Fund, the Offshore Feeder Fund, and Offshore Manager.

41. The Investment Management Agreement provided that Offshore Manager was to make "[a]ll investment decisions" and had broad authority to make trades on behalf of the Master Fund and Offshore Feeder Fund. Among other things, the Investment Management Agreement authorized Offshore Manager to purchase, hold, or otherwise deal in securities, commodities, currencies, forwards, swaps and other investments. The agreement also authorized Offshore Manager to perform other more minor roles that were consistent with its function as an

[2] The Offshore Feeder Fund was previously known as the Harbert Distressed Investment Offshore Fund, Ltd. Its formation date was December 5, 2001. On May 7, 2002, the entity changed its name to Harbert Distressed Investment Offshore Fund, Ltd. In or around early 2006, the entity changed its name to Harbinger Capital Partners Offshore Fund, I, Ltd.

[3] In 2002, Offshore Manager was the investment manager for the Offshore Feeder Fund, but not the Master Fund.

investment manager, including the power to conduct margin accounts with brokers and open, maintain and close bank accounts.

II. Offshore Manager Carried on Business in New York City

42. From 2002 through 2009, Offshore Manager's key income-generating work was carried on in New York City under the Senior Managing Director's leadership and supervision.

43. Offshore Manager's investment management functions were conducted by Offshore Manager's officers and agents because Offshore Manager did not have employees.

44. The Senior Managing Director was a member and an officer of Offshore Manager. As of June 2002, the Senior Managing Director had been appointed Vice President of Offshore Manager, and he became its Senior Portfolio Manager, effective January 1, 2003. He later was later appointed Senior Managing Director of Offshore Manager.

45. The Senior Managing Director was responsible for making Offshore Manager's investment decisions. Subject to certain risk management parameters set by HMC, the Senior Managing Director decided which investments to make, and when to trade investments.

46. The Senior Managing Director made investment decisions on behalf of Offshore Manager with the assistance of traders and investment professionals located in New York (the "New York Investment Team"), who reported to the Senior Managing Director. From 2004 to 2008, the New York Investment Team nearly tripled in size to more than thirty individuals.

47. The Senior Managing Director and the New York Investment Team performed this work for Offshore Manager from an office in New York City that was rented by an entity affiliated with the Master Fund and Offshore Feeder Fund.[4]

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[4] The office was rented by HMC-New York, Inc. HMC-New York, Inc. served as a consultant to Harbert Fund Advisors, Inc. (and its predecessor), which was the investment advisor to the Harbinger Fund and the Offshore Feeder Fund.

48. Although the members of the New York Investment Team were technically employed by an entity affiliated with the Master Fund and Offshore Feeder Fund rather than Offshore Manager itself, the New York Investment Team served as agents of Offshore Manager when they assisted the Senior Managing Director with investing and reinvesting the Funds' capital.

49. It was never contemplated that the Senior Managing Director should re-locate to Birmingham, Alabama, where HMC was based, to conduct these functions, or that he would be located anywhere but New York City.

50. Offshore Manager's presence in New York City is reflected in its governing documents. Offshore Manager's initial Limited Liability Company Agreement ("LLC Agreement"), dated as of June 1, 2002, provides that "[t]he principal office of the Company [Offshore Manager] is located at 919 Third Avenue, 27th Floor, New York, NY 10022."

51. When Offshore Manager restated and amended its LLC Agreement as of December 1, 2003 and December 15, 2005, Offshore Manager reaffirmed that its principal office was in New York City.

52. Offshore Manager's connection with New York is also reflected in its Investment Management Agreement, which provided that Offshore Manager's principal place of business was in the State of New York, until the agreement was superseded and replaced by an agreement dated as of December 21, 2007.

53. The primary investment management operations of Offshore Manager were conducted entirely in New York City, although certain limited functions, including accounting, legal, and risk-management functions, were handled primarily by officers and agents of Offshore Manager in Alabama.

54. The key functions of Offshore Manager under the Investment Management Agreement occurred in New York City, where the Senior Managing Director sat.

55. The Senior Managing Director was the key decision maker for Offshore Manager and his central importance to Offshore Manager is reflected in explanatory memoranda, which are investor solicitation materials, and other documents. For example, a February 2006 explanatory memorandum for the Offshore Feeder Fund stated:

> The Investment Manager [Offshore Manager] has exclusive responsibility for the Fund's, the Special Purpose Funds'[5] and the Master Fund's investment activities. .... The success of the Investment Manager's trading is to a large degree dependent upon [the Senior Managing Director], as well as the skills and abilities of the Investment Manager's other investment professionals. The loss of [the Senior Managing Director's] services could result in the Investment Manager's inability to trade effectively the Fund's, the Special Purpose Funds' and the Master Fund's account. In the event the Investment Manager withdraws from the Fund, the Special Purpose Funds or the Master Fund or [the Senior Managing Director] is no longer actively engaged in formulating the investment philosophy of the Investment Manager, there can be no assurance that a suitable successor investment manager would be located or appointed.

56. Similarly, the Senior Managing Director's role as key decision maker for Offshore Manager is confirmed by an October 2007 Offering Memorandum for the Onshore Feeder Fund. That document contained a "Key Man" provision under which the general partner of the Onshore Feeder Fund was required to notify the Fund's limited partners if the Senior Managing Director would no longer serve as Offshore Manager's Senior Managing Director, and to suspend limited partners' withdrawals immediately. A determination would then be made as to whether the Onshore Feeder Fund should cease operations and liquidate.

[5] The "Special Purpose Funds" were additional entities in the Harbinger master fund/feeder fund structure.

III. Offshore Manager Was Paid Incentive Fees for Its Services

57. As compensation for its services, and pursuant to the Investment Management Agreement, the Offshore Feeder Fund paid Offshore Manager incentive fees equal to 20% of the net profits (including net unrealized gains and losses) allocable to each common share of the Offshore Feeder Fund, subject to loss carryforwards.[6] In this way, Offshore Manager's fees were directly correlated with the success of its investments, as directed by the Senior Managing Director and his team in New York City.

58. From 2004 through 2008, the amount of incentive fees Offshore Manager earned grew from approximately $4.8 million to more than $850 million, totaling approximately $1.6 billion.

59. Offshore Manager had the option of being paid the incentive fees or deferring the payment of these fees. If the fees were paid to Offshore Manager, the fees were then distributed to members or other holders of interests in Offshore Manager. Between 2004 and 2008, Offshore Manager was paid hundreds of millions of dollars in incentive fees. Offshore Manager also deferred payment of hundreds of millions of incentive fees.

60. As a result of receiving distributions of incentive fees paid to Offshore Manager, members of Offshore Manager who were residents of Alabama received tens of millions of dollars of income generated in New York City.

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[6] Under the agreement, if a common share had a loss chargeable to it during any fiscal year and during a subsequent fiscal year there was a profit allocable to the share, there would be no incentive fee payable to the share until the amount of the loss had been recouped.

IV. Offshore Manager's Incentive Fee Income Was Subject to New York State Income Tax and New York City UBT

A. New York State Income Tax

61. New York State imposes income tax on the income earned by limited liability companies, like Offshore Manager, that receive compensation for services. A limited liability company itself is not subject to income tax; instead, the individual members of the limited liability company are liable for the tax in their individual capacities. *See* N.Y. Tax Law § 601(f); N.Y. Comp. Codes R. & Regs. tit. 20, § 117.1. Under the Tax Law, limited liability companies are generally classified as partnerships for tax purposes. *See* Tax Law § 601(f). Accordingly, the references to "partners" in the Tax Law's provisions on personal income tax apply to "members" of a limited liability company, and references herein to "partners" apply equally to Offshore Manager's members.

62. Residents and nonresidents of New York State have different income tax obligations.

63. For resident partners (*i.e.*, those who are residents of New York State for income tax purposes), New York State income tax is imposed on the partner's distributive share of partnership income, regardless of the state to which the income may be sourced. *See* N.Y. Comp. Codes R. & Regs. tit. 20, §§ 117.1, 117.2. New York residents are subject to tax on their worldwide income. Resident partners, however, are entitled to a credit for income tax paid to another state on income derived from sources in the other state. *See* N.Y. Tax Law § 620(a); N.Y. Comp. Codes R. & Regs. tit. 20, § 120.1.

64. For nonresident partners (*i.e.*, those who are not residents of New York State for income tax purposes), income tax is imposed on the individual partner's distributive share of

partnership income that is derived from or connected with New York sources. *See* N.Y. Tax Law §§ 601(e), 631(a), 632(a)(1); N.Y. Comp. Codes R. & Regs. tit. 20, § 137.1.

65. Income is derived from or connected to a New York source if it is, among other things, "attributable to ... a business, trade, profession or occupation carried on in this state ...." N.Y. Tax Law § 631(b)(1)(B); *see also* N.Y. Comp. Codes R. & Regs. tit. 20, §§ 132.2(b), 132.4(a)(1), 137.1.

66. A business is "carried on" within New York State by a nonresident when the nonresident "occupies, has, maintains or operates desk space, an office, a shop, a store, a warehouse, a factory, an agency or other place where such nonresident's affairs are systematically and regularly carried on, notwithstanding the occasional consummation of isolated transactions without New York State." N.Y. Comp. Codes R. & Regs. tit. 20, § 132.4(a)(2). In addition, a "[b]usiness is carried on within New York State if activities within New York State in connection with the business are conducted in New York State with a fair measure of permanency and continuity." *Id.* A business also is carried on in New York by a nonresident if he "pursues an undertaking continuously as one relying on the profit therefrom for such taxpayer's income or part thereof ...." N.Y. Comp. Codes R. & Regs. tit. 20, § 132.4(a)(2).

67. Because a nonresident's New York gross income includes only items derived from or connected with New York State sources, an apportionment and allocation of items of income, gain, loss and deduction is required when a partnership in which a nonresident individual is a partner, carries on a business, trade, profession or occupation partly within and partly without New York State. N.Y. Tax Law § 631(c); N.Y. Comp. Codes R. & Regs. tit. 20, § 132.12(a).

68. A business is carried on "partly within and partly without" New York State when its business activity "is systematically and regularly carried on within New York State and one or more of such activities is systematically and regularly carried on outside New York State, or when one or more of such activities is systematically and regularly carried on both within and without New York State." N.Y. Comp. Codes R. & Regs. tit. 20, § 132.14.

69. Where a partnership of which a nonresident individual is a partner carries on business partly within and partly without New York State, items of income, gain, loss, and deduction must be apportioned and allocated to New York State on a fair and equitable basis in accordance with approved methods of accounting. *See* N.Y. Tax Law § 631(c); N.Y. Comp. Codes R. & Regs. tit. 20, §§ 132.12(a), 132.15(a).

70. The apportionment and allocation can be derived from the books and records of a business, if those records show the "proportion of the net amount of the items of income, gain, loss and deduction derived from or connected with New York State sources" in a manner that is satisfactory to the State. *See* N.Y. Comp. Codes R. & Regs. tit. 20, § 132.15(b). If not, the apportionment and allocation is determined using a three-factor method that involves multiplying the net amount of income, gain, loss and deduction of the business by the average of three percentages: (1) a property percentage, (2) a payroll percentage, and (3) a gross income percentage. N.Y. Comp. Codes R. & Regs. tit. 20, § 132.15(c)-(f). In general, these percentages are computed by dividing the total amounts of property, payroll, or gross income that is connected with the business in New York State by amounts connected with the business both within and outside of New York State. [7]

[7] Where the three-factor apportionment method results in an apportionment that is not "fair and equitable," DTF may require a taxpayer to apportion and allocate items of income, gain, loss, and deduction "under such method as it

71. The gross income percentage—the only one of the three percentages relevant here[8]—is computed by "dividing (1) the gross sales or charges for services performed by or through an office, branch or agency of the business located within New York State, by (2) the total of all gross sales or charges for services performed within and without New York State." The sales or charges to be apportioned and allocated to New York State include "all sales negotiated or consummated, and charges for services performed, by an employee, agent, agency or independent contractor chiefly situated at, connected by contract or otherwise with, or sent out from, offices, branches of the business, or other agencies, situated within New York State." N.Y. Comp. Codes R. & Regs. tit. 20, § 132.15(f).

72. Limited liability companies like Offshore Manager that have income from New York sources must pay estimated taxes for their nonresident members on this income if the estimated tax is above a minimum threshold or unless DTF's Commissioner has waived this withholding requirement. N.Y. Tax Law § 658(c)(4)(A), (D). The estimated taxes are based on each member's distributive share or pro rata share of the entity's income that is derived from New York sources. *See* N.Y. Tax Law § 658(c)(4).

B. New York City UBT

73. New York City imposes a 4% tax on the unincorporated business taxable income of every unincorporated business that is wholly or partly carried on within the City. *See* N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-503(a). Unincorporated businesses may include the activities conducted by entities classified as a partnership for federal income tax purposes, including

prescribes, as long as the prescribed method results in a fair and equitable apportionment and allocation." N.Y. Comp. Codes R. & Regs tit. 20, § 132.25.

[8] Offshore Manager did not have property or payroll connected with New York State.

limited liability companies. *See* N.Y.C. Admin. Code tit. 11, Ch. 1, § 11-126; Ch. 5 § 11-501(m); Rules of the City of New York tit. 19, Ch. 28, § 28-02(c)(1).

74. For purposes of the UBT, "unincorporated businesses" generally include "any trade, business, profession or occupation conducted, engaged in or being liquated by an individual or an unincorporated entity ...." N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-502(a); *see also* Rules of the City of New York tit. 19, § 28-02(i). Where an unincorporated business carries on business both inside and outside of New York City, it must apportion and allocate a fair and equitable portion of its business income to the City.[9] N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-508(a); 7 Rules of the City of New York § 28-07(a).

75. For tax years beginning before 2005, the apportionment could be determined from the business's books and records if the Commissioner of the New York City Department of Finance approved the methods used in keeping the books as fairly and equitably reflecting income from the City. N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-508(b)(1). Under certain conditions, some taxpayers were permitted to continue to use this method for later years. *See* N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-508(b)(2)(i). For other taxpayers—at least during the time periods at issue in this matter—the portion of income allocated to the City is determined by multiplying business income by a business allocation percentage that is derived from a three-factor formula. N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-508(c).

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[9] Whether an unincorporated business carries on business both within and without the City is determined by an analysis, of, among other things, where it has a regular place of business—any "bona fide office, factory, warehouse or other place which is systematically and regularly used by the unincorporated business entity in carrying out its business." Rules of the City of New York, tit. 19, Ch. 28, § 28-07(b)(1). Other factors that may be considered include: (i) the nature of the business, (ii) the type and location of each place of business used in the activity, (iii) the nature of the activity engaged in at each place of business, and (iv) the regularity, continuity and permanency of the activity at each location. *Id.* at § 28-07(b)(3).

76. The business allocation percentage is determined by adding together a property percentage, a payroll percentage, and a gross income percentage, and dividing the result by the applicable number of percentages. N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-508(c); *see also* Rules of the City of New York, tit. 19, Ch. 28, § 28-07(d)(1).

77. The gross income percentage is the only relevant factor here because the property percentage and the payroll percentage are inapplicable because Offshore Manager did not have employees and did not own or rent property. The gross income percentage of an unincorporated business is computed by dividing the "gross sales or charges for services performed by or through an agency located within the city" by "the total of all gross sales or charges for services performed within and without the city." The "sales or charges" allocated to the City include "all sales negotiated or consummated, and charges for services performed, by an employee, agent, agency or independent contractor chiefly situated at, connected by contract or otherwise with, or sent out from, offices of the unincorporated business, or other agencies, situated within the city." N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-508(c)(3); *see also* Rules of the City of New York tit. 19, Ch. 28, § 28-07(d)(iii).

78. For tax years beginning on or after July 1, 2005, the gross income percentage was modified so that the "charges for services performed" must be allocated to the City "to the extent that the services are performed in the city," but this construct became applicable to unincorporated businesses like Offshore Manager only for tax years beginning on or after July 1, 2007. N.Y.C. Admin. Code, tit. 11, Ch. 5, § 11-508(c)(3)(A)-(C).

C. Offshore Manager's Incentive Fees Were Subject to State and City Tax

79. Offshore Manager's nonresident members were required to pay State income tax, and Offshore Manager was required to estimate this tax and pay it to New York State because

the incentive fees Offshore Manager earned were derived from and connected to New York State sources. Offshore Manager was also required to pay City UBT because it carried on a business in the City.

80. Offshore Manager's incentive fee income was derived from New York State sources because Offshore Manager was carrying on a business within New York City.

81. Offshore Manager's incentive fees were attributable to a business, trade, or profession that was carried on in New York City (and, therefore, New York State) because the Senior Managing Director and the New York Investment Team worked systematically and continuously from an office in New York City.

82. The Senior Managing Director and the New York Investment Team performed Offshore Manager's key business activity—making the investment decisions for the Master Fund and Offshore Feeder Fund and thus investing and reinvesting the Funds' capital. Their work was not merely an incidental activity connected with Offshore Manager, but instead created a permanent and continuous link between Offshore Manager and New York State and New York City.

83. The Senior Managing Director and the New York Investment Team's work generated the incentive fees that Offshore Manager earned. Under the Investment Management Agreement between and/or among Offshore Manager, the Master Fund, and the Offshore Feeder Fund, the incentive fees were calculated as a percentage of investment returns. Those investment returns were generated by the investment decisions that the Senior Managing Director and the New York Investment Team made for Offshore Manager in New York City.

84. To the extent that Offshore Manager carried on any business in Alabama, Offshore Manager would have been required to apportion and allocate income to the State and

the City under the three-factor test used for this purpose. Under this test, Offshore Manager had "charges for services" performed by or through an office, branch or agency of the business that was located within New York City and New York State. These "charges for services" were the incentive fees that the Offshore Feeder Fund paid Offshore Manager for investing and reinvesting its capital. These services were primarily performed by agents of Offshore Manager who were situated in New York City, namely, the Senior Managing Director and the New York Investment team. These agents and the services they performed were also connected by contract to New York City and State because, for many years, Offshore Manager's LLC Agreement and its Investment Management Agreement acknowledged that Offshore Manager's principal office and principal place of business was in New York City or New York State.

85. Accordingly, to the extent Offshore Manager carried on business in Alabama, Offshore Manager should have apportioned and allocated income to New York State and City.

D. Offshore Manager and its Nonresident Members Failed to Pay State and City Tax

86. In March 2005, Offshore Manager signed (and subsequently filed) a Partnership Return (IT-204) tax return for tax year 2004 with New York State that apportioned and allocated none of its income to New York State. Offshore Manager also failed to withhold funds and pay estimated income taxes on behalf of its nonresident members for tax year 2004.

87. In March 2006, Offshore Manager signed (and subsequently filed) a Partnership Return (IT-204) for tax year 2005 with New York State that similarly apportioned and allocated none of its income to New York State. Offshore Manager failed to withhold funds and pay estimated income taxes on behalf of its nonresident members for this tax year as well.

88. Offshore Manager failed to file Partnership Returns with New York State for tax years 2006 and 2007 even though it was required to do so. A limited liability company must file a Partnership Return if any of its members are New York residents, or if any income, gain, loss or deduction is from New York State sources. *See* N.Y. Tax Law § 658(c)(1); N.Y. Comp. Codes R. & Regs. tit. 20, §§ 151.4, 158.9(a). Both of these conditions were met for Offshore Manager because at all times relevant here, the Senior Managing Director, a New York resident, was a member of Offshore Manager, and Offshore Manager earned its income from New York State sources.

89. In August 2009, Offshore Manager filed a Partnership Return (IT-204) tax return in which it apportioned and allocated none of its income for tax year 2008 to New York State.

90. Offshore Manager's failure to allocate income to New York State caused its nonresident members to evade New York State income taxes on incentive fee income they received from Offshore Manager. That evasion continued until they settled with New York State following the commencement of this litigation.

91. During tax years 2004 through 2008, Offshore Manager apportioned 100% of its income to Alabama.

92. As a result, the Senior Managing Director and other members of Offshore Manager who were residents in New York State underpaid New York State taxes by claiming an inflated credit for taxes they paid to Alabama.

93. For tax years 2004 through 2007, Offshore Manager failed to pay City UBT.

94. During these tax years, Offshore Manager also failed to file City UBT returns (Form NYC-204) even though it was required to do so. Unincorporated businesses that meet certain income thresholds—which Offshore Manager met—must submit an annual New York

City Department of Finance Unincorporated Business Tax Return (Form NYC-204) that includes the amount of income allocated to New York City. *See generally* N.Y.C. Admin. Code tit. 11, Ch. 5, § 11-514(a); Rules of the City of New York, tit. 19, Ch. 28, § 28-18(a). The unincorporated business tax is due and payable on or before the date on which the tax return must be filed. *See* Rules of the City of New York, tit. 19, Ch. 28, § 28-18(e).

95. Offshore Manager filed a City UBT return for tax year 2008, partially apportioning and allocating incentive fee income to New York City. In its return, it stated that Offshore Manager "earned income for services that were performed in part in New York City."

V. Offshore Manager Was Warned that State and City Taxes Were Owed

96. Offshore Manager was warned by accountants and other tax professionals that State and City taxes were owed on its incentive fee income, but it evaded these taxes and knowingly made false statements to the tax authorities that concealed its New York presence.

A. In 2005, Offshore Manager Was Warned That State and City Taxes Were Owed

97. In March 2005, a few weeks before tax year 2004 tax returns were due, Offshore Manager's Alabama-based Executive Vice President and Chief Administrative Officer (the "CAO") became concerned that New York State and New York City tax might be due on incentive fees. For tax years 2002 through 2007, Offshore Manager's CAO and its Controller were the officers primarily responsible for Offshore Manager's taxes.

98. Although Offshore Manager had existed for some time, tax year 2004 was the first year that Offshore Manager earned incentive fees on which New York State income tax and New York City UBT were owed.

99. On Friday, March 11, 2005, the CAO wrote to International Accounting Firm A: "Ok, I hate to ask this one [] (sic) does the incentive fee received by the offshore manager

constitute trade or business income that would require the partners to file and pay New York state taxes & New York City taxes, or is there some exemption that allows the Alabama partners of the offshore manager to pay just in AL?"

100. International Accounting Firm A advised the CAO that New York State and New York City taxes were owed.

101. International Accounting Firm A's advice, which the CAO characterized as an "initial reaction" that was "[n]ot good news at this point," is reflected in an email the CAO sent later that day, March 11, 2005, to senior members of Offshore Manager, including the Senior Managing Director. In the email, the CAO alerted the members that New York nonresidents may have to pay 8% New York income tax and seek a credit on their Alabama returns, and Offshore Manager may have to pay the 4% UBT to New York City. The CAO explained that City UBT "causes a problem" because Offshore Manager had distributed all of its incentive fees and would have to claw those fees back to pay the tax. He indicated that he would research whether the "shareholders" (i.e., Offshore Manager's members) could pay the tax themselves.

102. On Sunday, March 13, 2005, the Senior Managing Director replied to the CAO's email, asking "What has changed for this to come up now?"

103. Offshore Manager's Alabama-based Executive Vice President and Chief Financial Officer, responded to the Senior Managing Director's email, saying, "I think [International Accounting Firm A] just figured it out ; [sic] ugh…. I hate taxes especially having to support some place I don't live. Another one of those high class problems[.]"

104. On March 16, 2005—one week before Offshore Manager signed its New York State Partnership Return—Offshore Manager's CAO wrote that apportioning 100% of income to Alabama and none to New York was "unsupportable" in a sheet he created that compared the tax

impact of different apportionments to Alabama and New York. He wrote: "All AL-unsupportable (future - move LLC to AL?)."

105. The CAO's analysis, which was forwarded to International Accounting Firm A with a request for its recommendation, shows that apportioning 100% to Alabama rather than apportioning 100% to New York could reduce taxes by more than half.

106. In this sheet, the CAO analyzed four different potential apportionment scenarios for Offshore Manager: 100% to New York; 50% to New York and 50% to Alabama; 25% to New York and 75% to Alabama; and 100% to Alabama.

107. The CAO wrote that a 25% apportionment to New York and 75% apportionment to Alabama based on a "costs of services" analysis was "aggressive" and that an apportionment of 50% to New York and 50% to Alabama was "like all agreements provide." The CAO did not comment on a 100% apportionment to New York, but he wrote that a 100% apportionment to Alabama, or "All AL," in his words, was "unsupportable."

108. The CAO's sheet reflects that he recognized that Offshore Manager was not based in Alabama. He wrote: "future – move LLC to AL?"

109. Around 2:00 p.m. on March 16, 2005, just hours after writing that a 0% apportionment to New York was "unsupportable," the CAO wrote, "We may get aggressive in determining that the LLC is AL if we can verify there is little AL risk and in the future close the New York bank accounts and transfer everything down here." The CAO wrote this in an email to Offshore Manager's Controller, another HMC employee, and another accountant in Alabama who was not affiliated with International Accounting Firm A.

110. In his email, Offshore Manager's CAO wrote that he was "researching ways to make the offshore manager, LLC incentive income all Al. income based on the LLC agreement,"

and he asked for Alabama tax advice on the consequences of that decision: "If it were AL, what would cause AL to try to tax the offshore fund investors since the offshore fund does not have any bank accounts, books, transactions, board meetings, etc, [sic] in AL?"

111. Less than an hour later, after sending this email about getting "aggressive in determining that the LLC is AL," the CAO sent an email containing a list of items that, in his words, "support" Offshore Manager's allocation income to Alabama.

112. These factors concerned ministerial or minor functions of Offshore Manager or were otherwise irrelevant to an apportionment analysis under New York State and City tax law.

113. The CAO's list was then forwarded to International Accounting Firm A with a request for comments, and it was also sent to the accountant in Alabama. On March 18, 2005, Offshore Manager's CAO wrote to other members of Offshore Manager that Offshore Manager's tax advisors were reviewing support that income should be apportioned to Alabama rather than New York. Notably, the emails forwarding the CAO's list of factors in "support" of an apportionment to Alabama, and the list itself, failed to inform the accountants that the core function of Offshore Manager—investing and reinvesting the Funds' capital—was performed on behalf of Offshore Manager by the Senior Managing Director and his investment team from an office in New York City.

114. Instead, the list of factors obscured the issue by stating that the "only connection to New York in the whole thing is currently the bank account, address of the company, and the fact some New York residents and employees of HMC-New York work for HFA [Harbert Fund Advisors, Inc., an affiliate of Offshore Manager] in investing the funds." The list obscured the facts because all—not some—of the individuals who made the investment decisions on behalf of Offshore Manager carried on this investment work in New York. In addition, the list failed to

note that although the individuals who made these investment decisions were employed by HMC-New York, they served as Offshore Manager's agents when they performed this work, and, when the Senior Managing Director performed this work, he also served as an officer of Offshore Manager. Moreover, contrary to the suggestion made in the list, investing the assets of the Master Fund and Offshore Fund was the primary function of Offshore Manager, not a mere peripheral role. The list obscures the importance of this investment work by placing this key function at the end of a list of the "only connection[s] to New York in the whole thing." Thus, to the extent that any advisors were reviewing this "support," it did not alert them to the critical facts.

115. The following week, on March 23, 2005, Offshore Manager's Controller signed a New York State partnership tax return for tax year 2004. In the return, Offshore Manager adopted the "unsupportable" position that none of its income should be apportioned to New York State. This return falsely asserted that Offshore Manager had changed its address. Although Offshore Manager had listed a New York address in previous returns, it now falsely listed only an Alabama address and concealed its New York City address, even when the return's instructions expressly required Offshore Manager to "List all places, both in and out of New York State, where the partnership carries on business."

116. Offshore Manager failed to file a City UBT return for tax year 2004.

117. After the 2004 tax return was signed, Offshore Manager's CAO sent an email to Offshore Manager's Controller forwarding his March 16, 2005 email purportedly containing his "support" for apportioning Offshore Manager's income to Alabama and asked her to save it in her files and in the tax files. The CAO's email does not state or otherwise suggest that an accountant approved of the apportionment position that Offshore Manager took, and other than

International Accounting Firm A's advice that taxes *were* owed, there is no other written evidence of advice given by accountants during this period.

118. After the return was filed, Offshore Manager attempted to shore up its unsupportable tax position. In a March 16, 2005 email, Offshore Manager's CAO had suggested that Offshore Manager would eventually close its bank accounts in New York and move the LLC to Alabama. As noted above, he wrote: "We may get aggressive in determining that the LLC is AL if we can verify there is little AL risk and in the future close the New York bank accounts and transfer everything down here." In 2005, Offshore Manager began to implement that plan. It surrendered its certificate of authority to do business in New York. It also completed an application to register as a foreign limited liability company in Alabama. Offshore Manager's bank accounts remained in New York through April 2005 and then were moved to Alabama.

119. Tellingly, Offshore Manager's certificate surrendering its authority to do business in New York, dated April 19, 2005, reflects that Offshore Manager continued to have a presence in New York City. The surrender of authority certificate provides: "The post office address within or without this state to which the New York Secretary of State shall mail a copy of any process against the Company served upon him or her is: 555 Madison Avenue, 16th Floor, New York, New York 10022." Offshore Manager surrendered its authority to do business in New York, but it continued to work out of an office in Manhattan, even though, because it had surrendered its certificate, it was no longer entitled to do so.

120. Neither surrendering its authority to do business in New York nor moving its bank accounts to Alabama changed the fact that Offshore Manager was carrying on a business in New York City and was required to apportion income to New York. Neither of these ministerial actions addressed the fact that the Senior Managing Director and his staff continued to conduct

Offshore Manager's core functions in New York City. They did nothing to alter the conclusion previously reached by Offshore Manager's CAO that apportioning all of Offshore Manager's income to Alabama was "unsupportable." Instead, these actions reflect that Offshore Manager had little faith in the tax position it took in tax years 2004 and 2005 that none of Offshore Manager's income should be apportioned to New York.

121. In 2005, 2006, and 2007, Offshore Manager's activity in New York State continued to increase. The Senior Managing Director hired additional staff in New York to assist Offshore Manager with its core functions, its assets under management grew dramatically, and its income increased accordingly. Offshore Manager earned approximately $67 million in incentive fees in 2006 and approximately $136 million in 2007, much of which it deferred.

122. Notwithstanding these changes, Offshore Manager failed to revisit its "unsupportable" position of apportioning none of its income to New York.

123. Instead, Offshore Manager relied on the cursory review it made of its New York State and New York City tax obligations in March 2005 for its tax positions in tax years 2005, 2006, and 2007.

B. In 2008, Offshore Manager Was Again Warned About Tax Obligations

124. In late 2008, the Senior Managing Director and other members of Offshore Manager in Alabama who were affiliated with HMC began negotiating an agreement under which the Senior Managing Director would assume sole ownership of Offshore Manager and other affiliated entities.

125. The Senior Managing Director retained a law firm and an international accounting firm ("International Accounting Firm B") to advise him in connection with the transaction. In January 2009, the Senior Managing Director's attorneys warned counsel for the Alabama

members of Offshore Manager that City UBT was due on Offshore Manager's incentive fee income since all or nearly all of the investment decisions were made in New York City. They also warned that Offshore Manager's nonresident members were subject to tax in New York State because Offshore Manager was earning income from a business conducted in the State. Counsel for the Alabama members of Offshore Manager then informed a senior lawyer at HMC (who was also Offshore Manager's Assistant Secretary) of this position.

126. On January 22, 2009, the General Counsel of Harbinger Capital Partners (who, in effect, worked for the Senior Managing Director) wrote to the senior lawyer at HMC (and Offshore Manager's Assistant Secretary), "Hopefully, [counsel for the Alabama members of Offshore Manager] is also looking at the NYC UBT and NYS non-resident tax issues, as those are a real concern." The General Counsel of Harbinger Capital Partners and the senior lawyer from HMC corresponded several times by email about these tax issues.

127. On February 1, 2009, the General Counsel of Harbinger Capital Partners again wrote to senior members of HMC (some of whom were officers of Offshore Manager) to emphasize that Offshore Manager faced significant tax exposure and to ensure that HMC was aware of the issue. He wrote: "[A]s you are aware, we have received advice from NY tax lawyers at [the Senior Managing Director's attorneys] and NY accountants from [International Accounting Firm B] that the Offshore Manager may have significant unpaid tax exposure. Please confirm that the board of the Offshore Manager has been informed of this advice."

128. Indeed, International Accounting Firm B, which had been retained to advise the Senior Managing Director, calculated the benefits of participating in a voluntary disclosure program with the State and the City under which Offshore Manager could disclose its failures to

pay taxes and in return the State and City would waive applicable tax penalties that would otherwise be imposed.

129. Rather than heeding the warnings that tax was due, HMC hired International Accounting Firm A to develop after-the-fact advocacy for Offshore Manager's prior tax positions and to draft a memorandum outlining that support. In doing so, however, HMC did not call International Accounting Firm A's attention to the fact that in 2005, other accountants at International Accounting Firm A had had indicated that tax was due.

130. The Senior Managing Director's representatives viewed the risk that nonresident members would owe tax and that Offshore Manager could be held liable for its failure to withhold taxes as significant enough that they asked the nonresident members to execute tax forms (Form IT-2658-E) that made the nonresidents themselves responsible for paying taxes.

131. Indeed, the purchase agreement that consummated the sale of assets to the Senior Managing Director required that the nonresidents deliver executed copies of these forms at or prior to the closing.

132. Ultimately, Offshore Manager's nonresident members signed the tax forms that waived Offshore Manager's responsibility for withholding and paying estimated income tax to New York State on behalf of the nonresidents for tax years 2008 and 2009.

133. Notwithstanding the warnings it had been given, on August 4, 2009—months after the deal closed—Offshore Manager filed a partnership return with New York State that apportioned and allocated none of Offshore Manager's income to New York State.

VI. Offshore Manager Knowingly Made False Statements Material to its Tax Obligations

134. Offshore Manager knowingly made false statements about the taxes it owed to New York State and took steps to conceal its significant New York business from the tax authorities.

A. Offshore Manager's Knowingly False Statements on its Tax Returns

135. Offshore Manager knowingly submitted Partnership Returns (IT 204) to the State for tax years 2004, 2005, and 2008 that contained false statements and material omissions and concealed its significant business presence from the taxing authorities.

i. Omitting Income That Should Have Been Apportioned to New York

136. Each of Offshore Manager's returns for these tax years was false because they omitted and thereby understated the amount of income that was required to be apportioned to the State.

137. Offshore Manager had actual knowledge or acted with deliberate ignorance or reckless disregard of the falsity of its returns because:

a. Offshore Manager's CAO received advice from International Accounting Firm A in 2005 that New York tax would be due on Offshore Manager's incentive fees;

b. A week before Offshore Manager signed its tax return for tax year 2005 Offshore Manager's CAO wrote that apportioning none of its income to New York was "unsupportable." On that same day, he declared that Offshore Manager may "get aggressive" on its apportionment position if it could confirm that there was little risk in Alabama as a consequence of that decision.

c. Offshore Manager's decision to apportion no income to New York was not revisited from March 2005 through the end of 2008 even though the New York Investment Team grew in size and the incentive fees continued to increase;

d. In 2009, tax experts again warned officers of Offshore Manager that its incentive fees were subject to State income tax;

e. Notwithstanding the warnings it had received, Offshore Manager failed to seek an advisory opinion or other guidance from DTF about whether tax was owed.

f. The governing statute and regulations, as well as DTF's instructions for the Partnership Returns, made plain that Offshore Manager should have apportioned and allocated income to New York. HMC's staff, including Offshore Manager's CAO and Comptroller, which assisted Offshore Manager on tax matters, recklessly disregarded these unambiguous rules. The governing statute and regulations, as well as DTF's instructions for the Partnership Returns, made plain that Offshore Manager should have apportioned and allocated income to New York. HMC's staff, including Offshore Manager's CAO and Comptroller, which assisted Offshore Manager on tax matters, recklessly disregarded these unambiguous rules.

138. Offshore Manager's failure to apportion and allocate income to New York on its tax returns was material to its obligation to estimate and pay taxes for its nonresident members. Offshore Manager's failure to apportion and allocate income was material to its nonresident members' obligations to pay taxes because had it allocated and apportioned income properly, both New York State and Offshore Manager's nonresident members would have been alerted that the nonresident members had income that had been derived from New York State sources.

139. Offshore Manager's failure to apportion and allocate income was also material to its resident members' tax obligations. Offshore Manager's decision with respect to New York led it to apportion 100% of its income to Alabama, which enabled its New York resident members to claim an inflated credit for taxes they paid to Alabama on that income.

ii. Offshore Manager Concealed its New York Address

140. On each and every tax return Offshore Manager submitted for tax years 2004, 2005, and 2008, Offshore Manager concealed its presence in New York. Offshore Manager knowingly responded falsely to a request in each tax return that instructed it to "List all places, both in and out of New York State, where the partnership carries on business."[10] In response to

[10] In 2008, it was instructed to "List all places, both in and out of NYS, where the partnership carries on business ...."

this instruction, Offshore Manager identified *only* an office address in Birmingham, Alabama. It failed to identify the office at 555 Madison Avenue, New York, New York.

141. For example, Offshore Manager's response to this question on its Partnership Return for tax year 2004 stated:

Schedule A
Part I - List all places, both in and out of New York State, where the partnership carries on business
(attach additional sheets if necessary)

Street address	City and state	Description
ONE RIVERCHASE PARKWAY, SOUTH	BIRMINGHAM,AL 35244	OFFICE

142. When these returns were submitted to DTF, Offshore Manager had actual knowledge, or acted with deliberate ignorance or reckless disregard of the fact that the Senior Managing Director and the New York Investment Team invested and reinvested the Funds' capital on behalf of Offshore Manager from an office in New York City and that they thereby carried on Offshore Manager's business in New York City. Despite this fact, Offshore Manager omitted this New York City address on its tax returns and concealed its business activities in New York State from DTF.

143. When these returns were submitted, Offshore Manager also had actual knowledge that it carried on business in New York because its LLC Agreement, which provided that its "principal office" was located at an address in New York City (until the agreement was amended as of March 1, 2008, when the location designated in the agreement was changed). Likewise, Offshore Manager's Investment Management Agreement provided that its principal place of business was located in New York State (until the agreement was replaced as of December 21, 2007, and the location designated in the agreement was changed).

144. Indeed, Offshore Manager's knowledge that it was carrying on business in New York is evident from the Partnership Returns it submitted in tax years 2002 and 2003—one of which was signed by Offshore Manager's CAO and the other by its Controller. In both of these

returns – each of which included the instruction, "List all places, both in and out of New York State, where the partnership carries on business" – Offshore Manager listed its New York City address and no other address. Below is an excerpt from Offshore Manager's return for tax year 2003:

Schedule A

Part I - List all places, both in and out of New York State, where the partnership carries on business
(attach additional sheets if necessary)

Street address	City and state	Description
555 MADISON AVENUE, SUITE 2800	NEW YORK, NY 10022	OFFICE

145. Notably, Offshore Manager only first identified an Alabama address in response to this instruction on its tax return for tax year 2004, the first year that tax would have been owed to New York State. Offshore Manager used a New York address in its returns for tax years 2002 and 2003, when no tax was due New York State.

146. At a minimum, Offshore Manager's failure to include its New York address in response to this instruction shows deliberate ignorance or reckless disregard of the truth of its response. DTF's instructions for the tax form (IT 204-I) made clear what the State meant by "carries on business." The instructions provide: "A partnership carries on a business, trade, profession, or occupation within New York State if (1) it maintains or operates an office, a shop, a store, a warehouse, a factory, an agency, or other place in New York State where its affairs are systematically and regularly carried on, or (2) it performs a series of acts or transactions in New York State with regularity and continuity for livelihood or profit, as distinguished from isolated or incidental transactions."[11] Despite meeting both of these tests, Offshore Manager omitted

[11] The instructions for tax year 2008 were slightly modified to provide: "A partnership carries on a business, trade, profession, or occupation within New York State if (1) it maintains or operates an office, shop, store, warehouse, factory, agency, or other place in New York State where its affairs are systematically and regularly carried on, or (2) it performs a series of acts or transactions in New York State with regularity and continuity for livelihood or profit, as distinguished from isolated or incidental transactions."

from its response the location from where the Senior Managing Director and the New York Investment team worked. At minimum, Offshore Manager's failure to comply with these instructions shows a reckless disregard of the truth of its response.

147. Offshore Manager's failure to identify its New York City address was especially egregious in its partnership return for tax year 2004—the first year that it had income subject to tax. On that tax return, Offshore Manager falsely checked a box to indicate that it had a "change of address." Unlike its previous returns, Offshore Manager's return for tax year 2004 identified its address as a location in Alabama. In fact, Offshore Manager had not changed its address. The Senior Managing Director and the New York Investment Team continued to work on behalf of Offshore Manager in New York City, and Offshore Manager's governing LLC Agreement provided at that time that its "principal office" was an address in New York City. In fact, just a week before the tax year 2004 return was signed, Offshore Manager's CAO sent an email to Offshore Manager's Controller, among others, noting that "the address of the company" was among the connections Offshore Manager had to New York.

148. These false statements were material to Offshore Manager's obligation to pay estimated taxes and its members' obligations to pay New York State taxes. Offshore Manager concealed from DTF information that was critically relevant to a determination about whether tax was owed.

iii. Offshore Manager Falsely Claimed That It Had No Income From New York Sources.

149. In each and every tax return Offshore Manager submitted for tax years 2004, 2005, and 2008, Offshore Manager also knowingly responded falsely to the question: "Did the

partnership have any income gain, loss, or deduction derived from New York sources during the tax year?"[12] Offshore Manager falsely answered "no."

150. DTF's instructions for the tax return clearly describe what the State meant by having income "derived from New York sources during the tax year." For example, the instructions for tax year 2004 provide: "[i]ncome from New York State sources includes: ... 2. income attributable to a business, trade, profession, or occupation carried on in New York State...." As noted above, the instructions also provide what is meant by "carries on business" in New York State.

151. Thus Offshore Manager's response was made with actual knowledge or with deliberate ignorance or reckless disregard of its falsity. Offshore Manager's income was attributable to a business carried on in New York State under this test, and Offshore Manager's statements to the contrary are false.[13]

152. Offshore Manager's statements were material to obligations to pay tax to the State because these statements concealed its business presence in New York and made it less likely that DTF would be able to learn that State income tax was due and owing and require that tax be paid.

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[12] The tax year 2008 tax return form substitutes "NY" for "New York."

[13] Similarly, for tax years 2004 and 2005, Offshore Manager attached to its returns a false statement that Offshore Manager "HAS NO NEXUS IN NEW YORK STATE AND HAS NO INCOME DERIVED FROM NEW YORK SOURCES." It attached a similar statement to its returns for tax year 2008, noting that it "HAD NO INCOME DERIVED FROM NEW YORK SOURCES." DTF's instructions for IT-204 required that certain entities attach a statement to their returns that indicated that the entity had "no income derived from New York sources." The instructions for tax year 2004 and 2005 make plain, however, that this statement is to be made only "if the partnership conducts business **entirely outside** of New York State .... " (emphasis in original). Offshore Manager did not conduct business entirely outside of New York State, and Offshore Manager's statement on the returns for these years is false. The instructions for 2008 indicate that the statement should be made only where the partnership had no New York source income. Offshore Manager had New York source income in tax year 2008, and its statements on its returns for tax year 2008 are also false.

iv. Offshore Manager Concealed Its Business by Failing to File Tax Returns

153. Offshore Manager compounded the false statements on its returns by failing to file State tax returns for tax years 2006 and 2007. Truthful returns for these years would have alerted DTF to Offshore Manager's failure to apportion and allocate income in earlier years and would have shown that tax was due.

154. Similarly, Offshore Manager failed to file City UBT returns for tax years 2004 through 2007 and thereby concealed its business in New York City from the City tax authorities. The filing of a truthful return would have alerted the City to Offshore Manager's failure to pay UBT and would have shown that tax was due.

B. Offshore Manager Concealed its New York Business During an Audit

155. In 2008, Offshore Manager took additional steps to conceal from DTF that it was carrying on business in New York. These steps arose in connection with an audit DTF commenced in December 2007 of personal income tax returns the Senior Managing Director and his wife filed for tax years 2004 through 2006.

156. During the audit, DTF requested information concerning the resident tax credit that the Senior Managing Director and his wife had taken on their tax returns for the 2004-2006 tax years for taxes paid to Alabama in connection with Offshore Manager's incentive fee income.[14]

157. On January 25, 2008, DTF sent a letter to the Senior Managing Director's representative, an attorney in New York who prepared tax returns for the Senior Managing

[14] Residents are entitled to a credit against their taxes for income tax paid to another state on income derived from sources in the other state. *See* N.Y. Tax Law § 620(a); N.Y. Comp. Codes R. & Regs. tit. 20, § 120.1.

Director and his wife (the "Tax Preparer"), seeking information about the nature of Offshore Manager's business activity and the source of its income for the tax years under audit.

158. HMC's Tax Manager, who was an agent of Offshore Manager, became aware of the audit, and, in an email dated February 26, 2008, she drafted a proposed response to the auditor's question, which she emailed to International Accounting Firm A. In her email to International Accounting Firm A, HMC's Tax Manager wrote: "Below is our proposed response to the NY Dept of Taxation and Finance. Please ask someone in your NY office to see if this will satisfy the state *and make sure it will not cause the offshore manager LLCs [sic] to be under NY's radar screen for future investigation*." The proposed response identified connections Offshore Manager had with Alabama, but failed to mention anything about its business activities in New York.

159. On March 3, 2008, Offshore Manager's Controller drafted a response to DTF's question, the text of which was substantially similar to the response proposed by HMC's Tax Manager. Offshore Manager's Controller's response, which was forwarded to DTF by the Senior Managing Director's Tax Preparer, catalogued Offshore Manager's limited connections to Alabama but failed to identify any of the work the Senior Managing Director or his agents performed in New York on behalf of Offshore Manager.

160. Approximately one week later, an amendment was drafted to Offshore Manager's LLC Agreement that made only a single modification to the agreement: the amendment changed the location of Offshore Manager's "principal office" from an address in New York City to an address in Alabama. The amendment provided that the company's LLC Agreement "incorrectly states in Section 1.5 that the principal office is located at 555 Madison Avenue, 16th Floor, New York, New York, 10022."

161. This amendment, which was then executed, was effective as of March 1, 2008.

162. Sometime later, Offshore Manager revised and restated the entire Offshore Manager agreement, effective as of March 1, 2008. This new restated agreement reflected in its body (i.e., not in an amendment) that the principal office of the company was located in Alabama.

163. On March 12, 2008, a DTF auditor wrote to the Senior Managing Director's Tax Preparer and indicated disagreement with the resident tax credit that was claimed on the the Senior Managing Director and his wife's 2004 through 2006 tax returns. The auditor wrote, "[i]n the present matter, Alabama imposed a tax on the income and the income is subject to tax under Article 22 of the New York Tax Law; however, based on the documentation provided the income does not appear to be derived from Alabama. Therefore, [the Senior Managing Director and his wife] would not be allowed a resident tax credit for the taxes paid to Alabama." The auditor asked that additional information be provided if the Senior Managing Director's Tax Preparer disagreed.

164. On May 19, 2008, International Accounting Firm A responded to the DTF auditor's March 12, 2008 letter on behalf of the Senior Managing Director and his wife, noting that the income was derived from the Harbert Management Corporation, which has its worldwide corporate offices in Birmingham, Alabama. International Accounting Firm A noted that "[t]he office is a tangible manifestation of a situs in Alabama where income-producing activity occurred on a routine basis." International Accounting Firm A's letter—a draft of which had been shared with Offshore Manager's Controller—failed to identify Offshore Manager's significant presence in New York.

165. On June 5, 2008, a DTF auditor wrote to the Senior Managing Director's Tax Preparer, and asked for a copy of the partnership agreement for the entity and "any other documentation that can substantiate the business activity and the source of the income of the partnership."[15]

166. While preparing a response to DTF's request, Offshore Manager's Controller drafted a memo to Offshore Manager's CAO, dated June 20, 2008, in which Offshore Manager's Controller made clear that any response should omit information that would alert New York authorities to Offshore Manager's presence within New York.

167. In her memo, Offshore Manager's Controller wrote that the DTF auditor "has requested a copy of the Harbinger Capital Partners Offshore Manager, LLC partnership agreement and any other documentation that can substantiate the business activity and the source of income of the partnership." She also wrote, "As we discussed, in response to [the auditor's] request, we will send the agreement (which has now been restated as of March 1, 2008) and the investment management agreement. The payment of fees for 2004 and 2005 were made from a New York bank so I would recommend that we not send copies of those."

168. The bank account information and the previous versions of the LLC Agreement would have alerted DTF to Offshore Manager's New York presence.

169. In her memo, Offshore Manager's Controller did not recommend sending this earlier version of the limited liability agreement, which, if it had been attached in its entirety, would have reflected not just that the principal office was in New York City, but that the

[15] The letter indicated that DTF had received a letter from International Accounting Firm A, but since no power of attorney had been submitted revoking the Tax Preparer's power of attorney, DTF would continue to address all issues with the Tax Preparer.

agreement was amended during the audit to change the address of the principal office from New York City to Birmingham, Alabama.

170. The memo from Offshore Manager's Controller to Offshore Manager's CAO suggests language for a cover letter, which the Controller said "will be remitted by" a partner of International Accounting Firm A. The proposed language highlighted the assertion that the principal office of the company was in Alabama. The Controller also wrote: "Enclosed please find the requested partnership agreement for Harbinger Capital Partners Offshore Manager, LLC (Manager).... Section 1.5 notes the principal office of the company as 'One Riverchase Parkway, South, Birmingham, AL, 35244[.]'" The Controller then reiterated: "As noted above, the manager's principal place of business is Birmingham, Alabama at the site of the worldwide corporate headquarters of Harbert Management Corporation, an affiliate of the Manager." In the proposed language, the Controller listed other minor connections Offshore Manager has to Alabama. The Controller wrote: "The majority of the officers of the [Offshore] Manager work from corporate headquarters and control of the Funds [defined as the Master Fund and the Offshore Feeder Fund], as well as all Harbert Funds, are administered from this location." Notably, the Controller failed to identify any of Offshore Manager's substantial connections to New York, and in particular failed to disclose that the Senior Managing Director and the New York Investment Team worked on behalf of Offshore Manager in New York City.

171. The Controller's proposed language also omitted the fact that Offshore Manager's LLC Agreement had, until recently, identified the principal office of Offshore Manager as being in New York City or that the agreement had been amended during the audit specifically to change the office's purported location to Alabama.

172. Offshore Manager's CAO handwrote "ok" on the memo, and dated it as of June 20, 2008. In a Post-it note attached to the memo, he also wrote "This looks fine." Furthermore, Offshore Manager's Controller wrote "Will not send" on a Post-it note attached to bank records for Offshore Manager that would have identified Offshore Manager's office location as New York City.

173. On June 26, 2008, an International Accounting Firm A partner sent a letter to DTF that adopted the Controller's language, with only minor changes. International Accounting Firm A's letter fails to mention that the LLC Agreement had been amended during the audit, that the principal place of business listed in the LLC Agreement for the duration of the audit period was in New York City, or that the Senior Managing Director performed work in New York on behalf of Offshore Manager.

174. Offshore Manager caused this letter to be submitted to DTF through the actions of its Controller and its CAO.

175. On July 17, 2008, the DTF auditor wrote to the Senior Managing Director's Tax Preparer again and noted that the investment management agreement and restated limited liability company agreements that were provided were not in effect during the 2004 through 2006 tax years. He wrote "[i]n order for us to determine the business purpose of the entities during the audit period, we are requesting a copy of the agreements that encompass the 2004-2006 years." The auditor also sought federal tax returns for that period.

176. Neither the Senior Managing Director nor Offshore Manger provided the earlier versions of the agreements to DTF.

177. On August 28, 2008, International Accounting Firm A sent a letter to the DTF Auditor on behalf of the Senior Managing Director and his wife that addressed a separate issue

of whether Offshore Manager was an investment partnership. In this letter, International Accounting Firm A again noted that "Offshore Manager conducts its business in Alabama and [the Senior Managing Director] is subject to Alabama tax on his share of income from Offshore Manager." International Accounting Firm A forwarded this letter to Offshore Manager's Controller and CAO, but Offshore Manager failed to correct the fact that the letter omitted the work the Senior Managing Director and his agents performed from an office in New York City.

178. In early 2009, DTF closed its audit without any modifications of the Senior Managing Director and his wife's tax returns.

179. Offshore Manager's efforts to conceal its New York business were successful. DTF did not open an audit concerning Offshore Manager's tax returns for the tax years before 2009.

180. Offshore Manager's officers caused false statements to be made to DTF that were material to the Senior Managing Director's resident credit and the tax he paid to New York State. Had Offshore Manager's statements been truthful, DTF likely would have rejected or reduced the resident credit he claimed, and he would have been required to pay additional tax to New York State.[16]

181. In addition, Offshore Manager's false statements were material to Offshore Manager's nonresidents' obligations to pay New York State income tax. Had truthful statements been made about Offshore Manager's presence in New York, DTF could have audited the partnership returns that Offshore Manager filed, including the tax return that Offshore Manager later filed for tax year 2008. In addition, had truthful information been provided, DTF could

[16] Had Offshore Manager's statements been truthful, DTF likely would have issued tax assessments to other New York residents who claimed similar resident credits for income from Offshore Manager.

have required Offshore Manager's nonresidents to pay income tax for tax years 2006 and 2007, when Offshore Manager concealed its New York presence by failing to file New York State partnership returns.

182. In sum, Offshore Manager knowingly made false statements and concealed its presence from the tax authorities for many years and thereby hid its "unsupportable" tax position.

FIRST CAUSE OF ACTION

AGAINST DEFENDANT OFFSHORE MANAGER

New York False Claims Act—State Fin. Law § 189(1)(g)

183. Plaintiffs repeat and re-allege the foregoing paragraphs as set forth herein.

184. Defendant Offshore Manager violated State Finance Law § 189(1)(g) in that it knowingly made, used, or caused to be made or used, false records or statements material to an obligation to pay or transmit money or property to the State.

185. The thresholds set forth in State Finance Law § 189(4)(i) and (ii) are satisfied because Defendant Offshore Manager had net income or sales in excess of $1 million for any taxable year subject to this action, and the damages pleaded exceed $350,000 in the aggregate.

SECOND CAUSE OF ACTION

AGAINST DEFENDANT OFFSHORE MANAGER

New York False Claims Act—State Fin. Law § 189(1)(d)

186. Plaintiffs repeat and re-allege the foregoing paragraphs as set forth herein.

187. Defendant Offshore Manager violated State Finance Law § 189(1)(d) in that it had possession, custody, or control of property or money used, or to be used, by the State and the City of New York and knowingly delivered, or caused to be delivered, less than all of that money or property.

188. For tax years 2004 to 2008, Offshore Manager received incentive fee income from the trading operations of the Harbinger Fund.

189. Before this income was distributed to Offshore Manager's members, Offshore Manager held this income.

190. Offshore Manager was responsible for withholding and paying estimated taxes on this income to New York State on behalf of its nonresident members.

191. DTF's instructions to the Form IT-204 for tax years 2004 through 2008 reminded partnerships of their obligation under State law to estimate and pay taxes.

192. Although it was required to do so, Offshore Manager failed to estimate and pay State income taxes for its nonresident members from 2005 through 2008.

193. In addition, Offshore Manager caused its nonresident members to fail to pay State income tax for tax years 2005 through 2008 by failing to apportion *any* income to New York and instead apportioning 100% to Alabama.

194. Offshore Manager was also required to pay New York City UBT on the incentive fee income it earned.

195. Offshore Manager knew that it owed UBT because of the advice it received from International Accounting Firm A in 2005.

196. In addition, the City's tax form instructions for tax years 2004 through 2007 make plain that Offshore Manager was required to pay UBT.

197. Offshore Manager failed to pay UBT to the City for tax years 2004 through 2007.

198. The State and the City would have used the revenue from income taxes and UBT owed on Offshore Manager's income for governmental purposes.

199. The thresholds set forth in State Finance Law § 189(4)(i) and (ii) are satisfied because Defendant Offshore Manager has net income or sales in excess of $1 million for any taxable year subject to this action, and the damages pleaded exceed $350,000 in the aggregate.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs demand and pray that judgment be entered against Defendant as follows:

a. Declaring, pursuant to CPLR § 3001, that Defendant Harbinger Capital Partners Offshore Manager LLC violated N.Y. State Finance Law §§ 187 *et seq.*;

b. Directing that Defendant Harbinger Capital Partners Offshore Manager LLC, pursuant to New York False Claims Act, State Finance Law §§ 187 *et seq.*, pay an amount equal to three times the amount of damages sustained as a result of Defendant's violations of the New York False Claims Act;

c. Directing that Defendant Harbinger Capital Partners Offshore Manager LLC, pursuant to State Finance Law §§ 187 *et seq.*, pay penalties of not less than $6,000 and not more than $12,000 for each violation of N.Y. State Finance Law § 189;

e. Directing that Defendant pay Plaintiffs' costs, including attorneys' fees as provided by law;

f. Directing such other equitable relief as may be necessary to redress Defendant's violations of New York law; and

g. Granting such other and further relief as the Court deems just and proper.

DEMAND FOR JURY TRIAL

Plaintiffs hereby demand a trial by jury of any issue of fact triable as of right by a jury.

Dated: New York, New York
September 26, 2018

Respectfully submitted,

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