SUPREME COURT OF NEW YORK

NEW YORK COUNTY

CIVIL BRANCH

STATE OF NEW YORK *EX REL* DAVID DANON, Bringing this action on behalf of the State of New York and all local governments within the State of New York, Plaintiffs. -against- VANGUARD GROUP, Inc., The Vanguard Group of Mutual Funds, Vanguard Marketing Corp., Defendants.	Index No: *SEALED* COMPLAINT **Filed under seal and *in camera* pursuant to N.Y. State Fin. L. § 190(2)(b).** **JURY TRIAL DEMANDED**

INTRODUCTION

1. Plaintiff-Relator David Danon ("Plaintiff or "Relator") brings this action against Defendants, The Vanguard Group, Inc. ("VGI"), subsidiaries of VGI (collectively with VGI, "Vanguard") and the Vanguard group of mutual funds (the "Funds", and, collectively with Vanguard, the "Vanguard Group") arising from Defendants' submission of false claims ("False Claims") under N.Y. State Fin. Law

§§ 187 – 194 (Hereinafter, the False Claims Act). Pursuant to N.Y. State Fin. Law § 190(2)(b) this action is brought *in camera* and filed under seal.

2. The Relator is an employee of VGI and the allegations of this Complaint arise from the Relator's first-hand, eyewitness knowledge of the Defendants' knowing violations of New York State and New York City (jointly, "New York") tax laws.

3. Vanguard has operated as an illegal tax shelter for nearly forty years, providing services to the Funds at prices designed to avoid federal and state income tax, sheltering hundreds of millions of dollars of income annually, avoiding approximately $1 billion of U.S. federal income tax and at least $20 million of New York tax over the last ten years.

4. In 2003, 2008, and 2001, Vanguard falsely stated in "Vendor Responsibility Questionnaires" submitted to the State of New York that it had filed all required New York returns and paid all required New York taxes.

5. In its submission to the State of New York for management of New York's Section 529 college savings plan (the "529 plan")—which Vanguard has managed since 2004—Vanguard represented that it had filed all required New York returns and paid all required New York taxes.

6. Since at least 2004, Vanguard has had extensive and significant business contacts and activity with and in New York. Such activity includes, but is not limited to, significant employee activity in New York, extensive advertising targeting New York investors, management of tens of billions of assets under management ("AUM") belonging to New York residents and domiciliary entities.

7. Despite clearly meeting the "doing business/nexus" standard requiring the filing of New York income tax returns, Vanguard failed to file such returns for the period preceding 2011 (the "Failure to File Years").

8. It is a condition of New York's 529 Plan management contract that the manager engage in extensive advertising targeting New York investors and provide four field agents dedicated to on-the-ground marketing.

9. Vanguard's bid for, and acceptance of, the 529 Plan management contract was a representation and acceptance that it would conduct acts creating a New York income tax nexus—a representation that directly contradicts its representation that it filed all required New York tax returns and paid all taxes due to New York.

10. In 2011 and 2012—when it filed New York returns and paid New York taxes—Vanguard filed false returns, ignoring New York's "shareholder based apportionment" rule and reported distorted and/or artificial income.

11. Section 482 ("Section 482") of the Internal Revenue Code (the "Code"), Section 211(5) ("Section 211(5)) of New York Tax Law (the "Tax Law")—as well as the laws of dozens of other jurisdictions—require that transactions between commonly controlled parties occur at market, "arms length" prices, and not bargain prices, or at prices otherwise designed to avoid federal or state income tax.

12. Vanguard and the Funds are commonly controlled. Vanguard violates Section 211(5) and Section 482 by providing services to the Funds at artificially low, "at-cost" prices. As a result, Vanguard shows little or no profit and pays little or no

federal or state income tax despite managing Funds with nearly $2 trillion in assets.

13. Vanguard knowingly and fraudulently failed to report and pay tax on its $1.5 billion "Contingency Reserve," avoiding approximately $500 million of U.S. federal income tax and $10 million of New York tax, even though the Contingency Reserve (1) is under VGI control and used for general Vanguard purposes, (2) has been funded by Fund service fee payments that reduce Fund net asset value ("NAV"), and which therefore reduce the value of a shareholder's investment in a Fund, and (3) Vanguard represents the Contingency Reserve as a VGI asset to third parties and regulators.

JURISDICTION AND VENUE

14. This Court has jurisdiction over this action pursuant to the False Claims Act.

15. This Court has jurisdiction over this action pursuant to New York Civil Practice Law and Rules ("CPLR") §§ 301, 302.

16. This Court further has jurisdiction over this action because the claims and violations in this action arose under the laws of New York.

17. Venue is proper because acts and omissions giving rise to this action occurred in New York.

18. Venue is further proper because at least one of the Defendants has and/or continues to regularly conduct business in New York.

19. The damages claimed in this action exceed $350,000.

THE PARTIES

20. Plaintiff-Relator Danon is a citizen of the United States of America and a resident of the Commonwealth of Pennsylvania. He brings this Qui Tam action based on direct information obtained through his employment at VGI, as well as his knowledge of federal and New York tax law.

21. Defendant VGI is a Delaware corporation with its principal place of business at 100 Vanguard Blvd., Malvern, PA 19355, as well as offices in North Carolina and Arizona. VGI's primary business is providing investment management and administrative services to certain U.S. funds (the Funds) that are treated as regulated investment companies ("RICs" or "mutual funds") under the Code.

22. Vanguard provides brokerage services to Fund investors through Vanguard Marketing Corporation ("VMC"), a wholly owned subsidiary of VGI, a variety of other investment-related services through VGI or its subsidiaries (e.g., retirement account record keeping, trustee services) and related or similar services in multiple non-U.S. jurisdictions through an extensive network of directly- or indirectly-owned subsidiaries of VGI.

23. Vanguard has approximately $2 trillion AUM, the vast majority of which are accounted for by the Funds. New York residents own shares with a value of between five and ten percent of the Funds' AUM. Consequently, New York residents own Fund shares with an approximate value of between $100 billion and $200 billion.

RELEVANT LAWS

Section 482, Section 211(5) and "Arms Length" Transactions

24. It is "black letter" law under virtually every income-taxing authority in the United States that transactions between a corporation and its shareholders—or persons otherwise under common control—must occur at "arms length" or market prices, and not at "bargain" prices, or prices that may otherwise avoid federal or state tax. This rule is embodied in Section 211(5), Section 482, and the laws of forty-five other states.

25. The arms-length transaction principle is a bedrock tax principle that permeates the legal framework of virtually every tax assessed based on value. Thus, among numerous examples:

i. Wealthy individuals may not sell their property to their heirs at bargain prices to avoid U.S. estate tax;

ii. Used car sales may not be reported at bargain prices to avoid state sales tax; and

iii. U.S. corporations may not sell products or services at bargain prices to foreign affiliates—or to their U.S. shareholders—to avoid federal or state corporate income tax.

26. Under Section 211(5), "if a taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received [New York may

tax] the taxpayer [on the income] which, but for such agreement, arrangement or understanding, the taxpayer might have derived from such transaction."

27. Under Section 482, the Internal Revenue Service ("IRS") may adjust income, deductions, or other items among businesses owned or controlled by the same interests in order to properly reflect income or prevent evasion of taxes.

28. New York courts have held that:

i. Section 482 and Section 211(5) share a common purpose; (*Matter of USV Pharm. Corp.*, Tax Appeals Tribunal, July 16, 1992);

ii. Section 482 adjustments required by the IRS are relevant in determining proper adjustments under section 211(5); *Id.* and

iii. New York should not accept transfer pricing reported on a taxpayer's federal income tax return merely because the IRS has audited the taxpayer. A taxpayer's transfer pricing of its related party/controlled transactions should be accorded deference only if there is evidence the IRS has specifically audited the controlled transactions at issue. *In the Matter of Medtronic, Inc.* New York Tax Appeals Tribunal, September 23, 1993.

29. "The purpose of IRC section 482 is to ensure taxpayers clearly reflect income attributable to controlled transactions and to prevent avoidance of taxes regarding such transactions. IRC section 482 places a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining true taxable income." Section 4.11.5.2 (11-01-2004) of the Internal Revenue Manual.

30. Under Treas. Reg. 1.482-1(i), “Controlled includes any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. It is the reality of the control that is decisive, not its form or the mode of its exercise.”

31. Under Section 482, non-arms-length prices create presumption of control. Treas. Reg. 1.482-1(i) states: "[a] presumption of control arises if income or deductions have been arbitrarily shifted.”

32. By definition, non-arms length (i.e., non-market) prices result in a shifting in income and deductions because they are not prices that would have been charged between taxpayers not under common control.

33. Section 482 has been applied to every possible type of U.S. or foreign taxpayer—individuals, corporations, partnerships, foreign entities and tax exempt entities.

34. Similarly, New York has applied Section 211(5) to any taxpayer entity to which it has been relevant.

35. There is no exception from Section 482 or Section 211(5) for any type of taxpayer or entity, including RICs or RIC service providers.

Constructive Receipt of Income

36. It is a fundamental principle of federal income tax law that “a taxpayer may not deliberately turn his back upon income in order and thus select the year for

which he will report it." *Hamilton Nat'l Bank v. CIR*, 29 BTA 63, 67 (1933). That is, income is "received" when "it is actually or constructively received" or "is due and payable to the taxpayer." Rev. Proc. 2004-34, 2004-22 IRB 991, § 4.04.

New York Combined Returns Law

37. Under Tax Law Section 211(4), related corporations are required to file combined New York tax returns if (1) the corporations have engaged in substantial intercorporate transactions, or (2) the corporations are engaged in a related business and filing separate returns would distort the corporations' activities, businesses, income or capital in New York.

38. Substantial intercorporate transactions exist if:

a. based on all activities and transactions of related corporations, including, performance of services for related corporations, sales of goods acquired from related corporations, performing related customer services using common facilities and employees and incurring expenses that benefit related corporations;

b. (i) 50 percent or more of a corporation's receipts included in entire net income (excluding nonrecurring receipts) are from a related corporation or related corporations; (ii) 50 percent or more of a corporation's expenditures included in computing entire net income, including inventory but not nonrecurring expenditures, are to a related corporation or related corporations; or (iii) (a) 50 percent of more of a corporation's expenditures

included in computing entire net income (excluding nonrecurring expenditures) directly or indirectly benefit a related corporation or related corporations, or (b) a corporation's expenditures included in computing entire net income (excluding nonrecurring expenditures) directly or indirectly benefiting a related corporation or related corporations are equal to 50 percent or more of the sum of such expenditures and the expenditures (excluding nonrecurring expenditures) of the beneficiary corporation or corporations.

New York Income Apportionment Law

39. Under Section 210(3)(a)(10))(ii) business income is allocated to New York based on the percentage of in-state sales.

40. Section 210(3)(a)(6) provides a "shareholder based apportionment" rule (an "SBA", and Section 210(3)(a)(6), in particular, the "NY SBA") for apportioning income received for providing management, administration, or distribution services to a RIC.

41. Under the NY SBA, a RIC service provider must apportion income from services to RICs to New York based on the percentage of the RICs' AUM owned by New York domiciliaries.

42. Thus, a service provider to RICs with an aggregate $1 billion NAV whose New York domiciliary shareholders own shares with an NAV of $100 million must allocate 10% of its service fee income to New York.

New York False Claims Act

43. New York False Claims Act § 189(1)(a) applies to any person who knowingly presents, or causes to be presented a false or fraudulent claim for payment or approval.

44. New York False Claims Act § 189(1)(b) applies to any person who knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.

45. New York False Claims Act§ 189(1)(d) has possession, custody or control of property or money used, or to be used, by the state or a local government and knowingly delivers, or causes to be delivered, less than all of that money or property.

46. New York False Claims Act §189(1)(g) knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the state or a local government.

VANGUARD'S TAX VIOLATIONS

Vanguard's Structure

47. Vanguard's formative documents established illegal tax avoidance and Vanguard has operated as an illegal tax shelter for nearly forty years.

48. VGI is a corporation—as are nearly all of its subsidiaries.

49. The Funds are RICs for U.S. federal income tax purposes.

50. VGI is wholly-owned by the Funds, generally in proportion to a Fund's NAV.

51. Vanguard's structure was established by the original eleven (11) Funds (the "Original Funds") in 1974 based on three conceptual pillars; mutual ownership (RIC ownership of a RIC's manager), index investing, and low cost.

52. The mutual ownership structure reflected a belief that a RIC's manager would only serve the RIC's interests if it was owned by the RIC, and that otherwise the manager would further the interests of its own shareholders.

53. The mutual ownership structure required approval of the U.S. Securities and Exchange Commission (the "SEC")—through an exemptive order—because transactions between the Funds and the Vanguard Group would be transactions between affiliated parties.

54. Based on the belief that passive or index investing outperforms active management and, therefore, that RIC returns are maximized through cost minimization, the Original Funds sought approval for the lowest cost structure possible.

55. Federal and state income taxes are a cost borne by every business with positive income. Thus, the lowest cost possible for VGI services would be "at-cost" services—services provided at prices generating no income, and therefore no tax liability.

56. As a result, the Original Funds requested an exemptive order based on an "at-cost" service structure. The SEC granted the order (the "Exemptive Order")

based on its view that the proposed terms were “reasonable” and that “no funds would be disadvantaged.”

57. Thus, to this day, year after year, the Vanguard Group (1) charges the Funds only the "costs" of providing its services, which include property, employee, and other expenses, but do not include profit or a return on capital, and (2) on its federal and state income tax returns shows aggregate gross revenue received from the Funds equal or close to its costs and little or no net income, despite the fact that the Funds constitute the largest group of mutual funds in the United States, and that VGI has approximately $2 trillion under management.

58. The SEC in no way conditioned the Exemptive Order on “at-cost” services. Through VGI proposed an “at-cost” structure, the order’s rationales of “reasonable terms” and not disadvantaging individual funds are fully consistent with the “arms length” prices required under Section 211(5) and Section 482.

59. Because VGI profits will always benefit the Funds under a mutual structure, the sole purpose of an “at-cost” pricing scheme is income tax avoidance. If VGI were to charge $1 over its “at-cost” price, it would pay net federal/state income tax of approximately $0.40. The $0.60 remaining after tax would benefit the Funds through their ownership of VGI. Thus, “at-cost” plus an arms length markup would not transfer value to an unrelated third party (other than taxing authorities). It would merely add tax cost—a cost every other business in the United States has to pay—to VGI’s costs.

60. The VGI board of directors (the "Board") and the Trustees of the Funds (the "Trustees") are entirely overlapping—all members of the Board are Trustees and all Trustees are members of the Board.

61. Vanguard and the Funds are explicitly managed jointly in order that "[all benefits accrue to the Funds]" because—as Vanguard advertises—its "interests are 100% aligned with clients " and its "unique client-ownership structure" avoids "competing loyalties."

62. In other words, VGI advertises that Vanguard prices are not arms length or market prices due to the common control of Vanguard and the Funds.

63. Vanguard adopts a diametrically opposite pricing approach with respect to its foreign affiliates, treating VGI as the sole "entrepreneurial", risk-taking and intellectual-property-owning member of the Vanguard Group, treating its "distinct approach to manufacturing index products" as the primary engine for Vanguard Group potential world wide, and treating all other Group members as "limited risk" members, entitled to a 7.5% cost-plus return.

64. In the non-U.S. context, Vanguard views "at-cost" as the amount necessary to satisfy non-U.S. arms length tax requirements, while it claims without basis that it is bound to at-cost—without tax—in the U.S. under the SEC order permitting Vanguard to operate under the terms of its own making.

65. Thus, Vanguard is the largest mutual fund service provider in the United States that through a multinational corporate group (1) seeks profit in every jurisdiction in the world other than the United States, and (2) through illegal price

manipulation with controlled parties seeks zero profits in the United States and the ability to shelter its worldwide income, in violation of dozens of U.S. laws.

66. Vanguard's foundational document (the contract between VGI and the Funds—the "Funds Service Agreement" (the "FSA")) demonstrates an astonishing instance of Vanguard's continued belief that it is simply not required to pay U.S. federal or state income taxes. In 1999—when Vanguard expanded its operation to non-Fund operations—the FSA was revised to provide that income earned by Vanguard from non-fund businesses ("Non-Fund Income") will be used to reduce expenses of the Funds.

67. That is, Vanguard shelters Non-Fund Income by charging less than cost to the Funds to create losses that offset that income, and believes that it could shelter Non-Fund Income equal to its entire $2 billion costs of providing services to the Funds.

68. Vanguard has never sought a ruling or approval from any U.S. tax authority—and no U.S. tax authority has become aware of, nor has approved—Vanguard's at-cost pricing scheme.

69. Vanguard's at-cost pricing scheme violates Section 211(5), Section 482 and the laws of dozens of other states that require taxpayers to charge "arms length" prices for transactions with commonly controlled parties and illegally avoids federal and state income taxes by (1) avoiding corporate level tax on Vanguard profit, (2) exploiting differences in tax rates applicable to corporations, individuals and investment returns taxed at preferential rates (e.g., qualified dividend income and

long term capital gain), and by (3) exploiting tax deferral on income realized through tax-deferred plans (i.e., retirement plans).

70. Vanguard's at-cost structure was established under the FSA, under which the Funds "establish[ed] a company to provide [services] at-cost to be wholly-owned by the Funds." Thus Vanguard is operating under precisely the type of agreement targeted by Section 211(5). Vanguard is a "taxpayer [that] conducts its activity or business under an[] agreement, arrangement or understanding [ ] to benefit its members or stockholders, [ ] by entering into [ ] transactions at [ ] less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received."

71. Arms length prices reflect opposing interests—the reverse of the alignment of interests intended by Vanguard's mutual ownership structure. They are the prices that would be charged by unrelated parties bargaining at arms length. See Treas. Reg. 1.482-1(b).

72. Thus, the goal of Vanguard's mutual structure—bargain, "at-cost" parent-subsidiary pricing—violates the bedrock principle of income tax law that pricing between separately taxed entities must occur at market prices.

73. VGI's assets under management ("AUM") have grown at a rate nearly twice the average rate in the mutual fund industry, and VGI is presently the largest mutual fund manager in the United States.

74. VGI has charged the Funds an average expense ratio well below the average expense ratio charged by competitor fund managers.

75. Vanguard's growth has occurred largely because of its low cost leadership role, which has translated to superior returns for many of its funds.

76. Vanguard's costs are, however, generally quite consistent with its competitors' costs, with the notable exception of Vanguard's tax costs. Vanguard's personnel costs—its largest single cost component—are, for example, consistent with those of other fund managers.

77. VGI has been the leader in low-cost mutual funds because (1) under its mutual structure it has been able to avoid providing market rate investment returns to third party shareholders (market pressures would have required arms length prices and profits in order to provide market investment returns to third party shareholders), and (2) it has flouted tax law rules requiring arms length prices between commonly controlled parties.

78. However, the above market rate investment returns would require precisely the arms length prices that are required under Section 482 and Section 211(5) (and the laws of most other states). Thus, Vanguard owes its low cost leader status largely to its violation of federal and state income tax laws.

79. No tax authority has ever examined Vanguard's mutual structure or its at-cost pricing.

80. Upon information and belief, the IRS has likely failed to indentify Vanguard's Section 482 violations because (1) Section 482 income shifting/tax avoidance transactions are more obvious and easier to detect in the cross-border context, and

(2) shareholders are generally the "controlling" parties in shareholder/corporation controlled transactions, rather than the corporation, as in Vanguard's case.

81. Vanguard's tax avoidance scheme is facilitated by the fact that its common control occurs between one hundred fifty publicly owned RICs and their management company. Absent reasonably identifiable indicia of common control (e.g., 50% ownership by a single party) the IRS would not generally discover Section 482 violations.

82. Vanguard's tax avoidance scheme is also facilitated by the fact that Vanguard often describes at-cost as "required" under the Exemptive Order, falsely implying that the SEC established an at-cost requirement.

83. Even if the SEC had imposed at-cost as a condition of the Exemptive Order, that would not permit Vanguard to operate free of tax liability. An SEC order does not trump tax law.

84. Upon information and belief, New York (as well as other states) has been unable to discover Vanguard's violations of their true income or controlled-party-transaction statutes because Vanguard knowingly failed to file required tax returns in New York (and other states) for decades and because, even when Vanguard has filed returns, it has done so on a false and fraudulent basis. See "Vanguard's New York Business," below.

85. Vanguard has begun filing returns in a number of states in the last year. See "Vanguard's New York Business," below. Upon information and belief, some states

(particularly states whose SBAs would allocate significant income to that state) may identify Vanguard's controlled transactions despite Vanguard's fraudulent returns.

86. Pennsylvania, the state where Vanguard is headquartered is, perhaps not coincidentally, one of only four states that lack Section 482-like statutes.

Vanguard's New York Conduct

87. VGI has approximately $2 trillion AUM, the vast majority of which is accounted for by the Funds. New York residents own shares with a value of between approximately five to ten percent of the Funds' AUM.

88. VGI provides brokerage services to investors in the Funds through its wholly-owned subsidiary, Vanguard Marketing Corporation ("VMC"). VMC has provided fee based brokerage services to New York residents since at least 2004, earning several million dollars of fees annually.

89. Retirement plans have accounted for a large portion of Vanguard's business and AUM since at least 2004. A large percentage of the Funds are held through retirement plans, and Vanguard provides administrative services (e.g., record-keeping) to these plans (Vanguard's retirement plan business, the "Institutional Business") directly and through other members of the Vanguard Group.

90. Vanguard employees have traveled extensively to New York and other states to meet with retirement plan clients and sponsors since at least 2004.

91. In the last several years, Vanguard's Fund business has become increasingly focused on exchange-traded funds ("ETFs"). A significant portion of the Fund ETF business is provided through financial advisors.

92. Vanguard employees have traveled extensively to New York and other states in the last several years to meet with financial advisors in support of Vanguard's ETF business.

93. Vanguard has been an investment manager and administrator for New York's 529 Plan since at least 2004.

94. Thus, for the last ten years, Vanguard has derived revenue directly from a New York-sponsored plan that provides New York tax benefits to New York residents.

95. Beginning in 2010, Vanguard changed its business model for servicing non-Pennsylvania clients because it concluded that Pennsylvania-based employees could not establish the extensive financial advisor contacts, which it believes are necessary for its ETF business as effectively as sales or marketing employees residing and working full-time in local markets.

96. As a result, Vanguard stationed sales/marketing employees ("FAS Employees") on a full-time basis in a number of states, including New York.

97. Because FAS Employees will reside outside Pennsylvania, have home offices in those states, be subject to state payroll tax withholding, and will file state income tax returns, Vanguard determined to file income tax returns in states in which it previously did not file tax returns.

98. In addition to its failure to file income tax returns and pay income tax, Vanguard failed to meet its payroll withholding obligations in New York and numerous other states since at least 2004.

99. Under the New York SBA, Vanguard management and service fee income is allocated to New York based on the percentage of Vanguard's AUM owned by New York residents. New York residents own Fund shares with a value of between five percent and ten percent of Vanguard's total AUM.

100. Vanguard knowingly disregarded the SBA in filing its 2011 New York Tax Return and in filing its estimated payments to New York for the 2012 and 2013 years (the "2012 Estimated Payments" and the "2013 Estimated Payments", respectively) and will disregard the SBA on its 2012 Tax Return.

101. Through pricing manipulation in violation of Section 211(5) and Section 482—achieved through common control of Vanguard and the Funds—Vanguard reported little or no profit on its 2011 and 2012 U.S. federal income tax return and its 2011 New York Tax Return, made the 2012 Estimated Payments and 2013 Estimated Payments based on realizing little or no profit, and will report little or no profit on its 2012 New York Tax Return.

102. As described above, Vanguard openly acknowledges common control, stating that its "at-cost" pricing is based on mutuality of interest between Vanguard and Fund shareholders, because the Funds own Vanguard. See "Vanguard Structure," above. Yet, under Vanguard's mutual structure, the only purpose of "at-cost" prices is to avoid federal and state income taxes.

103. Vanguard's domestic transfer pricing is diametrically opposed to its foreign affiliates transfer pricing method, in which it treats itself as the sole "entrepreneurial" intellectual property owning member, entitled to all profits in excess of a modest guaranteed return to its affiliates, as the return for its "[distinctive method of manufacturing index products]" and under which the foreign affiliates receive amounts necessary to satisfy local foreign-tax requirements for arms length returns.

104. Vanguard has had a tax nexus with New York, and has been subject to New York's unitary filing requirements for at least the last ten years because during this period:

a. Vanguard AUM owned by New York domiciliaries was at all times in the tens of billions of dollars—and is currently at least $100 billion;

b. Vanguard employees have traveled to New York extensively for client meetings each year;

c. Vanguard has derived direct benefit and revenue from New York's government through asset management and administration of New York's 529 Plan since at least 2003;

d. Vanguard had staff in New York to administer the 529 program—as is required under the terms and conditions of its agreement with New York;

e. Vanguard received millions of dollars of brokerage fees from New York residents each year; and

f. As a requirement for being named the administrator of the New York 529 Plan, Vanguard had to fill out Vendor Questionnaires. Question 8.4 on these questionnaires, asked whether Vanguard had been compliant with state tax laws. Vanguard falsely stated that it had complied with New York State tax laws—disregarding that it had failed to file the required state tax returns for the State of New York.

105. The 2011 New York Tax Return and the 2012 New York Tax Return were deceptive and misleading with respect to Vanguard's New York business activities, making the New York Department of Revenue (the "Department of Revenue") less likely to inquire regarding prior tax years, and, therefore, constitute a False Claim for the Failure to File Years.

106. Vanguard misrepresented its New York business activities to the Department of Revenue multiple times during the Failure to File Years.

107. Vanguard knowingly created false backup documentation underlying Vanguard's federal income tax return for the Failure to File Years. Because Vanguard reports New York income and pays New York tax based on income reported on its federal income tax return, these false documents were False Claims were respect to New York returns it failed to file in the Failure to File Years.

108. Vanguard has consistently refused to maintain comprehensive employee travel records to support its tax obligations in New York (and other states). A willful failure to maintain comprehensive records willfully caused the resulting available records to be false records and were, therefore, False Claims.

109. Because Vanguard failed to file New York tax returns for all years prior to 2011, Vanguard is liable for all unpaid tax, penalties and interest for these years, and because Vanguard prepared False Documents in connections with these failures, the False Claims Act applies with respect to these years.

110. Vanguard's false submission of documents to New York, its false and misleading tax returns, and other false and misleading conduct with respect to New York, disguised the extent of its New York tax liability, and was calculated to mislead New York tax authorities as to such tax liability.

111. During the years when Vanguard failed to file New York returns—or filed misleading returns—Vanguard was in possession of money to be used by New York (i.e., taxes paid and owing), and through the above-described conduct caused or failed to deliver such money to New York.

Vanguard's Fraudulent Treatment of its Contingency Reserve

112. In addition to, but separate from the above, Vanguard has fraudulently failed to report on its federal income tax return the $1.5 billion "Contingency Reserve" described below. New York's allocable portion of this income should result in between approximately $7 million to $14 million in additional tax liability.

113. The Contingency Reserve was established as a VGI-level reserve to cover unanticipated losses incurred by the Funds or by Vanguard, and is funded by "Contingency Reserve Fees," which are due as part of the management fee when the management fee is due.

114. Contingency Reserve Fees meet the "all events test" for deductibility by the Funds—the same test that requires Vanguard to include the Contingency Reserve Fees in its income.

115. Contingency Reserve Fees are deducted from the net asset value of the Funds—reducing the value of distributions received by shareholders, as well as the value of their Fund shares upon redemption.

116. Vanguard has unfettered rights with respect to the Contingency Reserve. The Vanguard Board of Directors has the authority to make disbursements that further VGI's business as ["a full service investment management company"] and Vanguard uses the Contingency Reserve to fund the losses of Vanguard or its subsidiaries and other operations.

117. The Contingency Reserve is included as an asset on Vanguard's balance sheets provided to lenders as a $1.5 billion long-term receivable—an amount approximately equal in value to the combined value of all Vanguard's other assets. Such a representation is fraudulent if the reserve does not represent a VGI asset and is described to regulators as a Vanguard asset offered as evidence of Vanguard's financial strength.

118. At $1.5 billion, the Contingency Reserve is 1,000 times the size of all payments made for its claimed purpose over the nearly 15 years since it was established. It bears no remote resemblance to a reserve for contingent liabilities (which would still be taxable to Vanguard).

119. Although Contingency Reserve Fees are deductible by the Funds and reduce the value of investors' interests in the Funds, Vanguard has not included them in income because it defers their receipt or transfers them back to the Funds (a loan subject to Section 7872, as discussed below) until Vanguard makes an actual disbursement.

120. In other words, Vanguard defers reporting and paying tax on the Contingency Reserve Fees because it chooses to defer receipt or invests them in the commonly controlled Funds, in violation of the fundamental income tax principle that income is taxable when "it is actually or constructively received" or "is due and payable."

121. Thus, Vanguard's failure to include Contingency Reserve Fees in its income is another clear violation of a basic federal income tax rule.

122. Contingency Reserve Fees created an excess of current receipts over current expenses, thereby generating current Vanguard income.

123. The Contingency Reserve is a fraudulent Vanguard effort to retain an excess of revenues over costs and still maintain that it is providing at-cost services.

124. Vanguard exercises the same control over the Contingency Reserve that any other corporation would exercise over its retained earnings, and yet has failed to pay tax on the Contingency Reserve.

125. Thus, Vanguard has fraudulently failed to pay tax on $1.5 billion of "long term receivables" from the commonly controlled Funds that it represents to lenders are assets comprising one-half of its total assets.

126. In 2003, when the Contingency Reserve was $283 million—much smaller than its present $1.5 billion balance—Vanguard disclosed the Contingency Reserve on "IRS Form 8886 Reportable Transaction Statement."

127. Vanguard no longer files the Form 8886 and does not include the Contingency Reserve on the "IRS Uncertain Tax Positions Schedule (the "Schedule UTP").

128. Vanguard's failure to include the Contingency Reserve on the Schedule UTP constitutes a fraudulent effort to conceal the nature of Contingency Reserve Fees from the IRS and state taxing authorities.

129. Vanguard loans the Contingency Reserve to the Funds in amounts equal to the expense ratio charge for Contingency Reserve Fees.

130. Section 7872 of the Code requires payment/accrual of interest on loans between a corporation and shareholders at the applicable federal rate.

131. Vanguard knowingly failed to report approximately $10 million of interest required under Section 7872 with respect to the Contingency Reserve in its federal income tax returns for each of the 2011 and 2012 tax years and approximately $200 million for the years 2004 through 2010.

132. In keeping with its practice of non-compliance, Vanguard's 2010 and 2011 U.S. federal income tax returns also fraudulently omit several million dollars of "Subpart F income" earned by several wholly-owned "controlled foreign corporations" ("CFCs"), and fraudulently failed to perform the required reporting for these CFCs.

133. As a result of pricing manipulation, disregard of the New York SBA, and failure to report Section 7872 interest, Vanguard under-paid approximately $6 million of New York tax for the 2011 and 2012 years and failed to pay at least $20 million of New York tax for the 2004 through 2010 years.

* * *

134. Based on the provisions of the New York False Claims Act, Plaintiff-Relator seeks through this action to recover, on behalf of the State of New York, damages and penalties arising from Defendants' making and causing to be made false or fraudulent records, statement and/or claims in connection with its knowing violations of New York Tax Laws.

CLAIMS

135. Vanguard's representations of benefits arising from its illegal structure in its securities offerings to New York residents and its misrepresentations of the SEC Exemptive Order permitting its mutual structure are false documents that constitute False Claims.

136. Vanguard committed Class B felonies under Tax Law Sections 1801 and 1806 by knowingly filing false tax returns and failing to pay New York tax for the 2011 and 2012 years (Vanguard's 2011 and 2012 New York tax returns (the "2011 New York Tax Return" and the "2012 New York Tax Return) by (1) manipulating prices charged to the Funds to lower, and nearly eliminate, all Vanguard income and avoid New York income tax, in violation of Section 211(5) and (2) failing to allocate

Vanguard's management and service fee income to New York under § 210(3)(a)(6) of the Tax Law ("Section 210(3)(a)(6)").

137. Vanguard committed a Class E felony under Section 1809(a) of the Tax Law by knowingly failing to file New York tax returns and failing to pay New York tax for at least the seven year period from 2004 through 2010 (the Failure to File Years), supporting these failures with false representations to New York and false documentation that constitute False Claims under the False Claims Act related to (1) pricing manipulation to charge at-cost prices to the Funds to lower, and nearly eliminate, all Vanguard income, (2) Vanguard's management and service fee income allocate to New York under §210(3)(a)(6) of the Tax Law ("Section 210(3)(a)(6)"), (3) failure to report and pay tax on New York's allocable portion of the $1.5 billion Contingency Reserve, and by (4) failing to report and pay tax on New York's allocable portion of approximately $200 million of interest income owing under Section 7872 of the Code with respect to the Contingency Reserve.

Count I – Failure to Pay Tax

138. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

139. Defendants knowingly made, used or caused to be used, false records or statements to conceal, avoid, evade, or decrease their obligation to pay taxes, transmit money or property to state and local governments in violation of the state False Claims Act. New York False Claims Act § 189(4)(a).

140. The net income or sales of Defendants exceeds $1 million for any tax year subject to this action.

141. The damages claimed in this action exceed $350,000.

142. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

143. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

144. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

145. All false or fraudulent statements and false records or false statements were material to the underlying violations.

146. All Defendants are jointly and severally liable for all damages under this count.

Count II – Presenting a False Claim

147. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

148. Defendants violated the False Claims Act by failing to pay required taxes to New York and local governments.

149. Defendants, in failing to pay such tax, knowingly presented or caused to be presented false or fraudulent claims for payment or approval. New York False Claims Act § 189(l)(a).

150. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

151. Defendant falsely stated in paragraph 8.4 of its Vendor Responsibility Questionnaire submitted to the State of New York for the 529 Program that they had filed returns in compliance with state law. New York False Claims Act §189(1)(b).

152. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

153. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

154. All false or fraudulent statements and false records or false statements were material to the underlying violations.

155. All Defendants are jointly and severally liable for all damages under this count.

Count III – False Records or Statements

156. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

157. Defendants violated the False Claims Act by failing to pay required taxes to New York and local governments.

158. Defendants, in failing to pay such tax, knowingly made, used, or caused to be used false records or statements material to a false or fraudulent claim under the tax law. New York False Claims Act § 189(l)(b).

159. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

160. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

161. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

162. All false or fraudulent statements and false records or false statements were material to the underlying violations.

163. All Defendants are jointly and severally liable for all damages under this count.

Count IV – False Records or Statements

164. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

165. Defendants violated the False Claims Act by failing to pay required taxes to New York and local governments.

166. Defendants, in failing to pay such tax, knowingly made, used, or caused to be used false records or statements material to an obligation to pay or transmit money

to the government of New York and to local governments. New York False Claims Act § 189(1)(g).

167. Defendant violated the False Claims Act by falsely certifying that it was in compliance with its state tax obligations. New York False Claims Act §189(1)(b).

168. Defendants shall be liable to the state or a local government, as applicable for a civil penalty of not less than six thousand dollars and not more than twelve thousand dollars, plus three times the amount of all damages New York False Claims Act § 189(1)(g).

169. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

170. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

171. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

172. All false or fraudulent statements and false records or false statements were material to the underlying violations.

173. All Defendants are jointly and severally liable for all damages under this count.

Count V – Conspiracy

174. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

175. Defendants failed to pay required taxes to New York and local governments.

176. Defendants knowingly presented or caused to be presented a false or fraudulent claim for payment or approval.

177. Defendants knowingly made, used, or caused to be made or used a false record or statement material to a false or fraudulent claim New York False Claims Act.

178. Defendants knowingly made, used, or caused to be used false records or statements material to an obligation to pay or transmit money to the government of New York and to local governments.

179. Defendants conspired to commit these violations by knowingly presenting a false or fraudulent claim for approval, by knowingly using or causing to be used false records or statements material to a false or fraudulent claim, and by knowingly using or causing to be used false records or statements material to an obligation to pay taxes to the state or a local government in violation of New York False Claims Act § 189(1)(c).

180. Defendants' failure to pay taxes to the State constitutes violations of the False Claims Act as part of a conspiracy to defraud the State. New York False Claims Act § 189(1)(c).

181. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

182. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

183. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

184. All false or fraudulent statements and false records or false statements were material to the underlying violations.

185. All Defendants are jointly and severally liable for all damages under this count.

Count VI – Failure to Disclose

186. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

187. Defendants violated the False Claims Act by having possession, custody or control of property or money used or to be used by the state or a local government and, intending to defraud the state or a local government, making or delivering the receipt without completely knowing that the information therein is true. New York False Claims Act § 189(1)(d).

188. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

189. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

190. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

191. All false or fraudulent statements and false records or false statements were material to the underlying violations.

192. All Defendants are jointly and severally liable for all damages under this count.

Count VII – False or Fraudulent Tax Refunds

193. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

194. Defendants violated the False Claims Act when they made false statements when they applied for tax refunds from the State of New York and local governments.

195. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

196. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

197. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

198. All false or fraudulent statements and false records or false statements were material to the underlying violations.

199. All Defendants are jointly and severally liable for all damages under this count.

Count VII – Retaliation

200. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

201. As a result of Plaintiff-Relator Danon's lawful acts in furtherance of this action, and of Plaintiff-Relator Danon's efforts to stop, correct, or otherwise remedy the violations described in this Complaint, Defendants have demoted Plaintiff-Relator Danon.

202. As a result of Plaintiff-Relator Danon's lawful acts in furtherance of this action, and of Plaintiff-Relator Danon's efforts to stop, correct, or otherwise remedy the violations described in this Complaint, Defendants have discharged Plaintiff-Relator Danon.

203. As a result of Plaintiff-Relator Danon's lawful acts in furtherance of this action, and of Plaintiff-Relator Danon's efforts to stop, correct, or otherwise remedy the violations described in this Complaint, Defendants have harmed Plaintiff-Relator Danon's career and ability to obtain employment.

Count XI – All Other Violations

204. Plaintiff-Relator Danon incorporates and restates by reference the above paragraphs and all allegations contained therein.

205. Plaintiff-Relator Danon alleges any and all other violations under the New York False Claims Act.

206. Defendants had actual knowledge of each and every false or fraudulent claim submitted and each and every false record or false statement submitted.

207. In the alternative, Defendants acted in deliberate ignorance of the truth or falsity of the information or claims submitted.

208. In the alternative, Defendants acted in reckless disregard of the truth or falsity of the information or claims submitted.

209. All false or fraudulent statements and false records or false statements were material to the underlying violations.

210. All Defendants are jointly and severally liable for all damages under this count.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff-Relator Danon, on behalf of himself and the state, prays:

(a) That this Court enter a judgment against all Defendants in an amount equal to three times the amount of damages the state has sustained, plus a civil penalty of $6,000 to $ 12,000 for each action in violation of the False Claims Act, and the costs of this action, with interest, including the cost to the state for its expenses related to this action;

(b) That because all Defendants are responsible for submitting false claims, using false records or statements to get such claims paid, failing to disclose the falsity of their claims, conspiring to submit false claims, and using false records or statements to hide the fact that replacements and/or refunds were due, all

Defendants are jointly and severally liable for the full amount of damages and penalties awarded in this case;

(c) That Plaintiff-Relator Danon be awarded all costs incurred in bringing this action, including attorney's fees;

(d) That state and local governments be awarded all costs and attorneys fees;

(e) That state and local government be awarded all consequential damages;

(f) Plaintiff-Relator shares should include 15% to 30% of recovery for all monies obtained by state and local governments including, but not limited to, all proceeds from any related actions, all attorney's fees and costs recovered by state and local governments and any consequential damages awarded to the State or to local governments;

(g) That in the event the state continues to proceed with this action, the Relator be awarded an amount for bringing this action of at least 15% but not more than 25% of the proceeds of the actions or settlement of the claims under the state False Claims Act;

(h) That in the event that the state does not proceed with this action, the Relator be awarded an amount that the Court decides is reasonable for collecting the civil penalty and damages, which shall be not less than 25% nor more than 30% of the proceeds of the action or settlement of the claims under the state False Claims Act;

(i) That Plaintiff-Relator Danon be awarded pre-judgment interest;

(j) That Plaintiff-Relator Danon be granted any and all preliminary and injunctive relief the Court deems appropriate;

(k) That Plaintiff-Relator Danon be granted any and all other relief available under the False Claims Act that was not specifically referenced above;

(j) That Plaintiff-Relator Danon be granted any and all other relief the Court deems appropriate.

Respectfully Submitted,

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May 8, 2013

JURY TRIAL DEMANDED