

Tax Whistle-Blowing: Many Cases, Few Results

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Enacted as part of the Tax Relief and Health Care Act of 2006, section 7623(b) created a tax whistle-blower program that offers the potential for enhanced rewards to informants who submit successful claims of large-dollar tax evasion to the IRS. The legislation established a new centralized Whistle-Blower Office within the IRS to coordinate the program. The new rewards are available to a whistle-blower only if, in the case of a reported individual, that individual's gross income for the year exceeds \$200,000 and the amount of tax (plus penalties, interest, and additions to tax) in dispute exceeds \$2 million.

The program has received significant attention from lawmakers, taxpayers, and tax professionals as the IRS works to implement new claim-handling procedures to effectively process the claims for investigation and possible payouts. But while many informants have come forward, few are seeing quick results in their cases, and many questions remain about how the process works.

Submissions Climb


In its 2009 annual report to Congress, which covered fiscal 2008, the IRS Whistle-Blower Office noted that claim submissions continue to climb as publicity about the program spreads. At the end of the fiscal year, the office had received more than 1,200 large-dollar claims under section 7623(b). Of those, 228 claims alleged underpayment by taxpayers of \$10 million or more, while 64 whistle-blowers alleged claims surpassing \$100 million in underpaid taxes. Total claims in fiscal 2008 rose to \$65 billion. (For the report, see *Doc 2009-21539 [PDF]* or *2009 TNT 187-17* )

The 2009 report made clear that no rewards have been issued under the new law.

The office is slowly making progress in putting together administrative components and manuals. It now has 14 staff members, including 10 analysts. Goals for fiscal 2009 include revising and updating published guidance, developing baseline information, enhancing

communications, and building program stability.

TIGTA Finds Fault

A new report on the IRS Whistle-Blower Office by the Treasury Inspector General for Tax Administration faulted the agency for what government auditors perceived as ineffective controls over the claims process, as well as long processing times. (For the report, see *Doc 2009-22190* [PDF] or *2009 TNT 193-21* )

One area in which the IRS needs to improve is its tracking of submitted whistle-blowing claims, TIGTA said. The use of multiple inventory control systems has resulted in numerous inaccuracies and inconsistencies, according to the report. The Whistle-Blower Office acknowledged the problem and said it is on schedule to fully integrate its single inventory tracking system by 2010, the report said.


TIGTA also expressed concern that claims were not being timely processed. TIGTA found that it took an average of 30 days for a claim to be routed from the Whistle-Blower Office to an analyst for review, with a high of 454 days in one case. It took an additional average of 107 days to move the claim from the analyst to the operating division, although that range was from 1 day to 507 days. Also, closing letters to informants when claims were rejected were often not sent or were very untimely, the report said.

The report also recommended that legislation be passed to provide additional protection for informants against employer retaliation, similar to the protections already included in the False Claims Act.

TIGTA outlined the normal case review process. If, after initial intake and review by the Whistle-Blower Office staff, a case is deemed to meet the section 7623(b) criteria, an acknowledgement letter is sent to the informant. The case is then sent to the IRS operating divisions for review by subject matter experts, unless tax fraud is involved, in which case the claim is passed along to the IRS Criminal Investigation division. If an examination results from the claim and produces collection of unpaid taxes, a report is passed back to the Whistle-Blower Office for determination of the proper award amount; if no examination takes place, a closing letter is sent to the informant.

The entire process can take years and frustrates many informants, TIGTA said. TIGTA noted one case it reviewed in which it took the IRS 15 years to process a claim before payment was made. TIGTA reported that as of March 30, the Whistle-Blower Office had some 1,500 section 7623(b) cases open in its inventory, with nearly half pending in CI review.

Hopes for Improvement

Senate Finance Committee ranking minority member Chuck Grassley, R-Iowa, has been the main proponent of changes to the tax whistle-blower program. In response to the TIGTA report, Grassley said he hopes "the IRS will work faster to process the whistle-blower submissions, try not to accumulate a backlog, and stop as many big-dollar fraud operations as possible." (For Grassley's statement, see *Doc 2009-22247* [PDF] or *2009 TNT 193-33* )

"Good-faith whistle-blowers often have very valuable things to say," Grassley said. "The IRS should see them as a valuable resource in fighting the tax gap and put their knowledge to good

use."

Dean Zerbe, special counsel to the National Whistleblowers Center and a former Finance Committee tax counsel, said the recent report showed that "the new law is working far beyond anyone's wildest imagination in providing the IRS information about potential tax fraud." (For Zerbe's statement, see *Doc 2009-22288* [\[PDF\]](#).)

Zerbe, national managing director of Alliantgroup, urged senior IRS leaders to show further commitment to the program by streamlining the bureaucratic claims process.

"The fact remains that billions of dollars have been brought forward by whistleblowers but not a dime of reward has been paid out and not a single cooperative contract has been entered into with a whistleblower," he said. "This has to change" for whistle-blowers to remain interested in the program, he said.

Whistle-Blower Entrepreneurs

A recent book by Liberty University law Prof. Joel D. Hesch, *Reward: Collecting Millions for Reporting Tax Evasion*, details the process for ordinary taxpayers to make tax whistle-blowing claims. The book provides an easily understood overview, but might be considered overreaching in its claims.

While the book tracks the history of the IRS's whistle-blower program and sets out all the requirements in making a claim, Hesch presents an overly optimistic view on the prospects of receiving an award. "The sky is the limit," he writes, trotting out numerous examples throughout the book of multimillion-dollar payouts from ratting on tax cheats. At one point, he says that discussions about the program by the IRS Whistle-Blower Office hint at the likelihood that "someone would receive a billion-dollar reward." The book notes that the average informant reward amount under the old program was between \$22,000 and \$45,000 from 2001-2005.

Hesch's promise of possible large-dollar rewards is made by recounting some of the recent settlements the IRS has reached with major companies over tax shelters, including GlaxoSmithKline (\$3.4 billion settlement), Merck (\$2.3 billion), and KPMG (\$456 million in penalties). He encourages readers to become whistle-blower "entrepreneurs" and assists them by giving a rundown of various "areas of underpaid taxes ripe for reporting," which include employee misclassification, abusive trusts, promoters, and offshore funds.

Hesch provides a thorough overview of how to submit a claim (including a handy checklist), along with suggestions on how to avoid having filings rejected by the IRS and considerations in determining whether to acquire legal representation.

"Money can't buy happiness," Hesch cautions, but his overall message is that whistle-blowing should be the new hobby of the citizenry.

Practitioner Views

Gregory Lynam of the Ferraro Law Firm said his firm has completed more than \$40 billion in submitted claims under the section 7623(b) whistle-blowing program. "We've seen the IRS drop the ball on a couple of cases," he said, but his firm has "also seen very active perusal in

some instances with significant audit activity."

Informants often have concerns about the consequences of coming forward, Lynam said, but he praised the IRS for its efforts to date. "The Service has done a very good job of keeping the existence and identity of informants confidential," he said. The IRS has at times issued "fuzzy" document requests that ask broad questions so as not to reveal that the government already knew a corporate taxpayer had damaging information, he said.

Lynam told Tax Analysts that while legislation setting up additional protections for whistle-blowers would be nice, "it's not essential to the performance of the Whistle-Blower Office."

Scott Knott, also of the Ferraro Law Firm, said he hopes the IRS will be able to promptly make payouts on submitted claims. "I hope for streamlining once collection has occurred," he said. The privacy protections under section 6103 seem to be adequately putting the onus on the IRS to take confidentiality seriously, he said.

Regarding criticism that the IRS provides little information about pending cases, Lynam acknowledged that his clients are "still in a black hole of waiting to find out what their status is."

The TIGTA report may have helped identify shortcomings in the IRS Whistle-Blower Office, but other problems may also hamper effective functioning of the program. Don Rocen of Miller & Chevalier said the Whistle-Blower Office faces short-term operational challenges in implementing the new law. "As an institution, the office has a large task ahead in pulling together the pieces, particularly embedding itself into the IRS process," he said. The office also must sort out how to establish avenues of communication among the various IRS functions, he said.

While practitioners who represent individuals making whistle-blower claims have advocated looser restrictions on taxpayer data for purposes of substantiating and monitoring a claim, Rocen said the IRS is unlikely to be a proponent of expanding section 6103's strict disclosure rules.

One potentially negative outcome of the changes to the whistle-blower law is the disruption of tax administration during large-company audits, Rocen said. Because of the timing of some claims, there can be tension when a company has to step outside the traditional bounds of an exam and put added effort into showing that a complaint has no merit, he said. "The potential for larger awards than previously available could motivate whistle-blowers, either on their own or with the assistance of legal counsel, to be aggressive in presenting claims to the IRS," Rocen said.

George Clarke of Miller & Chevalier said the best corporate response to the tax whistle-blower law is to integrate good practices. Implementing good file documentation, limiting access to certain financial information to small groups of in-house employees, providing complete information document request responses, and maintaining strong attorney-client relationships can all have a dramatic impact on fending off claims, he said. "But there's no silver bullet," he warned.

Although there has been a trickle of guidance from the Whistle-Blower Office on issues concerning the new statute, Clark said he doesn't expect a "groundswell" of new regulations or notices to come out this year. One area that does need clarification is how whistle-blower

claims affect a corporation's qualified amended returns. Whereas in the past, companies informed the IRS of position changes after filing a tax return before the start of an audit engagement, that timeline could now be shortened if whistle-blower claims cause the Service to investigate earlier, he said.

David Blair, also of Miller & Chevalier, said the current rules do not adequately protect companies against disgruntled employees. "There is an incentive for even claims of dubious merit to be made," he said, because there is no fraud requirement in the new framework. "Without a mechanism for weeding out claims regarding errors that the taxpayer planned to disclose anyway, such as Rev. Proc. 94-69 disclosures, the statute leads to a deadweight loss for the government," he said.

Although the TIGTA report noted long routing times for claims through the process, Blair said scrutiny of submissions is an important filter for checking whether that information already exists. Also, the review process provides the IRS with a good record should its decision be questioned later, he said.

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Tax Analysts Information

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