

Reluctant Whistleblower Recovery: IRS Whistleblower Statute Gives Little Incentive for Reporting

By: Phillip Windom

I. Introduction

Americans are afraid of the U.S. Internal Revenue Service (IRS) and with good reason. The consequences of failing to report taxable income can culminate in both monetary losses and legal penalties ranging from fines to heavy prison time. Incidents of tax evasion by famous people have littered American pop culture over the years, including Henry Thoreau, Al Capone, Wesley Snipes, and Pete Rose. To ensure that the IRS collects taxes that are owed, the agency has put measures in place to incentivize whistleblowers to inform the IRS of instances of tax fraud.¹ However, these incentives may not actually be functioning as well as Congress had intended.²

In 1867, Congress enacted a statute giving the Secretary of the Treasury the authority to pay sums of money, not in excess of the taxes due that the Secretary requires, to find, prosecute, and punish those that break internal revenue laws.³ This statute formed the basis of the award system between by the IRS and whistleblowers.⁴ In 1996, Congress amended the statute, adding a clause that allows payment for “detecting underpayments of tax” in an effort to expand the grounds of recovery for whistleblowers, forming the basis for Section 7623(a).⁵

¹ Edward H. Arens, *Giving Credit Where Credit Is Due: Requiring the IRS to Properly Attribute Its Recoveries to Whistleblowers*, BLOOMBERG BNA: TAX MANAGEMENT MEMORANDUM (2017).

² *Id.*

³ 26 I.R.C. § 7623 (1867). (“The Secretary, under regulations prescribed by the Secretary, is authorized to pay such sums, not exceeding in the aggregate the sum appropriated therefor, as he may deem necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same, in cases where such expenses are not otherwise provided for by law.”).

⁴ Arens, *supra* note 1; 26 I.R.C. § 7623(a).

⁵ 26 I.R.C. § 7623 (1996).

Under Section 7623(a), the potential whistleblower must report the suspected illegal activity to the IRS service center or to the “Criminal Investigation Division at a local IRS Office.”⁶ The whistleblower files a Form 211, and a board of IRS area directors determine if the information meets the standard for an award.⁷ The IRS pays an award proportional to the information that the whistleblower provided, but the award percentage cap was “15% of collected taxes and penalties,” while the award cap was restricted to no more than \$10 million.⁸

Section 7623(a) allowed the IRS to have a significant amount of discretion concerning what constituted as adequate information to qualify for an award.⁹ In practice, the IRS hardly ever awarded any whistleblowers for their contributions, which forced Congress to further amend the statute with Section 7623(b) in an effort to improve the odds of whistleblower recovery and keep the IRS honest.¹⁰

II. Statutory Framework of the Whistleblower Statute

In 2006, Congress looked to update Section 7623 for the reasons mentioned above.¹¹ In the Tax Relief and Health Care Act of 2006, Congress attempted to make significant alterations to the whistleblower awards program with the addition of Section 7623(b).¹² The primary change to the statute made whistleblower awards mandatory, rather than discretionary.¹³ Congress’s hope was that whistleblowers, knowing that the IRS was required to provide substantial awards, would feel more comfortable reporting illegal activity by improving their odds of recovery.¹⁴

⁶ Arens, *supra* note 1.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ 26 U.S.C. § 7623 (2006).

¹² Internal Revenue Service, *History of the Whistleblower/Informant Program*, IRS.GOV (March 21, 2017) <https://www.irs.gov/uac/history-of-the-whistleblower-informant-program>.

¹³ *Id.*

¹⁴ Arens, *supra* note 1.

In an effort to focus IRS investigations only on substantial underpayment, the statute was also amended to provide that “the tax, penalties, interest, addition to tax, and additional amounts in dispute” must exceed \$2 million, and that the taxpayer in question, if she is an individual, must have a gross income exceeding \$200,000 for each taxable year at issue.¹⁵ Congress also solidified the parameters of the award system by providing that the whistleblower must receive 15 to 30% of the funds collected due to the whistleblower’s aid.¹⁶ Finally, Congress removed the ten million dollar cap found in Section 7623(a).¹⁷

The statute provided that the amount of an award paid to a whistleblower as a result of the whistleblower’s information would depend on “the extent to which the individual [whistleblower] substantially contributed” to any administrative or judicial action undertaken by the IRS.¹⁸ The IRS initially interpreted the terms “substantially contributed” narrowly.¹⁹ The IRS read in a “but-for” condition into the “substantially contribute” language, which made it difficult for the whistleblower to qualify for an award.²⁰ With such a high standard, it was logical that the IRS had not given out many awards because most whistleblowers could not meet the standard.²¹

In 2012, the IRS implemented regulations that served to solidify its interpretation of the statute to include a but-for standard.²² However, after some push back, the IRS removed the but-for standard from its final regulations as a requirement for a whistleblower to “substantially contribute” to the IRS’s actions.²³ The fact remains that the IRS still has an incredibly high amount of discretion regarding the enforcement of the whistleblower provision by setting the bar

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ I.R.C. § 7623(b)(1) (2006).

¹⁹ Arens, *supra* note 1.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

too high for a whistleblower to qualify for an award through her substantial contribution.²⁴ Even today, the IRS Whistleblower Office (WO) persists in its reluctance to award whistleblowers because of the high standard used when evaluating a whistleblower's role in a claim.²⁵

III. The Inefficiencies in the Statute and a Proposed Solution

Even with all of these changes to the statute put in place over a decade ago, Congress has not achieved its desired results in incentivizing whistleblowers to come forward and forcing the IRS to pay them for their information.²⁶ The IRS has paid a disproportionately small number of awards relative to the number of claims that it receives, so fewer people are willing to come forward as whistleblowers.²⁷

For instance, between 2013 and 2015, 507 whistleblower claims ended with a monetary payment by the IRS, while 19,757 claims ended without a payment over that same time period.²⁸ This means that less than 5% of whistleblower claims through Sections 7623(a) and 7623(b) closed with an award for the whistleblowers.²⁹ Out of these 507 instances, the majority of them were given through Section 7623(a), meaning that the payments tended to be small.³⁰ Since the addition of Section 7623(b) in 2006, the IRS has paid only seventeen awards to whistleblowers under that provision.³¹ These facts dissuade whistleblowers from reporting.³²

It is odd that a program that is mandatory for the IRS has such a low number of awards given out. Some have argued that the IRS's procedural problems, such as its secrecy and long

²⁴ *Id.*

²⁵ Arens, *supra* note 1.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ Arens, *supra* note 1.

³² *Id.*

wait times for awards, are the reasons for the program's lack of success.³³ But there are other more systemic problems with the statute. Even without the inclusion of the but-for requirement in the final regulations, the change did not have a practical effect on the awards given out, so the issue must not be a narrow interpretation of a particular phrase.³⁴

One of the principal problems with the statute is that many whistleblowers are reporting the illicit activities of their employers.³⁵ However, because the IRS whistleblower statute does not have any anti-retaliatory provisions to prevent employers from firing employees who engage in whistleblowing, reporting employers to the IRS is not an option for many whistleblowers.³⁶ While the employer might not fire them, employers might engage in harassment or other disparaging behavior to dissuade other employees from reporting them to the IRS.³⁷ Employers can also seriously damage a whistleblower's reputation, so she may find it extremely difficult to acquire other employment in her field.³⁸

The issue of the IRS's whistleblower statute lacking an anti-retaliation provision has been recognized by government officials.³⁹ In his budget, President Obama proposed for the 2009, 2012, and 2014 fiscal years, an anti-retaliation provision for the IRS whistleblower statute similar to the one found in the False Claims Act (FCA).⁴⁰ The House and Senate rejected these

³³ *Id.*

³⁴ *Id.*

³⁵ Eric Schlabs, *Improving the Tax Whistleblower Program*, REGBLOG (May 16, 2016), <http://www.regblog.org/2016/03/16/schlabs-tax-whistleblower-program/>.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ R. Scott Oswald (Editor-in-Chief), *Obama's Budget Plan: Protect IRS Whistleblowers from Retaliation*, THE EMPLOYMENT LAW GROUP, P.C. (April 16, 2013), <http://employmentlawgroupblog.com/obamas-budget-plan-protect-irs-whistleblowers-from-retaliation/>.

⁴⁰ 31 U.S.C. § 3730(h) (highlighting the anti-retaliation provision); Oswald, *Obama's Budget Plan*.

provisions.⁴¹ President Obama later attempted to amend Section 7623 of the Tax Code to include the anti-retaliatory provision, but Congress failed to approve it.⁴²

The False Claims Act has included anti-retaliatory provisions to prevent employers from taking action against whistleblowers by firing, suspending, or harassing them.⁴³ In a successful retaliation claim against an employer under the FCA, a whistleblower may be entitled to back pay, interest on the back pay, reasonable attorney fees, reinstatement into the same job with the same level of seniority, and any special damages to compensate the employee for the discrimination.⁴⁴

The inclusion of the anti-retaliation provision has increased the number of whistleblowers who have filed claims under the FCA. After the implementation of the anti-retaliation provision in 2012, the whistleblower claims under the FCA increased by almost 70% compared to the previous year.⁴⁵ In 2016, the government collected “more than \$4.76 billion in settlements and judgments,” which was almost a billion more than in 2015.⁴⁶ Over 700 new qui tam⁴⁷ cases were filed in 2016, compared to only 630 filed in the previous year.⁴⁸ The IRS could potentially see gains similar to the FCA if it enacts similar policies.

In fact, the gains under the IRS whistleblower statute could be even larger than those under the FCA. The Treasury Department’s Inspector General for Tax Administration filed a

⁴¹ Oswald, *supra* 39.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ 31 U.S.C. § 3730.

⁴⁵ Oswald, *supra* note 39.

⁴⁶ Christopher Babbit & Jonathan Cedarbaum, *False Claims Act: 2016 Year-in-Review*, WILMERHALE (January 31, 2017), https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/WH_Publications/Client_Alert_PDFs/2017-01-31-false-claims-act-year-in-review.pdf.

⁴⁷ Phillips & Cohen, *What is the False Claims Act? How does a qui tam case work?*, WHISTLEBLOWER RESOURCES: WHAT IS A QUI TAM CASE?, <https://www.phillipsandcohen.com/what-is-a-qui-tam-case/> (“Qui tam lawsuits are a type of civil lawsuit whistleblowers bring under the False Claims Act, a law that rewards whistleblowers if their qui tam cases recover funds for the government. Qui tam cases are a powerful way for whistleblowers to help the government stop many kinds of fraud. . . .”) (last visited July 19, 2017).

⁴⁸ Babbit, *supra* note 46.

report stating that “examinations initiated based on [whistleblower] information” yielded a higher dollar amount per hour and a lower no-change rate than the returns chosen through the IRS’s main avenue for selecting returns, the Discriminant Index Function (DIF).⁴⁹⁵⁰ The IRS can profit significantly more from whistleblowers’ information regarding potential tax fraud than through the use of the IRS’s mathematical formula for choosing which returns to audit. Therefore, the IRS should prioritize incentivizing whistleblowers to come forward by adding an anti-retaliatory provision.

Beyond the FCA, the Sarbanes-Oxley Act of 2002⁵¹ and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)⁵² also provide whistleblowers with protection from retaliation from employers in the Securities and Exchange Commission (SEC) context. Similar to the FCA, these statutes help to suggest models that Congress, and the IRS can use when drafting an anti-retaliation provision for the IRS’s whistleblower statute. Sarbanes-Oxley protects employee whistleblowers from retaliation in the form of discharge, demotion, suspension, threats, harassment, or discrimination.⁵³⁵⁴

Dodd-Frank amended Sarbanes-Oxley to “declar[e] void any agreement, policy form, or condition of employment, including a predispute arbitration agreement that waives an employee’s rights and remedies against retaliation in connection with a whistleblowing event.”⁵⁵

Dodd-Frank also requires the SEC “to pay a bounty to whistleblowers who voluntarily provide

⁴⁹ Denise M. Farag & Terry M. Dworkin, *A Taxing Process: Whistleblowing Under the I.R.S. Reward Program*, SOUTHERN LAW JOURNAL SPRING (2016), http://www.southernlawjournal.com/2016_1/SLJ_Spring%202016_Farag-Dworkin.pdf. (“Typically the IRS selects returns for audits by using a mathematical formula known as the Discriminate Index Function (or “DIF”).”).

⁵⁰ *Id.* at 3.

⁵¹ 18 U.S.C. § 1514A (2010).

⁵² 15 U.S.C. § 78u-6 (2010).

⁵³ Carolyn P. Short, Esq. & Jonathon R. Nadler, Esq., *Fundamentals of Sarbanes-Oxley Whistleblower and Other Retaliation Claims*, REEDSMITH, 12

https://www.reedsmith.com/files/Uploads/Documents/Fundamentals_of_SOX_Whistleblower_and_Other_Retaliation_Claims.pdf.

⁵⁴ 18 U.S.C. § 1514A (2010).

⁵⁵ Short, *supra* note 53, at 14, 18 U.S.C. § 1514A(e) (2010).

original information that results in successful prosecution, in which the SEC obtains monetary sanctions of more than one million” with a bounty between 10 and 30% of the sanctions.⁵⁶

In a 2015 Congressional report, the United States Government Accountability Office (GAO) had recommended that Congress take action and implement anti-retaliatory legislation governing the IRS whistleblower statute to encourage whistleblower employees to report their employers while protecting the whistleblowers from any retaliation.⁵⁷

Even in the unlikely scenario that a whistleblower does qualify for an award by the IRS, claims can take many years to process.⁵⁸ The IRS takes anywhere between five and seven years before awarding a successful whistleblower claim.⁵⁹ For instance, the first award given out due to the mandatory provision in Section 7623(b) did not reach its recipient until 2011, a period of time longer than five years.⁶⁰ The time disparity between the whistleblower’s report and the receipt of tangible dividends negatively impacts the incentive to report failures to pay taxes.⁶¹

The GAO has investigated some of the causes of the IRS’s slowness regarding the distribution of its awards.⁶² The organization found that one of the causes of the lack of timeliness was the IRS’s failure to track the progress of a whistleblower claim.⁶³ Although IRS officials blame the excessive delays on the lack of resources, the procedures currently in place can cause superfluous processing, resulting in inefficient use of staff time and already limited

⁵⁶ Short, *supra* note 53, at 60 (Dodd-Frank’s provision incentivizes whistleblowers to report on amounts exceeding one million dollars. While the odds of some of the returns going to a whistleblower increase under Dodd-Frank, more whistleblowers will report on large sums of money because the terms are clear to receive a cut of the returns).

⁵⁷ US Government Accountability Office (GAO), *IRS Whistleblower Program, Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* (October 2015), 45 <http://www.gao.gov/assets/680/673440.pdf>.

⁵⁸ Schlabs, *supra* note 35.

⁵⁹ Denise M. Farag, *supra* note 49.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² US Government Accountability Office (GAO), *IRS Whistleblower Program, Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* (October 2015), <http://www.gao.gov/assets/680/673440.pdf>.

⁶³ Farag, *supra* note 49.

resources.⁶⁴ Claims are constantly shifting between the different internal units such as the Initial Claim Evaluation (ICE) unit, Small Business/Self-Employed (SB/SE) operating division (OD) and the Case and Development and Oversight (CDO) for further review.⁶⁵ Because the claims go through administrative processing first by ICE before any kind of review on the merits of the claim, much of ICE's time is spent on frivolous claims.⁶⁶ This allows claims that are known to be lacking in substance to advance, which clogs up the process for more legitimate claims.⁶⁷

The IRS's whistleblower office has suggested rectifying this problem by streamlining the administrative processing and the initial review to weed out less-substantive claims.⁶⁸ The IRS intends to further increase the quality of claims by more effectively educating potential whistleblowers as to what makes a successful whistleblower claim by "updating and expanding educational materials."⁶⁹ While the sluggishness of the award distribution process is a problem in and of itself, the torpidity exacerbates other issues within the IRS's whistleblower program, such as communication between the WO and the stakeholders.⁷⁰

In the same investigation, the GAO also evaluated the IRS's whistleblower office and its communications with whistleblowers.⁷¹ The GAO reviewed "relevant regulations covering confidentiality and disclosure of information issues"; reviewed "IRS's internal and external communications plan"; and interviewed the WO, which was responsible for the plan's implementation.⁷² The GAO reasoned that effective communication between the IRS's

⁶⁴ GAO, *supra* note 57, at 19.

⁶⁵ *Id.* at 8.

⁶⁶ *Id.* at 19.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ Marlene Koury, Constantine Cannon LLP, *IRS Whistleblower Report to Congress Signals a Brighter Future*, ACCOUNTINGWEB (Feb. 18, 2016), <http://www.accountingweb.com/tax/irs/irs-whistleblower-report-to-congress-signals-a-brighter-future>.

⁷⁰ GAO, *supra* note 57, at 3.

⁷¹ *Id.*

⁷² *Id.* at 3.

whistleblower office and the public is essential to function efficiently and to build trust in the system.⁷³ The GAO suggested that the IRS could enter into individual contracts with whistleblowers to share information and keep the lines of communication open.⁷⁴ While a private cause of action exists for employee whistleblowers who face retaliation from their employers, the SEC has opted to bring retaliation claims on behalf of whistleblowers.⁷⁵ With this policy, the SEC has shown a level of solidarity with whistleblowers that the IRS has not. Because one of the issues is a lack of trust between the public and the IRS, changing the policy to be more in line with the SEC can serve to build some trust between the two groups.

Politicians from both major political parties have acknowledged the problems: (1) communication between the whistleblower community and the IRS, (2) confidentiality, (3) and retaliation by employers.⁷⁶ Sen. Charles E. Grassley (R-Iowa) and Sen. Ron Wyden (D-Ore.) have introduced the IRS Whistleblower Improvements Act of 2017.⁷⁷ The bill would increase communication between the IRS and the whistleblower community “while protecting taxpayer confidentiality and protecting whistle-blowers from retaliation.”⁷⁸ The bill attempts to improve communication by having the IRS send periodical updates to the whistleblower when the claim reaches significant points during processing.⁷⁹ The bill also includes provisions barring retaliation against employee whistleblowers in the form of firing.⁸⁰ Although it addresses the major concerns discussed here, no action has been taken on the bill since it was introduced. Seemingly, the IRS’s issues with its whistleblower program will have to wait.

⁷³ *Id.* at 44.

⁷⁴ *Id.*

⁷⁵ Steve J. Pearlman, *Dodd-Frank Retaliation: What’s Protected Activity?*, LAW360 (October 11, 2012).

⁷⁶ Matthew Beddingfield & Colleen Murphy, DAILY TAX REPORT (April 3, 2017), <https://www.bna.com/irs-whistleblower-office-n57982086147/>.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*