

COMMENT

A RACE TO THE IRS: ARE SNITCHES AND CRIMINALS THE NEW BUSINESS MODEL?*

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* This Comment received the Akin, Gump, Strauss, Hauer & Feld, LLP Award for Best Paper on Corporate, Securities, or Business Law. I would like to thank my parents, Keith and D'Rene Aldinger, for their support and encouragement throughout law school, and without whom none of my accomplishments would be possible. I would also like to thank Professor Bret Wells for his advice and suggestions during the writing process. Lastly, I would like to thank the editors of the *Houston Law Review* for their time and dedication in preparing this Comment for publication.

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I. INTRODUCTION

“Sometimes, crime does pay,” which was the case for the tax whistleblower Bradley Birkenfeld.¹ Birkenfeld was a former United Bank of Switzerland (UBS) banker who served thirty months in federal prison for conspiring to evade income taxes.² Birkenfeld withheld information from prosecutors about his relationship with a customer, a wealthy California developer.³ In 2007, while still working at UBS, he began to cooperate with the authorities, providing the prosecutors with detailed descriptions of the schemes used by the bank to encourage American citizens to evade their taxes.⁴ As a result of blowing the whistle on his employer, Birkenfeld was awarded \$104 million for his help in “unleash[ing] an international crackdown on tax evasion.”⁵ He “confessed to running errands for rich clients,” including smuggling diamonds into the United States in a toothpaste tube and “helping clients hide wealth by purchasing art and jewels from funds in Swiss accounts.”⁶ Birkenfeld admitted, “[B]ankers used encrypted laptops and erased references to U.S. banking clients in communications.”⁷

1. David Kocieniewski, *Get Out of Jail Free? No, It's Better*, N.Y. TIMES, Sept. 12, 2012, at A1.

2. *Id.*

3. Laura Saunders & Robin Sidel, *Whistleblower Gets \$104 Million*, WALL ST. J., Sept. 12, 2012, at C1. Birkenfeld was given a forty-month sentence, and he finished his sentence under home confinement. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.* (internal quotation marks omitted).

Birkenfeld's case exposed the "Swiss bank secrecy that for decades had allowed wealthy people world-wide to evade taxes."⁸ UBS paid \$780 million to avoid criminal prosecution and also turned over account information of more than 4,000 clients.⁹ Birkenfeld received a lot of media attention because his award appears to be the "largest-ever whistleblower payout to an individual."¹⁰ The award is a "milestone" for the Internal Revenue Service (IRS) whistleblower program, which offers an award of up to 30% of the proceeds recovered by the government.¹¹

Birkenfeld's \$104 million award is shocking because it is equivalent to more than \$4,600 for every hour he spent in prison.¹² Thus, the age-old lesson that cheating does not pay is unfortunately false if one is a tax whistleblower, as long as the whistleblower is not the principal actor.¹³ In addition to ethical problems, the potential for large awards will cause a rush in whistleblower claims brought before the IRS, thereby burdening the IRS with greater administrative costs.¹⁴ This excessive award, paid to a convicted felon while serving time, illustrates that the IRS means business and is willing to go to great lengths to collect unpaid taxes.¹⁵ Although Birkenfeld eventually received a large bounty, the prolonged process took roughly five years.¹⁶ Such a long wait may discourage whistleblowers from submitting high-quality claims because of the significant costs

8. *Id.*

9. Kocieniewski, *supra* note 1; Saunders & Sidel, *supra* note 3.

10. Kocieniewski, *supra* note 1; Saunders & Sidel, *supra* note 3.

11. Kocieniewski, *supra* note 1. The award is 26% of the amount collected by the IRS from the settlement. Saunders & Sidel, *supra* note 3. In 2011, the IRS paid the first award since the IRS whistleblower program was overhauled in 2006. IRS, FISCAL YEAR 2011 REPORT TO THE CONGRESS ON THE USE OF SECTION 7623 (2011) [hereinafter FISCAL YEAR 2011 REPORT], available at http://www.irs.gov/pub/irs-utl/fy2011_annual_report.pdf.

12. Kocieniewski, *supra* note 1.

13. 26 U.S.C. § 7623(b)(3) (2012) (denying an award to whistleblowers if they are criminally convicted of certain crimes).

14. See *U.S. Tax Whistleblower Gets \$2 Million IRS Award—Lawyer*, REUTERS (Oct. 4, 2012), <http://www.reuters.com/article/2012/10/04/usa-tax-whistleblower-idUSL1E8L4F7G20121004> (commenting that Birkenfeld's large award has prompted a "rush of would-be imitators hoping to reap big payouts for exposing tax cheats"); see also *infra* Part III.B.1 (describing the sudden increase in claims submitted to the IRS after the 2006 amendments). One tax whistleblower who received a \$2 million reward under the pre-2006 program previously received two other million-dollar payouts from the IRS. *U.S. Tax Whistleblower Gets \$2 Million IRS Award—Lawyer*, *supra*. A whistleblower who receives multiple awards is strong evidence that some whistleblowers are blowing the whistle for personal gain, rather than seeking to improve corporate compliance. See *id.*

15. Saunders & Sidel, *supra* note 3.

16. See *id.* (noting that Birkenfeld came forward in 2007 and ultimately received the award a week before the article was published in 2012).

whistleblowers face,¹⁷ thereby inhibiting the goal of the whistleblower program.¹⁸

Some federal officials suggest that awards should be denied to informants who engage in illegal activity or withhold information from the authorities.¹⁹ However, the legal community was afraid that potential whistleblowers would not come forward if Birkenfeld received nothing, given that his exploits were so high-profile, appearing on the front page of newspapers across the world.²⁰ Furthermore, although whistleblowers may have dirty hands, they are in a unique position because they have the best access to the “most serious instances of corporate fraud.”²¹ Since the IRS whistleblower program was amended in 2006,²² an industry of whistleblower lawyers and private investigators has appeared.²³ The amendments produced “hundreds of [tax whistleblower] claims alleging tens of billions of dollars in tax evasion.”²⁴ Officials have argued that without the help of insiders, tax evasion schemes are otherwise not revealed.²⁵ Dean Zerbe, Birkenfeld’s lawyer, remarked that “encouraging knowledgeable insiders to stick their necks out is often the only way we can ever find out about tax cheating by the fat cats.”²⁶ Whistleblowers face significant hurdles in their decision to come forward, such as loss of employment, social shunning, and threats of violence.²⁷ Therefore, scholars argue, a generous bounty award is necessary

17. See *infra* Part IV.A.

18. See *infra* Part III.B.1 (explaining the purpose of the amendments); see also IRS, FISCAL YEAR 2012 REPORT TO THE CONGRESS ON THE USE OF SECTION 7623, at 1 (2012) [hereinafter FISCAL YEAR 2012 REPORT], available at http://www.irs.gov/pub/whistleblower/2012%20IRS%20Annual%20Whistleblower%20Report%20to%20Congress_mv.w.pdf (“The primary purpose of the Act was to encourage people with knowledge of significant tax noncompliance to provide information to the IRS.”).

19. Kocieniewski, *supra* note 1.

20. *Id.*

21. Geoffrey Christopher Rapp, *False Claims, Not Securities Fraud: Towards Corporate Governance by Whistleblowers*, 15 NEXUS: CHAPMAN’S J.L. & POL’Y 55, 57 (2009).

22. See *infra* Part III.B (detailing the 2006 amendments to the IRS whistleblower program); see also Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, 120 Stat. 2922, 2958 (codified at 26 U.S.C. § 7623 (2012)).

23. Kocieniewski, *supra* note 1; see also Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357, 381–82 (2008) (noting a 15% to 26% increase in the tax whistleblower bar since the passage of the 2006 amendments).

24. Kocieniewski, *supra* note 1.

25. See Saunders & Sidel, *supra* note 3 (reporting that a Justice Department official stated at Birkenfeld’s sentencing that it is unlikely that the government would have discovered the massive tax fraud scheme had Birkenfeld not come forward in 2007).

26. *Id.* (internal quotation marks omitted).

27. Rapp, *supra* note 21, at 61.

for potential whistleblowers to come forward to compensate for the fear of retaliation.²⁸ However, a recent study illustrates that there are stronger factors besides a financial incentive that motivate a whistleblower to report illegal activity.²⁹

This Comment analyzes the deficiencies in the amended IRS whistleblower program and the practical and ethical implications of the excessive mandatory rewards. Part II describes the instances of corporate fraud that led to the implementation of transparency reforms, which incorporate whistleblower provisions. Part III discusses the IRS whistleblower program before the 2006 amendments and the current amended program. Part IV analyzes the costs and motivations of reporting illegal activity and the effects of the bounty program. Part V recommends several reforms to the IRS whistleblower program.

First, the IRS should require tax whistleblowers to report internally to their company before filing a claim with the IRS. Second, the IRS should allow a *qui tam* action for tax whistleblowers. Third, the bounty award should have a nominal dollar cap, and criminals should be barred from receiving an award, or at the very least, receive a significantly reduced award. Lastly, the IRS should add protective retaliation measures to Section 7623.

II. CORPORATE GOVERNANCE AND INFORMANT PROGRAMS

Instances of corporate fraud are at an all-time high, beginning with the Enron scandal in 2001 and culminating with the 2008 financial market collapse.³⁰ Economic crises lead to more regulation of businesses.³¹ In response to these instances of corporate fraud, Congress instituted reforms to restore integrity in the corporate world and financial markets.³² This Part addresses weak corporate governance as a facilitator of economic crises and details federal legislation that incorporates whistleblower provisions: the Sarbanes–Oxley Act of 2002 (SOX), the Dodd–Frank Wall Street Reform and Consumer Protection

28. *See id.* (“When a person blows the whistle on corporate fraud, they expose themselves to the loss of years of investment in career and reputation; a generous bounty provides needed compensation to ensure that such persons do what policy ought to demand, and blow the whistle.”); Ventry, *supra* note 23, at 363 (recognizing that compensation is warranted for a whistleblower’s endangerment of career and reputation).

29. *See infra* Part IV.B (stating the motivations of whistleblowers to come forward and describing the study).

30. *See* Umang Desai, Comment, *Crying Foul: Whistleblower Provisions of the Dodd–Frank Act of 2010*, 43 LOY. U. CHI. L.J. 427, 427 & n.1 (2012).

31. Rapp, *supra* note 21, at 55.

32. *See infra* Part II.B–D.

Act (Dodd–Frank Act), and the False Claims Act (FCA). The provisions of other federal informant programs can provide insight into the IRS whistleblower program.

A. Corporate Governance

Corporations in the United States operate in a market-based economy, and the trend is toward self-governance.³³ Corporate governance is a set of principles and behaviors by which a company is directed and managed.³⁴ The primary goals of corporate governance include full disclosure and the production of accurate financial documents.³⁵ A lack of corporate governance facilitated the corporate fraud crises.³⁶ Whistleblowers can play a key role in corporate governance because whistleblowers are often the first to know when corporate disclosures are inaccurate.³⁷ Congress instituted regulations in order to reduce corporate fraud, incorporating whistleblower protections because whistleblowers play a role in maintaining corporate integrity.³⁸

B. Sarbanes–Oxley Act

In the fall of 2001, Congress faced a “crisis in public confidence with respect to the financial reporting of public companies.”³⁹ The financial collapse of several companies,

33. John W. Cioffi, *State of the Art: A Review Essay on Comparative Corporate Governance: The State of the Art and Emerging Research*, 48 AM. J. COMP. L. 501, 504, 530–31 & n.83 (2000) (describing the current trend toward self-governance).

34. R.P. Austin, *What Is Corporate Governance? Precepts and Legal Principles*, 2005 N.Z. L. REV. 335, 336.

35. *Id.* at 337; see also Clyde Stoltenberg et al., *A Comparative Analysis of Post-Sarbanes-Oxley Corporate Governance Developments in the US and European Union*, 53 AM. J. COMP. L. 457, 461–64 (2005) (describing the disclosure and reporting requirements of the Sarbanes–Oxley Act).

36. Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime After Sarbanes–Oxley*, 81 WASH. U. L.Q. 357, 358–59 (2003).

37. See Richard E. Moberly, *Sarbanes–Oxley’s Structural Model to Encourage Corporate Whistleblowers*, 2006 BYU L. REV. 1107, 1113, 1116–17 (noting that whistleblowers can monitor corporations to ensure corporations are being honest to the shareholders). Although shareholders have ownership stakes in a corporation, shareholders often possess little knowledge of the daily occurrences. See ROBERT A. RAGAZZO & FRANCES S. FENDLER, *CLOSELY HELD BUSINESS ORGANIZATIONS* 327 (2d ed. 2012). Whistleblowers, who are often employees of the company, are in a unique position because they have knowledge that the public and shareholders cannot access. Rapp, *supra* note 21, at 61.

38. See *infra* Part II.B–D (describing Sarbanes–Oxley Act, Dodd–Frank Act, and the False Claims Act).

39. Bret Wells, *Voluntary Compliance: “This Return Might Be Correct but Probably Isn’t”*, 29 VA. TAX REV. 645, 651 (2010).

including Enron and WorldCom, fueled the financial crisis.⁴⁰ In the years leading up to 2002, many corporations were victims of corporate fraud, which cost investors billions of dollars and sent many investors and corporations into insolvency.⁴¹ Publicly filed financial statements did not sufficiently disclose imminent risks, and the internal controls did not advise management of this inadequacy.⁴²

To restore public confidence, Congress instituted sweeping reforms, including the enactment of the Sarbanes–Oxley Act of 2002, which changed how tax compliance is conducted.⁴³ Section 302 requires the chief executive officer and the chief financial officer to certify, under penalty of perjury, the reliability of their company’s financial statements.⁴⁴ Section 404 requires management to report the adequacy of the company’s internal controls, and the external auditor must report its opinion as to management’s effectiveness of the company’s internal controls.⁴⁵

Under SOX, a whistleblower is protected from discharge, demotion, suspension, harassment, or any other form of discrimination by the employer when the employee provides information about conduct that the employee reasonably believes is in violation of Securities and Exchange Commission (SEC) regulations.⁴⁶ If the whistleblower proves that the prohibited act was done in response to the whistleblowing, then the whistleblower is entitled to “all relief necessary to make the employee whole,” including compensation for special damages, back pay with interest, and “reinstatement with the same seniority status that the employee would have had, but for the discrimination.”⁴⁷

C. Dodd–Frank Act

Another financial crisis surrounding corporate governance occurred in 2008, highlighted by Bernard Madoff’s \$50 billion Ponzi

40. *Id.*

41. Brickey, *supra* note 36, at 377 n.86.

42. *See id.* at 377; Edward J. Janger, *Brandeis, Business Ethics, and Enron*, in ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 63, 65–66 (Nancy B. Rapoport & Bala G. Dharan eds., 2004) (describing the lack of disclosure in Enron’s financial statements).

43. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745; Troy A. Paredes, *Enron: The Board, Corporate Governance, and Some Thoughts on the Role of Congress*, in ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS, *supra* note 42, at 495, 515.

44. Sarbanes–Oxley Act of 2002 § 302(a) (codified at 15 U.S.C. § 7241(a) (2012)).

45. *Id.* § 404 (codified at 15 U.S.C. § 7262).

46. *Id.* § 806(a) (codified at 18 U.S.C. § 1514A(a)).

47. *Id.* § 806(a) (codified at 18 U.S.C. § 1514A(c)).

scheme and the subprime mortgage crisis.⁴⁸ The risky business practices of large financial institutions were also a partial reason for the financial crisis.⁴⁹

Congress attempted to improve ineffective whistleblower provisions following the 2008 financial crisis by passing the Dodd–Frank Act partially to encourage whistleblower participation in the promotion of corporate governance.⁵⁰ Section 922 amended the Securities Exchange Act of 1934 by adding Section 21F, entitled “Securities Whistleblower Incentives and Protection.”⁵¹ Section 922 provides a whistleblower program that rewards individuals who assist the SEC in uncovering securities violations.⁵² Under the Dodd–Frank Act, awards are up to 30% of the monetary sanctions or recovery obtained by the SEC.⁵³ To be eligible for an award, a whistleblower must voluntarily provide the SEC with “original information” that leads to the successful enforcement of a federal court or administrative action.⁵⁴ Additionally, the SEC must obtain monetary sanctions greater than \$1 million.⁵⁵ A whistleblower is not eligible for an award if the whistleblower was criminally convicted in the case.⁵⁶

48. Christine Hurt, *Evil Has a New Name (and a New Narrative): Bernard Madoff*, 2009 MICH. ST. L. REV. 947, 952–54 & n.41 (discussing Madoff’s Ponzi scheme); Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 8 (2009) (noting that while the 2008 financial crisis could largely be attributed to the banks, economic factors, such as the decrease in home prices, also contributed to the collapse).

49. Moran, *supra* note 48, at 12.

50. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S.C.); *see also* Rapp, *supra* note 21, at 57 (recognizing that whistleblowers are an integral part of corporate structure and its regulation).

51. Dodd–Frank Wall Street Reform and Consumer Protection Act § 922, 15 U.S.C. § 78u-6.

52. *Id.*

53. *Id.* § 922(b) (codified at 15 U.S.C. § 78u-6(b)).

54. *Id.* § 922(a)(3), (b) (codified at 15 U.S.C. § 78u-6(a)(3), (b)) (defining “original information” to include information “derived from the independent knowledge or analysis of a whistleblower” that is not otherwise “known to the Commission . . . unless the whistleblower is the original source of the information”).

55. *Id.* § 922(a)(1) (codified at 15 U.S.C. § 78u-6(a)(1)).

56. *Id.* § 922(c)(2)(B) (codified at 15 U.S.C. § 78u-6(c)(2)(B)) (“No award . . . shall be made . . . to any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award . . .”); *see also* Stuart Gittleman, *SEC Whistleblower Program Stricter Than IRS Bounty Which Paid \$104 Million to Felon, Former Official Says*, REUTERS (Sept. 12, 2012, 4:06 PM), <http://blogs.reuters.com/financial-regulatory-forum/2012/09/12/sec-whistleblower-program-stricter-than-irs-bounty-which-paid-104-million-to-felon-former-official-says/> (noting that Birkenfeld’s criminal conviction would disqualify him from the SEC program).

The SEC encourages internal reporting, but it is not required in order to be eligible for an award.⁵⁷ If a whistleblower first reports to the company's internal compliance system, the SEC can increase the award, and conversely, interference with internal corporate compliance procedures could decrease the award.⁵⁸ While the final rules provide some incentive to report internally, employees may choose to bypass robust internal compliance systems and go directly to the SEC.⁵⁹

The Dodd–Frank Act enhanced the anti-retaliation whistleblower protection of individuals who provide the SEC with information about possible securities violations, including a private cause of action against retaliators.⁶⁰ If a whistleblower is terminated in retaliation for coming forward, the Dodd–Frank Act provides for “reinstatement with the same seniority status that the individual would have had, but for the discrimination,” rewards double back pay plus interest, and reimburses the whistleblower's litigation costs and attorney fees.⁶¹

The SEC paid the first award under the Dodd–Frank Act within the first year of the whistleblower program.⁶² Sean McKessy, Chief of the SEC's Office of the Whistleblower, commented that the first payment within the first year illustrates that the SEC is “open for business.”⁶³ Since the

57. Kathleen L. Casey, Commissioner, SEC, Statement at Open Meeting of the U.S. SEC, Adoption of Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 (May 25, 2011), available at <http://www.sec.gov/news/speech/2011/spch052511klc-item2.htm>.

58. 17 C.F.R. § 240.21F-6(a)(4), (b)(3) (2013).

59. Casey, *supra* note 57 (“An inherent risk of the approach adopted in the final rule, is that the monetary sums at stake will provide a significant enough incentive for whistleblowers to completely bypass internal reporting in favor of coming straight to the Commission. A fundamental failure of today's release is that it underestimates this dynamic and the ensuing impact on internal compliance reporting mechanisms.”).

60. Dodd–Frank Wall Street Reform and Consumer Protection Act § 922(h)(1)(B) (codified at 15 U.S.C. § 78u-6(h)(1)(B)); Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,300–305 (June 13, 2011) (to be codified at 17 C.F.R. pts. 240, 249) (explaining the anti-retaliation provisions protecting whistleblowers under the Dodd–Frank Act).

61. Dodd–Frank Wall Street Reform and Consumer Protection Act § 922(h)(1)(C) (codified at 15 U.S.C. § 78u-6(h)(1)(C)).

62. SEC, ANNUAL REPORT ON THE DODD–FRANK WHISTLEBLOWER PROGRAM: FISCAL YEAR 2012, at 8 (Nov. 2012), available at <http://www.sec.gov/about/offices/owb/annual-report-2012.pdf>; see also *SEC Issues First Whistleblower Program Award*, SEC (Aug. 21, 2012), <http://www.sec.gov/news/press/2012/2012-162.htm>.

63. *SEC Issues First Whistleblower Program Award*, *supra* note 62 (internal quotation marks omitted). The Dodd–Frank Act, like the IRS whistleblower program, created an Office of the Whistleblower within the SEC to administer and effectuate the whistleblower program. Dodd–Frank Wall Street Reform and Consumer Protection Act § 924(d) (codified at 15 U.S.C. § 78u-7(d)). Section 924(d) requires the Commission's Office of the Whistleblower to report annually to Congress on the whistleblower program. *Id.*

program was established in August 2011, around eight tips a day are reported to the SEC.⁶⁴ While the SEC has proven it can distribute awards quickly, another federal informant program, the False Claims Act, has been the most successful.

D. False Claims Act

The False Claims Act provides a private cause of action, called a *qui tam* suit, against those who commit fraud on the government.⁶⁵ The informant, called a “relator,” can sue on the government’s behalf and receive a bounty, which is a portion of the government’s recovery.⁶⁶ In order to be eligible for an award under the FCA, the whistleblower must initiate the action, which must be based on some false claim for money or property made to the federal government.⁶⁷ The *qui tam* plaintiff files a complaint under seal,⁶⁸ and the Department of Justice then decides whether to intervene in, dismiss, or decline to intervene in the case.⁶⁹ Before the government can dismiss the action, the court must provide the informant with a hearing on the motion.⁷⁰ If the government proceeds with the action, any recovery goes to the government, with the *qui tam* plaintiff receiving a bounty of 15% to 25% of the recovered proceeds or settlement.⁷¹ If the government does not proceed with the action, the informant has the right to conduct litigation⁷² and is eligible for an award that the court deems reasonable between 25% and 30% of the proceeds.⁷³

If the plaintiff planned and initiated the false claims violation, then the court may lower the percentage awarded.⁷⁴ If

64. SEC Issues First Whistleblower Program Award, *supra* note 62.

65. 31 U.S.C. § 3730(b) (2012); Rapp, *supra* note 21, at 62–63. Congress excluded tax claims from the False Claims Act. 31 U.S.C. § 3729(e).

66. Rapp, *supra* note 21, at 62.

67. 31 U.S.C. §§ 3729, 3730(b).

68. *Id.* § 3730(b)(2)–(4). The claimant’s complaint must comply with the Federal Rules of Civil Procedure. Marsha J. Ferziger & Daniel G. Currell, *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, 1999 U. ILL. L. REV. 1141, 1159. The claimant must plead the fraud complaint with sufficient particularity under Rule 9(b) and with adequate support under Rule 11(b)(3). FED. R. CIV. P. 9(b), 11(b)(3).

69. 31 U.S.C. § 3730(b)(4); Rapp, *supra* note 21, at 63.

70. 31 U.S.C. § 3730(c)(2)(A).

71. *Id.* § 3730(d)(1). The amount of the reward depends on the extent to which the whistleblower “substantially contributed to the prosecution of the action.” *Id.* If the court determines the action is based primarily on public information, then the whistleblower may be rewarded up to 10% of the proceeds. *Id.*

72. *Id.* § 3730(b)(4)(B), (c)(3).

73. *Id.* § 3730(c)(3), (d)(2).

74. *Id.* § 3730(d)(3).

the plaintiff was convicted of criminal conduct for the role of planning and initiating the violation, then the plaintiff is barred from an award.⁷⁵ The FCA also protects whistleblowers from retaliatory action; the employee is entitled to “all relief necessary to make that employee . . . whole,” which includes reinstatement, double back pay with interest, and compensation for special damages.⁷⁶

The FCA has been the most successful of the federal whistleblower bounty programs.⁷⁷ The FCA is the only significant federal bounty program that allows a *qui tam* action.⁷⁸ The government has recovered billions of dollars through FCA lawsuits filed by private whistleblowers on behalf of the government.⁷⁹ Administrative costs for FCA cases are lower than all other bounty programs because the majority of FCA litigation is carried out privately, not by the government.⁸⁰ The FCA reduces the number of claims the government examines and provides the government with the option to pay a higher bounty rather than incurring litigation costs.⁸¹ The success of *qui tam* actions under the FCA, along with the whistleblower protections of the other informant bounty programs, should be considered in the IRS whistleblower program.

III. THE IRS WHISTLEBLOWER PROGRAM

The IRS has been authorized to pay awards to individuals who blow the whistle on tax cheats since 1867.⁸² The IRS whistleblower program was initially unsuccessful because the program had decentralized management, poor oversight, and only issued discretionary awards.⁸³ Due to the ineffectiveness, Congress amended the program in 2006 to encourage whistleblowers to report significant tax fraud.⁸⁴ This Part discusses both the pre-2006 IRS whistleblower program and the revamped program.

75. *Id.*

76. *Id.* § 3730(h)(1)–(2).

77. Rapp, *supra* note 21, at 62; Ventry, *supra* note 23, at 368.

78. CHARLES DOYLE, CONG. RESEARCH SERV., QUI TAM: THE FALSE CLAIMS ACT AND RELATED FEDERAL STATUTES 4 (2009).

79. Rapp, *supra* note 21, at 62.

80. *See* Ferziger & Currell, *supra* note 68, at 1159 (noting the lower administrative costs of FCA cases).

81. *See supra* text accompanying notes 65–76 (detailing the requirements under the FCA).

82. Ventry, *supra* note 23, at 360.

83. *Infra* Part III.A.

84. *See* Ventry, *supra* note 23, at 362, 365; *infra* Part III.B.

A. *Whistleblower Program Before the 2006 Amendments*

The IRS whistleblower program was underused and ineffective.⁸⁵ In the ten-year span between 1989 and 1998, the IRS paid out 2% of recovered proceeds to informants.⁸⁶ The IRS had “virtually unchecked discretion to decide whether to pay an award at all, as well as how much, if any, to pay.”⁸⁷ Courts have held that Section 7623 gives the IRS broad discretion to determine whether to pay an award and the amount of the award.⁸⁸ Before 2006, the IRS administratively provided a minimum award of 1% and a maximum award of 15% of amounts recovered with a nominal cap of \$2 million.⁸⁹ Decision-making was dispersed among offices, and procedures to process claims were not standardized.⁹⁰ Informants were expected to come forward to request an award.⁹¹ The IRS did not advertise its whistleblower program, and the IRS instructed employees not to solicit people to provide information in exchange for an award.⁹²

Before 2006, Section 7623 did not give whistleblowers the right to appeal award determinations.⁹³ However, the Tucker Act provides courts with jurisdiction to hear whistleblower suits

85. Ventry, *supra* note 23, at 362–64 (concluding that the law that was in effect before December 2006 had “paltry bounties, stingy administrators, inadequate protection for whistleblowers, and unreceptive courts”).

86. *Id.* at 364. During the same time period, FCA paid 15.7% of recoveries to informants. *Id.*

87. Michelle M. Kwon, *Whistling Dixie About the IRS Whistleblower Program Thanks to the IRC Confidentiality Restrictions*, 29 VA. TAX REV. 447, 451 (2010); *see also* Treas. Reg. § 301.7623-1(a)(1), (c) (2012) (giving the district or service center directors the authority to approve awards “in a suitable amount” for information that leads to the “detection of underpayments of tax” and requiring that the amount represent “adequate compensation”).

88. *See, e.g.*, Merrick v. United States, 846 F.2d 725, 726 (Fed. Cir. 1988); Conner v. United States, 76 Fed. Cl. 86, 87 (2007).

89. IRS, PUB’N NO. 733 (REV. 10-2004), REWARDS FOR INFORMATION PROVIDED BY INDIVIDUALS TO THE INTERNAL REVENUE SERVICE [hereinafter PUBLICATION 733], *available at* <http://www.unclefed.com/IRS-Forms/2005/p733.pdf>. The \$2 million nominal cap was raised to \$10 million for claims submitted after August 13, 2004. IRS, INTERNAL REVENUE MANUAL § 25.2.2.9.1, Exhibit 25.2.2-13 (2008) [hereinafter INTERNAL REVENUE MANUAL], *available at* http://www.irs.gov/irm/part25/irm_25-002-002.html; TREASURY INSPECTOR GEN. FOR TAX ADMIN., THE INFORMANTS’ REWARDS PROGRAM NEEDS MORE CENTRALIZED MANAGEMENT OVERSIGHT 2 (2006). A 15% award was available if the whistleblower provided “specific and responsible information,” a 10% award if the information was “of value in the determination of tax liabilities although not specific,” and a 1% award if the information caused an investigation but “had no direct relationship” to the recovery. PUBLICATION 733, *supra*. If the whistleblower and IRS enter into a special agreement, the award can exceed these percentage and dollar caps. TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra*, at 2.

90. TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 89, at 1 n.7 (stating that whistleblower claims were handled at five different Service campuses).

91. Kwon, *supra* note 87, at 453.

92. *Id.*

93. *Id.*

challenging an award or the denial of an award based upon the existence of a contract with the IRS.⁹⁴ The Court of Federal Claims has jurisdiction under the Tucker Act to hear contract claims in excess of \$10,000 asserted against the United States.⁹⁵ However, Publication 733 does not create a contract, so a whistleblower cannot bind the IRS to the award percentages in Publication 733.⁹⁶ One scholar notes, “[F]ew whistleblowers filed suit to challenge their award determinations, [and] those who did had little success.”⁹⁷ From 1941 to 1998, the IRS won all nineteen cases by whistleblowers who challenged their award determinations.⁹⁸ This is partially because the Court of Federal Claims reviewed award challenges based on an abuse of discretion standard.⁹⁹ *Krug v. United States* illustrates that this standard of review was a “no-win situation” for whistleblowers because the whistleblower is not able to provide sufficient factual allegations to meet the abuse of discretion standard.¹⁰⁰ The IRS has commented that a “meaningful right to appeal to Tax Court requires disclosure to the whistleblower of the basis for the award determination, which often will include taxpayer information that is protected from disclosure under section 6103.”¹⁰¹ Although the pre-2006 program was ineffective for the reasons discussed above, the changes in the 2006 amendments raised the stakes for tax whistleblowers.¹⁰²

B. Amended Whistleblower Program

Section 406 of the Tax Relief and Health Care Act of 2006 amended Section 7623.¹⁰³ The amendments established a

94. See, e.g., *Conner v. United States*, 76 Fed. Cl. 86, 87–88 (2007) (finding no subject matter jurisdiction because the whistleblower had no contract with the IRS).

95. 28 U.S.C. § 1491(a)(1) (2012); see also *id.* § 1346(a)(2) (providing concurrent jurisdiction among the federal district courts and the Court of Federal Claims to hear contract claims of \$10,000 or less).

96. See *Cambridge v. United States*, 558 F.3d 1331, 1335–36 (Fed. Cir. 2009) (concluding that the whistleblower failed to show any enforceable contract when the whistleblower sought an additional payment based on the formula provided in Publication 733).

97. Kwon, *supra* note 87, at 455.

98. Terri Gutierrez, *IRS Informants Reward Program: Is It Fair?*, 84 TAX NOTES 1203, 1205 (1999).

99. *Id.* at 1205–07.

100. *Krug v. United States*, 41 Fed. Cl. 96, 98–99 (1998), *aff'd*, 168 F.3d 1307 (Fed. Cir. 1999) (holding that the IRS did not abuse its discretion in refusing to pay Krug an award). The IRS recovered proceeds but denied an award to an informant, giving pretextual reasons; the IRS asserted that legal restrictions prevented it from disclosing the true reasons. *Id.* at 97–98.

101. FISCAL YEAR 2012 REPORT, *supra* note 18, at 13.

102. See Ventry, *supra* note 23, at 361–62 (“The 2006 amendments to section 7623 breathed life into the statute.” (footnote omitted)).

103. Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406, 120 Stat. 2922, 2958–60.

Whistleblower Office within the IRS to administer the whistleblower program.¹⁰⁴ The IRS must report to Congress each year on the whistleblower program.¹⁰⁵ Congress amended the program to encourage insiders to blow the whistle on people who are not paying their taxes.¹⁰⁶ Congress increased the maximum potential award to try to reduce the “tax gap.”¹⁰⁷ The tax gap is the difference between what taxpayers owe and the amount timely paid.¹⁰⁸ The tax gap is a byproduct of a voluntary compliance federal income tax system. The net tax gap was estimated at \$385 billion for tax year 2006.¹⁰⁹ The federal government uses different methods to discover noncompliance by taxpayers, and the principal method is its examination power, which allows the government to audit a taxpayer and determine whether the taxpayer’s tax return complies with the law.¹¹⁰ Another method is through the use of whistleblowers who are used as a “tool for peeking inside the otherwise private zone of voluntary compliance.”¹¹¹ This Subpart details the notable changes to the IRS whistleblower program, which were enacted in an attempt to help close the tax gap.

104. *Id.* § 406(b)(1).

105. *Id.* § 406(c).

106. FISCAL YEAR 2012 REPORT, *supra* note 18, at 1; *see also* TREASURY INSPECTOR GEN. FOR TAX ADMIN., DEFICIENCIES EXIST IN THE CONTROL AND TIMELY RESOLUTION OF WHISTLEBLOWER CLAIMS 2 (2009) (stating that the intent of the 2006 amendments was to “provide focus on large-dollar cases with the potential of collecting billions of dollars for the Department of the Treasury”).

107. Ventry, *supra* note 23, at 366 (commenting on Congress’s goal to close the “tax gap”). Compare 26 U.S.C. § 7623(b)(1) (2012) (stating that an award cannot exceed 30% of the collected proceeds), with PUBLICATION 733, *supra* note 89 (setting forth 15% of the collected proceeds as the highest possible award).

108. Ventry, *supra* note 23, at 359 n.13.

109. IRS, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012) [hereinafter *Tax Gap Estimates*], available at <http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study>. The net tax gap is tax that is never collected, and the gross tax gap represents voluntary and timely compliance, which was estimated at \$450 billion for tax year 2006. *See* IRS, *Tax Gap “Map”: Tax Year 2006* (Dec. 2011), available at http://www.irs.gov/pub/newsroom/tax_gap_map_2006.pdf. The three components of the tax gap are: nonfiling (failure to file a tax return), underreporting (understating income or overstating deductions), and underpayment (failure to fully pay reported taxes owed). *Tax Gap Estimates, supra*. Underreporting of tax liabilities accounted for over 80% of the tax gap in 2006. *See id.* Individuals are the dominant source of the underreporting gap. *See* IRS, TAX YEAR 2006 TAX GAP ESTIMATE—SUMMARY OF ESTIMATION METHODS 1–3 (Jan. 2012), available at http://www.irs.gov/pub/newsroom/summary_of_methods_tax_gap_2006.pdf.

110. 26 U.S.C. § 7602(a); Edward A. Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the “Tax Gap,”* 24 AKRON TAX J. 1, 2 (2009).

111. Morse, *supra* note 110, at 3.

1. *The New Section 7623(b)*. The 2006 amendments redesignated the prior Section 7623 as Section 7623(a), and the “key change” was the addition of subsection (b) to Section 7623.¹¹² Under Section 7623(b), whistleblower awards are no longer discretionary.¹¹³ The law is mandatory in that the IRS now generally must pay whistleblowers a minimum award of 15% of the collected proceeds—awards based on additions to tax, penalties, interest, and other amounts—from an administrative or judicial action initiated by the IRS.¹¹⁴ The 2006 amendments raised the maximum award to 30% of the collected proceeds.¹¹⁵ The minimum award under Section 7623(b) is the maximum under Section 7623(a).¹¹⁶ The new law also removed the pre-2006 nominal cap so that only percentage limits exist on the award amount under Section 7623(b).¹¹⁷

No person who was an employee of the Department of the Treasury when the individual discovered information relating to violations of the internal revenue laws is eligible for an award.¹¹⁸ An eligible whistleblower must meet several conditions to qualify for an award under Section 7623(b). A whistleblower is eligible to receive an award if: (1) the whistleblower provides specific information on a tax noncompliance matter in excess of \$2 million;¹¹⁹ (2) the information substantially contributes to a decision to take administrative or judicial action;¹²⁰ and (3) the

112. 26 U.S.C. § 7623; FISCAL YEAR 2012 REPORT, *supra* note 18, at 2–3. The new Section 7623(b) applies to information provided to the IRS on or after December 20, 2006, while Section 7623(a) applies to claims submitted before December 20, 2006, and those that do not meet the Section 7623(b) thresholds. *Id.* at 1, 3 n.5. Awards are discretionary under Section 7623(a). *Id.* at 2.

113. 26 U.S.C. § 7623(b)(1) (“[S]uch individual *shall* . . . receive an award . . .” (emphasis added)).

114. *See id.*

115. *Id.*

116. *Compare* 26 U.S.C. § 7623(b)(1) (stating that an award will be at least 15% of the collected proceeds), *with* PUBLICATION 733, *supra* note 89 (setting forth 15% of the collected proceeds as the highest possible award). If the whistleblower is not the original source of the information because the information is publicly disclosed, the award is reduced to 10%. 26 U.S.C. § 7623(b)(2); FISCAL YEAR 2012 REPORT, *supra* note 18, at 3.

117. 26 U.S.C. § 7623(b)(1).

118. Treas. Reg. § 301.7623-1(b)(2) (2012).

119. 26 U.S.C. § 7623(b)(5)(B). If the taxpayer is an individual, the taxpayer’s gross income must exceed \$200,000 for any taxable year at issue. *Id.* § 7623(b)(5)(A). If the information does not meet the Section 7623(b) criteria, the IRS may consider it under the discretionary Section 7623(a). FISCAL YEAR 2012 REPORT, *supra* note 18, at 3 n.5.

120. The specific amount of an award within the range depends on how much the whistleblower’s information substantially contributed to the investigation. 26 U.S.C. § 7623(b)(1). If the whistleblower provides significant information, the whistleblower can receive up to 30% of the recovery. *Id.* If the information contributed was a nonsignificant factor, then the whistleblower is entitled to a reduced award. *Id.* § 7623(b)(2). Even a

IRS collects proceeds from an administrative or judicial action or from any settlement in response to the action.¹²¹ A claim can be denied if the IRS already has the same information from another source, the taxpayer is not found to be liable, or the taxpayer turns out to have no assets against which the IRS can collect.¹²² The award will also be denied if the whistleblower is convicted based on the role of planning and initiating the action.¹²³

The amended whistleblower program has increased the number of claims.¹²⁴ In fiscal year 2008, 377 submissions allegedly met the \$2 million threshold.¹²⁵ Although higher submission rates may indicate that the increased award is luring potential whistleblowers to come forward,¹²⁶ this does not necessarily mean the program is attracting high-quality claims. The IRS has acknowledged that “many times . . . a claim initially thought to be a potential 7623(b) claim did not result in a dispute . . . in excess of \$2,000,000.”¹²⁷ From 2005 to 2008, the amount of awards paid to informants increased to an average of 9.8% of recovered proceeds,¹²⁸ an expansion from the average of

person who “planned and initiated” the actions that led to the underpayment may be entitled to an award unless that person is convicted. *Id.* § 7623(b)(3).

121. FISCAL YEAR 2012 REPORT, *supra* note 18, at 3.

122. Kwon, *supra* note 87, at 466; *Confidentiality and Disclosure for Whistleblowers*, IRS (Mar. 7, 2013), <http://www.irs.gov/uac/Confidentiality-and-Disclosure-for-Whistleblowers>.

123. 26 U.S.C. § 7623(b)(3). Under proposed regulations, the Whistleblower Office will make a threshold determination on whether the informant planned and initiated the action, but this determination would not result in an automatic reduction of the award. Awards for Information Relating to Detecting Underpayments of Tax or Violations of the Internal Revenue Laws, 77 Fed. Reg. 74,798, 74,803 (Dec. 18, 2012). A claimant meets the threshold if the claimant:

- (i) designed, structured, drafted, arranged, formed the plan leading to, or otherwise planned an underlying act, (ii) took steps to start, introduce, originate, set into motion, promote or otherwise initiated an underlying act, and (iii) knew or had reason to know that there were tax implications to planning and initiating the underlying act.

Id. If the informant meets the threshold, then the Whistleblower Office will evaluate the extent of the informant’s planning and initiating based on a list of factors to determine the appropriate reduction. *Id.*

124. Kwon, *supra* note 87, at 460–61.

125. FISCAL YEAR 2012 REPORT, *supra* note 18, at 7 tbl.1. In fiscal year 2012, 332 claims allegedly met the \$2 million threshold. *Id.* The IRS noted that it cannot tell if the whistleblowers’ estimates are accurate or how many will result in collected proceeds. *Id.* at 1.

126. Kwon, *supra* note 87, at 461.

127. FISCAL YEAR 2012 REPORT, *supra* note 18, at 12.

128. IRS, FISCAL YEAR 2009 ANNUAL REPORT TO CONGRESS ON THE USE OF SECTION 7623, at 8 tbl.2 (2009), available at <http://www.irs.gov/pub/whistleblower/whistleblowerfy09rtc.pdf>.

2% in earlier years.¹²⁹ However, in fiscal year 2011, the whistleblower submissions that appeared to meet the \$2 million threshold dropped in relation to 2010.¹³⁰ Furthermore, the first award under Section 7623(b) was paid in fiscal year 2011, so any payments before that were made under the pre-2006 law.¹³¹

The 2006 amendments to the IRS whistleblower program are similar to the FCA, but there are some noteworthy differences. Most significantly, in contrast to the whistleblower's right to conduct litigation under the FCA, "a tax whistleblower has a seat at the table only if invited by the [IRS]."¹³² A whistleblower has the right to report the claim but does not have the right to prosecute it and cannot compel the IRS to investigate such a claim.¹³³ Furthermore, a tax whistleblower cannot take up a private cause of action if the IRS declines to pursue an investigation.¹³⁴

2. *Procedures for Filing a Claim.* An informant must submit an IRS Form 211—Application for Award for Original Information—to the Whistleblower Office in order to seek an award under the IRS whistleblower program.¹³⁵ The Whistleblower Office conducts an initial review to reject meritless claims and those that do not satisfy the threshold

129. Ventry, *supra* note 23, at 364 (noting that the payout ratio—i.e., the amount paid out to informants out of the recovered proceeds—was 2.01% during the period between 1989 and 1998, while the payout ratio under FCA was 15.7% during the same time period).

130. FISCAL YEAR 2011 REPORT, *supra* note 11, at 6, 7 tbl.1 ("It is not yet known how many of these cases will result in collected proceeds after examination or investigation, as the amounts alleged reflect only the whistleblower's estimate of the potential recovery."). There were 332 submissions under Section 7623(b) for fiscal year 2012, which is a slight increase from 2011 but still lower than the submissions in the years 2008, 2009, and 2010. FISCAL YEAR 2012 REPORT, *supra* note 18, at 7 tbl.1.

131. FISCAL YEAR 2012 REPORT, *supra* note 18, at 1, 5–6.

132. Kwon, *supra* note 87, at 459.

133. *Id.*

134. See Ventry, *supra* note 23, at 370–72 (remarking that legislators need to provide an independent statute to extend *qui tam* suits to tax because the FCA does not currently apply to the Internal Revenue Code). Scholars recommend that *qui tam* actions should be permitted for tax claims. See, e.g., Joshua D. Rosenberg, *The Psychology of Taxes: Why They Drive Us Crazy, and How We Can Make Them Sane*, 16 VA. TAX REV. 155, 205–09 (1996) (advocating for extension of *qui tam* to tax); Ventry, *supra* note 23, at 359, 372–76 (same). Six states (Rhode Island, Nevada, Illinois, Indiana, Florida, and Delaware) allow their citizens to bring *qui tam* actions for tax fraud. Kwon, *supra* note 87, at 457 n.59.

135. INTERNAL REVENUE MANUAL, *supra* note 89, § 25.2.2.3. Form 211 includes attachments that describe "specific [facts] and credible information" about the alleged violation, the relationship between the taxpayer and whistleblower, how the information was obtained, and the amount owed. I.R.S. Notice 2008-4 I.R.B. 254 (Jan. 14, 2008). The whistleblower must reveal their identity in submitting the award request because the request must be signed under the penalty of perjury. *Id.*

requirements.¹³⁶ Claims that pass the initial review are sent to a subject matter expert (SME) at the operating divisions for evaluation.¹³⁷ The SME will debrief the whistleblower and determine whether to pursue the claim.¹³⁸ Pursued claims are forwarded for examination, and those not pursued are returned to the Whistleblower Office.¹³⁹ At the end of examination, an award claim file is created to assist the Whistleblower Office in determining whether to make an award.¹⁴⁰ The Whistleblower Office will determine the amount of the award and will notify the whistleblower in writing of its determination.¹⁴¹

3. *New Tax Court Appeal Right.* Whistleblowers can appeal the award determination under Section 7623(b) to the U.S. Tax Court, while determinations under Section 7623(a) cannot be appealed.¹⁴² The whistleblower must appeal within thirty days of the award determination.¹⁴³ A contract is no longer necessary for an individual to appeal an award under Subsection (b).¹⁴⁴ Whistleblower claims may be appealed only if the IRS “actually proceeds with an administrative or judicial action.”¹⁴⁵

The IRS issued proposed regulations that would provide guidance for the IRS whistleblower program. The proposed regulations clarify that the IRS does not have to pay an award if it does not take some action beyond simply analyzing the

136. FISCAL YEAR 2012 REPORT, *supra* note 18, at 3, 7. The Whistleblower Office also determines whether a fraud referral should be made to the Criminal Investigation Division. INTERNAL REVENUE MANUAL, *supra* note 89, § 25.2.2.7(2).

137. *Id.* § 25.2.2.6.

138. *Id.* § 25.2.2.7(7).

139. *Id.* § 25.2.2.6.

140. *Id.* § 25.2.2.6(6).

141. *Id.* §§ 25.2.2.2(9), 25.2.2.6(20), 25.2.2.13.

142. 26 U.S.C. § 7623(b)(4) (2012); I.R.S. Notice 2008-4 I.R.B. 254 (Jan. 14, 2008) (“[T]here is no right to appeal to the Tax Court for claims under section 7623(a.”); *see also* *Dacosta v. United States*, 82 Fed. Cl. 549, 555 (2008) (noting the Tax Court has exclusive jurisdiction over claims under Section 7623(b)).

143. 26 U.S.C. § 7623(b)(4).

144. *Id.* § 7623(b)(6)(A). Although an individual cannot appeal under subsection (a), the whistleblowers can still challenge an award or denial under the Tucker Act. *See supra* text accompanying notes 94–95.

145. 26 U.S.C. § 7623(b)(4) (“Any determination regarding an award under paragraph (1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court”); Kwon, *supra* note 87, at 465. Paragraph (1) of Section 7623(b) is operative only if the IRS proceeds with “administrative or judicial action” based on the whistleblower’s information. 26 U.S.C. § 7623(b)(1). Paragraphs (2) and (3) reduce the award if the whistleblower was not the original source of information or the whistleblower planned or initiated the underlying action. *Id.* § 7623(b)(2)–(3).

information submitted to it.¹⁴⁶ The IRS “proceeds based on the information” when the IRS “initiates a new action that it would not have initiated, expands the scope of an ongoing action that it would not have expanded, or continues to pursue an ongoing action that it would not have continued but for the information provided.”¹⁴⁷ If the IRS does not take any action based on a whistleblower’s provided information, then the determination is not appealable.¹⁴⁸ The Tax Court cannot force the IRS to act on a whistleblower’s claim to pursue the taxpayer.¹⁴⁹

IV. PRACTICAL AND ETHICAL IMPLICATIONS OF BOUNTY AWARDS

Whistleblower programs are disconcerting because utilizing a whistleblower is a strategy that often relies on bad blood—office politics, vengeance, divorce, etc.—to bring information to the government’s attention.¹⁵⁰ There are serious moral issues with paying financial awards to motivate individuals to report noncompliance tax issues. Does the government truly need to appeal to the self-interest of our citizenship to get citizens to stand up and speak out against wrongdoers? Furthermore, the IRS can award criminals—e.g., Birkenfeld discussed in Part I—who are not the mastermind of the tax violations.¹⁵¹ Is it not morally reprehensible to allow a criminal to become wealthy from a tax evasion scheme in which he was personally involved? Because whistleblowers are not viewed in a positive light, potential whistleblowers face hurdles in their decision as to whether they will report violations to the government. This Part delves into the complex motivations of whistleblowers and analyzes the practical implications of the increased mandatory bounty awards, which include an increase in administrative costs and circumvention of companies’ internal compliance systems.

146. Awards for Information Relating to Detecting Underpayments of Tax or Violations of the Internal Revenue Laws, 77 Fed. Reg. 74,798, 74,800 (Dec. 18, 2012).

147. *Id.*

148. Kwon, *supra* note 87, at 465.

149. See *Cohen v. Comm’r*, 139 T.C. 299, 302 (2012) (holding that the court cannot order the IRS to pursue a claim when the IRS has decided not to pursue any administrative action or collect any proceeds).

150. Victor Fleischer, *A Strategy of Tattletales at the I.R.S.*, N.Y. TIMES (Sept. 20, 2012), http://dealbook.nytimes.com/2012/09/20/a-strategy-of-tattletales-at-the-i-r-s/?_r=0.

151. *Supra* Part I; see also Kocieniewski, *supra* note 1.

A. *The Price of Blowing the Whistle*

“Paying cash awards to individuals who turn in delinquent taxpayers [is] controversial.”¹⁵² During the debate of the 1998 Internal Revenue Service Restructuring and Reform Act, Senator Harry Reid proposed eliminating the IRS whistleblower program, which he referred to as the “Reward for Rats Program” and the “Snitch Program.”¹⁵³ Senator Reid found the idea of paying “snitches” to rat on their “associates, employers, relatives, and [ex-spouses]” as “unseemly, distasteful, and just wrong.”¹⁵⁴ Eight years later in 2006, Congress modified the program to boost the IRS’s authority to pay awards to tax whistleblowers.¹⁵⁵ Despite the moral hazards of a bounty program, it survives because it brings in tips.¹⁵⁶ Programs that enhance tax enforcement efforts are appealing to lawmakers because they tighten the tax gap.¹⁵⁷

If an informant wants to seek a bounty award, the informant should understand the potential implications of turning in the employer and that filing a tax whistleblower claim is not a get-rich-quick scheme. One lawyer describes the decision as “a life-changing experience.”¹⁵⁸ There is a high degree of whistleblower bankruptcy, and whistleblowers often become unemployable.¹⁵⁹ Potential whistleblowers often fear retaliation for disclosing their

152. Kwon, *supra* note 87, at 448–49.

153. 144 CONG. REC. S4379, S4397–98 (daily ed. May 6, 1998) (statement of Sen. Harry Reid); *see also* Ralph Vartabedian, *IRS ‘Rewards-for-Snitches’ Program Comes Under Fire*, L.A. TIMES, Apr. 15, 1998, at A1 (referring to whistleblowers as “paid stool pigeons”).

154. 144 CONG. REC. S4379, S4398 (daily ed. May 6, 1998) (statement of Sen. Harry Reid); *see, e.g.*, Vartabedian, *supra* note 153 (“Many experts say the [IRS whistleblower] program is one of the most unseemly parts of the U.S. tax system.”); Kara Scannell, *Ex-Wife Gets Payment over Pequot Case*, WALL ST. J., July 24–25, 2010, at B3 (discussing a case in which an ex-wife received an award for giving information on her ex-husband’s fraud).

155. 26 U.S.C. § 7623(b) (2012).

156. *See* Ferziger & Currell, *supra* note 68, at 1143 (noting that the bounty programs bring in tips that the government would not otherwise have investigated).

157. *See* U.S. DEP’T OF THE TREASURY, UPDATE ON REDUCING THE FEDERAL TAX GAP AND IMPROVING VOLUNTARY COMPLIANCE 5, 31 (2009), *available at* http://www.irs.gov/pub/newsroom/tax_gap_report_final_version.pdf.

158. Paul Sullivan, *The Price Whistle-Blowers Pay for Secrets*, N.Y. TIMES, Sept. 22, 2012, at B1; *see also* Rapp, *supra* note 21, at 61 (“[W]histleblowers face significant barriers, including social ostracism, loss of employment, ‘blacklisting’ within an industry, and even threats of physical violence.”).

159. Sullivan, *supra* note 158 (commenting that “[h]ome foreclosures, divorce, suicide and depression” are associated with whistleblowing); *see also* Welch v. Chao, 536 F.3d 269, 274, 279 (4th Cir. 2008) (finding that an employee could not prove retaliatory discharge because he did not engage in protected activity as defined the law). David Welch, for example, lost his job after blowing the whistle on his former employer. *Id.* at 274.

employer's illegal activity.¹⁶⁰ The IRS whistleblower program does not prohibit retaliation, but the IRS protects the whistleblower's identity.¹⁶¹ However, the confidentiality of the whistleblower's identity is qualified.¹⁶² Assuming the individual meets the requirements and receives an award from the IRS, the payoff is usually a small amount in comparison to Birkenfeld's award.¹⁶³ Doing the "right" thing can be emotionally costly, and to make matters worse, the process is very long.¹⁶⁴

B. What Motivates Whistleblowers?

"The motivations . . . of whistleblowers . . . [are] relatively under-researched."¹⁶⁵ The primary purpose of the IRS whistleblower program is to encourage the reporting of major tax noncompliance issues. Scholars argue that those who have useful information often do not have clean hands.¹⁶⁶ Stephen Whitlock, the first director of the IRS Whistleblower Office, commented that "the

160. ETHICS RES. CTR., NATIONAL BUSINESS ETHICS SURVEY: AN INSIDE VIEW OF PRIVATE SECTOR ETHICS 6 (2007), available at http://www.ethics.org/files/u5/The_2007_National_Business_Ethics_Survey.pdf (finding that 36% of employees who witnessed misconduct but did not report it feared retaliation from at least one source). "A strong enterprise-wide ethical culture dramatically decreases misconduct, increases the likelihood of reporting, and reduces retaliation against employees who report." *Id.* at 10.

161. FISCAL YEAR 2011 REPORT, *supra* note 11, at 13 (noting that other federal whistleblower laws prohibit retaliation). There may be recourse under state law, although federal law does not provide a remedy for tax whistleblowers. *Id.*

162. *Id.* The IRS may reveal the whistleblower's identity if the whistleblower is a key witness or if the court orders the IRS to do so. *Id.* "If an informant's testimony is indispensable, anonymity is impossible to maintain under the Sixth Amendment." Ferziger & Currell, *supra* note 68, at 1157. Even if the testimony is unnecessary to prove the offense, the defendant's Sixth Amendment right may permit discovery of the informant's identity. *Id.*

163. Sullivan, *supra* note 158 (noting that the IRS paid \$8 million to 97 people in 2011 and anticipate paying \$24 million to 100 people in 2012, excluding Birkenfeld's \$104 million award).

164. *See id.* (describing millionaire whistleblowers who quiver and cry while trying to tell their stories); *see also* Dean Zerbe, *The IRS Whistleblower Program: What to Do When the IRS Isn't Moving on Your Submission*, FORBES (Nov. 14, 2013), <http://www.forbes.com/sites/deanzerbe/2013/11/14/the-irs-whistleblower-program-what-to-do-when-the-irs-isnt-moving-on-your-submission/> (detailing the lengthy submission process).

165. Justin Blount & Spencer Markel, *The End of the Internal Compliance World as We Know It, or an Enhancement of the Effectiveness of Securities Law Enforcement? Bounty Hunting Under the Dodd-Frank Act's Whistleblower Provision*, 17 FORDHAM J. CORP. & FIN. L. 1023, 1048 (2012). Some scholars attribute the lack of research in this area to the difficulty of finding individuals with knowledge of illegal conduct who agree to identify themselves to the researcher. *Id.*

166. *See supra* note 21 and accompanying text (recognizing that though whistleblowers have unique access to information about violations, they may not have clean hands).

law recognizes that [whistleblowers may have dirty hands], and that's OK."¹⁶⁷

The decision to blow the whistle is difficult and complex with different factors driving the whistleblower to come forward, such as the potentially devastating personal consequences.¹⁶⁸ Other factors that play a role include the level of moral outrage at the conduct, the organizational status of the violator, and the scale of the harm.¹⁶⁹ A recent study by Yuval Feldman and Orly Lobel suggests that “no one-size-fits-all policy design exists, but . . . policy makers must evaluate the full scope of psychological and situational factors in order to design the most efficient incentive structures.”¹⁷⁰ The empirical study examines legal mechanisms that are designed to encourage reporting, including anti-retaliation protection, a duty to report, and monetary incentives.¹⁷¹ Although a financial reward might be a motivation of whistleblowers, the desire to profit is not always the driving motive.¹⁷² Moral outrage,¹⁷³ religion or faith,¹⁷⁴ and revenge¹⁷⁵ can each play a substantial role in motivating a whistleblower to come forward. Many are motivated by “legitimacy,” which is a “feeling of obligation to obey the law and

167. Sullivan, *supra* note 158. Under Section 7263, there is a distinction between one who is a participant and one who is the mastermind. See 26 U.S.C. § 7623(b)(3) (2012) (stating that an award is reduced for those who planned and initiated the actions, but those who are convicted for their role of planning and initiating are denied an award).

168. Sullivan, *supra* note 158; see also Blount & Markel, *supra* note 165, at 1048 (“Understanding why employees blow the whistle as opposed to taking other available actions is difficult because it involves the interaction of internal motivations (such as individual employees’ sense of morality, altruism or self-interest), as well as organizational and environmental considerations (such as ethical culture, internal governance policies, organizational environment and regulatory environment).” (footnote omitted)).

169. Blount & Markel, *supra* note 165, at 1048.

170. Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality*, 88 TEX. L. REV. 1151, 1207 (2010); see also Sullivan, *supra* note 158 (commenting that there is a divide on whether the money award is important to whistleblowers). For some, the financial incentive is the deciding factor, but others are motivated to right a wrong. *Id.*

171. Feldman & Lobel, *supra* note 170, at 1154.

172. *Id.* at 1173–74.

173. *Id.*

174. See Eamon Javers, *Religion, Not Money, Often Motivates Corporate Whistleblowers*, CNBC (Feb. 12, 2011), <http://www.cnbc.com/id/41494697> (“[W]histleblowers can be deeply religious people, whose faith gives them an identity outside their corporate life.”).

175. Jonathan Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 MICH. L. REV. 1899, 1907 (2007); see also Vartabedian, *supra* note 153 (commenting that informants are “[m]otivated by a combination of greed and revenge”).

to defer to the decisions made by legal authorities.”¹⁷⁶ And, a desire to clear one’s name can also be a key factor.¹⁷⁷

The Feldman and Lobel study showed that respondents overwhelmingly were motivated by “intrinsic ethical concerns [rather] than the actions of others.”¹⁷⁸ Scholars have commented that “[w]histleblowing is often regarded as akin to betrayal, a decision to bring the organisation into disrepute.”¹⁷⁹ Whistleblowers are often not praised as social or corporate heroes.¹⁸⁰ When a legal violation is morally offensive, creating a duty to report may be more effective as it supports good citizenship behavior.¹⁸¹ The study suggests existing laws may have “inadvertent counterproductive effects by offering monetary incentives rather than triggering internal motivations of potential reporting individuals.”¹⁸² It is important for legislators to understand that in creating the optimal whistleblower program, there are factors other than a financial reward that influence the decision to turn in employers.¹⁸³

C. Ineffectiveness of Bounty Awards

Expected bounty awards are one of the important factors that influence an individual’s decision to blow the whistle, but there are also other factors that motivate a whistleblower, as discussed above.¹⁸⁴ The whistleblower’s uncertainty can be

176. Tom R. Tyler & Jeffrey Fagan, *Legitimacy and Cooperation: Why Do People Help the Police Fight Crime in Their Communities?*, 6 OHIO ST. J. CRIM. L. 231, 235 (2008).

177. See Sullivan, *supra* note 158 (describing a case in which an individual spent his life savings on litigation to clear his name). The individual stated that he may not get an award as large as Birkenfeld’s, but “I’ll get a different pot of gold that is more important to me. I’ve lost everything, but I haven’t lost me.” *Id.*

178. Feldman & Lobel, *supra* note 170, at 1156.

179. James Gobert & Maurice Punch, *Whistleblowers, the Public Interest, and the Public Interest Disclosure Act 1998*, 63 MOD. L. REV. 25, 27 (2000). There is motive to “suffer in silence” out of fear of harassment. See Feldman & Lobel, *supra* note 170, at 1158 (internal quotation marks omitted). Other scholars have commented that whistleblowing could be “professional suicide.” Gobert & Punch, *supra*, at 35. For example, some WorldCom employees told auditors that they “wish they had left the accounting issues alone.” Susan Pulliam & Deborah Solomon, *Uncooking the Books: How Three Unlikely Sleuths Discovered Fraud at WorldCom*, WALL ST. J., Oct. 30, 2002, at A1.

180. TERANCE D. MIETHE, WHISTLEBLOWING AT WORK: TOUGH CHOICES IN EXPOSING FRAUD, WASTE, AND ABUSE ON THE JOB 12 (1999) (claiming that a whistleblower is normally “considered a lowlife who betrays a sacred trust largely for personal gain”). *But see* Rapp, *supra* note 21, at 56 (“In the popular press whistleblowers are heralded as heroes.”).

181. Feldman & Lobel, *supra* note 170, at 1155.

182. *Id.*

183. See *id.* (“[I]n laws that are likely to trigger strong internal ethical motivation, offering monetary rewards may be unnecessary or, worse yet, counterproductive.”).

184. See Ferziger & Currell, *supra* note 68, at 1184 (naming as other motivating factors “retaliation, bankruptcy, [and] settlement”).

attributed to an agency's discretion to award a reduced bounty or no bounty.¹⁸⁵ However, with the 2006 amendments, the whistleblower's uncertainty is largely eliminated under Section 7623(b) because the whistleblower is certain to receive a reward of at least 15% provided that the information results in a sanction exceeding \$2 million.¹⁸⁶ The excessive mandatory awards provided by the IRS whistleblower program are likely to have several implications, including an increase in the number of whistleblower claims,¹⁸⁷ a burden on administrative costs,¹⁸⁸ and employees' circumvention of companies' internal compliance systems.¹⁸⁹

1. *Excessive Bounties.* The IRS whistleblower program overincentivizes whistleblowing and wastes administrative resources because it provides excessive awards. Although the purpose of increasing the bounty award was to encourage high-quality claims, the large monetary awards are unnecessary in advancing the goal.¹⁹⁰ The whistleblower program incentivizes whistleblowing by providing a mandatory reward to informants who provide original information about a potential tax violation.¹⁹¹ The severity of the wrongdoing has a significant effect on the likelihood of reporting.¹⁹² A recent study concluded that in cases in which the whistleblower has "a greater ethical stake in the outcome," monetary incentives may be "unnecessary [and] counterproductive" because they undermine the whistleblower's internal ethical and moral motivations to report wrongdoing.¹⁹³ Thus, for severe misconduct such as tax fraud in excess of \$2 million, a large bounty award would be unnecessary and could undermine the informant's ethical motivation to come forward. The study implicitly suggests that other incentives, such as protection from retaliation or a duty to report, are stronger

185. *Id.* at 1152.

186. 26 U.S.C. § 7623(b)(1) (2012).

187. Whistleblower lawyers noted that Birkenfeld's record-setting award "has prompted a rush of would-be imitators hoping to reap big payouts for exposing tax cheats." *U.S. Tax Whistleblower Gets \$2 Million IRS Award—Lawyer*, *supra* note 14.

188. Ferziger & Currell, *supra* note 68, at 1152, 1158. The ratio of bounties awarded to penalties paid does not express the administrative costs. *Id.* at 1158. The profitability also depends upon the administrative costs of "separating the meritorious from the nonmeritorious claims." *Id.*

189. Blount & Markel, *supra* note 165, at 1039–40.

190. Feldman & Lobel, *supra* note 170, at 1155, 1207.

191. *Supra* note 114 and accompanying text.

192. *See* Feldman & Lobel, *supra* note 170, at 1194 & fig.2.

193. *Id.* at 1155, 1207.

incentives than a large reward.¹⁹⁴ Thus, “the combination of a duty [to report] and a high level of internal motivation results in the highest level of reporting behavior.”¹⁹⁵ On the other hand, when the misconduct is low, monetary rewards matter more to the decision to report the illegality.¹⁹⁶ These results are “contrary to the basic intuition of the legal policy maker to give higher rewards as the misconduct is more severe.”¹⁹⁷ Another study shows that these “extrinsic motivators . . . do not alter the attitudes that underlie our behaviors . . . [or] create an enduring commitment to any value or action.”¹⁹⁸ The Feldman & Lobel study illustrates that excessive bounty awards may be unnecessary and counterproductive for the high-level tax fraud that the IRS is targeting.¹⁹⁹ The increased mandatory awards will also increase administrative costs due to the significant increase in claim submissions.

2. *Administrative Costs.* When the monetary rewards are high, “every potential informant with a crumb of information might crawl out of the woodwork hoping to hit the bounty jackpot.”²⁰⁰ Whistleblowers may race to report alleged violations before they confirm the allegations are valid in order to be the original source of information.²⁰¹ Unlike the False Claims Act, under which the government does not conduct most of the litigation,²⁰² the administration under the IRS whistleblower program will have to devote further resources to investigate the alleged misconduct.²⁰³ Given that the 2006 amendments will likely result in a drastically increased amount of whistleblower claims, agencies will expend additional “time and resources . . . to sort good tips from bad.”²⁰⁴ The rules provide that whistleblowers

194. *Id.* at 1195.

195. *Id.*

196. *Id.* at 1194–95.

197. *Id.* at 1204.

198. Alfie Kohn, *Why Incentive Plans Cannot Work*, HARV. BUS. REV., Sept.–Oct. 1993, at 54, 55 (emphasis omitted).

199. Feldman & Lobel, *supra* note 170, at 1203.

200. Ferziger & Currell, *supra* note 68, at 1152.

201. Blount & Markel, *supra* note 165, at 1039, 1041.

202. Ferziger & Currell, *supra* note 68, at 1159 (“Of the first four hundred [False Claims Act] cases filed, the Department of Justice . . . joined as a litigant in only seventy; the others proceeded privately.”).

203. *Id.* at 1158; *see also* Blount & Markel, *supra* note 165, at 1041 (noting that a rush of claims after the amendments will cause a burden on administrative costs).

204. Ferziger & Currell, *supra* note 68, at 1171. Implementing whistleblower programs also has ethical implications, and the morality of rewarding informants has been disputed. *Id.* at 1191–92. A common opinion is that informants “should come forward with information voluntarily,” rather than being bribed to disclose illegal activity. *Id.* at

must declare under the penalty of perjury that their submissions are truthful to the best of their knowledge.²⁰⁵ However, the rules do not prevent whistleblowers from reporting claims *in the hopes* that they will result in sanctions exceeding \$2 million. Thus, while the submissions may not constitute perjury, they may not be of the large amount sought by legislators when drafting the 2006 amendments.²⁰⁶

The IRS whistleblower program was profitable before the 2006 amendments,²⁰⁷ but the IRS did not pay the maximum reward of 15%.²⁰⁸ In 1993, the IRS paid an average reward of 3%.²⁰⁹ The IRS paid small percentages and small rewards to a small number of claimants.²¹⁰ Under the 2006 amendments, the IRS must pay eligible whistleblowers at least 15% of the collected proceeds, assuming the whistleblower provides original information that substantially contributes to the prosecution of an action that collects more than \$2 million.²¹¹ Thus, it is questionable whether the post-2006 whistleblower program will turn a profit. While the rush of claims under the amended program will increase administrative costs, large potential awards will also cause employees to bypass their companies' internal corporate compliance systems because employees will want to reap a big award.

3. *Internal Compliance System.* The IRS whistleblower program is likely to undermine companies' established internal compliance systems. As discussed above, whistleblowers play an important role in corporate governance. Employees are in a unique position to detect corporate fraud and can help maintain corporate integrity by detecting and reporting fraud early.²¹² “[T]he threat of external whistleblowing is a potentially effective method to monitor internal compliance programs that are not

1191–92. One U.S. District Court Judge noted, “I don’t think that turkeys like [whistleblowers] ought to receive a dime of my money.” *Id.* at 1191 (quoting Judge Alcee Hastings). Others, however, do not find such whistleblower incentives to be immoral. *Id.* at 1192. Some view whistleblower programs as “right and honorable” and believe that whistleblowers are protecting the public. *Id.*

205. INTERNAL REVENUE MANUAL, *supra* note 89, § 25.2.2.3(2).

206. *See supra* note 119 and accompanying text (stating the threshold requirement of \$2 million).

207. Ferziger & Currell, *supra* note 68, at 1166–67.

208. *Id.* at 1167.

209. *Id.*

210. *Id.* at 1168.

211. 26 U.S.C. § 7623(b)(1) (2012).

212. *See supra* Part II.A (discussing corporate governance and its role in preventing and detecting fraud).

enforced.”²¹³ However, a better solution would be to require the employee to first report the fraud internally because the company can correct the fraud quicker than the claim sitting with the IRS for several years.²¹⁴ By diverting tips from private channels to the government, the violations will “last longer and grow more serious.”²¹⁵ Kathleen Casey, the SEC Commissioner, commented that the public investigative process is “substantially more ponderous and time-consuming than private investigative processes.”²¹⁶

A study found that “when an organization emphasizes internal compliance, it can have a positive effect on the willingness of employees to internally report illegal behavior and a negative effect on external reporting.”²¹⁷ Under the current IRS whistleblower program, informants can report the misconduct directly to the IRS, and there is no obligation or incentive to report internally to their company. Informants who seek external rewards may be seen as motivated by personal gain rather than improving corporate compliance.²¹⁸ Thus, the circumvention of reporting internally contributes to the social stigma associated with whistleblowers. The external bounty award, without a duty to report internally, vitiates the company’s efforts to create and implement an effective compliance system.

V. SUGGESTED CHANGES TO THE IRS WHISTLEBLOWER PROGRAM

Although the 2006 amendments improved the IRS whistleblower program, the program needs more reform in order to achieve its objective. While there are moral issues with rewarding whistleblowers, it is highly unlikely that the government will abandon this long-standing strategy, so Congress should focus on creating the optimal bounty program. As the Feldman and Lobel study suggests, large bounty awards are unnecessary and undermine an informant’s internal motivation to report when the illegality is severe.²¹⁹ Because the IRS is targeting major tax noncompliance

213. Blount & Markel, *supra* note 165, at 1043.

214. See FISCAL YEAR 2012 REPORT, *supra* note 18, at 1 (noting that the time between the whistleblower’s reporting of the fraud and the receipt of award can be “several years”).

215. See Casey, *supra* note 57.

216. *Id.*

217. Blount & Markel, *supra* note 165, at 1050.

218. See MIETHE, *supra* note 180, at 12 (commenting that whistleblowers betray a “sacred trust” for their own personal gain).

219. Feldman & Lobel, *supra* note 170, at 1204, 1207.

claims,²²⁰ the IRS should take into consideration stronger incentives, including a duty to report internally and retaliation protections.²²¹ This Part recommends several changes to address the deficiencies in the IRS whistleblower program.

A. *Duty to Report Internally*

Do we want a program that focuses on curing a problem or preventing a problem?²²² A requirement that a whistleblower report internally to the company would seek to intervene and prevent a bigger problem. Under the IRS whistleblower program, there is no requirement to report violations through the internal channels of a company.²²³ Although a bounty award could be lucrative to an informant, bringing an internal claim would likely be easier. Internal claims can be addressed earlier before the violations grow and become more serious.²²⁴ Companies should be given the opportunity to step in and confront fraud within the organization.²²⁵ Legislators should require the whistleblower to first report the alleged illegal conduct to the employer's internal compliance system, and if the issue is not resolved, only then should the whistleblower be allowed to file a claim with the IRS.²²⁶ By requiring a whistleblower to report first through the company's internal compliance system, management would be provided with the opportunity to remedy the alleged violation

220. See 26 U.S.C. § 7623(b)(5)(B) (2012) (offering whistleblower awards only when the amount alleged is greater than \$2 million).

221. See *supra* text accompanying notes 193–94 (noting that other incentives play a stronger role with severe illegal conduct).

222. See, e.g., Casey, *supra* note 57 (suggesting that one material flaw of the whistleblower provision of another fraud statute, the Dodd–Frank Act, undermined internal compliance programs). The SEC Commissioner stated that by not requiring whistleblowers to report internally to their company, the SEC has “implement[ed] a whistleblower program that favors a pound of cure over an ounce of prevention.” *Id.*

223. See 26 U.S.C. § 7623. While the SEC provides an incentive to report internally by providing for an increased award, it is unlikely the increased award will outweigh the potential whistleblower's fear of retaliation. See Desai, *supra* note 30, at 443–44; see also Ventry, *supra* note 23, at 386.

224. See Casey, *supra* note 57 (“Unlike a company engaged in the act of self-policing, the Division must observe numerous legal formalities that are required of government actors. As a consequence, the public investigative process can be substantially more ponderous and time-consuming than private investigative processes. And there is a danger in not addressing matters quickly and decisively. By diverting tips and complaints from private channels to the Commission, we may end up permitting violations to last longer and grow more serious. This cannot be the result intended by Congress . . .”).

225. See Blount & Markel, *supra* note 165, at 1040.

226. See *id.* at 1043 (implicating the importance of whistleblower provisions as a balance to the self-regulation required for effective fraud deterrence in the context of the Dodd–Frank bounty program).

early and minimize the adverse consequences to the company.²²⁷ Furthermore, reporting internally, instead of externally to the IRS, reduces the negative social stigma attached to whistleblowing.²²⁸ By reporting the tax issue to the company, the whistleblower is seen as enforcing corporate governance and not seen as seeking personal gain.

B. Timeliness and Private Cause of Action

A tax whistleblower may not receive an award determination from the IRS for several years after filing the claim.²²⁹ The IRS paid the first award under Section 7623(b) in fiscal year 2011.²³⁰ The IRS has paid five claims under Section 7623(b), and most of the awards paid during fiscal year 2012 were claims filed under the prior law.²³¹ The IRS indicated that the quantity of awards under the revised law is “not projected to grow dramatically” in fiscal year 2013.²³²

A private cause of action is one solution to addressing fraud in a more efficient and timely manner.²³³ A private cause of action “prevent[s] the most frivolous claims from going forward.”²³⁴ The FCA system weeds out the meritless claims because the claimant’s complaint must comply with the Federal Rules of Civil Procedure.²³⁵ The FCA reduces the number of claims the government examines and provides the government the option to pay a higher bounty rather than incurring litigation costs.²³⁶

227. See Rapp, *supra* note 21, at 61–62 (“Reputational injury to the corporation will be minimized where it responds promptly and concertedly to a whistleblower’s allegations.” (footnote omitted)).

228. See Albert D. Clark, *Ethical Implications of Whistle Blowing*, 42 LA. B.J. 364, 365–67 (1994) (describing the social stigma associated with external whistleblowing and arguing that employees should exhaust internal remedies before reporting improprieties to the authorities); see also *supra* notes 153–54 and accompanying text (describing the stigma attached to whistleblowers who benefit financially from “snitching” on others).

229. FISCAL YEAR 2012 REPORT, *supra* note 18, at 1 (noting that the taxpayer must exhaust all appeals rights and the statutory period for filing a claim for refund must expire before the whistleblower receives the award); see also TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 106, at 2 (finding that the timeliness standards for processing claims are insufficient and inconsistent). When there are protracted appeals or collection actions, the process may last five to seven years. FISCAL YEAR 2012 REPORT, *supra* note 18, at 16.

230. FISCAL YEAR 2012 REPORT, *supra* note 18, at 6.

231. *Id.* at 1, 6.

232. *Id.* at 6

233. Ventry, *supra* note 23, at 370 (commenting that FCA *qui tam* suits have “proven effective in exposing fraud committed against the federal government”); see also *supra* note 77 and accompanying text (stating the FCA is the most successful bounty program).

234. Ferziger & Currell, *supra* note 68, at 1159.

235. *Id.*; see also *supra* note 68.

236. Ferziger & Currell, *supra* note 68, at 1159.

The IRS should use *qui tam* actions because fraud detection has proven successful through *qui tam* bounty provisions.²³⁷ When a *qui tam* bounty was available, employees accounted for 46% of fraud detection, while employees accounted for 16.3% of fraud detection without a *qui tam* action.²³⁸ As illustrated by the FCA's success, a private cause of action is the most efficient and timely.²³⁹ Scholars have suggested that *qui tam* should be extended to tax.²⁴⁰ One scholar argues that the private enforcement of public law can be a powerful monitoring and prosecutorial mechanism when "due to asymmetric information and active concealment [by] regulated entities," regulators are "unable to enforce and prosecute the law effectively."²⁴¹ The possibility of a *qui tam* lawsuit could "alter risk assessments of reporting positions by taxpayers and their advisors and thereby improve tax compliance."²⁴²

C. Nominal Cap and Reduction for Felons

High bounties will likely cause a surge in tax whistleblower claims as informants seek to hit the jackpot.²⁴³ The administrative cost of working through such a vast amount of claims may exceed the benefit from enticing a few risk-averse informants for high-level crimes.²⁴⁴ Higher bounty awards would decrease revenues due to the higher bounty cost.²⁴⁵ Although bounty awards need to be large enough to justify the risk of unemployment, retaliation protections could also serve this purpose.

Legislators should cap the mandatory award for eligible whistleblowers. Legislators could argue that a large bounty is needed to incentivize potential whistleblowers, as the previous

237. Rapp, *supra* note 21, at 61; Rosenberg, *supra* note 134, at 212–18; Ventry, *supra* note 23, at 370–72.

238. Rapp, *supra* note 21, at 61.

239. See Ventry, *supra* note 23, at 368, 370, 382 & n.139; see also FISCAL YEAR 2011 REPORT, *supra* note 11, at 1 (stating that it takes several years for the IRS to pay an award because the taxpayer's appeals period must lapse); *supra* note 11 (noting that at least four years lapsed before the first award was paid out).

240. See Rosenberg, *supra* note 134, at 208–09, 211–12.

241. Ventry, *supra* note 23, at 371. Taxpayers pay money to advisors skilled at concealing information from regulators, so it is efficient to provide incentives for private persons to step up with information about tax abuse. *Id.*

242. *Id.* at 372.

243. See Ferziger & Currell, *supra* note 68, at 1152 (predicting that high potential awards in any federal civil bounty program will lead to a flood of claims).

244. *Id.*

245. *Id.*

program was unsuccessful.²⁴⁶ However, the award was discretionary before 2006, so it is difficult to argue that the award amount, not the inconsistent application, was the reason for the unsuccessful program.²⁴⁷

Additionally, Congress should eliminate or reduce the reward considerably for those whistleblowers who engaged in the illegal conduct.²⁴⁸ The IRS whistleblower law does not preclude paying a whistleblower payout to convicted felons like Birkenfeld,²⁴⁹ as long as the whistleblower is not convicted for the role of planning or initiating the tax fraud.²⁵⁰ A whistleblower's illegal conduct should matter.²⁵¹ Under the SEC's program, Birkenfeld would not receive an award.²⁵² The IRS should not award a significant sum of money to a convicted felon for ratting out a tax evasion scheme in which he was personally involved.²⁵³ A convicted felon complicit in a tax evasion scheme should not make \$4,600 for every hour he spent in prison.

Furthermore, high monetary awards for violations involving high levels of moral outrage are unnecessary and counterproductive.²⁵⁴ Although a low award may affect an informant's decision to report matters of a smaller scale, a high bounty can be ineffective in encouraging informants to report serious violations.²⁵⁵ A large bounty undermines the whistleblower's internal motivation to report illegal conduct, so the uncapped dollar bounty awards under Section 7623(b) are counterproductive. By framing external reporting as a "commodity with a price tag attached," the large bounty award

246. See Ventry, *supra* note 23, at 362–64.

247. See *supra* Part III.A.

248. See Sullivan, *supra* note 158 (noting that Birkenfeld's award is complicated because some see him as a "felon who was complicit in the crime he reported and does not deserve his reward").

249. See 26 U.S.C. § 7623(b)(3) (2012) (describing the situations in which those involved in the fraud can collect an award); see also Gittleman, *supra* note 56 (suggesting that while Birkenfeld received an award under the IRS whistleblower program, he would not have received an award from the SEC).

250. 26 U.S.C. § 7623(b)(3).

251. See Sullivan, *supra* note 158 (commenting that an award to a convicted felon is complicated and suggesting that a felon does not deserve an award).

252. 15 U.S.C. § 78u-6(c)(2)(B) ("No award . . . shall be made . . . to any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award . . ."); Gittleman, *supra* note 56.

253. See Sullivan, *supra* note 158 (noting the tension in awarding convicted felons); see also *supra* note 204 (stating that the morality of awarding whistleblowers is disputed).

254. Feldman & Lobel, *supra* note 170, at 1207.

255. *Id.* at 1192–93.

“may actually suppress internally motivated action.”²⁵⁶ Thus, the IRS should put a nominal cap on the award amount and reduce the award considerably for criminals.

D. Greater Retaliation Protections

The 2006 amendments to Section 7623 failed to provide sufficient protection for whistleblowers, even though the fear of retaliation is one of the greatest concerns for an informant.²⁵⁷ Potential whistleblowers fear retaliation because they are putting their careers, and sometimes even their lives, at risk.²⁵⁸ The IRS acknowledged that Section 7623 does not prohibit retaliation against the whistleblower.²⁵⁹ The IRS whistleblower program provides that the whistleblower’s identity remains a secret unless the whistleblower must testify in court.²⁶⁰ However, the IRS should provide greater retaliation protections like those found in the FCA and the Dodd–Frank Act.

Other federal whistleblower programs have retaliation protection, which provide for reinstatement of seniority status, back pay, and compensation for special damages.²⁶¹ “Although an informant may not find his former workplace a pleasant . . . environment,” the retaliation protections ensure that the whistleblower remains employed and “receives compensation for any harm suffered in the workplace,” thus mitigating the retaliation costs.²⁶² By increasing retaliation protections, the reward can be lowered because the whistleblower incurs less risk than without retaliation measures. Because informants fear retaliation, the IRS should statutorily provide for retaliation protections just like the other federal bounty programs explicitly provide.

256. *Id.* at 1202.

257. Ventry, *supra* note 23, at 386.

258. ETHICS RES. CTR., *supra* note 160, at 6; Rapp, *supra* note 21, at 61.

259. *See* FISCAL YEAR 2012 REPORT, *supra* note 18, at 14 (noting that there may be recourse under state law, but federal law does not provide a remedy).

260. FISCAL YEAR 2011 REPORT, *supra* note 11, at 13.

261. *See supra* text accompanying notes 47, 61, 76; *see also* Rapp, *supra* note 21, at 61 (“Anti-retaliation measures . . . are an important first step in that they may reduce some of the costs of whistleblowing and deter corporate retaliation against whistleblowers.”).

262. Ferziger & Currell, *supra* note 68, at 1174. Costs may also include “reputational harms arising from the informant’s status as a ‘snitch’ and the mental and emotional costs of testifying in litigation.” *Id.*

VI. CONCLUSION

Although the 2006 amendments revamped the IRS whistleblower program in order to reduce the tax gap, the program still has deficiencies that need to be addressed in order to make the program more effective. Most significantly, large mandatory bounties are excessive and counterproductive in furthering the goal of targeting major tax fraud because they undermine the internal motivation to report when the illegal conduct is severe. Thus, a nominal cap should be placed on the awards. Additionally, Congress should consider stronger incentives, including a duty to report internally and retaliation protections. The combination of a duty to report and a high level of internal motivation results in the highest level of reporting. By requiring an informant to report through the internal channels of the company, the informant is seen as enforcing tax compliance rather than seeking personal gain. With greater retaliation protection, a whistleblower has less risk and may be more willing to receive a smaller award. Furthermore, the enticement of uncapped awards will cause a surge in whistleblower claims, which in turn will increase the administrative costs on the IRS. Because of the vast increase in claims and the slow-moving wheels of the IRS to process claims, a *qui tam* action should be extended to tax. Fraud protection has proven to be successful with *qui tam* bounty provisions. Lastly, due to the controversial nature of financial awards for “snitches,” whistleblowers who are convicted for the fraud should receive a significantly reduced award, if one at all. Crime should not pay.

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