

Shrink the Tax Gap by Strengthening the IRS Whistleblower Program

by Dean Zerbe



Dean Zerbe

Dean Zerbe is a partner at Zerbe, Miller, Fingeret, Frank and Jadav LLP and was senior counsel and tax counsel to the Senate Finance Committee.

In this article, Zerbe explores how the IRS can crack down on tax evaders and close the tax gap by strengthening the IRS whistleblower program.

Copyright 2021 Dean Zerbe.
All rights reserved.

The Congressional Budget Office recently released its analysis¹ on the amount of revenue that will be raised through an \$80 billion increase of funding for the IRS over a 10-year period.² The CBO estimated that the increased IRS funding would result in \$200 billion in additional revenue — minus the \$80 billion in spending — for a net revenue gain of \$120 billion. This is not what those drafting the proposed \$1.9 trillion reconciliation bill wanted to hear because it is far short of the \$400 billion to \$700 billion in additional revenue projected by Treasury.³

However, there is light. Tax writers and the administration can bolster their arguments that sizable revenue can be raised by going after the tax gap (particularly as it relates to wealthy

individuals and businesses) by strengthening the IRS whistleblower program, which has a proven track record of success. Not only would strengthening the program raise additional revenue, but a robust whistleblower program would go far in ensuring that new IRS examiners and agents enjoy better success in targeting the most egregious big-time tax evaders. Happily, Congress has the answers at its fingertips with the IRS Whistleblower Program Improvement Act of 2021,⁴ the bipartisan and bicameral legislation⁵ introduced by Senate Finance Committee Chair Ron Wyden, D-Ore., and committee member Chuck Grassley, R-Iowa, on June 15. The House version of the bill (H.R. 4107) was sponsored by Rep. Mike Thompson, D-Calif., and Rep. Mike Kelly, R-Pa. There are also steps (discussed later) that the administration can take to improve the program.

Overlooking Proven Success

As the tax-writing committees look to bolster revenue from enforcement, they and the administration should consider strengthening the extraordinarily successful IRS whistleblower program, which has brought in more than \$6 billion⁶ to the treasury since it was modernized in 2006. It's worth noting that the \$6 billion-plus brought in by the whistleblower program far exceeds the expectations of the Joint Committee on Taxation estimate⁷ of \$182 million over 10 years for the 2006 reforms to the program.

¹Phillip L. Swagel, "The Effects of Increased Funding for the IRS," Congressional Budget Office (Sept. 2, 2021).

²Treasury, "The American Families Plan Tax Compliance Agenda" (May 2021).

³Treasury, "Investing in the IRS and Improving Tax Compliance" (Apr. 28, 2021).

⁴IRS Whistleblower Program Improvement Act of 2021, S. 2055, 117th Congress (2021).

⁵Geoff Schweller, "Newly Introduced Reforms to IRS Whistleblower Program Supported by Whistleblower Advocates," *Whistleblower Network News*, June 16, 2021.

⁶IRS Publication 5241, "Fiscal Year 2020 Whistleblower Program Annual Report" (2020).

Further, even the \$6 billion figure reported by the IRS significantly underestimates the amount of revenue the whistleblower program has brought in. First, the \$6 billion excludes all dollars (before 2018) collected from taxpayers (thanks to whistleblowers) that were paid to the treasury in the form of criminal penalties, foreign bank account reporting penalties, forfeitures, etc. Congress clarified the law on what constitutes “collected proceeds” for the IRS whistleblower program in 2018,⁸ leading to a big increase since then in the amounts determined to be brought in thanks to the program.

Second, the IRS Whistleblower Office’s \$6 billion figure doesn’t include the indirect effect on taxpayer behavior thanks to the whistleblower program — that is, the deterrence effect.⁹ For example, a good deal of the success of the voluntary disclosure program for illegal offshore accounts (which has brought in more than \$11 billion thanks to whistleblowers)¹⁰ has come from the concerns of tax cheats who not only have to evade the IRS but also have to worry that no one is going to blow the whistle on them.

Third, the IRS Whistleblower Office — in a significant departure from longtime practice before 2006 — is no longer giving whistleblowers any awards for information about a tax cheat first identified by a whistleblower that leads to the IRS collecting funds if the IRS collects dollars from the tax cheat on a different issue than that raised by the whistleblower.¹¹ For example, if the whistleblower tells the IRS that Mr. X is failing to report cash income from his restaurant and the IRS, based on the information provided by the whistleblower, decides to audit Mr. X and finds that Mr. X is instead failing to report cash income from his laundromat, the IRS does not give the whistleblower any award even though the IRS never would have audited Mr. X but for the

whistleblower. The whistleblower program provides key assistance to the IRS in addressing a major problem of examination — the high no-change rates of wealthy individuals.¹² Yet the IRS doesn’t include those revenues in the amounts brought in thanks to the whistleblower program.

Thus, the real number of dollars brought into the treasury (directly and indirectly) thanks to the whistleblower program is far higher than the (already impressive) \$6 billion and can be increased significantly by improving and strengthening the program with the legislation proposed by Wyden, Grassley, Thompson, and Kelly, dedicating resources from an expanded IRS to focus on whistleblower cases, and the administration championing additional reforms of the program.

Finding Wealthy Tax Evaders

The academic reports that Treasury cites¹³ to support a marked increase in IRS funding and expanded audits recognize that it is whistleblowers who have been critical in revealing wealthy individuals who are evading taxes.¹⁴

Perhaps the most sobering piece of evidence about the importance of whistleblowers comes in another academic study that Treasury cites, a National Bureau of Economic Research working paper from March titled “Tax Evasion at the Top of the Income Distribution: Theory and Evidence.”¹⁵ This NBER paper found that in IRS audits of individuals with undeclared offshore accounts, the IRS discovered only 7 percent of those accounts. To make matters worse, these IRS audits were National Research Project audits — the IRS’s version of a root canal — and yet the agency still only found the offshore account 7 percent of the time.

⁷ Joint Committee on Taxation, “Estimated Revenue Effects of the Revenue Provisions Contained in H.R. 6408,” JCX-51-06 (Dec. 7, 2006).

⁸ Dean Zerbe, “Congress in Budget Rolls Out Red Carpet for Tax Whistleblowers,” *Forbes*, Feb. 9, 2018.

⁹ Niels Johannesen and Tim Stolper, “The Deterrence Effect of Whistleblowing: Evidence From Offshore Banking,” *VoxEU.org*, July 2, 2017.

¹⁰ IRS, “IRS to End Offshore Voluntary Disclosure Program; Taxpayers With Undisclosed Foreign Assets Urged to Come Forward Now” (Mar. 13, 2018).

¹¹ *Lissack v. Commissioner*, 157 T.C. No. 5 (2021).

¹² Treasury Inspector General for Tax Administration, “The Large Case Examination Selection Method Consistently Results In High No-Change Rates” (June 22, 2020).

¹³ Niels Johannesen et al., “Taxing Hidden Wealth: The Consequences of U.S. Enforcement Initiatives on Evasive Foreign Accounts,” *12 Am. Econ. J.: Econ. Pol’y* 312 (Aug. 2020).

¹⁴ *Id.* at 316 (discussing the role of my client, Bradley Birkenfeld, the UBS whistleblower as breaking open secret Swiss banking).

¹⁵ John Guyton et al., “Tax Evasion at the Top of the Income Distribution: Theory and Evidence,” NBER Working Paper Series (Mar. 2021).

These dismal results should give strong pause to anyone who believes that “more” — more IRS agents and examiners — will alone solve the problems of uncovering tax evasion by wealthy individuals. “Smarter” is the better answer, and supporting whistleblowers is critical to smarter, targeted, and effective IRS audits. This is highlighted by the fact that it is through whistleblowers, not increased random audits, that thousands of wealthy tax evaders self-reported or were revealed. Those advocating for increased IRS resources to pay for examinations to go after high-wealth tax cheats should remember who brought them to the dance — whistleblowers.

To their credit, the authors of the NBER study recognize there are limits to what can be accomplished with a simple strategy of more audits — that audits “may not detect sophisticated evasion strategies, because doing so can require much more information, resources and specialized staff than available to tax authorities.” The answer, in part, according to the NBER study — is whistleblowers: “As standard audit procedures can be limited in their ability to detect some forms of evasion by high-income taxpayers, additional tools should also be mobilized to effectively combat high-income tax evasion. These tools include facilitating whistleblowing that can uncover sophisticated evasion (which helped the United States start to make progress on detection of offshore wealth).” The simple fact is that the discovery of the wealthiest tax evaders who commonly engage in the most sophisticated tax evasion (the hardest for the IRS to detect) is the area in which whistleblowers are most needed.

The idea that whistleblowers (particularly insiders) are critical in detecting fraud (which by design is hidden) and better at it than auditors is well known in areas outside of tax as well. For example, a recent PwC study¹⁶ found that professional auditors detected 19 percent of the frauds on private corporations. By comparison, whistleblowers exposed 43 percent. Executives said that the whistleblowers saved their shareholders billions of dollars. Congress needs

to apply these fraud detection best practices to the area of tax.

Tax whistleblowers are a key reason that usable information concerning fraud gets brought to the attention of the IRS. It’s clear that without informants, compliance rates would suffer, as standard audit programs, more IRS agents, and even the most sophisticated enforcement software won’t allow the IRS to fully tackle issues of tax fraud, especially involving wealthy individuals. It is for these reasons that former National Taxpayer Advocate Nina Olson agreed with Grassley at a May 11 Finance Committee hearing that whistleblowers were a useful tool for the IRS in dealing with the tax gap — particularly as it relates to offshore accounts.

Protecting Taxpayers

Advocates for a more robust IRS should have their eyes open that long-term support for a bigger IRS is dependent on public support for the work of the IRS. If the public’s view is that the IRS is grinding honest taxpayers and squeezing the last drops from the lemon, support for an expanded IRS will quickly turn sour.

As noted earlier, the IRS whistleblower program allows the IRS to better use its limited resources. A 2006 Finance Committee report¹⁷ showcased the findings of a Treasury Inspector General for Tax Administration report that revealed “the cost/benefit ratio of the [whistleblower] Program compared favorably with other IRS enforcement programs.” The report found that the IRS incurred slightly more than 4 cents in cost for each dollar collected from the whistleblower program, compared to a cost of greater than 10 cents per dollar collected for all enforcement programs.

Further, the TIGTA report found that “examinations initiated based on informant information had a high dollar yield per hour and a lower no-change rate when compared to returns selected using the IRS’ primary method of selecting returns, the Discriminant Index Function (DIF).” The whistleblower-based examinations were found to bring in \$946 per

¹⁶ National Whistleblower Center, “Whistleblowers Still the Best at Detecting Fraud.”

¹⁷ Finance Committee release, “Grassley: Report Shows IRS Could Better Use Whistleblowers to Catch Tax Cheats” (June 9, 2006).

hour, as opposed to DIF-selected returns that brought in only \$548 per hour. Similarly, the no-change rate was only 12 percent for the whistleblower-based audits, while it was 17 percent for DIF-selected audits, and as mentioned earlier, the no-change rate for high-end taxpayers has since ballooned to more than 47 percent. The numbers were similar when the focus was just on Small Business/Self-Employed Division cases, with whistleblower-based cases bringing in \$688 per hour, compared to \$382 per hour for DIF cases, and a 21 percent no-change rate for whistleblower-based cases as opposed to a 28 percent no-change rate for DIF cases.

Not only does the whistleblower program provide more bang for the buck and a more effective use of limited IRS Exam resources, but the lower no-change rate also means that the IRS is spending less time on unproductive audits (and bothering honest taxpayers) and more time focused on those evading tax. Thus, the whistleblower program is also taxpayer friendly. Congress has banged the drum for the idea that the new IRS funding should not go to auditing those making less than \$400,000, but instead the IRS's audit focus should be targeted on high-dollar tax evasion. Strengthening the IRS whistleblower program is a critical way to help ensure that the congressional goal of having the IRS focus on high-dollar tax evasion is realized.

Improving the Whistleblower Program

The IRS Whistleblower Office is fortunate to be staffed by dedicated and capable personnel led by engaged and knowledgeable managers that are supportive of the program. However, the Whistleblower Office labors under the problems of a small shop in a big bureaucracy. Reforms that the administration can make to improve the whistleblower program include the following:

1. Bring back discretionary "A" awards for large-dollar cases. In passing the 2006 amendments to the IRS whistleblower award program, which created the mandatory award program (section 7623(b)), Congress did not eliminate the ability of the IRS to provide discretionary awards (section 7623(a)) for cases involving unpaid taxes exceeding \$2 million. However, on its own initiative, the

IRS did eliminate the ability to provide these discretionary awards. The IRS should reinstate discretionary awards for those cases involving more than \$2 million of unpaid taxes when the IRS does not believe the assistance provided by the whistleblower rises to the threshold necessary to qualify for a mandatory award. This would be a fairer result for whistleblowers who get nothing right now even though they've provided useful and meaningful information to the IRS (for example, identifying someone evading taxes), and it would encourage other whistleblowers to come forward, thereby reducing unnecessary litigation in Tax Court.

2. Have smarter review of whistleblower submissions. The IRS needs to make better use of data analytics and incorporate the Whistleblower Office in the agency's enterprise case management system. One of the purposes of that system is to provide a 360-degree view of a taxpayer — civil, criminal, and other activity. Also, the Whistleblower Office should be given the resources to establish a central repository of all claims and use advanced data analytics and artificial intelligence to conduct link analysis for all claims. These additional steps will give the Whistleblower Office an enhanced perspective on each claim and a firmer understanding of whether a claim should be moved forward to the field.
3. Expedite Office of General Counsel guidance. A significant number of award cases are pending and waiting for months if not over a year for guidance and opinions from the Office of General Counsel. These significant delays in awards are extremely dispiriting for whistleblowers and dampen support for the program and discourage others from coming forward. The IRS Whistleblower Office had its own attorney at one time (like the Taxpayer Advocate Service and TIGTA) and that should be considered again or, alternatively, hard deadlines

- should be set on the Office of General Counsel for responses.
4. Contract with whistleblowers to consult with the IRS. One of the great benefits of a whistleblower is the ability for them to work closely with the IRS and assist the agency with their knowledge and experience. It is very difficult to convey in one filing everything a whistleblower knows from their experience — for example, 20 years working in an offshore bank. While the IRS Criminal Investigation division is superb at working with whistleblowers (as is the Department of Justice), the IRS has still never issued a section 6103(n) contract that would allow it to have a freer exchange and give-and-take with a whistleblower — and fully benefit from the whistleblower's knowledge. While the IRS Whistleblower Office and senior IRS management have been supportive of section 6103(n) contracts, engaging in them is a matter that needs to be pressed hard from IRS management to change the culture at the field level of the Large Business and International and SB/SE divisions. Recognizing and awarding IRS employees for successfully working with whistleblowers would be one way to change the outlook and mind-set of auditors and examiners.
 5. Facilitate awards. Nothing brings forward other whistleblowers more than seeing awards being given. IRS senior management needs to help the IRS Whistleblower Office identify and eliminate delays and roadblocks in awards (beyond those mentioned earlier). Further, the IRS should announce awards. I understand section 6103, but I would say that confidentiality concerns would be solvable with proper wording and also note that the SEC, the Commodity Futures Trading Commission, and the Department of Justice (with the False Claims Act) trumpet every award given. These agencies know that awards beget whistleblowers.
 6. Preach. The IRS hides its light about the whistleblower program under a bushel. The agency (outside the Whistleblower Office and the good leadership of its director, Lee Martin) does little publicly to encourage whistleblowers to come forward. The IRS should be loud and proud in asking whistleblowers to come forward and assist with information about areas of compliance. Imagine if the head of CI came out and said, "We are very interested in anyone with information about the following listed transaction; call this number or email us at. . . ." The deterrent effect alone would be significant, but this would also go a long way (along with awards) to encourage whistleblowers to come forward and have confidence that the IRS will take a hard look at their information.

Conclusion

The IRS whistleblower program is a proven success, bringing in billions of dollars — far more than was expected when the 2006 reforms were enacted. Whistleblowers bring to light tax evasion that the IRS would be unable to find even with a host of new agents. With a significant increase in IRS funding in the offing, strengthening the IRS whistleblower program should be a critical part of Congress's and the administration's efforts to effectively target high-dollar tax evaders. ■