

Cash for US Tax Whistleblowers

Most Canadian tax practitioners are familiar with the CRA's Informant Leads Program, and many undoubtedly assume that the United States runs a parallel program. This assumption is correct, but there is a critical difference between the two programs: the IRS's Whistleblower Office can pay awards to informants who are willing to reveal their identity to the IRS.

The potential quantum of the awards recently made headlines after a former UBS banker received a \$104 million reward for reporting how Swiss banks were enabling tax evasion ("Whistle-Blower Awarded \$104 Million by IRS," *New York Times* (September 11, 2012)). Bradley Birkenfeld pleaded guilty to conspiracy in 2008--a year after reporting how UBS bankers came to the United States and wooed rich Americans, managed their assets, and helped them evade tax--and was released from prison on August 1, 2012. The reward was paid to him shortly after his release.

The cash-for-tips program (authorized under Code section 7623 and regulation 301.7621-1) is divided into a permissive payment scheme (section 7623(a)) and a mandatory payment scheme (section 7623(b)). An award under section 7623(b) can be as high as 30 percent of the tax, penalties, and interest collected or of the refund denied as a result of the information provided. An award under section 7623(a) can be as high as 15 percent of the tax, penalties, and interest collected, to a maximum of \$10 million.

For a whistleblower to qualify for the more generous section 7623(b) rules, the tax, penalties, and interest in dispute must exceed \$2 million, and if the reported taxpayer is an individual, his gross income must exceed \$200,000. A reward of 15 to 30 percent must be paid (section 7623(b)(1)) if the whistleblower's information forms the basis for commencing an investigation of the reported taxpayer; a reward of up to 10 percent must otherwise be paid (section 7623(b)(2)). A determination of whether the whistleblower is entitled to a section 7623(b) award may be appealed to the Tax Court; no appeal lies from a section 7623(a) determination.

The whistleblower rules contain built-in provisions to prevent abuse. Section 7623(b)(6) and regulation 301.7623-1(f) require all tips to be submitted on IRS form 211, which contains the whistleblower's personal information and a statement that the information is submitted under penalty of perjury. Moreover, section 7623(b)(3) provides that any section 7623(b) award may be reduced if the whistleblower planned and initiated the tax evasion by the reported taxpayer, and the award must be denied if the whistleblower was convicted for his role in the reported taxpayer's evasion.

The IRS will know the whistleblower's identity after form 211 is submitted, but regulation 301.7623-1(e) generally prohibits the disclosure of his identity to the reported taxpayer or to the public. However, protection from disclosure is not absolute: the IRS will disclose the identity of a whistleblower who is an essential witness in a judicial proceeding.

How well does the whistleblower compensation program work? According to the US Government Accountability Office (GAO), the IRS has not kept sufficient records to permit a proper evaluation of the effectiveness of the program (see *Tax Whistleblowers: Incomplete Data Hinders IRS 's Ability To Manage Claim Processing Time and Enhance External Communication* (GAO 2011)). Thus, it is difficult to say with certainty whether the whistleblower program represents an effective policy.

Notwithstanding the potential for significant awards, few large payouts were made before September 2012. Under regulation 301.7623-1(c), no amount can be paid until tax has been assessed; the tax, penalties, and fines have been collected; and the time period to claim a refund or appeal has expired. The GAO reported that 66 percent of the claims submitted since the section 7623(b) rules became effective in 2006 were still in progress, and the majority of

the claims not in progress had already been rejected. The IRS said that it paid an average of 146 awards per year between 2007 and 2011, and the average award paid was \$94,070 (*Fiscal Year 2011 Report to the Congress on the Use of Section 7623* (IRS 2011)); only 38 of these awards were paid in cases that met the \$2 million threshold in section 7623(b)(5).

It is also unclear whether the IRS's financial incentives are superior to the CRA's offer of complete anonymity for would-be informants. The CRA reports that it receives about 24,000 leads annually; the GAO reported that the IRS received a total of 9,540 leads from 1,387 informants between 2007 and 2011. The leads received by the IRS generally appear to be of high quality: only 1,286 leads were rejected, and most of the remaining leads were under audit, under appeal, or in collections. Unfortunately, the CRA has not disclosed the rate at which its leads are converted to audits or result in reassessments or prosecutions, so a comparison of outcomes is impossible.

Should Canada consider adopting its own cash-for-tips program? The answer to this question likely depends on how many of the CRA's anonymous leads reveal significant non-compliance: a high volume of trivial leads or those motivated by revenge imposes an administrative burden and risks obscuring genuine leads. However, would-be informants may value their anonymity more than they value compensation. If trivial leads are a concern, they would almost certainly be eliminated by requiring informants to provide leads under penalty of perjury, but that requirement would also almost certainly eliminate leads from informants who themselves have reason to fear CRA scrutiny. Moreover, in a sluggish economy, anyone who is ambivalent about reporting tax evasion by a neighbour or business associate may be persuaded to boost his income through compensation for the lead and, in the result, also increase government revenues.

Mike Dolson

Felesky Flynn LLP, Edmonton