Rewarding Whistleblowers for Disclosing Tax Violations to the IRS

By R. Scott Oswald

In 2006, Congress revamped the IRS's program for rewarding informants who disclose tax violations. The first beneficiary of the new program was a CPA, who received a $4.5 million reward when he discovered and disclosed a tax liability greater than $20 million at a large national financial services firm. The discussion below provides an overview of the program, the requirements for disclosure, certain confidentiality rules for financial advisors, and protections under the law.

How It Works

Under the IRS Whistleblower Reward Program, an individual who exposes tax fraud can receive an award ranging from 15% to 30% of the proceeds recovered by the IRS. To qualify for an award, the tax, penalties, interest, additions to tax, and additional amounts in dispute must exceed $2 million; if the allegedly noncompliant person is an individual, the individual's gross income must exceed $200,000.

In such cases, the IRS first completes an investigation and then its whistleblower office issues a preliminary summary. The whistleblower then has 30 days to respond and argue for an increased award. The whistleblower is also given the opportunity to meet with the whistleblower office and review the documents used in determining the award; then, a final determination is issued on the amount of the award. If whistleblowers believe that the award does not adequately reflect their contributions, they may appeal the IRS's decision to the Tax Court within 30 days.

The potential areas for award are only limited by the ways a taxpayer can violate the Internal Revenue Code (IRC). These violations include obvious misdeeds, such as deliberately underreporting or omitting income, claiming false deductions, hiding or transferring assets or income, and making false entries in records; they also extend to the nefarious, such as maintaining two sets of books, misusing trusts, or abusing charitable deductions. Beyond these specific violations, many other areas are ripe for whistleblower disclosures—for example, a taxpayer's use of offshore accounts, tax shelters, or shell companies.

It is important to remember that whether the taxpayer is aware of the violation is immaterial; the violation itself gives potential whistleblowers grounds for disclosure.

Requirements for Disclosure

Ideally, an IRS whistleblower can offer specific information about a taxpayer's tax violations and can provide the IRS with proof that actually supports those claims. The disclosure needs to have the hallmarks of credibility, not speculation or hearsay.

The IRS is looking for something more. Disclosures made by employees of taxpayers—such as bookkeepers or executive assistants—who have access to financial records are ideal. The IRS seeks whistleblowers with inside knowledge of undisclosed fraudulent transactions and the documentation to support the disclosure. In addition, the disclosure should be based on original information; disclosures based on media or governmental reports are disfavored and will lessen the amount of a potential reward.

Professional Obligations

One important note merits highlighting: professional organizations (such as the AICPA and NYSSCPA) have specific rules regarding the disclosure of confidential information that CPAs receive from clients. For example, part 29-10(c) of the New York State Rules of the Board of Regents prohibits a CPA from revealing personally identifiable facts, data, or information obtained in a professional capacity without the client's prior consent. As another example, Rule 301 of the NYSSCPA Code of Professional Conduct states that a "member who practices public accountancy shall not disclose any confidential client information, nor disclose any confidential employer information, obtained in the course of performing professional services without the specific consent of the client or employe r" (http://www.nysscpa.org/ezine/ETPArticles/2011/10611/qepc_5.htm).

Potential whistleblowers must weigh these professional obligations when deciding whether to disclose violations to the IRS Whistleblower Office.

Protection under the Law

Potential whistleblowers—especially employees of an offending taxpayer—often wonder what kind of protections the law affords them. Many statutes encouraging whistleblowers contain anti-retaliation protections for employees who disclose transgressions of their employers, including the Sarbanes-Oxley Act of 2002,among others.

But the IRS whistleblower program lacks such protections. At this time, no statutory provisions protect IRS whistleblowers against retaliation by their employers. Instead, the IRS focuses on protecting whistleblowers by keeping their identity confidential to the fullest extent possible. Despite this, the IRS might reveal a whistleblower's identity if it is necessary to continue the investigation. If the IRS chooses to reveal a whistleblower's identity, it "will inform the whistleblower before deciding whether to proceed" (IRC section 7623). These identity-protecting regulations are a weak protection for whistleblowers from employer retaliation.

But there is some hope: the CPA who received the first reward under the new program has remained anonymous. The financial services firm never learned his identity and he was never publicly identified by the IRS.

A Public Service

Potential whistleblowers have the opportunity to do a great service in aiding to return funds to the public purse where they belong. These whistleblowers can be rewarded for enticing the IRS by making disclosures accompanied by substantial and credible information. ❑

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