Whistleblowers and *Qui Tam* for Tax

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TABLE OF CONTENTS

I. Introduction

In 1998, as Congress listened to sensational testimony of abuse and coercion by Service agents—nearly all of which turned out to be false or grossly

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exaggerated[1]—Senator Harry Reid (D-NV) was fuming mad. In addition to encouraging its revenue agents to engage in intimidation tactics, the Service was enlisting taxpayers in overzealous collections efforts by rewarding them for retaliating against alleged tax cheats. Referring to an informant program that he dubbed the "Reward for Rats Program," Reid told Congress that the Service was paying "snitches to act against associates, employers, relatives, and others—whether motivated by greed or revenge—in order to collect taxes."[2] Reid found the program "unseemly, distasteful, and just wrong," as well as "a powerful incentive to anyone interested in becoming rich at the expense of a neighbor, former business associate, former wife, former husband."[3] Reid urged his colleagues to abolish the program.

Nine years later, in May 2007, Senator Charles Grassley (R-IA) spoke of the same program that had infuriated Reid. Rather than refer to Service informants as "rats," however, Grassley praised their "courage and patriotism."[4] These individuals, Grassley said, "often risk their careers to expose fraud, waste, and abuse in an effort to protect not only the health and safety of the American people, but the federal treasury and taxpayer dollars."[5] Grassley was speaking of all federal whistleblowers in a speech kicking off "National Whistleblower Week." But he likely was thinking in particular of *tax* whistleblowers, given that he had championed legislation in 2004[6] for the creation of a Service Whistleblower Office and that his staff wrote the provision in the Tax Relief and Health Care Act of 2006[7] that authorized such an office, greatly enhancing the Service's whistleblower program.[8]

This Article examines the expanded tax informant program and the recently established Whistleblower Office. It largely embraces the revamped tax whistleblower provisions, and recommends that Congress broaden the program still further to allow private citizens to bring *qui tam* lawsuits against taxpayers

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[1]*See* Leandra L. Lederman, *Of Taxpayer Rights, Wrongs, and a Proposed Remedy*, 87 Tax Notes (TA) 1133, 1135-36 (May 19, 2000) (describing unsubstantiated and false anecdotes of Service "horror stories" relayed by witnesses at the 1998 Service oversight hearings); *GAO Report on Allegations of IRS Taxpayer Abuse, Special Report, Tax Administration: Investigation of Allegations of Taxpayer Abuse and Employee Misconduct Raised at Senate Finance Committee's IRS Oversight Hearings*, 2000 Tax Notes Today 80-13 (May 24, 1999) (finding "no evidence that IRS employees had acted improperly" as alleged by hearing witnesses).

[2]*Internal Revenue Service Restructuring and Reform Act of 1998*, 144 Cong. Rec. S4379-05, 4397-98 (daily ed. May 6, 1998) (statement of Sen. Reid).

[3]*Id.* at 4398.

[4]*Floor Statement of Senator Chuck Grassley: National Whistleblower Week*, [May 14, 2007], 7 TaxCore 93 (BNA) (May 15, 2007).

[5]*Id.*

[6]*See* S. 1637, 108th Cong. § 488 (2004).

[7]Pub. L. No. 109-432, § 406, 120 Stat. 2911, 2958-60 (2006).

[8]Dustin Stamper, *Whitlock Tapped to Head New IRS Whistle-blower Office*, 114 Tax Notes (TA) 628 (Feb. 12, 2007) (describing the role of Grassley's staff in drafting the provision).

for violations of the internal revenue laws.[9] Other federal and state whistleblower statutes, including the wildly successful False Claims Act (FCA),[10] already provide for *qui tam* actions against persons submitting false claims to the government.[11] The FCA, like the tax whistleblower statute, rewards private individuals for exposing others' attempts to cheat the government. But unlike the tax statute, the FCA authorizes private individuals to sue on the government's behalf in the form of *qui tam* actions. This Article proposes using the FCA as a model for the tax whistleblower statute, and extending *qui tam* to tax.

The experience of the FCA suggests that private enforcement of public law[12] can be a particularly powerful monitoring and prosecutorial mechanism in areas of law where government officials—due to asymmetric information, active concealment by regulated parties, and weak enforcement—are unable or unwilling to enforce the law or prosecute offenders effectively. Current tax regulation suffers from all three symptoms, and could benefit from private enforcement efforts. The 2006 amendments to the tax whistleblower statute significantly expand the potential size of rewards paid to informants, and thereby heighten the threat that an insider might expose abusive taxpayer behavior. In this way, the enhanced tax whistleblower statute has added risk of detection and prosecution to the compliance calculus. Extending *qui tam* to tax would add an additional element of risk to tax cheating and noncompliance, and further assist the government in enforcing tax laws.

Part II of this Article provides a brief history of the tax whistleblower law, and describes the 2006 amendments. Part III explains why Congress expanded the tax whistleblower statute, including legislators' explicit hopes that an enhanced tax informant program would assist in the collection of evaded tax liabilities, close the "tax gap,"[13] and improve tax compliance. Part IV describes

[9]"*Qui tam*" is shorthand for "*qui tam pro domino rege quam pro se ipse*" or "he who sues for the king as for himself."

[10]31 U.S.C. §§ 3729-3733 (2000).

[11]As of October 1, 2007, sixteen states (California, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Massachusetts, Michigan, Montana, Nevada, New Hampshire, New Mexico, New York, Oklahoma, and Virginia) and the District of Columbia had enacted false claims statutes containing *qui tam* provisions. Three additional states (Louisiana, Tennessee, and Texas) had *qui tam* laws that applied to heath care fraud, while two municipalities, Chicago and New York City, had enacted false claims ordinances with *qui tam* enforcement mechanisms. *See* http://www.taf.org/statefca.htm.; *see also* JOHN T. BOESE, CIVIL FALSE CLAIMS AND *QUI TAM* ACTIONS §§ 6.01, 6.02 & 6.05 (3d ed. 2007).

[12]"Public law" encompasses laws governing the relationship between individuals and the state (such as tax, securities, and constitutional law) and is often juxtaposed against "private law," encompassing laws governing the relationship between individuals and other individuals (such as contract and tort law).

[13]The "tax gap" is defined as the difference between the tax that taxpayers should pay and what they pay on a timely basis. For further discussion of the tax gap and Congress's response to it, see *infra* notes 50-53 and accompanying text.

the design, implementation, and success of the False Claims Act. Part V articulates the argument for bringing *qui tam* to tax. It demonstrates the multiple benefits of private enforcement of the nation's tax laws, including (1) assisting tax officials in overcoming information deficits and aggressive concealment on the part of taxpayers; (2) adding risk to abusive taxpayer behavior by increasing the probability of detection and prosecution of tax violations; (3) closing the "resource gap" currently separating tax regulators and private sector tax lawyers; (4) aligning the interests of taxpayers and tax regulators by providing economic incentives for private persons to expose alleged tax violations; and (5) altering governance and compliance norms within business organizations, thus deterring noncompliant behavior at the source. Part VI addresses potential concerns respecting an expanded tax whistleblower program, including taxpayer privacy, frivolous and harassing claims, and inadequate protections for whistleblowers.

Finally, Part VII examines in detail perceived threats to professional confidentiality created by the new whistleblower statute. Recent legislative and administrative changes—particularly requirements under the Sarbanes-Oxley Act of 2002, amendments to regulations governing tax practice in 2005, and legislative and jurisprudential trends extending whistleblower protections—impose heightened obligations on lawyers and other professionals to monitor and enforce public policies underlying public laws. Thus, in an increasing number of situations, these advisors already have a duty under federal law to disclose confidential information. Both the enhanced tax whistleblower statute and the recommendation to extend *qui tam* to tax buttress those public policy obligations for lawyers, and impose similar duties on non-lawyers to help enforce the nation's tax laws.

II. What's New?

As early as 1867, the federal government had at its disposal a law allowing it to pay individuals supplying information for "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same."[14] The original statute authorized $100,000, "or so much thereof as may be necessary,"[15] to finance the informant program, a phenomenally high figure given a federal budget that only a few years earlier

[14]As enacted: Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473 (codified by ch. 11, § 3463, 35 Rev. Stat. 686 (1873-74)). The tax informant statute followed closely on the heels of the original federal False Claims Act, enacted "to prevent and punish Frauds upon the Government of the United States." Congress enacted the earlier statute, originally known as the "Informants' Act" or "Lincoln's Law," to address allegations of fraud, defective weaponry, and illegal price-fixing of the Union Army during the Civil War. The False Claims Act was codified as the Act of Mar. 2, 1863, ch. 67, 12 Stat. 696, 696-98 (reenacted by §§ 3490-3494, 36 Rev. Stat. 691-92 and ch. 5, § 5438, 70 Rev. Stat. 1054-55 (1878)).

[15]Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. at 473.

barely exceeded $60 million.[16] The statute authorizing the informant program remained separate from the revenue acts until Congress enacted section 3792 of the Revenue Act of 1934, providing expenses for the "detection and punishment of frauds" related to the internal revenue laws.[17] In 1954, the statute was recodified as section 7623, where it remained largely unchanged, underutilized, and unknown until last year.[18]

The 2006 amendments[19] to section 7623 breathed life into the statute. First, the enabling legislation authorized the Service to create a centralized Whistleblower Office[20] that will process tips received from individuals who "spot tax problems in their workplace, while conducting day-to-day personal business, or anywhere else they may be encountered."[21] The new office will also determine whether to investigate the matter itself or assign it to another Service office, and it will monitor actions taken by the Service with respect to informant information. In addition, it will determine whether and how much to pay informants, a responsibility previously delegated to Service District Directors dispersed throughout the country. The new office opened for business in February 2007, with the former head of the Service Office of Professional Responsibility, Stephen Whitlock, taking over as its first Director.[22] Early indications are that the revamped whistleblower program is working as planned, with "knowledgeable insiders" turning over "big, fat piles of paper" some involving hundreds of millions of dollars.[23] Indeed, after only a few months under the revamped program, Whitlock noted a stunning increase in the size of unpaid tax liabilities reported by informants, a magnitude never seen "in the preamendment days."[24] Only a few months later, in October 2007, the Whistleblower Office received its first $1 billion submission, fol-

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[16]*See* http://encarta.msn.com/encyclopedia_761567354_18/Civil_War.html.

[17]Revenue Act of 1934, ch. 3792, 48 Stat. 680.

[18]*See* I.R.C. § 7623 (1954). Prior to the 2006 amendments to section 7623, the only material change after 1954 involved the 1996 amendments, which included for the first time "detecting underpayments of tax" as a criterion for awarding payments to informants, adding to the existing "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same." Detecting Underpayments of Tax, Pub. L. No. 104-168, § 1209(a), 110 Stat. 1452 (2006).

[19]*See* Awards to Whistleblowers, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2922 (2006) (adding subsection (b)).

[20]I.R.C. § 406(b). The enabling legislation also required Treasury to issue guidance respecting the operation of the Whistleblower Office by December 20, 2007, which it did in Notice 2008-4.

[21]IR-News Rel. 2007-25.

[22]Stamper, *supra* note 8.

[23]Tom Herman, *Whistleblower Law Scores Early Success, Higher Rewards Attract Informants Submitting Tips*, Wall St. J., May 16, 2007, at D3 (quoting Director Whitlock).

[24]Jeremiah Coder, *Tax Analysts Exclusive: Conversations: Stephen Whitlock*, 116 Tax Notes (TA) 98 (July 9, 2007).

lowed closely by a $2 billion submission.[25]

No doubt informants have been motivated by the promise of hefty cash rewards. The 2006 amendments to section 7623 added an entirely new subsection, "Awards to whistleblowers," which significantly increased potential bounties for exposing tax violations.[26] Under the new subsection, the Secretary is authorized to pay whistleblowers between 15% and 30% of the collected proceeds, including penalties, interest, additions to tax, and any other amounts resulting from the action.[27] Prior law made the payments discretionary, depending on what the District Director "deem[ed] to be adequate compensation in the particular case," which generally did not exceed 15% of the amounts collected.[28] Prior law also capped rewards at $2 million (and at $50,000 as late as 1989),[29] while the amended statute includes no cap on the absolute dollar amount that can be awarded. The statute provides for reduced awards in cases of less "substantial contribution," generally defined as cases involving previously disclosed public information or allegations.[30] In such instances, the Whistleblower Office may award such sums it considers appropriate but in no case more than ten percent of the collected proceeds. Awards can also be reduced or denied in the event the Whistleblower Office determines that an informant "planned and initiated" the abusive behavior providing the basis of the award claim.[31] In the event of an award, whistleblowers may take an above-the-line deduction for attorneys' fees and costs paid to recover the award.[32]

III. What Animated the Changes?

There are three primary reasons for the recent amendments to the Service whistleblower program. First, the program was broken. In June 2006, the Treasury Inspector General for Tax Administration (TIGTA) issued a report detailing the various shortcomings of the Service Informants' Rewards Program, which previously administered the authority provided under section

[25]J.P. Finet, *Tax Whistleblower Action Claims $1 Billion Underpayment by Fortune 500 Company*, Daily Tax Rep. (BNA), Oct. 12, 2007, at G-5; J.P. Finet, *Whistleblower Action Claims Major Firm Underpaid Its U.S. Taxes by $2 Billion*, 238 Daily Tax Rep. (BNA), Dec. 12, 2007, at G-9.

[26]Awards to Whistleblowers, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2922 (2006) (adding subsection (b)).

[27]I.R.C. § 7623(b)(1).

[28]Reg. § 301.7623-1(c).

[29]*See* IRS Publication 733 (rev. 7-80). The cap was raised to $100,000 in 1990. *See* IRS Publication 733 (rev. 11-90).

[30]I.R.C. § 7623(b)(2)(A). The specific language relating to "less substantial contribution" involves actions based on allegations "resulting from a judicial or administrative hearing, from a governmental report, hearing, audit, or investigation, or from the news media."

[31]I.R.C. § 7623(b)(3).

[32]I.R.C. § 62.

7623.[33] The program suffered from decentralized management, poor oversight, lack of standardization with respect to informant tips and Service payments, and inefficient processing of claims, examinations, and rewards. In particular, TIGTA found that the program was administered in ad hoc fashion by Service campuses spread throughout the country, each of which had "traditionally operated as a semi-autonomous entity."[34] For instance, the five geographically dispersed Informants' Claims Examiner (ICE) units tracked claim inventory differently, and none implemented ongoing oversight programs to monitor performance, such as operational reviews or management assistance. Moreover, the Service did not operate a nationwide database of informants' claims, thereby creating severe inconsistencies in the handling of claims and payments. TIGTA found that 45% of the case files it examined for informant claims suffered basic control issues, such as missing copies of key forms and no record of letters to informants. It further found that in 32% of the cases, the ICE reviewer offered no justification for the percentage awarded to the informant. And for rejected claims in its sample, TIGTA found that in 76% of the cases reviewers failed to offer any explanation or rationale for rejecting the claim.

In addition, TIGTA reported that informant claims languished in administrative and judicial processes for years. On average it took 7.5 years between the filing of a claim by an informant and the payment of a reward. Untimely processing of claims, TIGTA observed, made the rewards "lose some of their motivating value" with respect to encouraging informants to come forward with information.[35] For a program that largely existed to provide incentives for private enforcement of the tax laws, it is hard to imagine that the average taxpayer even knew the program existed. The Service did not promote the program in any meaningful way, its website did not contain any information with respect to the program, and its webpage for reporting tax fraud did not even mention the availability of rewards.[36]

According to FTC Commissioner William Kovacic, one reason to pay generous bounties under laws that provide for private enforcement is to compensate the informant for endangering investment in her career and damaging reputation in her community.[37] The old Informants' Reward Program failed to

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[33]Treasury Inspector General for Tax Administration (TIGTA), The Informants' Rewards Program Needs More Centralized Management Oversight, 2006-30-092 (June 6, 2006).

[34]*Id.* at 7.

[35]*Id.* at 8. Informants are paid after the Service collects additional taxes, fines, and penalties from the alleged misconduct. *See* Reg. § 301.7623-1(a) (stating that rewards provided by section 7623 and the regulations "will be paid from the proceeds of amounts (other than interest) collected by reason of the information provided").

[36]*Id.* at 2.

[37]William E. Kovacic, *Private Monitoring and Antitrust Enforcement: Paying Informants to Reveal Cartels*, 69 Geo. Wash. L. Rev. 766, 772 (2001); William E. Kovacic, *Whistleblower Bounty Lawsuits as Monitoring Devices in Government Contracting*, 29 Loy. L.A. L. Rev. 1799, 1819 (1996).

provide such an incentive, with paltry bounties, stingy administrators, inadequate protection for whistleblowers, and unreceptive courts. Until as late as 1989, the program capped awards at $50,000.[38] In 2004, the Service raised the top award from $2 million to $10 million, but neglected to address the other systemic problems that prevented the promise of more lucrative awards from providing sufficient incentive for informants to come forward with evidence of tax violations.[39]

Even with rising caps, rewards paid to informants remained low. Between 1989 and 1998, 95,105 claims for rewards were submitted under the old Service program, but only 6,310 claims were allowed in full or in part (6.63% of claims) with only $29,227,222 paid out to informants of the $1,450,808,529 recovered by the government (2.01% of collections).[40] Compared to other federal whistleblower rewards programs, the Service program was particularly ungenerous. During the same period between 1989 and 1998, government recoveries under the False Claims Act totaled $2,300,589,823, with $360,573,093 paid out to private individuals, for a payout rate of 15.7%.[41] In addition, while annual recoveries under the Service whistleblower program have never crested $100 million,[42] recoveries continue to climb under the FCA, topping $1.4 billion in 2006.[43]

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[38] *See supra* note 29.

[39] *See* 1 IRS Organization, I.R.M. (CCH), ¶ 795 at 2389 (2007).

[40] Terri Gutierrez, *IRS Informants Reward Program: Is It Fair?*, 84 Tax Notes (TA) 1203, 1205 tbl.1 (Aug. 23, 1999). Frequency and size of rewards were even lower in earlier years of the program. Between 1982 and 1986, there were 34,123 claims for rewards, but only 3,516 claims allowed in full or in part (10% of claims), with only $5,056,122 paid out to informants of the $392,038,826 collected by the government (1.3% of recoveries). Mark Uhlfelder, *Financial Rewards for Ratting on Tax Cheats Are Small and Rare*, 37 Tax Notes (TA) 1300, 1301 (Dec. 28, 1987). Comparing claims paid to claims submitted using short time horizons may yield misleading results. Awards can only be paid to informants from collected proceeds (*see supra* note 35), thereby creating a lag between submission of a claim and payment of an award. Moreover, as the TIGTA reported in its June 2006 report, the Service has historically taken an average of 7.5 years to process successful informant claims (including examination, assessment and collection of tax owed, and waiting for taxpayers to exhaust appeals rights). TIGTA, *supra* note 33, at 8. Therefore, while it is reasonable to assume that some claims submitted during a defined period of years are paid during the period, it is also likely that claims paid would include claims submitted *prior* to the period in question and equally likely that claims submitted would include claims resulting in payments made *after* the period. If the government possessed data linking submission dates to payment dates (which it currently does not), it might find no meaningful difference between comparing claims paid to claims submitted with or without the data. However, until the government generates such data, we cannot assume a link between claims submitted for a particular time horizon and claims paid for that horizon. I am grateful to Stephen Whitlock for sharing this caveat.

[41] Calculated from U.S. Department of Justice, Civil Division, Fraud Statistics Overview, (Oct. 1, 1986 – Sept. 30, 2006), *available at* http://www/lopds.com/files/pdf/stats-fy2006.pdf.

[42] TIGTA, *supra* note 33, at 3.

[43] U.S. Department of Justice, *supra* note 41.

Given the above numbers, it is clear that whistleblowers under the Service program have had a harder time than other federal whistleblowers collecting their share of judgments and settlements. Courts have contributed to this difficulty by preventing informants from enforcing their claims to rewards. A study of all court cases between 1941 and 1998 filed by informants against the Service seeking a redetermination of amounts awarded (a total of 19 cases) found that the taxpayer lost every case.[44] In particular, courts have sided overwhelmingly with the government with respect to the Service's exclusive discretion in determining whether to award payments to whistleblowers at all[45] as well as the amount of any award.[46] Moreover, for an informant to have a claim on which relief can be granted, there must be some affirmative agreement between the government and the informant; a mere offer for an award (either through section 7623, regulations, or Service publications) does not create a contract (implied or otherwise) between the informant and the government.[47]

The second explanation for why Congress passed the recent amendments to the Service informants' program is that legislators recognized that an improved whistleblower statute could be an effective weapon against noncompliance.

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[44]Gutierrez, *supra* note 40, at 1205-06.

[45]*See, e.g.,* Krug v. United States, 168 F.3d 1307, 1309 (Fed. Cir. 1999) (affirming summary judgment for government in informant's suit to recover a reward because, among other things, the Service did not abuse its discretion in deciding not to pay an award); Saracena v. United States, 508 F.2d 1333, 1336 (Ct. Cl. 1975) (Service District Director has complete discretion to determine whether reward should be paid to informant).

[46]*See, e.g.*, Katzberg v. United States, 36 F. Supp. 1023, 1023 (Ct. Cl. 1941), *cert. denied*, 314 U.S. 620 (1941) (determining Commissioner has total discretion to determine size of award); *Saracena*, 508 F.2d at 1336 (absent a showing of unreasonableness, the District Director has complete discretion to determine the size of award).

[47]*See, e.g., Krug*, 168 F.3d at 1309 (affirming summary judgment for government in informant's suit to recover a reward because, among other things, an enforceable contract arises only after an informant and the Service negotiate and fix a specific award, and neither section 7623 nor Publication 733 create an implied-in-fact contract for payment); Diamond v. United States, 213 Ct. Cl. 766 (1977) (offer of an award from Service to informant does not create a contract between Service and informant, and informant is not automatically entitled to an award); Lagermeier v. United States, 214 Ct. Cl. 758 (1977) (offer to pay reward by the Service is only an offer to pay such reward as District Director deems suitable; no contract is otherwise created); *Katzberg*, 36 F. Supp. at 1023 (offering an award from the Service to informant does not create a contract between Service and informant, and informant is not automatically entitled to an award). A lesser-known program, the Special Agreement Program, has historically allowed informants to enter into contracts with the Service stipulating the parties' understanding of what percentage the whistleblower would receive in the event the Service obtained a recovery. The Service has been reluctant to enter into such contracts, and according to *qui tam* attorney Paul Scott, "has tended in practice to reserve those agreements only for information associated with high-dollar recoveries." Paul D. Scott, *Tax Whistle-Blowers to Receive Increased Awards*, 114 Tax Notes (TA) 441, 442 (Jan 29, 2007).

The report issued by TIGTA in June 2006 noted that despite room for improvement, the Informants' Rewards Program had "significantly contributed to the IRS' efforts to enforce tax law," and that additional management focus "could enhance the effectiveness of the Program as an enforcement tool."[48] The report also noted that examinations of taxpayer returns initiated by information supplied by private informants were nearly twice as "effective and efficient" (measured by dollars recovered per hour of examination time) than examinations initiated by the Service's primary statistical method for selecting returns.[49] The reward program's potential effectiveness as a compliance tool resonated particularly loudly with a Congress nearly obsessed with closing the "tax gap."[50] In 2006, the Service reported that the gap approached a record $350 billion for tax year 2001,[51] reflecting a compliance rate of 83.7%.[52] Assuming that the tax gap grows in proportion to increased tax

[48] *See* TIGTA, *supra* note 33, at 1.

[49] The Service uses the Determinant Index Function (DIF) to select returns for audit. DIF evaluates income tax returns for potential examination by assigning weights to various return characteristics. *See* TIGTA, *supra* note 33, at 1-2 and 4-5. It is important to note that the selection criteria for informant claims cases, if applied properly, would *always* result in informant claims cases yielding more effective returns than DIF selected cases. The Service pursues cases based on informant leads that appear more likely to yield productive results than cases based on other sources, including DIF selected cases. Thus, an informant lead that appears less productive than a DIF lead will not be pursued by the Service. I am grateful to Stephen Whitlock for this information.

[50] *See supra* note 13. Congress has spent much of the last year trying to figure out how to close the gap, and the Treasury Department has responded with a number of policy recommendations. *See, e.g.*, James M. Bickley, Congressional Research Service, Tax Gap and Tax Enforcement, CRS RL338882 (Aug. 13, 2007); Internal Revenue Service and Department of the Treasury, Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance (2007); U.S. Department of the Treasury, Office of Tax Policy, A Comprehensive Strategy for Reducing the Tax Gap (2006).

[51] The "gross" tax gap was estimated at $345 billion, but does not account for taxes paid voluntarily though late or for recoveries from Service enforcement activities, which, together, reduce the "net" tax gap to an estimated $290 billion for a compliance rate of 86.3%. *See IRS and the Tax Gap: Hearing Before the H. Comm. on Budget*, 110th Cong. (2007) (statement of J. Russell George, Treasury Inspector General for Tax Administration), *available at* http://www.house.gov/budget_democrats/hearings/2007/08Georgetestimony.pdf.

[52] Press Release, Department of the Treasury, Testimony of Treasury Assistant Secretary for Tax Policy Eric Solomon before the Senate Finance Committee on Ways to Reduce the Tax Gap (Apr. 18, 2007), *available at* http://www.treasury.gov/press/releases/hp360.htm. The gap would be even larger if not for involuntary forms of tax payment. The administrative mechanisms of withholding and information reporting generate phenomenally high rates of compliance by making third parties (usually employers) responsible for reporting and paying a taxpayer's taxes. *See* Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 Stan. L. Rev. 695 (2007). The misreporting or noncompliance rate for withholding (associated with wage and salary income) barely tops one percent, while the noncompliance

liability, the $350 billion figure for 2001 is equivalent to a $400 billion tax gap for 2006.[53] According to recent Congressional estimates, a fully funded whistleblower program would raise at least $400 million over ten years, narrowing the distance between what taxpayers pay and what they should pay.[54] Given the high-dollar submissions ($1 billion and $2 billion) to the Whistleblower Office in its first year of operation,[55] this estimate may prove wildly conservative, with additional tax collections reaching hundreds of millions of dollars per year.

Finally, Congress expanded the Service whistleblower program thanks in large part to the indefatigable efforts of Senator Grassley. Grassley, a longtime advocate of strengthened whistleblower statutes, had been an architect of the 1986 amendments to the False Claims Act, which transformed the statute into the government's most powerful mechanism for private enforcement of public laws.[56] Moreover, in 2004, Grassley championed an office within the Service explicitly to oversee whistleblower claims and awards.[57] Furthermore, when the TIGTA released its 2006 report criticizing aspects of the Informants' Rewards Program, Grassley used the opportunity to urge Congress and the Service to overhaul the whistleblower program so that private citizens could more easily "blow the whistle on big tax cheats."[58] Also in 2006, Grassley's office drafted legislation providing the basis for the new Whistleblower Office and awards program.[59]

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rate for information reporting (interest and dividend income) is an estimated 4.5%. Internal Revenue Service, Tax Gap Figures (2006), *available at* http://www.irs.gov/pub/irs-news/tax_gap_figures.pdf. Comparatively, the rate for income not subject to withholding or information reporting, such as small business income, is an astounding 53.9%. *Id.* Thus, breaking out the income reported through withholding and information reporting results in a "voluntary" compliance rate significantly below official estimates. *See* Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 Kan. L. Rev. 971, 972-76 (2003). Some of the recent proposals to close the tax gap recognize the necessity of relying on information reporting and withholding strategies. *See* Internal Revenue Service and Department of the Treasury, *supra* note 50; U.S. Government Accountability Office, Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap, GAO-07-391T (2007).

[53]Eric Toder, *Reducing the Tax Gap: The Illusion of Pain-Free Deficit Reduction*, Urban Institute-Brookings Institution Tax Policy Center (2007).

[54]Wesley Elmore, *Finance Approves Small-Business Tax Breaks, Complete with Offsets*, 114 Tax Notes (TA) 267, 268 (Jan. 22, 2007).

[55]*See supra* note 25.

[56]For further discussion of the False Claims Act as a model of private enforcement of public laws, see *infra* notes 61-84 and accompanying text.

[57]*See supra* note 6.

[58]Wesley Elmore, *Grassley: TIGTA Report Validates Concerns Over Reward Program*, 111 Tax Notes (TA) 1342, 1342 (June 19, 2006).

[59]*Id.*

Indeed, Grassley and other legislators have recognized the compliance enhancing potential of a coordinated program for tax whistleblowers. As supporters shape and fine-tune the new program during its formative stages,[60] it would be prudent to examine the most successful whistleblower statute to date, and one that could serve as a model: the False Claims Act.

IV. What's Worked Before?

The False Claims Act is the lodestar of private enforcement of public law, boasting "tremendous success in attracting tips regarding fraud against federal government programs."[61] Since 1986, the year Congress passed significant amendments to the FCA,[62] recoveries under the program have skyrocketed, from zero in 1987 to over $1.4 billion in 2006.[63] Logistically, the FCA is enforced by the Department of Justice, and pays bounties to informants for tips on fraud against federal government programs. It creates civil liability for any person who knowingly submits a false claim for payment to the federal government, knowingly uses a false statement to induce the payment of a false claim, conspires to defraud the government to pay a false claim, or knowingly uses a false statement to decrease an obligation to pay money to the government.[64] A "claim" under the FCA consists of any request or demand for money or property where the federal government pays any portion of the money or property in question.[65] Moreover, the statute defines "knowing" conduct as actual knowledge of false information as well as "deliberate ignorance" or "reckless disregard" of the truth.[66] The decision to prosecute on the basis of an informant's tip and information is delegated to the Attorney General and the Department of Justice[67] as well as to the informant or "private person."[68] If the government declines to proceed with the action, the informant may continue alone as a *qui tam* plaintiff in the name of the government.[69] However, the Attorney General can still decide to motion the court to dismiss the action.[70]

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[60]Service Whistleblower Office Director Stephen Whitlock has said that existing Service "policies regarding tax informants will need to be amended or abolished to conform" to the new bounty legislation. *See* Stephen Joyce, *Whitlock Outlines Whistleblower Office Plan; IRS, Treasury Officials Cite Lack of Guidance*, 24 Daily Tax Rep. (BNA), Feb. 6, 2007, at G-6. This will be a big task, and one that could benefit from examining precedential programs.

[61]Scott, *supra* note 47, at 442.

[62]*See* False Claims Amendments Act, Pub. L. No. 99-562 (1986) (codified as amended at 31 U.S.C. §§ 3729-3731 (2000)).

[63]U.S. Department of Justice, *supra* note 41.

[64]31 U.S.C. § 3729(a) (2000).

[65]*Id.* § 3729(c).

[66]*Id.* § 3729(b).

[67]*Id.* § 3730(a).

[68]*Id.* § 3730(b).

[69]*Id.* § 3730(b)(4).

[70]*Id.* § 3730(b)(1).

Actions brought by private persons under the FCA are brought in the judicial district in which the defendant resides, transacts business, or in which any alleged activity proscribed by the statute occurred.[71]

With respect to awards for informants, if the government proceeds with the action, the whistleblower "shall . . . receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim" depending upon the extent to which the whistleblower "substantially contributed" to the prosecution of the action.[72] In addition, there is no absolute dollar cap on the amount that can be awarded. If the court finds that the action is based primarily on publicly available information or information otherwise available to the government rather than specific and unique information provided by the private person, it may award "such sums as it considers appropriate," but not more than ten percent of the proceeds of the action or settlement.[73] The informant will also receive payment for reasonable expenses including attorneys' fees and costs.[74] If the government does *not* proceed with the action and the whistleblower successfully prosecutes the case, the whistleblower will receive an amount that the court decides is reasonable, but not less than 25% and not more than 30% of the proceeds or settlement.[75] Again, there is no absolute dollar cap on the amount that can be recovered, and the informant will be reimbursed for reasonable expenses.

Under certain conditions, a whistleblower's award can be reduced. For instance, if the court determines that the action was brought by an informant who "planned and initiated the violation" upon which the action was brought, the court may decrease the share of the proceeds received taking into consideration "the role of that person in advancing the case to litigation and any relevant circumstances pertaining to the violation."[76] Furthermore, if the person bringing the action is convicted of criminal conduct arising from her role in the violation, she shall be dismissed from the civil action and not receive any share of the proceeds.[77] If the government opts not to prosecute the action, but the person bringing the action goes forward as a *qui tam* plaintiff, the court may award the *defendant* reasonable attorney's fees and expenses if the defendant prevails and the court finds that the claim was "clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."[78]

The FCA also bars certain actions from the whistleblower statute. The two most pertinent for our discussion include a jurisdictional barrier as well as

[71] *Id.* § 3732.
[72] *Id.* § 3730(d)(1).
[73] *Id.*
[74] *Id.*
[75] *Id.* § 3730(d)(2).
[76] *Id.* § 3730(d)(3).
[77] *Id.*
[78] *Id.* § 3730(d)(4).

an absolute bar to actions involving allegations under the Code. First, courts do not have jurisdiction over actions based upon "the public disclosure" of allegations or transactions unless the action is brought by the Attorney General or the informant qualifies as an "original source of the information."[79] A person is considered an "original source of the information" if she "has direct and independent knowledge" of the information underlying the allegations, and has provided the information to the government before filing a *qui tam* action.[80] This requirement has proven to be a meaningful jurisdictional barrier for *qui tam* plaintiffs, and the basis for dismissal of many *qui tam* actions.[81] Recently, the Supreme Court strictly construed the FCA's "original source" requirement to mean that an informant must have knowledge of the actual facts underlying the allegations on which he may ultimately prevail, thereby making it even more difficult for *qui tam* plaintiffs to prosecute and prevail in actions against persons submitting false claims to the government.[82]

The second bar prevents *qui tam* plaintiffs from enforcing the nation's tax laws. The FCA does not apply to "claims, records, or statements made under the Internal Revenue Code of 1986."[83] Thus, to the extent legislators like Senator Grassley envisioned bringing *qui tam* to tax in the hope that private enforcement of tax laws would prove as effective as private enforcement of other public laws, they needed to provide an independent enforcement statute. Section 7623 and the Informants' Rewards Program already existed. In 2006, Congress simply enhanced the program, adding a few bells and whistles.[84]

V. Why *Qui Tam* for Tax?

The recent enhancements to section 7623 and the creation of a Service Whistleblower Office have provided significantly heightened incentives for informants to come forward with information about undetected tax avoidance activity. As the last section demonstrated, this kind of private enforcement of public laws has proven effective in exposing fraud committed against the federal government. But is it appropriate to apply the private enforcement model to such an essential government function as the monitoring and enforcement of the internal revenue laws? Moreover, is it appropriate for private citizens to enforce the nation's tax laws when application of fact to law contains countless unknown outcomes, and the "right" answer is ambiguous at best? In

[79] *Id.* § 3730(e)(4)(A).

[80] *Id.* § 3730(e)(4)(B).

[81] *See, e.g.,* Robert L. Vogel, *The Public Disclosure Bar Against Qui Tam Suits*, 24 Pub. Cont. L.J. 477, 491-99 (1995) (describing the difficulties faced by *qui tam* plaintiffs in overcoming the public disclosure jurisdictional barrier).

[82] *See* Rockwell Int'l Corp. v. United States, 127 S. Ct. 1397, 1409 (2007).

[83] 31 U.S.C. § 3729(e) (2000).

[84] Pun intended.

many ways, tax law is stochastic, with no clear law at all. The law itself often becomes a random variable, with a certain probability that it is X and a certain probability that it is Y. Add the difficulty of assigning a particular probability to the different outcomes—to say nothing of the fact that regulators and courts can express preferences for form, substance, or any point in between—and making accurate assessments of reporting positions and transactions can become a task of partially informed guesswork. In a world of such uncertainty, do we really want private persons enforcing the law? For the reasons set forth below, the answer is, "Yes."

A. *Increasing Transparency with Private Enforcement*

Private enforcement of public law is particularly appropriate when regulators, due to asymmetric information and active concealment on the part of regulated entities, are unable to enforce and prosecute the law effectively. In the world of tax regulation, taxpayers and their advisors possess the information that tax regulators seek. The goal is to keep as much of the information from the regulators as possible, and taxpayers pay considerable sums of money to those advisors most skilled at concealment. In this cat-and-mouse game, it is appropriate as well as efficient to provide incentives for private persons to come forward with information and reveal details about what Professor Mark Gergen has called "the common knowledge of tax abuse."[85] Indeed, as FTC Commissioner Kovacic has said with respect to private enforcement of cartels, "[o]ne way to counter greater efforts at concealment is to establish mechanisms for inducing [] insiders to disclose their misconduct."[86] "Private monitoring," Kovacic argues, "can be an antidote to concealment";[87] it can be "particularly destabilizing where the success of an illegal practice requires covert collective action."[88] Professor Joshua Rosenberg made a similar observation ten years ago when contemplating the benefits of bringing *qui tam* litigation to tax. "As has happened with the current *qui tam* provisions," Rosenberg wrote, referring to the False Claims Act, "some large tax *qui tam* cases would likely attract significant media attention. Attorneys, accountants, and other tax planners and tax compliance personnel would realize that they could no longer rely on the silence and acquiescence of others, and that cheating on taxes had become a dangerous sport both for their employer and, because their participation would inevitably be exposed, for themselves."[89] If sunlight

[85]Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 SMU L. Rev. 131 (2001).
[86]Kovacic, *supra* note 37, at 767.
[87]*Id.* at 774.
[88]*Id.*
[89]Joshua D. Rosenberg, *The Psychology of Taxes: Why They Drive Us Crazy and How We Can Make Them Sane*, 16 Va. Tax Rev. 155, 211 (1996). Rosenberg's article represented the first scholarly examination of *qui tam* in the tax context. Recently, Rosenberg has offered additional insights on the subject in Joshua D. Rosenberg, *Narrowing the Tax Gap: Behavioral Options*, 117 Tax Notes (TA) 517, 525-31 (Oct. 29, 2007).

is the best antiseptic, the looming possibility of *qui tam* actions could alter risk assessments of reporting positions by taxpayers and their advisors and thereby improve tax compliance.

As currently written, section 7623 is a whistleblower statute, not a *qui tam* statute. It pays bounties to private citizens for detecting underpayments of tax and assisting the successful prosecution of tax cheats. But unlike the FCA, if the government declines to prosecute the alleged tax violation, the private citizen cannot proceed with the action on her own. This Article argues that extending *qui tam* to tax, though not without potential pitfalls, can be a particularly effective weapon in the government's tax compliance arsenal. It argues further that a strong *qui tam* approach would not necessarily deprive the government of its enforcement discretion respecting good faith differences in interpreting ambiguous tax rules. With procedures in place to reserve enforcement discretion to the Service—just as the FCA reserves such discretion to the Department of Justice—both the current bounty approach and this Article's recommended *qui tam* approach can effectively reinforce the government's compliance efforts.

B. *Taxpayer Privacy and Harassment Concerns*

Two primary and frequently invoked problems associated with private enforcement of tax law, including bringing *qui tam* to tax, involve privacy and harassment concerns. Section 6103 prohibits the Service from disclosing "to any person in any manner whatever" information pertaining to tax returns.[90] The statute specifically authorizes disclosure of tax return information to certain persons, including individuals designated by the taxpayer; state tax officials; persons having a material interest in the information (the taxpayer herself, spouses, partners, and certain shareholders in a corporation); Congressional committees; the President and White House personnel; and the Treasury Department and the Department of Justice in civil and criminal tax cases. The concern among critics of private enforcement of the tax laws through either a bounty system or *qui tam* approach is that allowing private citizens to profit by disclosing taxpayer information would result in those individuals recklessly exposing information to persons not authorized by statute to receive such information.

This concern is invalid for at least two reasons. First, under the existing Service whistleblower statute and the federal *qui tam* statute, informants and *qui tam* plaintiffs, respectively, must turn their unique and specific information over to the government to initiate claims. Service informants disclose to the Treasury Department while *qui tam* plaintiffs disclose to the Department of Justice, two agencies already authorized under section 6103 to receive such information. Second, section 6103 protects distribution of tax return infor-

[90] *See* I.R.C. § 6103(a), (b)(8).

mation obtained by the Service and other statutorily authorized agencies and persons, *not* by private individuals. A private informant who obtains information from the taxpayer or some other source is not covered by section 6103.

Even more generally, privacy concerns associated with the tax whistleblower statute and *qui tam* for tax must be balanced against public policies that encourage private persons to expose tax cheating and thereby increase transparency in the law. Though policymakers have historically considered the tax disclosure rules sacred, there is reason to believe that efforts to relax them for purposes of further enhancing the tax whistleblower statute might have some traction among current tax officials and legislators seeking increased transparency. For example, former Commissioner of Internal Revenue Mark Everson and Securities and Exchange Commission Chairman Christopher Cox recently advocated loosening section 6103 to facilitate information sharing between government agencies.[91] In fact, Everson recommended making corporate tax returns public,[92] a proposal with historical roots,[93] and one with at least some support from members of Congress.[94] Moreover, given recent congressional preoccupation with closing the tax gap,[95] relaxing disclosure rules further to allow private citizens to help the government collect unpaid tax revenues is not such a far-fetched idea. Also, if disclosure takes the form of campaigns that publicize the whistleblowing and *qui tam* activity, there is evidence to suggest that such publicity would raise tax compliance "by assuring compliant taxpayers that others are likely to comply" with the tax laws.[96] Indeed, researchers have shown that the historically uncritical acceptance of taxpayer confidentiality has hindered rather than helped Service enforcement, while lower privacy

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[91]Dustin Stamper, *SEC, IRS "Discuss" Making More Corporate Tax Data Public, Cox Says*, 81 Highlights & Doc. 794 (May 2, 2006).

[92]Dustin Stamper, *Everson Makes Another Pitch for Transparency*, 2006 Tax Notes Today 241-2 (Dec. 15, 2006); Dustin Stamper & Allen Kenney, *Everson Calls for Debate on Making Corporate Returns Public*," 2006 Tax Notes Today 50-1 (Mar. 15, 2006).

[93]The corporation excise tax of 1909, the precursor to the modern corporate income tax, included a publicity provision opening returns to public inspection. *See* Marjorie E. Kornhauser, *Corporate Regulation and The Origins of the Corporate Income Tax*, 66 Ind. L.J. 53, 94-136 (1990). In 1934, Congress required certain *personal* income tax information be made public. The law was repealed the following year. *See* Marjorie E. Kornhauser, *Shaping Public Opinion and the Law in the 1930s: How a "Common Man" Campaign Ended a Rich Man's Law*, Tulane Public Law Research Paper No. 06-02 (2006).

[94]Sheryl Stratton, *Closing the Credibility Gap by Disclosing Corporate Returns*, 96 Tax Notes (TA) 322, 322 (July 15, 2002) (discussing calls from Senator Grassley to make corporate tax returns public).

[95]For efforts to close the tax gap, see *supra* note 50.

[96]Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 Ohio St. L.J. 1453, 1463 (2003); *see also* Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 U. Kan. L. Rev. 1065, 1076 (2003) (reporting that econometric and social norm theories of tax compliance indicate "that publicity campaigns highlighting the revenue authority's successful enforcement efforts can positively impact . . . taxpayer compliance").

protections could have the effect of increasing compliance.[97] Finally, though Congress explicitly excluded claims arising under the Code from the FCA in 1986, it did so "to allow the Internal Revenue Service to enforce the I.R.C. as it sees fit," rather than to protect taxpayer information.[98] Thus, it seems likely Congress would accept a "*qui tam* for tax" proposal so long as the plan reserves oversight and gatekeeping authority to the Service, and does not infringe on the agency's enforcement discretion, which is incident to its interpretive authority.

Harassment concerns appear more difficult to overcome. There would be nothing to stop *qui tam* plaintiffs from bringing actions on open questions of law, for instance, where regulators or courts or Congress had not provided sufficient guidance, or, as problematic, where regulators and courts and Congress provided conflicting guidance. Similarly, *qui tam* for tax could provide an opportunity for the plaintiffs' bar to generate lawsuits based on these ambiguities, conceivably with or without specific insider or informant information. Consider what *qui tam* for tax might have wrought between the Supreme Court's 1992 decision in *INDOPCO v. Commissioner*[99] and the Treasury Department's issuance of temporary regulations in 2002 pertaining to expensing and capitalizing intangibles.[100] In the intervening decade, the *qui tam* plaintiffs' bar could have conceivably brought lawsuits against every company that reported legal expenses or other professional costs on financial statements or other filings. These companies may have been trying in good faith to comply with the tax law, and either expensed the costs (as was customary and as the regulations subsequently provided) or capitalized them (as *INDOPCO* required). Without specific guidance from the government, it was hard to tell how to treat certain expenses under certain conditions. *Qui tam* litigation under these conditions of ambiguity and uncertainty would be harassing as well as counterproductive.

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[97] *See* Christopher S. Rizek, *Taxpayer Privacy and Disclosure Issues Will Continue to Touch Us All*, *in* The Future of American Taxation: Essays Commemorating the 30th Anniversary of Tax Notes 81, 89 (2002) (noting the "intuitive persuasive power" of the argument that taxpayers "may be more likely to report accurate information to the government if their neighbors, business partners, and the entire world, not just the IRS, can review and analyze it"); George Guttman, *The Confidentiality Statute Needs Rethinking*, 86 Tax Notes (TA) 318, 320 (Jan. 17, 2000) (discussing how information sharing among government agencies and publishing lists of tax delinquents could increase compliance).

[98] United States *ex rel.* Lissack v. Sakura Global Capital Mkts., Inc., No. 95-1363, 2003 U.S. Dist. LEXIS 14600, at *19 (S.D.N.Y. Aug. 21, 2003); *see also* United States *ex rel.* Mikes v. Straus, 853 F. Supp. 115, 119 (S.D.N.Y. 1994) (holding that the FCA did not permit subject matter jurisdiction over false tax claims and that such tax "matter[s] [should be] reported to the [Service], to permit it to determine what inquiries, if any, may be called for under the circumstances"); Boese, *supra* note 11, at § 2.02[H], Tax Claims.

[99] 503 U.S. 79 (1992).

[100] *See Guidance Regarding Deduction and Capitalization of Expenditures*, Prop. Reg. §§ 1.167(a)-3, 1.263(a)-4, 1.446-5, 67 Fed. Reg. 77,701-01 (2002). I am grateful to Kristin Hickman for providing this example to help explain why we might be wary of extending *qui tam* to tax.

Concerns over harassing lawsuits under a hypothetical *qui tam* statute for tax, though real, are eminently surmountable. First, Congress could take a page out of the FCA and delegate to the Service the decision to prosecute a *qui tam* taxpayer (the FCA vests such authority in the Attorney General).[101] If the Treasury declined to proceed with the action, the informant could pursue the matter alone as a *qui tam* plaintiff, and the Commissioner could still move the court to dismiss actions deemed meritless.[102] Essentially, the Service would be placing claims into three categories: (1) government prosecution; (2) express dismissal; and (3) colorable claim where the *qui tam* plaintiff could proceed on her own, subject to rules similar to those imposed by the FCA for receipt of award payments associated with successfully prosecuted actions.[103]

Second, if a situation arises like the one described above with respect to *INDOPCO* and the subsequent legal ambiguity of the Court's decision, courts could abstain or otherwise stay *qui tam* cases pending resolution of the ambiguity. Under this recommendation, in the period between *INDOPCO* and the issuance of regulations, *qui tam* cases could have been stayed to avoid conflicting legal determinations between the judicial and executive branches.

Third, Congress could minimize the possibility of harassing claims by restricting *qui tam* tax litigation to high-dollar cases. Current law limits informant claims to cases against taxpayers whose gross annual income exceeds $200,000 and whose potential indebtedness for taxes, penalties, and interest exceeds $2,000,000.[104] If Congress felt that existing limits were too low, it could raise them for cases prosecuted by *qui tam* plaintiffs.

Fourth, to discourage the plaintiffs' bar from aggressively collecting *qui tam* plaintiffs, Congress could require informants to provide specific and unique information before the Service and the court could authorize them as *qui tam* plaintiffs. It could, for instance, require would-be plaintiffs to meet the Supreme Court's recent interpretation of the FCA's "original source" rule whereby an informant must have knowledge of the actual facts underlying the allegations on which she believes she can prevail.[105] In addition, the current tax whistleblower statute merely reduces awards to informants the Service determines do not possess specific and unique information.[106] Alternatively, Congress could prohibit such informants from prosecuting actions altogether.

Finally, experience under the FCA indicates that allowing *qui tam* plaintiffs to prosecute actions without the government has not resulted in a flood of

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[101] 31 U.S.C. § 3730(a) (2000).

[102] The FCA, for its part, requires both the court and the Attorney General to give written consent for dismissal of an action in the event the government decides against prosecution. *See id.* § 3730(b)(1).

[103] *See id.* § 3730(d)(2).

[104] I.R.C. § 7623(b)(5).

[105] *See* 31 U.S.C. § 3730(e)(4)(A), (B) (2000); *see also* Rockwell Int'l Corp. v. United States, 127 S. Ct. 1397, 1409 (2007); Vogel, *supra* note 81, at 491-99.

[106] *See* I.R.C. § 7623(b)(2)(a).

harassing or frivolous lawsuits. With the Department of Justice and courts acting as gatekeepers, illegitimate *qui tam* claims get screened out early in the process. Moreover, those *qui tam* plaintiffs who manage to make it through the screening process and proceed with the action independent of the government receive a small portion of all *qui tam* settlements and judgments. Between 1987 and 2006, just 3.6% of all *qui tam* settlements and judgments went to *qui tam* plaintiffs suing alone, while in 2006, *qui tam* plaintiffs received only 1.17% of all *qui tam* collections.[107] The experience of the FCA indicates that the low expected financial payout associated with prosecuting *qui tam* actions that the government decides not to pursue, presumably the weakest cases, may discourage individuals from bringing such actions.[108]

C. *Recalculating the Compliance Calculus and Closing the Resource and Information Gaps*

The benefits of extending *qui tam* litigation to tax significantly outweigh any potential shortcomings. The possibility of *qui tam* actions adds downside risk, both real and perceived, to the compliance calculus by increasing the probability of detection as well as subsequent prosecution. The mere threat of *qui tam* investigations and lawsuits initiated by knowledgeable insiders could discourage noncompliant behavior. Meanwhile, successful prosecution of tax violators and widely publicizing the conviction of illegal behavior could both discourage noncompliant behavior and reinforce compliant behavior.[109] People pay taxes for various reasons. But fear of detection, more than the size of potential penalties, seems to provide the strongest incentive to comply with the tax law.[110]

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[107]Calculated from U.S. Department of Justice, *supra* note 41.

[108]The low expected payouts associated with prosecuting *qui tam* actions independent of the government does not necessarily lead to the conclusion that adding a *qui tam* provision to the current tax whistleblower statute would provide no marginal benefit to the existing bounty system. *See infra* notes 142-46 and accompanying text.

[109]*See supra* notes 96-97 and accompanying text.

[110]This is not to say that tax penalties cannot have a positive impact on compliance. *See* James Alm, Isabel Sanchez & Ana De Juan, *Economic and Noneconomic Factors in Tax Compliance*, 48 Kyklos 3 (2001); Ana De Juan, Miguel A. Lasheras & Rafaela Mayo, *Voluntary Tax Compliant Behavior of Spanish Income Tax Payers*, 49 Pub. Fin. 90 (Supp. 1994); Steven Klepper & Daniel Nagin, *Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution*, 23 Law & Soc'y Rev. 209 (1989). But researchers have shown that nominal penalties do not correlate as strongly as probability of detection with increased compliance. *See* Joel Slemrod, Marsha Blumenthal & Charles W. Christian, *Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota*, 79 J. Pub. Econ. 455 (2001); A. Mitchel Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 Harv. L. Rev. 869 (1998); Kurt J. Beron, Helen V. Tauchen & Anne D. Witte, *The Effect of Audits and Socioeconomic Variables on Compliance*, *in* Why People Pay Taxes 67 (Joel Slemrod ed. 1992); Jeffrey A. Dubin & Louis L. Wilde, *An Empirical Analysis of Federal Income Tax Auditing and*

In a world of inadequate enforcement and stupendously low audit rates, *qui tam* litigation could augment government efforts to detect abusive taxpayer behavior. In 2006, the Service audited less than one percent of all individual returns,[111] and even then could not verify all positions embedded in examined returns.[112] The other 99% of the time, the opposing party's assertions went unexamined and unchallenged. In addition, despite higher absolute audit rates for businesses, examinations and probability of detection continue to decline. In 2006, exams of companies with assets of more than $10 million decreased 7.5%, to 18.6%, while for companies with assets of more than $250 million audits dropped 25%, to 35.3%.[113] Even for corporations subject to annual audit, there is no guarantee the Service will identify questionable

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Compliance, 41 Nat'l Tax J. 61 (1988); Jeffrey A. Dubin, Michael J. Graetz & Louis L. Wilde, *Are We a Nation of Tax Cheaters?: New Econometric Evidence on Tax Compliance*, 77 Am. Econ. Rev. 240 (1987). In fact, some studies have reported a "crowding out" of tax compliance when penalties are introduced, and a corresponding *increase* in evasion. *See* Valerie Braithwaite, *Dancing with Tax Authorities: Motivational Postures and Non-compliant Actions*, *in* Taxing Democracy: Understanding Tax Avoidance and Evasion 15 (Valerie Braithwaite ed. 2003); Doreen McBarnet, *When Compliance Is Not the Solution but the Problem: From Changes in Law to Changes in Attitude*, *in* Taxing Democracy: Understanding Tax Avoidance and Evasion 229 (Valerie Braithwaite ed. 2003); Mark Lubell & John T. Scholze, *Cooperation, Reciprocity, and the Collective-Action Heuristic*, 45 Am. J. Pol. Sci. 160 (2001); Bruno Frey, *A Constitution for Knaves Crowds Out Civic Virtues*, 107 Econ. J. 1043 (1997). In the end, neither the traditional deterrence strategy nor the punishment strategy fully explains why people pay taxes. Moral, ethical, and social inputs are as important in determining whether and how taxpayers comply with the law as the threat of economic or legal punishment. *See* Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 Iowa L. Rev. 863, 916-21 (2004); Lederman, *supra* note 96; Marsha Blumenthal, Charles Christian & Joel Slemrod, *Do Normative Appeals Affect Tax Compliance? Evidence from a Controlled Experiment in Minnesota*, 54 Nat'l Tax J. 125 (2001); Dan M. Kahan, *Trust, Collective Action, and Law*, 81 B.U. L. Rev. 333 (2001); Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 Va. L. Rev. 1781 (2000); Brian Erard & Jonathan S. Feinstein, *The Role of Moral Sentiments and Audit Perceptions in Tax Compliance*, 49 Pub. Fin. 70 (Supp. 1994); Laurie Mason & Robert Mason, *A Moral Appeal for Taxpayer Compliance: The Case for a Mass Media Campaign*, 14 L. & Pol'y 381 (1992); Harold G. Grasmick & Robert J. Bursick, *Conscience, Significant Others, and Rational Choice: Extending the Deterrence Model*, 24 Law & Soc'y Rev. 837 (1990).

[111]Stephen Joyce, *IRS Official Says Personal Audits to Rise, Corporate Audit Strategies Being Developed*, Daily Tax Rep. (BNA), Dec. 21, 2006, at G-7 (citing 0.98%); Stephen Joyce, *IRS Collected Record $48 Billion in FY 2006; Increases in Individual, Business Audits Cited*, Daily Tax Rep. (BNA), Nov. 21, 2006, at G-5. Individuals claiming income of $100,000 or more faced an audit rate of 1.67%, while those claiming income under $100,000 confronted an audit rate of just 0.89%.

[112]*See* Rosenberg, *supra* note 89, at 189 ("Even if the Service does audit the taxpayer, it may not notice whatever tax evasion the taxpayer may have engaged in. To the extent that it must rely on the taxpayer's own records to incriminate the taxpayer, the Service is in a difficult position.").

[113]Joyce, *supra* note 111.

tax-motivated transactions, either because of gaps in the corporate taxpayer's records,[114] affirmative concealment of questionable transactions,[115] or the ability of corporations to set the audit agenda and include for scrutiny legitimate transactions while excluding illegitimate transactions.[116] Finally, even though absolute dollar amounts from enforcement have increased in recent years,[117] the Service has left a significant amount of money on the table. The Service audited 50% fewer total companies between 1997 and 2006.[118] For every category of business taxpayer—including small business, large corporation, and tax-exempt—the Service performed fewer audits in 2006 than in 1997.[119] In addition, the Service has begun allocating fewer hours to each audit,[120] and allegedly pressuring agents to close audits of large corporations prematurely as part of negotiated compromises.[121] Private enforcement of tax laws in the form of *qui tam* actions can fill these gaps in public enforcement, and supplement public resources allocated to detecting and prosecuting abusive and illegal activity.

Qui tam actions might also help fill the "resource gap" currently separating tax regulators and private sector tax lawyers. In many respects, compared to the private tax bar, the Service is short personnel, money, and expertise.[122] The first two deficiencies go hand in hand. Between 1996 and 2003, funding

[114]Rosenberg, *supra* note 89, at 189.

[115]Graeme S. Cooper, *Analyzing Corporate Tax Evasion*, 50 Tax L. Rev. 33, 100 (1994) (stating that business entities conceal tax-motivated transactions from auditors).

[116]Joint Committee on Taxation, Study of Present Law Penalty and Interest Provisions, as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998, JCS-3-99 (1999), at 212.

[117]Between 2001 and 2006, the Service reported an increase in enforcement revenue of 40%, from $33.8 billion in 2001 to $48.7 billion in 2006. IR-News Rel. 2006-28 (2006); Joyce, *supra* note 111.

[118]*See generally* IR-News Rel. 2006-28 (2006).

[119]*See generally* Joyce, *supra* note 111.

[120]Stephen Joyce, *TRAC Says IRS Spends Less Time on Audits: IRS Says Worker Gains Mean More Revenue*, Daily Tax Rep. (BNA), Dec. 21, 2006, at G-8.

[121]David Cay Johnston, *Agents Say Fast Audits Hurt I.R.S.*, N.Y. Times, Jan. 12, 2007, at C1. One Service auditor referred to the practice as "catch and release," with agents being prevented from pursuing too diligently questionable corporate tax deductions. Subsequent to the *N.Y. Times* article, the Service established an internal website through which revenue agents may register complaints about Service management oversight of auditing practices. *See* Stephen Joyce, *Everson Defends IRS Audit Practices, Use of Private Collection Agencies*, Daily Tax Rep. (BNA), Mar. 21, 2007, at G-6. For the Service's response to criticism of its large corporate audit program, see *Everson Responds to Doggett on IRS Corporate Audit Cycles*, 2007 Tax Notes Today 55-16 (Feb. 28, 2007).

[122]David Schizer has drawn a similar conclusion. "In important respects, the private tax bar outmatches their counterparts in government. This imbalance is one of sheer numbers, of access to information, and, at least in some cases, of sophistication and expertise." David M. Schizer, *Enlisting the Tax Bar*, 59 Tax L. Rev. 331, 331 (2006).

for Service personnel resources fell dramatically, resulting in a 36% decline in combined collection and examination function enforcement staff.[123] During the same period, the number of revenue officers and revenue agents, two groups critical to detection and compliance efforts, declined by 40% and 50%, respectively.[124] Meanwhile, Service workload jumped sharply, with the number of taxpayers filing returns growing from 115 million in 1995 to 132 million in 2006.[125]

Shortfalls in expertise are harder to quantify. But anecdotal evidence suggests that this component of the resource gap is an even larger problem than personnel and funding issues.[126] One seasoned tax lawyer reported that in one of the biggest partnership tax cases of the last 20 years, the investigating revenue agent suspended the audit for several weeks toward the end of the inquiry to attend an entry-level partnership class. In another partnership investigation, a private-sector lawyer spent several hours trying to explain to the investigating agents that, as the agents *did* understand, reduction of debt inside a partnership is treated as a cash distribution[127] (which had not been reported as income by the partners in the case), but there was the offsetting fact that the debt also increased outside basis when it was first assumed by the partnership, so the distribution was not in excess of basis after all.[128] Once the agents understood that they had overlooked the effect of the debt on outside basis, they closed the case, but only after months of expensive, resource-intensive investigation. In addition, some practitioners report that 40% to 50% of issues on tax returns get picked up by revenue agents today, whereas of old that figure was closer to 70% to 90%.[129] Professor John Braithwaite has reported a similarly dismal assessment of revenue agent competence among elite tax lawyers in the New York legal market. It is "not hard to get things by them," one of Braithwaite's interviewee's shared, while another opined, "The real issue is that the IRS aren't [sic] smart enough to find these [sophisticated tax shelter] deals on a tax return."[130] Finally, a recent national news story exposed in stark relief this purported "competence gap," a subset of the gaping resource gap that is currently undermining the government's tax enforcement

[123]Colleen M. Kelley, Internal Revenue Service Operations and the Tax Gap, Prepared Remarks Submitted to the House Ways and Means Subcommittee on Oversight, 07 No. 053 BNA Taxcore 018 (Mar. 20, 2007) (statement of Colleen M. Kelley, National Treasury Employees Union).

[124]Diane Freda, *NTEU President Kelley Tells Congress More Workers Key to Reducing Tax Gap*, Daily Tax Rep. (BNA), Mar. 20, 2007, at G-6.

[125]*Id.*

[126]The "anecdotal evidence" was gathered from discussions with practitioners in the Los Angeles, New York, and Washington, DC legal markets.

[127]I.R.C. § 752(b).

[128]I.R.C. § 752(a).

[129]*See supra* note 126.

[130]John Braithwaite, Markets in Vice, Markets in Virtue 133 (2005).

efforts. The government successfully prosecuted the biggest tax fraud case in the nation's history only to botch the plea agreement, preventing it from collecting over $100 million in unpaid taxes.[131]

The Service has implemented aggressive measures to reduce the alleged competence gap. The initiatives of Chief Counsel Donald Korb are particularly laudable. For the last two years, Korb and his deputies have personally recruited at the nation's top law schools with an aggressive campaign dubbed, "Great Place to Start" and a glossy brochure that contains biographies of tax luminaries whose legal careers began at the Service.[132] Korb's stated message—in addition to recruiting top talent to the nation's largest tax law firm, the Chief Counsel's office—is to return "a healthy respect for the IRS."[133] By all accounts, the program has been incredibly successful. In both 2006 and 2007, the Chief Counsel's Office received over 3000 applications from law students, and it interviewed at more than 150 law schools, compared to only 60 law schools in 2005.[134]

While these recent efforts are undoubtedly necessary to generate respect for the Service and to populate Service enforcement personnel with talented attorneys, they are not sufficient. For one thing, the Chief Counsel Office's recruiting efforts do not address the deficiencies in expertise among revenue agents or federal prosecutors. More drastic measures need to be considered, including the recommendations offered by David Schizer, Dean of Columbia Law School. With respect to increasing government expertise as part of the effort to combat overaggressive tax reporting and sheltering, Schizer proposes recruiting senior private practice tax attorneys out of retirement to mentor recent law school graduates entering government work, adopting a generous

[131]Eccentric telecommunications mogul Walter C. Anderson received a nine-year prison term in March 2007, but he escaped paying restitution because federal prosecutors mistakenly listed the wrong statute in the agreement. *See* Jeremiah Coder, *Justice Dept. Loses Again in Tax Fraud Collection Case*, 115 Tax Notes (TA) 1260 (June 26, 2007); Carol D. Leonnig, *Prosecutors' Slip Keeps Money in Limbo; Court Refuses Restitution Order for Mogul, Says Plea Deal Cites Incorrect Law*, Wash. Post, Mar. 29, 2007, at B06.

[132]Robert Guy Matthews, *It's Taxing to Recruit Top Law Grads to IRS, But a New Push Betters Returns*, Wall St. J., Oct. 10, 2006, at B1; Sheryl Stratton, *After One Year on the Job, IRS Chief Counsel Reviews, Previews*, 107 Tax Notes (TA) 292, 292 (Apr. 18, 2005). For the brochure, see http://taxprof.typepad.com/taxprof_blog/files/publication_4063.pdf. The tax luminaries include Sheldon Cohen (former Service Chief Counsel and Commissioner of Internal Revenue), Pamela Olson (former Assistant Secretary of the Treasury for Tax Policy), and Ronald Pearlman (former Assistant Secretary).

[133]Quoted in Alison Bennett, *Korb Defends Aggressive Shelter Approach; Vows to Help Efforts to Reach 'Equilibrium,'* 198 Daily Tax Rep. (BNA), Oct. 13, 2006, at G-1.

[134]Telephone Interview with Hsinyu Yu, Attorney Recruitment Manager, IRS Chief Counsel Office (Jan. 30, 2008).

loan forgiveness program for these graduates, and retaining expert academics and private law firms to litigate important tax controversies.[135]

Even with the smartest, best educated, highest paid personnel, the Service would still be at a disadvantage. Staffing and retention are problems for the Service, but skill level is not the primary issue. Indeed, in many respects, the "information gap" separating tax regulators from private sector tax lawyers is significantly wider than the resource gap. Service enforcement is so severely handicapped by informational asymmetries that taxpayers can engage in abusive tax planning, accurately report transactions associated with that planning, yet still provide the Service no indication that abusive activity may have taken place.[136]

Qui tam for tax could level the compliance playing field by mitigating these resource and information gaps. Aligning the interests of taxpayers, tax practitioners, and tax regulators by providing economic incentives for exposing abusive taxpayer behavior would put taxpayers on the enforcement side of the tax avoidance game. In addition, would-be *qui tam* plaintiffs would need to consult private practitioners respecting the information they possess and how they should interact with the government, particularly the new Service Whistleblower Office. In the event the government decided not to prosecute the case based on an informant's information, but allowed the informant to proceed as a *qui tam* plaintiff, the informant would need legal representation. In this way, *qui tam* for tax might also encourage private sector tax lawyers to align on the side of tax collection rather than tax avoidance. In fact, since

[135]Schizer, *supra* note 122, at 333, 346-52. The government may not even have to pay top dollar for these services. According to interviews conducted by sociologist John Braithwaite, elite New York tax attorneys seemed "almost itching at the thought of being invited to serve in a senior capacity at the IRS." Braithwaite, *supra* note 130, at 133. For those attorneys requiring economic incentives to assist tax officials, Professor Rosenberg has recommended a bounty program that would pay practitioners cash for alerting the government to legal uncertainties and undiscovered tax avoidance schemes. Rosenberg, *supra* note 89, at 224-26.

[136]Consider the intermediary transaction tax shelter, typically involving four parties: a seller (S) who wants to sell the stock of a target corporation (T); a promoter-controlled intermediary entity (E); and a buyer (B) who wants to purchase the assets but not the stock of the target. Under the terms of a pre-arranged plan, S purports to sell the stock of T to E. E has arranged financing for the sale through a bridge loan, which is secured by the assets of T. At the same time or shortly after the stock sale, E purports to sell T's assets to B. The bridge loan is repaid from the proceeds, while any excess proceeds are retained by E, essentially as a fee for serving as the accommodation party. As a result of the transaction, S recognizes reduced gain due to its high basis in the stock of T; B receives larger depreciation and amortization deductions based on the fair market value of the assets (rather than taking T's basis in the assets); and E avoids paying tax on the gain from the asset sale by offsetting the gain with losses from the sale of inflated-basis assets. As far as the Service is concerned, S's tax return reflects a simple sale, while B's reflects a straight asset purchase. The only way for the Service to expose the scheme is to examine the returns of all four parties and nail the promoter. *See* Notice 2001-16, 2001-9 I.R.B. 730. I am grateful to William Alexander for this example of information asymmetries.

passage of the 2006 amendments to the tax whistleblower statute, the tax whistleblower bar has grown perceptibly, as much as 15% to 20% according to the national organization of *qui tam* lawyers.[137] The influx of private sector tax attorneys to *qui tam* practice increases the number of tax advisors available to assist *qui tam* plaintiffs, as well as tax officials, in collecting unpaid taxes.

Perhaps most importantly, the threat of *qui tam* actions could alter governance and compliance norms *within* organizations, and deter noncompliant behavior at the source. The threat of *qui tam* litigation, the promise of bounties, and improved protections for whistleblowers[138] could strongly encourage insider-informants to expose noncompliance. This private enforcement of tax law can provide a particularly efficient form of regulation. Modern economic theory suggests that it is appropriate and often optimal for regulators to shift the cost of compliance to the party or parties with the lower cost of monitoring.[139] In many instances, that party is the outside tax professional or compliance counselor within regulated entities, both of whom often possess intimate knowledge of potentially noncompliant activity. "The chief virtue of private monitoring," Kovacic has observed, "is that it gives monitoring tasks to individuals closest to the relevant information."[140] Those individuals are in a unique position to deter and detect noncompliant behavior. To the extent tax professionals advise reporting positions and transactions, or are themselves the decision makers within organizations,[141] the threat of whistleblower actions and subsequent *qui tam* litigation might make them think twice before advising or endorsing impermissible or likely impermissible activity. Furthermore, as the last section of this Article demonstrates, these tax professionals may already be obligated to disclose insider information pertaining to tax violations, even purportedly privileged information, under federal securities laws.

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[137]Telephone Interview with Jeb White, Editor, *Quarterly Review*, the official publication of Taxpayers Against Fraud (TAF), (July 3, 2007).

[138]*See infra* notes 157-72 and accompanying text.

[139]*See, e.g.*, Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. Legal Stud. 1, 1-15 (1974) (concluding that private enforcement of public laws can be more efficient than public enforcement). For a more recent discussion in the context of antitrust regulation, see Jonathan B. Baker, *Antitrust in the 1990s*, *in* FTC History: Bureau of Economics, Contributions to Law Enforcement, Research, and Economic Knowledge and Policy (2003), *available at* http://www.ftc.gov/be/workshops/directorsconference/docs/directorstableGOOD.pdf#page=136.

[140]Kovacic, *supra* note 37, at 774.

[141]Susan Morse has shown that changes in substantive regulation and disclosure requirements—including internal controls imposed by Sarbanes-Oxley and heightened opinion standards imposed by Circular 230—have had a positive impact on tax compliance norms shared by tax decision-makers at large public corporations. These norms have produced "general liability concerns within organizations, including the corporate taxpayer itself, accounting firms, and other advisors to which members of the tax decision-making group belong." Susan Cleary Morse, *The How and Why of the New Public Corporation Tax Shelter Compliance Norm*, 75 Fordham L. Rev. 961, 964 (2006).

VI. Fine-Tuning *Qui Tam* for Tax Whistleblowers

It remains to be seen whether an enhanced whistleblower statute will prove as effective an enforcement mechanism for tax as it has proven for other areas of the law. In particular, it is unclear whether allowing private persons to bring *qui tam* actions in the event the government decides not to prosecute an alleged tax violation will provide marginal benefits beyond the existing bounty system. Indeed, this Article has argued that extending *qui tam* to tax would not induce frivolous claims on grounds that, among other things, the low expected financial payouts in the FCA context associated with prosecuting *qui tam* actions when the government decides not to pursue a *qui tam* claim might provide insufficient incentives for individuals to bring such actions.[142] Assuming similarly low recovery percentages for *qui tam* plaintiffs in the tax context, it is fair to ask whether adding a few more successful whistleblowers is worth the trouble of providing a *qui tam* element to the tax whistleblower statute. In some respects, the current bounty system may encourage *more* whistleblowers to come forward than a *qui tam* system, because the procedures of a bounty system are less onerous; whistleblowers can simply submit a claim to the Service, for instance, while *qui tam* plaintiffs typically must hire a lawyer to initiate proceedings.

Though the ultimate benefits of extending *qui tam* to tax are uncertain, the existing evidence suggests that adding a *qui tam* provision to the tax whistleblower statute would deter noncompliance and enhance enforcement. First, as discussed above, the threat of *qui tam* lawsuits adds real as well as perceived risk to the compliance calculus.[143] It increases the probability of detection and subsequent prosecution, which researchers have shown corresponds particularly strongly with increased tax compliance.[144] Second, if the government publicizes the threat of *qui tam* lawsuits and the successful prosecution of tax cheats, research also indicates that such publicity could discourage noncompliant behavior and at the same time reinforce compliant behavior.[145] Third, the *qui tam* approach might actually encourage more private persons to come forward with information of wrongdoing than a pure bounty system for two additional reasons: some would-be informants might be comforted knowing that the federal government will help prosecute the lawsuit they initiate, while other informants might be comforted knowing that they will have an opportunity to proceed with the action on their own if the government does not act on what the informant believes to be unique and important information. Fourth, the mixture of bounties and *qui tam* lawsuits seems to be working

[142] *See supra* notes 107-08 and accompanying text.
[143] *See supra* notes 109-10 and accompanying text.
[144] *Id.*
[145] *See supra* notes 96-97 and accompanying text.

effectively in the FCA context,[146] and the foregoing discussion indicates that the same mixture could work even more effectively in the tax context. Finally, the *qui tam* approach bridges private and public enforcement of the law, thereby reconceptualizing the law and its enforcement as a civic obligation not only of public officials but also of private persons. In this way, it recruits private citizens into the government's enforcement efforts, and provides tax officials with valuable information to detect otherwise undiscovered tax cheating.

Whether Congress decides to rely exclusively on a bounty system for the Service whistleblower statute or to embrace a complementary *qui tam* approach, policymakers will encounter a number of difficult implementation issues, including (1) taxpayer privacy; (2) the potential for frivolous and harassing claims; (3) inadequate protections for whistleblowers; (4) informants connected to the underlying abusive behavior; and (5) jurisdictional competence and inefficiencies. This Part offers recommendations for addressing these issues.

A. *Taxpayer Privacy and Frivolous Claims*

Critics of the tax whistleblower statute have argued that it infringes on taxpayer rights. Informants can allege wrongdoing with little or no evidence, use the statute as a way to carry out personal vendettas, and impose "tremendous costs" on taxpayers under investigation by the Whistleblower Office.[147] Moreover, critics have expressed concern that when an award is made to a former employee of a particular company that disclosed in its reporting materials a tax penalty for the period related to the award, it might be possible to connect the dots, and identify the informant by linking the award and the penalty.[148]

These concerns over taxpayer harassment and privacy are grossly overblown. With respect to privacy concerns, current regulations prohibit disclosure of an informant's identity, even after the case is closed and the Service has paid the bounty.[149] Thus, unless someone affirmatively breaks the law by revealing

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[146] *See supra* notes 61-84 and accompanying text.

[147] *See, e.g.*, Allen Kenney, *Critics Question Whistleblower Proposal in Senate ETI Bill*, 104 Tax Notes (TA) 111, 112 (July 12, 2004) (quoting former Assistant Secretary for Tax Policy Pamela Olson).

[148] *See, e.g.*, Stephen Joyce, *IRS Working on Whistleblower Office Rules; Issues Include Confidentiality, Award Process*, Daily Tax Rep. (BNA), May 15, 2007, at G-2. While there may be a good argument for wanting to hold a *qui tam* taxpayer accountable for wrongdoing, and even publicizing that wrongdoing, we might be less enthusiastic in cases involving settlements, particularly for small sums of money, rather than judgments.

[149] *See* Reg. § 301.7623-1(e) ("No unauthorized person will be advised of the identity of an informant."); *see also* I.R.C. § 6103(i)(6) (stating that "the Secretary shall not disclose any return or return information . . . if . . . such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.").

the identity of an informant, "connecting the dots" would be a very difficult endeavor. Moreover, if a private citizen prosecutes the action after the government has declined to proceed, she can sue anonymously under a pseudonym to avoid revealing her identity. To the extent privacy concerns extend to *qui tam* taxpayers rather than *qui tam* plaintiffs, Congress might very well be in the mood to relax section 6103 prohibitions against disclosure of tax return information, as discussed above.[150]

Respecting harassment concerns, Director Whitlock has stated explicitly that his office will develop "'a positive message' about the program in order to instigate cases with merit without compelling citizens to make personal or vindictive claims."[151] In addition, the Service has said it wants the Whistleblower Office to concentrate on large-dollar cases.[152] The recent amendments to section 7623 limit claims to cases against taxpayers whose gross annual income exceeds $200,000 and whose potential indebtedness for taxes, penalties, and interest exceeds $2,000,000.[153] Therefore, while there is nothing to prevent informants from bringing vindictive or spiteful whistleblower claims, the dollar limitations shrink considerably the potential universe of such actions. Moreover, the enhanced whistleblower law could be amended still further to include sanctions for frivolous claims. The False Claims Act provides that a defendant may be awarded "reasonable attorneys' fees and expenses if the defendant prevails in the action and the court finds that the claim was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."[154] If we are still worried about harassing claims, particularly in the early stages of the new program where informants might try to cash in by exposing past abuses, the Whistleblower Office could allow for a period of amnesty, whereby *qui tam* taxpayers pay tax and interest due without penalty. Recent experience with amnesty programs and settlement initiatives has been quite

[150] *See supra* notes 91-95 and accompanying text.

[151] Joyce, *supra* note 60.

[152] *See* Joyce, *supra* note 148 (quoting Director Whitlock as saying that the Whistleblower Office will focus on large-dollar cases).

[153] I.R.C. § 7623(b)(5). But see legislative efforts to decrease that amount to $20,000, which supporters have advocated as a revenue raising measure. Fair Minimum Wage Act of 2007, H.R. 2, 110th Cong. § 233 (2007) (as passed by House on January 20, 2007 and as passed by Senate on February 1, 2007). The Service has opposed efforts to lower the monetary thresholds. *See* Joyce, *supra* note 148 (quoting Director Whitlock as saying that a lower threshold could create a "significant problem" for the current policy of concentrating on large-dollar cases); Joyce, *supra* note 60 (reporting Service officials as wanting to keep the monetary threshold at $2,000,000 to avoid the submission of "weak claims and vindictive cases among neighbors"). For additional commentary on the pros and cons of eliminating the monetary thresholds, see Todd Simmens, *Proposed Whistle-Blower Reforms: Not Ready for Prime Time*, 105 Tax Notes (TA) 743, 743-44 (Nov. 1, 2004).

[154] 31 U.S.C. § 3730 (2003).

successful in prompting tax evaders to come forward, cut their losses, and pay tax owed.[155] Moreover, amnesty programs have been shown to increase long-term compliance by bringing people onto the tax rolls, and identifying continuing sources of previously unreported income.[156]

B. *Whistleblower Protections*

While some criticism of the enhanced tax whistleblower statute concerns the treatment of *qui tam* taxpayers, other criticism involves the treatment of *qui tam* plaintiffs. The recent amendments to section 7623 added significant monetary incentives for tax whistleblowers to come forward, but they failed to provide adequate protections for those informants. Larger awards might compensate the informant for risking investment in her career and standing in her community of peers, but not against retaliatory actions on behalf of employers or colleagues. The False Claims Act addresses this problem by providing safeguards for employees who are punished by employers because of the employee's lawful acts in investigating, initiating, testifying, and otherwise assisting in a *qui tam* action. In particular, under the FCA, the aggrieved employee may obtain "all relief necessary to make the employee whole," including restoring seniority, two times back pay, interest on back pay, special damages, litigation costs, and reasonable attorneys' fees.[157]

Federal securities law offers stronger whistleblower protections that might serve as a model for improving the Service whistleblower statute. Section 806 of the Sarbanes-Oxley Act[158] created a new federal cause of action, "Whistleblower Protection for Employees of Publicly Traded Companies," designed to protect whistleblowers from retaliation by employers for providing information on violations of federal securities law, the SEC rules, or "any Federal law relating to fraud against shareholders."[159] Under the statute, a protected employee cannot be discharged, demoted, suspended, threatened, harassed, or discriminated against due to a protected disclosure.[160] Employees that encounter employer retaliation for covered disclosures are entitled to "all relief

[155]The Service has had particular success with amnesty programs and global settlements associated with some of the most notorious tax shelters. *See, e.g.*, Stephen Joyce, *About 2,000 Taxpayers to Pay $2 Billion in Global Settlement, Everson Says*, Daily Tax Rep. (BNA), Mar. 28, 2006, at G-2; IR-News Rel. 2005-72.

[156]*See, e.g.*, Ronald C. Fisher, John H. Goddeeris & James C. Young, *Participation in Tax Amnesties: The Individual Income Tax*, 42 Nat'l Tax J. 15, 19 (1989). Amnesty programs are less effective when taxpayers perceive that they will be followed by lax enforcement of the law. *See id.*

[157]31 U.S.C. § 3730(h) (2000).

[158]*Id.*

[159]Pub. L. No. 170-204, § 806(a), 116 Stat. 745, 802-03 (codified at 18 U.S.C. § 1514A(a)(1) (Supp. 2003)).

[160]*Id.* § 1514A(a).

necessary to make the employee whole," including immediate reinstatement to the same seniority status that the employee would have had but for the adverse employment action; back pay; interest; and "special damages" such as litigation costs, expert witness fees, and reasonable attorney fees.[161] Section 1107 of Sarbanes-Oxley offers whistleblower protection to employees of public as well as private companies for disclosures related to the purported commission of *any* federal offense.[162] Employers found to have violated section 1107 of Sarbanes-Oxley are subject to fines and up to ten years in prison.[163]

Though sections 806 and 1107 of Sarbanes-Oxley, as written, extend powerful protections to corporate whistleblowers, as implemented, the sections have largely failed to protect informants. For instance, it appears that the criminal provision, section 1107, has yet to be used by the Department of Justice.[164] In addition, of the nearly 1,000 complaints filed under section 806 between the enactment of Sarbanes-Oxley and June 2007, not a single complaint ended with the whistleblower prevailing. In total, 947 whistleblower cases were filed with the Department of Labor's (DOL) Occupational Safety and Health Administration, the agency charged with administering the majority of federal whistleblower laws.[165] The DOL dismissed 665 of those complaints as having no merit, while another 138 were settled before the DOL could rule on them, and 126 were withdrawn by the complainant (and presumably settled).[166] Only 17 cases made it through the first level of

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[161] *Id.* § 1514A(c).

[162] *Id.* § 1513(e). The flush language of the statute, codified as part of the federal criminal code prohibiting retaliation against witnesses, victims, or informants, reads:

> Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.

Id.

[163] *Id.*

[164] Email from Richard Moberly to Dennis Ventry (July 20, 2007) (on file with author).

[165] Tim Reason & Stephen Taub, *Whistle-blowers Never Win*, CFO.com (June 8, 2007), *available at* http://www.cfo.com/article.cfm/9321686?f=related (reporting on a study published by the law firm Orrick, Herrington & Sutcliffe, LLP). For an earlier report with equally depressing figures, see Kathleen Day, *Whistle-Stop Campaigns: Some Firms Are Trying to Limit Protection of Workers Who Expose Wrongdoing*, Wash. Post, Apr. 23, 2006, at F1.

[166] Reason & Taub, *supra* note 165. Of the settled cases, several have pertained to employees whose whistleblowing involved tax matters. One particularly high-profile case involved Michael Hamersley, a former senior manager and tax lawyer at the accounting firm, KPMG, who alleged that he was put on administrative leave after refusing to sign off on questionable tax shelters sold to an audit client. *See* Request for Dismissal, Hamersley v. KPMG LLP (Cal. Jan. 8, 2004) (No. BC297905) (settling in 2004 for an undisclosed amount). For a more detailed account of the circumstances surrounding Mr. Hamersley's lawsuit, see Tanina Rostain, *Travails in Tax: KPMG and the Tax Shelter Controversy*, *in* Legal Ethics Stories 89 (Deborah L. Rhode & David Luban eds. 2006). For another, still unresolved, case involving tax whistleblowers and

DOL review, and only six whistleblowers prevailed on the merits at the second level of review (the DOL's administrative law judges).[167] Of those six cases (just 0.7% of all complaints filed under section 806), three were reversed at the final level of review, the DOL's Administrative Review Board, and of the remaining three cases, two settled and one remains open.[168]

Professor Richard Moberly has examined in rich detail the low rate at which whistleblowers currently prevail under Sarbanes-Oxley protections. After looking at every case filed under section 806, Moberly concludes that administrative decisionmakers at the DOL have strictly construed and even misapplied the protections to the disadvantage of employee-whistleblowers.[169] Moberly also suggests several ways to improve Sarbanes-Oxley's anti-retaliation provisions, such as making procedural and interpretive clarifications to assist the DOL in the appeals process, and expanding the Act's whistleblower protections to private as well as public companies and to disclosures pertaining to *any* unlawful activity rather than simply to corporate fraud.[170] To the extent Congress or tax officials rely on Sarbanes-Oxley whistleblower protections as a model for an enhanced tax whistleblower statute, they will need to be wary of the difficulties of translating "the idealistic legislative goal of broad employee protection into realistic rights and attainable remedies."[171] Other scholars have noted that under-enforcement of the whistleblower provisions undermines Congress's desire to encourage private individuals to expose corporate wrongdoing. To provide additional incentives to counteract the shortcomings of Sarbanes-Oxley's anti-retaliation features, some of these scholars recommend adopting a *qui tam* bounty approach for the securities and corporate fraud

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the Sarbanes-Oxley protections, see generally Schmidt v. Levi Strauss & Co., No. 419398, 2004 WL 2418291 (Cal. Ct. App. 2004) (a suit against Levi Strauss & Co. by two former in-house tax directors of the company who alleged retaliation for blowing the whistle on purported falsification of financial statements). *See also* Sally Beatty & Glenn R. Simpson, *Levi Again Hires Counsel to Review Tax Accounting*, Wall St. J., June 2, 2003, at A-3.

[167]Reason & Taub, *supra* note 165.

[168]*Id.*

[169]Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 Wm. & Mary L. Rev. 65, 67-68 (2007). For additional criticism of inadequate protections for whistleblowers under Sarbanes-Oxley, see Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 Mich. L. Rev. 1757 (2007); Richard E. Moberly, *Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers*, 2006 BYU L. Rev. 1107 (2006). The phenomenally low rates of vindication for whistleblower claims might have more to do with the high frequency of frivolous claims than with the government's lack of commitment to enforcing the provision in the employee's favor. Discussions with defense lawyers in several legal markets revealed a firm belief that the first thing managers do when they are about to be terminated for cause is to manufacture bogus whistleblower allegations. *See supra* note 126.

[170]Moberly, *Unfulfilled Expectations*, *supra* note 169, at 134-52.

[171]*Id.* at 74.

context.[172] These proposals parallel those contained in this Article, and argue that a mixture of bounties and *qui tam* lawsuits provide strong incentives for private enforcement of public laws, which, going forward, could deter non-compliant behavior and at the same time encourage compliant behavior.

C. *"Connected" Informants and Streamlining Jurisdiction over Tax Whistleblowers*

In addition to offering adequate protections for informants, the amended tax whistleblower statute will also have to adopt procedures for dealing with informants connected to the underlying abusive behavior providing the basis for a cause of action. Section 7623(b)(3) offers some guidance, stating that the Whistleblower Office "may appropriately reduce [an] award" if it finds that the informant "planned and initiated" the actions underlying the award claim.[173] The office may also deny a claim altogether if the informant is convicted of criminal conduct associated with the planning or initiating of the actions giving rise to the award claim.[174] In this respect, the tax whistleblower statute reflects the False Claims Act, which cuts off recoveries by persons who participate in the challenged misconduct. The FCA whistleblower receives nothing if she is convicted of criminal conduct that also violates the FCA. If there is no criminal conviction, the court may reduce the bounty of a whistleblower who plans and initiates the violations, but must account for the person's role "in advancing the case to litigation and any relevant circumstances pertaining to the violation."[175] Neither whistleblower statute is particularly helpful on its face, however, and both require interpretation with respect to the treatment of interested or conflicted informants. In the case of the FCA, the district courts have accumulated considerable experience with evaluating award determinations.[176] They also have experience handling inappropriate claims filed for purposes of harassment or delay, as well as leveling sanctions against abusive *qui tam* informants.[177] Unfortunately, the current tax whistleblower statute

[172] *See* Dworkin, *supra* note 169, at 1769-71; Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. Rev. 91, 126-34 (2007); Moberly, *Sarbanes-Oxley's Structural Model*, *supra* note 169, at 1108 n.5.

[173] I.R.C. § 7623(b)(3).

[174] I.R.C. § 7623(b)(3). For a discussion of these issues among officials and practitioners, see Joyce, *supra* note 148, at G-2.

[175] 31 U.S.C. § 3730(d)(3) (2000).

[176] Recall that 31 U.S.C. § 3732 places jurisdiction for FCA claims in the district court in which the defendant resides, transacts business, or in which any alleged violation occurred. And, as Todd Simmens has pointed out, district courts, concurrent with the Court of Federal Claims, "generally hear cases involving monetary claims against the United States or against taxpayers." Simmens, *supra* note 153, at 744. *See* I.R.C. §§ 7402-7405; 28 U.S.C. §§ 1346, 1491.

[177] *See* Simmens, *supra* note 153, at 744.

requires informants to appeal Service award determinations to the United States Tax Court,[178] a tribunal considerably less experienced in these matters than district courts. To remedy this shortcoming of the tax whistleblower statute and to help the Service determine what to do with interested informants, Congress could provide jurisdiction for review of whistleblower award determinations in the district courts alone or concurrent with the tax court.

VII. Duty to Protect Versus Duty to Disclose

The most difficult issue confronting proponents of an invigorated tax whistleblower law involves potential violations of professional confidentiality. By paying valuable awards to informants, the enhanced statute could create a conflict for an attorney, pitting her ethical obligation to uphold client confidences against the legislatively authorized incentive to expose her client's purported tax violations. While the new tax whistleblower law and this Article's recommendation to extend *qui tam* to tax raise issues of confidentiality for tax professionals, federal law already requires tax advisors in certain situations to disclose client communications associated with tax violations. In particular, securities law imposes a compulsory whistleblower requirement on lawyers with knowledge of, among other things, material violations of federal or state tax laws.[179] In addition, recent changes to standards of tax practice promulgated by the Treasury Department impose on tax practitioners new disclosure requirements, and further deputize tax advisors in the government's longstanding effort to crack down on tax avoidance.[180] Moreover, Congress, the courts, and the Department of Justice continue to extend protections to lawyers as well as non-lawyers acting under federal whistleblower laws, even if state law obligations of confidentiality otherwise restrict those individuals from sharing client or employer communications.[181] The recommendations contained in this Article for fine-tuning the tax whistleblower statute and extending *qui tam* to tax reinforce a powerful trend that encourages private enforcement of public law, and protects informants from disclosing violations of law or public policy, even when disclosure conflicts with private law obligations.

A. *Muffling the Whistleblower: The Duty to Protect Confidential Information*

Tax practitioners have expressed particular concern over the potentially perverse incentives of the tax whistleblower program on client confidentiality. Even before the recent amendments added heightened monetary incentives to blow the whistle on tax cheats, including clients, some practitioners

[178] I.R.C. § 7623(b)(4).
[179] *See infra* notes 214-23 and accompanying text.
[180] *See infra* notes 252-55 and accompanying text.
[181] *See infra* notes 256-57, 259-61 and accompanying text.

argued that "voluntarily disclosing information regarding a client or former client would violate the professional standards of the CPA or the attorney and could well lead to loss of professional status. Yet there may be money to be made" under the whistleblower statute, accountants Burgess and William Raby warned, "and perhaps grudges to be settled or professional judgments to be vindicated, on rare occasions."[182] In those damage situations, Raby and Raby noted that alternative remedies exist, "but they no more should involve turning informer than they should involve taking a sledgehammer to the offender's automobile or inflicting bodily harm on him or her."[183] Although the analogy strains symmetry, the fact remains that under some circumstances attorneys and accountants may violate professional obligations in the event they voluntarily disclose information regarding a client or former client even if that disclosure exposes a violation of the tax law leading to its successful prosecution.

Disclosure of confidential information under the tax whistleblower statute could result in other adverse consequences for the tax professional. For example, attorneys and accountants can expose themselves to potential tort liability for sharing confidential client communications, as well as to breach of contract claims to the extent the engagement includes an enforceable confidentiality agreement. In addition, section 7216 makes it a misdemeanor for a tax practitioner to "knowingly or recklessly" disclose any information furnished in connection with the preparation of tax returns, or to use such information for any other purpose.[184] Moreover, Circular 230, the Treasury regulations governing standards of tax practice,[185] does not obligate the tax practitioner to notify the Service in the event of a discovered error on a previously filed return; the practitioner need only notify her taxpayer-client, at which point, she has fulfilled her professional duties. Furthermore, if the practitioner is an accountant, the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct mandates that a CPA "in public practice shall not disclose any confidential client information without the specific consent of the client."[186] If the practitioner is an attorney, the ABA Model Rules of Professional Conduct similarly prohibit her from revealing information related to the representation of a client without the client's informed consent.[187] In

[182]Burgess J.W. Raby & William L. Raby, *The Tax Practitioner as Tax Informer*, 2000 Tax Notes Today 230-14 (Nov. 29, 2000).

[183]*Id.*

[184]I.R.C. § 7216(a).

[185]*See* 31 C.F.R. pt. 10 (2007) [hereinafter Circular 230]. Circular 230 regulations govern tax practice "before the IRS," which is read broadly to include all written tax advice, from planning to litigation.

[186]AICPA Code of Prof'l Conduct R. 301 (1992), *available at* http://www.aicpa.org/about/code/et_300.html#et_301.

[187]*See* Model Rules of Prof'l Conduct R. 1.6 (2003).

the absence of such consent, the attorney can reveal client confidences only to prevent reasonably certain death or substantial bodily harm,[188] to prevent the client from committing a crime or fraud,[189] or to rectify or mitigate losses suffered at the hands of a client's criminal activity or fraud.[190] If the client is an organization rather than an individual, the Model Rules permit the attorney to reveal information relating to the representation but only if the information pertains to a violation of a legal obligation to the organization or a violation of law that could reasonably be imputed to the organization, and even then only if the attorney has exhausted all internal procedures for reviewing the violation, and believes with reasonable certainty that the violation will cause substantial injury to the organization.[191] Under extreme circumstances, the attorney can withdraw from the representation, but permissible withdrawal includes protecting client confidences.[192]

In sum, if a practitioner blows the whistle on her client or former client and in the process reveals information related to the representation of that client, the practitioner could be subject to liability under tort law, contract law,[193] and the Code.[194] She could also be subject to discipline under her licensing body for violating rules of professional conduct, and she could lose her license to practice either as an attorney or an accountant.[195]

Given these dire consequences to personal financial well-being and professional status, it is uncertain whether the monetary awards associated with the revamped tax whistleblower statute provide enough incentive for practitioners to expose client confidences. A tax practitioner may be in a good position to detect underpayments of tax or other violations of the tax laws, and the government might be willing to pay substantial sums of money for such information. But if the information is related to the representation of a client, and the practitioner turns it over to the government, the potential whistleblower award (the receipt of which is hardly certain) might not cover the practitioner's subsequent financial losses. Recall that a tax whistleblower can receive, at most, 30% of the collected proceeds resulting from the legal action based on the informant's information or from settlement of such action.[196] In the event the client sues the practitioner under tort or contract theories, the damages sought

[188] *Id.* R. 1.6(b)(1).
[189] *Id.* R. 1.6(b)(2).
[190] *Id.* R. 1.6(b)(3).
[191] *Id.* R. 1.13(b) and (c).
[192] *Id.* R. 1.16.
[193] This assumes the existence of an enforceable confidentiality agreement. *But see infra* notes 259-61 and accompanying text.
[194] *But see infra* notes 208-09 and accompanying text.
[195] For a fuller discussion of the issues pertaining to accountants, see Raby and Raby, *supra* note 182.
[196] I.R.C. § 7623(b)(1).

would presumably equal or exceed the amount of total collected proceeds, a figure several multiples larger than any potential whistleblower award, which might not even be forthcoming given the above discussion of reduction and denial of awards.[197] Thus, to the extent the new whistleblower law provides economic incentives for practitioners to turn over client information to the government, those incentives could be outweighed by the disincentives to share such information.

B. *Enabling the Whistleblower: Sarbanes-Oxley and the Federal Regulation of Lawyers*

Professional obligations of confidentiality are not as definitive or unyielding as they first appear. Nor are the circumstances under which a lawyer is permitted to share client confidences.[198] In addition, the obligation of tax professionals to protect client communications is increasingly ambiguous in many circumstances. What are the ethical obligations of lawyers and accountants, for instance, who are licensed but not active? Consider the licensed though inactive CPA working in-house and under the supervision of another licensed but fully active CPA or lawyer who signs off on all the company's documents. Can the inactive CPA share client information if she has knowledge of wrongdoing? Can the inactive lawyer, assuming she is not engaged in the unauthorized practice of law? [199] In addition, under the AICPA Rules of Conduct, a CPA "in public practice shall not disclose any confidential client information without the specific consent of the client."[200] But what about a member not in public practice, such as an in-house accountant? Consider, too, the Code's provision relating to confidentiality privileges and taxpayer information. Congress originally conceived section 7525,[201] enacted in 1998, as equivalent to the common law attorney-client privilege and applicable to all "federally authorized practitioners."[202] The provision protects communi-

[197] *See supra* notes 30-31 and 40-47 and accompanying text. Interestingly, the damages claimed would reflect the client's or employer's illegally avoided obligations plus interest and penalties on those evaded liabilities. It is hard to imagine that such a plaintiff would prevail in such a lawsuit, because the state law right of action would effectively make the plaintiff whole for violating federal tax law, thereby raising issues of preemption or at least a situation where the result was contrary to established public policy.

[198] "Few problems are as vexing," the federal court in the Eastern District of Virginia has opined, "as determining what evidence justifies a lawyer's disclosure of a client's confidential information and documents, which the lawyer believes reflect an ongoing or future crime or fraud," the classic exception to the attorney-client privilege. X Corp. v. Doe, 805 F. Supp. 1298, 1300 (E.D. Va. 1992), *aff'd*, Under Seal v. Under Seal, 17 F.3d 1435 (4th Cir. 1994).

[199] *See* Model Rules of Prof'l Conduct R. 5.5 (2003).

[200] *Supra* note 186 and accompanying text.

[201] I.R.C. § 7525.

[202] I.R.C. § 7525(a)(1). Section 7525(a)(3)(A) defines "federally authorized practitioner" according to Circular 230, which, in turn, defines the category to include attorneys, certified public accountants, enrolled agents, and enrolled actuaries.

cations pertaining to tax advice between a client and her tax adviser when those communications would have been considered privileged if between a taxpayer and her attorney.[203] However, over a very short period during which time Congress was responding to egregious corporate accounting scandals, the privilege was narrowed considerably by both the courts and the Service,[204] such that it effectively does not protect from disclosure, among other things, the identity of a taxpayer,[205] tax practitioner work product,[206] or non-tax proceedings.[207] Finally, recall that section 7216 prohibits a tax practitioner from "knowingly or recklessly" disclosing any information furnished in connection with the preparation of tax returns, or from using such information for any other purpose.[208] However, the statute also contains an exception for disclosures made "pursuant to any other provision of this title,"[209] including the tax whistleblower statute, section 7623.

Courts have even opined that the value of publicly disclosing private information can outweigh an attorney's confidentiality obligations. A lawyer's duty of confidentiality, for example, does not prevent her from bringing a *qui tam* action against a former client under the False Claims Act.[210] That is not the same thing as saying the FCA authorizes an attorney to disclose freely client confidences in bringing a *qui tam* action. And in fact, professional obligations of client confidentiality may have the effect of preventing disclosure in most circumstances. But if the attorney can overcome the various confidentiality duties (including the evidentiary attorney-client obligation,[211] which provides

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[203] *Id.* § 7525(a)(1).

[204] *See, e.g.*, Danielle M. Smith & David L. Kleinman, *What Remains of the Federal Tax Practitioner Privilege Established Under Internal Revenue Code Section 7525?*, Daily Tax Rep. (BNA), June 9, 2006, at J-1; Amandeep S. Grewal, *Selective Waiver and the Tax Practitioner Privilege*, 112 Tax Notes (TA) 1139 (Sept. 25, 2006); Sheryl Stratton, *Lawyers Discuss Postshelter Assault on Privilege*, 107 Tax Notes (TA) 289 (Apr. 18, 2005).

[205] *See* United States v. BDO Seidman, 337 F.3d 802 (7th Cir. 2003).

[206] *See* United States v. KPMG, 237 F. Supp. 2d 35, 39 (D.D.C. 2002); United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999) (stating in *dicta* that section 7525 "does not protect work product").

[207] *See* Chao v. Koresko, 2005 U.S. App. LEXIS 22025 (3d Cir. 2005); Doe v. Wachovia Corp., 268 F. Supp. 2d 627, 637 (W.D.N.C. 2003).

[208] *Supra* note 184 and accompanying text.

[209] I.R.C. § 7216(b)(1)(A).

[210] Doe v. X Corp., 862 F. Supp. 1502, 1506-07 (E.D. Va. 1994) (finding that an individual's status as an attorney did not bar him from bringing a *qui tam* action against his former employer, because the FCA did not specifically exclude lawyers from acting as *qui tam* plaintiffs); *see also* Erickson v. Am. Inst. of Biological Sciences, 716 F. Supp. 908, 912 (E.D. Va. 1989) ("In defining the classes of persons eligible to bring *qui tam* actions, Congress had a choice: It could have chosen to make eligible as *qui tam* relators only certain defined groups and persons and exclude all others or it could have chosen to include all persons as eligible *qui tam* relators with certain specific exceptions. It chose the latter scheme.").

[211] The evidentiary privilege applies to disclosures of certain types of confidences communicated between client and attorney during the course of the attorney's representation of the client. The traditional justification of the privilege is enunciated in *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981):

a crime-fraud exception, as well as the general confidentiality obligation under the Model Rules, which contain a number of limited exceptions),[212] she would be able to proceed under the FCA even if that meant revealing client confidences.[213]

Increasingly, private law obligations of confidentiality are giving way to trends in public law emphasizing disclosure and transparency. This trend is

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> Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client.

Because the attorney-client privilege "impedes [the] full and free discovery of the truth," *Weil v. Investment/Indicators, Research & Management, Inc.*, 647 F.2d 18, 24 (9th Cir. 1981), and operates "in derogation of the public's 'right to every man's evidence,'" *In re Horowitz*, 482 F.2d 72, 81 (2d Cir. 1973), *cert. denied*, 414 U.S. 867 (1973), federal courts have narrowly construed its application. Thus, the privilege is determined on a case-by-case basis (see *Upjohn*, 449 U.S. at 396-97) and applies only if:

> (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate, and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 358-59 (D. Mass. 1950), *overruled on other grounds by* Am. Standard, Inc. v. Pfizer, Inc., 828 F.2d 734 (Fed. Cir. 1987).

The only way for an attorney to overcome an assertion of the privilege by a client is to make a prima facie showing that the communication or communications in question either: (1) were made for an unlawful purpose or to further an illegal scheme or (2) reflect an ongoing or future unlawful or illegal scheme or activity. For the classic statement of this exception, see *Clark v. United States*, where "[a] client who consults an attorney for advice that will serve him in the commissions of a fraud will have no help from the law. He must let the truth be told." 289 U.S. 1, 15 (1933).

[212] *See infra* notes 228-30 and accompanying text.

[213] *See Doe*, 862 F. Supp. at 1506-07 (ruling that former in-house lawyer was permitted to disclose to the government his former client's confidential documents and information—under both the evidentiary privilege and the general obligation to protect client confidences—if a reasonable attorney in the circumstances would have concluded that the disputed documents and information established the employer-client's fraud). To the extent the attorney was barred from bringing the action in the instant case, it was because he did not "possess enough information that he may legally disclose to form the basis of a valid complaint" under the FCA. *Id.* at 1510. In other words, he could not satisfy the exceptions. It should be noted that while the evidentiary attorney-client privilege and the lawyer's ethical obligation to preserve client confidences are conceptually distinct as a technical matter, in practice "(1) clients do not understand the difference between the two concepts; (2) courts routinely confuse the concepts; and (3) lawyers either share in the confusion or fail to address the differences adequately." Kristi Belt & Geoffrey P. Kirshbaum, *Report of the Working Group on Confidentiality and the Limits on the Attorney-Client Privilege*, 41 S. Tex. L. Rev. 37, 37 (1999).

most clearly articulated in federal securities law, which imposes affirmative duties on lawyers that conflict with and ultimately supersede state law obligations of confidentiality.

Section 307 of the Sarbanes-Oxley Act amounts to a pseudo-whistleblower statute for attorneys.[214] In passing the landmark securities legislation in 2002, Congress directed the SEC to prescribe "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in *any way* in the representation of issuers."[215] The SEC acted quickly. In early 2003, the Commission adopted a final rule to implement section 307.[216] The new rule requires attorneys "in the representation of an issuer"[217] to report evidence of a "material violation"[218] of securities law or breach of fiduciary duty or similar violation "up-the-ladder" within the issuer corporation to the chief legal counsel or CEO.[219] Communicating such evidence to the company's officers or directors, the SEC has ruled, "does not reveal client confidences or secrets or privileged or otherwise protected information related to the attorney's representation."[220] If, after "reporting up," the lawyer determines that

[214]Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (codified at 15 U.S.C. § 7245 (Supp. 2003)).

[215]*Id.* (emphasis added) (requiring the SEC to issue rules "setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule--(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.").

[216]17 C.F.R. § 205.3 (2007).

[217]The SEC rule covers any representation of issuers, and captures attorneys providing legal services to an issuer company who are on notice that their work might be incorporated into SEC filings. *See id.* § 205.2(g) ("*In the representation of an issuer* means providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer." (emphasis added)).

[218]*See infra* notes 241-42 and accompanying text.

[219]*See* 17 C.F.R. § 205.3(b) (2007). The rule does not necessarily require a nexus between the legal representation and the affirmative duty for the lawyer to be aware of a potential material violation. *But see* American Bar Association, Report of the American Bar Association Task Force on Corporate Responsibility 45 (2003) (criticizing this policy, stating that "it would be unfair to hold responsible a lawyer working in one field of the law to understand that facts of which he was aware should have led to a conclusion of law violation in a field with which he was unfamiliar.").

[220]*See* 17 C.F.R. § 205.3(b) (2007).

the chief legal officer or CEO does not provide an appropriate response[221] to the evidence within a reasonable time, the lawyer is further required to report the evidence to the company's audit committee, a separate committee of independent directors, or the full board of directors. In addition, the new rule permits an attorney, *without the consent of her client*, to reveal confidential information related to her representation to the extent the attorney reasonably believes such disclosure necessary (1) to prevent the issuer from committing a material violation likely to cause substantial injury to the financial interest or property of the issuer or investors; (2) to prevent the issuer from committing or suborning perjury or perpetrating a fraud against the SEC during an investigative or administrative proceeding; or (3) to rectify the consequences of a material violation by the issuer that produced, or may later produce, substantial injury to the financial interest or property of the issuer or investors.[222] To the extent the new standards of professional conduct promulgated by the SEC conflict with state law, federal law governs, except in cases where state law imposes more stringent disclosure obligations on attorneys that are not inconsistent with the SEC rules, in which case state law governs.[223]

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[221]An "appropriate response" would convince the lawyer, under a reasonableness standard, that no material violation occurred, is ongoing, or is about to occur, *id.* § 205.2(b)(1); that the issuer has taken appropriate action to remedy or address any past, present, or future material violation, *id.* § 205.2(b)(2); or that the issuer has retained an attorney to conduct an independent review of the alleged material violation, and that either the issuer has implemented effective remedial action or the independent review has concluded that the issuer has a colorable defense to the allegations, *id.* § 205.2(b)(3).

[222]*Id.* § 205.3(d)(2) (emphasis added). The SEC's original proposal included additional provisions to section 205.3(d) that would have permitted or required attorneys under different circumstances to withdraw from representation of an issuer, to notify the SEC of the withdrawal, and to disaffirm any documents filed or submitted to the SEC on behalf of the issuer. These "noisy withdrawal" provisions were not included in the final rule, but the SEC continued to consider them "potentially important minimum standards for attorneys appearing and practicing before the Commission in the representation of issuers." Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670-01 (Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205). In a separate release issued simultaneous to the final rule, the SEC solicited additional comments on the noisy withdrawal proposals, and offered an alternative approach that would have required the issuer rather than the attorney to report an attorney's withdrawal from representation. To date, the proposal remains under consideration. *See* Implementation of Standards of Professional Conduct for Attorneys, 72 Fed. Reg. 23,640-01 (Apr. 30, 2007).

[223]*See* 17 C.F.R. § 205.1 (2007).

> These standards supplement applicable standards of any jurisdiction where an attorney is admitted or practices and are not intended to limit the ability of any jurisdiction to impose additional obligations on an attorney not inconsistent with the application of this part. Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflicts with this part, this part shall govern.

Id.; *see also* Giovanni P. Prezioso, SEC, Remarks Before the American Bar Association Section of Business Law 2004 Spring Meeting (Apr. 3, 2004) (stating "the Commission takes the position that its rules preempt any conflicting provision of state law").

In summary, the new rule requires attorneys representing issuer clients in any capacity to "report up" evidence of corporate malfeasance. Moreover, it permits lawyers to "report out" such evidence in the event the corporate entity does not stop, prevent, or rectify the alleged wrongdoing. Not surprisingly, the new "up-the-ladder" requirements have generated considerable debate among scholars and practitioners as to whether and to what extent the new federally imposed ethical guidelines preempt state law obligations on attorneys.[224] Congress clearly intended to supersede state laws that otherwise prevent reporting up purported violations.[225] But it is less clear whether Congress wanted to preempt state rules with respect to reporting out violations.[226] The permissive "reporting out" rule is more ambiguous of legislative and regulatory intent than the obligatory reporting up rule. There are no federal obligations, however, preventing disclosure by reporting out purported violations. And there is a good argument that the reporting out feature of the law reflects the legislative intent of the reporting up rule; namely, to expose information that if kept secret would damage markets and hurt investors. To date, the issue remains unsettled.

The sharing of client information, either through reporting up or reporting out, is not a novel concept. Even the ABA Model Rules, traditionally

[224] *See*, *e.g.,* Susan J. Stabile, *Sarbanes-Oxley's Rules of Professional Responsibility Viewed through a Sextonian Lens*, 60 N.Y.U. Ann. Surv. Am. L. 31 (2004); Timothy P. Glynn, *One Privilege to Rule Them All?: Some Post-Sarbanes-Oxley and Other Reflections on a Federally Codified Attorney-Client Privilege*, 38 Loy. L.A. L. Rev. 597 (2004); Stephen M. Bainbridge & Christina J. Johnson, *Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307*, Mich. St. L. Rev. 299 (2004); Matthew Eslick, Note, *Tension Among Section 307 of the Sarbanes-Oxley Act of 2002, 17 C.F.R. § 205.3(d)(2), and State Rules Governing Disclosure of Confidential Client Information*, 53 Drake L. Rev. 133 (2004); Erin Hoch, Note, *The SEC's 307 Disclosure Rules for Sarbanes-Oxley Act: A Step in the Right Direction, But Was it a Step Too Far?*, 29 J. Corp. L. 685 (2004); Jennifer Wheeler, *Securities Law: Section 307 of the Sarbanes-Oxley Act: Irreconcilable Conflict with the ABA's Model Rule and Oklahoma Rules of Professional Conduct?*, 56 Okla. L. Rev. 461 (2003); Stephanie R.E. Patterson, Note, *Section 307 of the Sarbanes-Oxley Act: Eroding the Legal Profession's System of Self-Governance?*, 7 N.C. Banking Inst. 155 (2003). Practicing lawyers continue to feel threatened by the federal ethical guidelines issued by the SEC. "Our professional status is being challenged, if not undermined," the Association of Corporate Counsel has written, by turning lawyers into "gatekeepers" and "sentries of the marketplace." Association of Corporate Counsel, The SEC Rules for Lawyers, Three Years Later: How the SEC Now Views a Lawyer's Ethical Responsibilities 1-2 (2005), *available at* http://www.acc.com/chapters/sanant/ethicalresponsibilties.pdf.

[225] *See* 15 U.S.C. § 7245 (2000) (quoting section 307 instructing the SEC to promulgate a reporting up requirement).

[226] *Id.* (noting that section 307 of Sarbanes-Oxley did not provide any direction to the SEC for promulgating a reporting out requirement).

protective of client confidences,[227] recognize several exceptions to the general rule that a lawyer cannot share client information.[228] In fact, in 2003, the ABA responded directly to the SEC's reporting up and reporting out rules by acknowledging that its then-current Model Rules respecting treatment of the lawyer's obligation of confidentiality was "significantly out of step" and "increasingly dissonant" with trends in public opinion and legislative action demanding "that lawyers play a greater role in promoting corporate responsibility."[229] Subsequently, the ABA approved resolutions amending Rules 1.6 and 1.13, loosening, respectively, general confidentiality requirements and

[227] *See* Model Rules of Prof'l Conduct R. 1.6 cmt. 2 (2003).

> A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation . . . . This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively, and, if necessary, to advise the client to refrain from wrongful conduct.

Id.

[228] *See id*. R. 1.6(b)(1) (preventing reasonably certain death or substantial bodily harm); *id.* R. 1.6(b)(2) (preventing the client from committing a crime or fraud); *id.* R. 1.6(b)(3) (rectifying or mitigating losses suffered at the hands of a client's criminal activity or fraud); *id.* R. 1.6(b)(5) (establishing a claim or defense in a case pitting the lawyer against the client); *id.* R. 1.6(b)(6) (complying with other law or a court order); *id.* R. 1.13 (protecting an organizational client from substantial injury associated with a violation of a legal obligation or a violation that might be imputed to the organization); *id.* R. 3.3(b) and cmt. [10] and [11] (stating that where the lawyer knows that a client has testified falsely, she may be required, not merely permitted, to disclose the falsity to the tribunal); *id.* R. 4.1(b) and cmt. [3] (stating that where a lawyer's withdrawal from representation will not avoid continued assistance to a client's crime or fraud, the lawyer may be required to "give notice of the fact of withdrawal and to disaffirm an opinion, document, affirmation or the like.").

[229] American Bar Association, Resolution to Amend Rule 1.6 of the Model Rules of Professional Conduct and Its Comment 15 (2003). In its report on the resolution, the ABA Task Force on Corporate Responsibility stated it believed:

> [T]he interest of society, and the bar, in assuring that a lawyer's services are not used by a client in the furtherance of a crime or a fraud creates a demanding need for an exception to the important principle of confidentiality, as most states have recognized. The importance of protecting both society and the bar from the consequences of a client's misuse of the lawyer's services in the furtherance of a serious crime or fraud must be balanced against the importance to the client-lawyer relationship of the principle of confidentiality.

Id. at 16; *see also* American Bar Association, *supra* note 219, at 35 ("In their role of promoting their organizational clients' compliance with law, a key function of lawyers is to bring issues of legal compliance to the attention of appropriate authorities within the organization."). For a discussion of lawyers balancing the duties to uphold federal securities law and preserve client confidences, see Lisa H. Nicholson, *A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance Between the Obligation of Client Loyalty and Market Gatekeeper*, 16 Geo. J. Legal Ethics 91 (2002).

conditions for reporting out information concerning a business or organizational client.[230]

Although the Model Rules recognize conditions under which an attorney can share client confidences, those conditions are narrowly drawn, and require the presence of fraud, other criminal activity, or false testimony in an adjudicative proceeding. The bar, if you will, is high. Moreover, recent changes to the Model Rules respecting organizational clients, largely designed to encourage lawyers to improve and monitor corporate responsibility, fall short of the requirements promulgated by the SEC, which reflect the general proposition that "concerns about impacting the attorney-client relationship must yield to the public interest where an issuer seeks to commit a material violation that will materially damage investors, seek to perpetrate a fraud upon the Commission in enforcement proceedings, or has used the attorney's services to commit a material violation."[231] The ABA has been very clear that changes to Rule 1.13 contain "strict conditions that must exist before any 'reporting out' is allowed."[232] In particular, the lawyer must possess "a heightened level of certainty as to the violation of law . . . the actual or threatened violation must be 'clear,'" and "there is no permission to 'report out' when the organizational governance failure involves a violation of legal duty to the organization but is not otherwise a violation of law."[233] By comparison, the SEC rule allows an attorney to report out on the basis of credible evidence and a reasonable belief that a violation has occurred,[234] and it further permits an attorney to report out violations of legal obligations specific to the organization, such as violations of fiduciary duty.[235] Furthermore, while the SEC rule obliges a lawyer as a matter of law to report up evidence of covered wrongdoing,[236] Model Rule 1.13 merely directs the lawyer to "proceed as is reasonably necessary in the best interest of the organization."[237]

In addition to being considerably more permissive than the ABA Model Rules with respect to sharing client confidences, federal securities law pre-

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[230] *See* American Bar Association, *supra* note 229; American Bar Association, Resolution to Amend Rule 1.13 of the Model Rules of Professional Conduct and Its Comment (2003).

[231] Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, Exchange Act Release No. 47,276, Investment Company Act Release No. 25.919, 68 Fed. Reg. 6320 (Jan. 29, 2003).

[232] American Bar Association, Resolution to Amend Rule 1.13, *supra* note 230.

[233] *Id.*

[234] The SEC defines "evidence of a material violation" as "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." 17 C.F.R. § 205.2(e) (2007).

[235] *See id.* §§ 205.2(i), 205.3(b).

[236] *See id.* § 205.3(b); *see also supra* notes 217-21 and accompanying text.

[237] *See* Model Rules of Prof'l Conduct R. 1.13 (2003).

empts state standards of professional conduct.[238] Recall that the SEC rule *requires* attorneys to report up evidence of a "material violation" of securities law or breach of fiduciary duty or similar violation,[239] and *permits* them to report out such evidence in the event the organization does not take appropriate steps to remedy the violation.[240] The SEC defines "material violation" for purposes of its reporting up and reporting out rule in somewhat circular fashion as "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law."[241] The SEC adopts the generally accepted definition of "materiality" under federal securities laws, which emphasizes the significance of an omitted fact to a reasonable investor, and whether that information would be relevant to her in making a decision to buy, hold, or sell a security.[242] Under this definition, all infractions of the law are not material. But material infractions must not necessarily rise to the level of fraud or criminal activity before the SEC rule requires them to be reported up or allows them to be reported out. Meanwhile, the ABA rule does not even allow the attorney to report up violations if she does not believe disclosure to be "in the best interest of the organization."[243]

The standards of professional conduct covering lawyers under federal securities law not only impose higher obligations on attorneys than state ethical rules with respect to sharing client confidences. They also directly implicate legal representation associated with providing tax advice, a professional endeavor intimately "intertwined with a company's finances, financial statements, and governance procedures."[244] Indeed, given the broad purview of the SEC rule—

[238] *See* 17 C.F.R. § 205.1; *supra* note 223 and accompanying text.

[239] *See supra* notes 217-21 and accompanying text.

[240] *See supra* note 222 and accompanying text.

[241] 17 C.F.R. § 205.2(i).

[242] The SEC final rule cites *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-36 (1988) and *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976), both of which define materiality as follows:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

[243] Model Rules of Prof'l Conduct R. 1.13(b) (2003).

[244] George R. Goodman, *The Taxpayer's and Tax Adviser's Guide to Sarbanes-Oxley*, 100 Tax Notes (TA) 691, 698 (Aug. 4, 2003).

covering *any* representation of issuers involving preparation of documents the attorney knows or should know will be filed with or incorporated into an SEC filing—providing tax advice to an issuer places the tax lawyer squarely within the scope of the reporting up and reporting out obligations. In this respect, Sarbanes-Oxley requires tax lawyers to share client information associated with material violations of state and federal law, including internal revenue laws.

Although Sarbanes-Oxley requires tax lawyers to share confidential information in certain circumstances, and under relatively low standards of proof,[245] the inherent ambiguity in tax law might prevent lawyers from sharing such information even if they wanted to blow the whistle on clients. Credible evidence of tax fraud is an easy case, clearly covered by statute. But what about credible evidence of a particularly aggressive tax position or transaction on which the Treasury has not opined, the case law is silent or ambiguous, and the position or transaction is not a sham per se, reflecting at least a modicum of economic substance?[246] Such a violation is considerably less clear in this case, as is the authority under Sarbanes-Oxley to report up or to report out client information. Both the current Service bounty approach and the recommended *qui tam* approach provide economic incentives to sell out confidential client information. Exceptions to confidentiality obligations of lawyers should not be triggered by the prospect of personal gain. In fact, the Model Rules explicitly prohibit such activity.[247] Therefore, we might be inclined to exclude lawyers from both the whistleblower statute and any prospective *qui tam* for tax statute. However, we must also balance the lawyer's confidentiality obligations against the benefits of including lawyers in these statutes. As discussed *supra*,[248] both in-house and outside counsel are in unique positions to detect and deter noncompliant behavior. Shifting enforcement obligations to these private parties with lower costs of monitoring can be an efficient and potentially optimal compliance approach.

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[245] *See* 17 C.F.R. § 205.2(e) (2007).

[246] The economic substance doctrine has been a particularly effective tool in the fight against tax shelters, and reflects an amalgam of other common law anti-abuse doctrines, including business purpose, sham transaction, and substance over form. At its heart, the economic substance doctrine represents a judicial effort "to prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit." Coltec Industries, Inc. v. United States, 454 F.3d 1340, 1353-54 (Fed. Cir. 2006). *See, e.g.,* Dennis J. Ventry, Jr., *Save the Economic Substance Doctrine from Congress*, 118 Tax Notes (TA) 1405 (Mar. 31, 2008); David P. Hariton, *When and How Should the Economic Substance Doctrine Be Applied?*, 60 Tax L. Rev. 29 (2006); Peter C. Canellos, *A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. Rev. 47 (2001); Joseph Bankman, *The Economic Substance Doctrine*, 74 S. Cal. L. Rev. 5 (2000).

[247] *See* Model Code Of Prof'l Conduct R. 1.8(b) (2003) (prohibiting both use of information for lawyer's personal gain and use of information to client's disadvantage).

[248] *See supra* notes 85-89, 139-41 and accompanying text.

Recent legislative and administrative changes to federal law pertaining to corporate governance indicate a strong preference for raising rather than lowering lawyers' obligations to report violations of the law, even if that means disclosing confidential client information. Congress enacted Sarbanes-Oxley in part because "some lawyers [had] forgotten their responsibility" to the corporate entity, to the market, and to investors.[249] In addition, according to the SEC as well as members of Congress and expert observers, state ethical rules had failed utterly as "an effective deterrent to attorney misconduct,"[250] notwithstanding the organized bar's empty and repeated injunctions to the contrary.[251] Recent amendments to Circular 230 regulations governing standards of tax practice[252] represent yet another example of federal regulators and legislators attempting to improve compliance with the law by deputizing lawyers and turning them into compliance counselors rather than overzealous client advocates.[253] Both Sarbanes-Oxley and Circular 230 amendments reflect

[249]148 Cong. Rec. S6551 (daily ed. July 10, 2002) (statement of Sen. Edwards); *see also* Harvey L. Pitt, SEC Chairman, Remarks Before the Annual Meeting of the American Bar Association's Business Law Section (Aug. 12, 2002), *available at* http://www.sec.gov/news/speech/spch579.htm (stating "recent events have refocused our attention on the need for the profession to assist us in ensuring that fundamental tenets of professionalism, ethics, and integrity work to ensure investor confidence in public companies.").

[250]*Supra* note 231 and accompanying text; *see also* 148 Cong. Rec. S6555 (daily ed. July 10, 2002) (statement of Sen. Enzi) ("I am usually in the camp that believes that States should regulate professionals within their jurisdiction. However, in this case, the State bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation. Even if they do have a general rule that applies, it often goes unenforced."); *see generally* Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 Colum. L. Rev. 1236, 278-80 (2003); Susan P. Koniak, *Corporate Fraud: See, Lawyers*, 26 Harv. J.L. & Pub. Pol'y 195, 216, 225-26 (2003).

[251]*See* American Bar Association, Independence of the Legal Profession: Section 307 of the Sarbanes-Oxley Act (Dec. 1, 2004), *available at* http://www.abanet.org/poladv/priorities/sarbanes.html ("State court ethical rules are enforceable through a range of sanctions, including suspension and disbarment. These state court rules have worked well over time, and additional rules are unnecessary.").

[252]Circular 230, *supra* note 185. Amendments to the regulations in June 2005 raised reporting and disclosure standards for tax practitioners, particularly with respect to written advice. *See, e.g.*, Deborah H. Schenk, *The Circular 230 Amendments: Time to Throw Them Out and Start Over*, 110 Tax Notes (TA) 1311 (Mar. 20, 2006); David T. Moldenhauer, *Circular 230 Opinion Standards, Legal Ethics and First Amendment Limitations on the Regulation of Professional Speech by Lawyers*, 29 Seattle U. L. Rev. 843, 844-46 (2006); Michael Schler, *Effects of Anti-Tax-Shelter Rules on Nonshelter Tax Practice*, 109 Tax Notes (TA) 915, 918-22 (Nov. 14, 2005); Jeffrey H. Paravano & Melinda L. Reynolds, *The New Circular 230 Regulations—Best Practices or Scarlet Letter?*, 46 Tax Mgmt. Memo. (BNA) 339 (2005).

[253]*See, e.g.,* Dennis J. Ventry, Jr., *Cooperative Tax Regulation*, 41 Conn. L. Rev. ___ (2008) (describing amendments to Circular 230 as government efforts to raise "the ethical bar on tax practitioners, deputizing them (largely involuntarily) in the fight against abusive tax shelters"); William H. Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 Fordham L. Rev. 1453, 1471 (2006) (noting that Circular 230 changes involved "auditing lawyers and accountants, as a means of assessing the reliability of their vouching for their clients"); *see also* Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron*, 35 Conn. L. Rev. 1185, 1194-97, 1207-15 (2003).

a discernible regulatory trend toward "creeping external regulation of lawyers by administrative agencies."[254] Such efforts recognize that insiders, particularly lawyer-insiders, are well positioned to identify, address, and remedy violations of state and federal law.[255] Moreover, Sarbanes-Oxley extends protections to these lawyer-whistleblowers, including those who expose material violations of tax law.[256] There is no reason to believe that Sarbanes-Oxley whistleblower provisions do not protect attorneys covered by section 307 who, after exhausting their reporting up obligations, decide to report out purported violations.[257]

There may be a difference worth noting between Sarbanes-Oxley disclosure requirements and those in the tax context.[258] Sarbanes-Oxley and other corporate governance efforts are concerned with duties owed either to the client itself (*i.e.*, the corporation rather than individual officers and directors) or to persons to whom the client owes a fiduciary duty (*i.e.*, shareholders). Thus, in the Sarbanes-Oxley context, disclosure may not only be in the client's best interests, but actually required by them. In the tax context, by comparison, disclosure of aggressive tax transactions can hurt the client in that it results in the client paying out more in taxes. In this way, tax disclosures are not the same as corporate governance disclosures that expose errant managers or concealment of information that should be available to the market. However, disclosure in the tax context is analogous to disclosure in the corporate governance context for at least three reasons. First, disclosing purported tax violations could fulfill rather than violate a lawyer's fiduciary duty to the client to the extent the violations were potentially damaging in the long-run; that is, if the cost of the violations (expenses associated with Service examination, potential litigation, penalties and interest owed on back taxes) exceeded the expected benefits (tax savings). Second, if the purported violations rose to the level of tax cheating that could potentially hurt the client or conceal information from the market, disclosure once again would fulfill rather than violate

[254]Anthony C. Infanti, *Eyes Wide Shut: Surveying Erosion of Professionalism of the Tax Bar*, 101 Tax Notes (TA) 517, 528 n.121 (2003).

[255]*See, e.g.*, Sheryl Stratton, *ABA Tax Section Meeting: Everson to Tax Bar: You Should Do More*, 114 Tax Notes (TA) 404, 404 (Jan. 9, 2007) (quoting Commissioner of Internal Revenue Everson as expecting tax professionals "to do more to protect the integrity of the system"); Tom Gilroy, *Tax Fraud: IRS Chief Counsel Calls Practitioners 'First Line of Defense' Against Fraud*, Daily Tax Rep. (BNA), Oct. 25, 2006, at G-3 (quoting Service Chief Counsel Donald Korb as calling tax practitioners "the first line of defense" against overaggressive tax avoidance behavior); 17 C.F.R. § 205.3 (2007) (serving "to deter corporate misconduct and fraud" and "improve the corporate governance").

[256]*See supra* notes 158-163 and accompanying text.

[257]In the context of environmental regulation, the Fifth Circuit recently held that an attorney may invoke whistleblower protection under federal law. *See* Willy v. Admin. Review Bd., 423 F.3d 483, 496-501 (5th Cir. 2005) (holding that under federal environmental whistleblower protection laws an attorney may use otherwise privileged information against an employer for wrongful discharge).

[258]I am grateful to William Simon for this insight.

a lawyer's fiduciary duty in addition to her duty of loyalty. Finally, even if the purported violations fell short of tax cheating, disclosure could save the client from subsequent negative publicity that could adversely effect stock price or firm image among investors and customers in the event the tax reporting position was challenged, litigated, and invalidated.

The duty of confidentiality continues to give way to broader public policies emphasizing disclosure and transparency. Recently, the Department of Justice briefed the limitations on the obligation of confidentiality owed by an employee to an employer arising by operation of an express confidentiality agreement or common law fiduciary duty. "For public policy reasons," the DOJ wrote in the context of the FCA, "agreements that purport to limit the right of a party to cooperate with a criminal investigation or to disclose matters of public importance are unenforceable."[259] Violations of an employment contract or fiduciary duty are covered by state law; therefore, it should follow that confidentiality requirements imposed on attorneys by state law "that purport to limit the right of a party to cooperate with a criminal investigation or to disclose matters of public importance" are similarly unenforceable as against public policy.[260] Congress, meanwhile, has continued to add protections and avenues for prosecuting whistleblower claims with new legislation for informants acting under federal whistleblower statutes.[261]

Sarbanes-Oxley, Circular 230, and the new tax informant statute all reflect the underlying public policy of whistleblower statutes "to enhance the Government's ability to recover losses sustained as a result of fraud against the Government."[262] Moreover, Sarbanes-Oxley and the tax whistleblower law permit even lower thresholds than fraud before employee-insiders are allowed and, in some cases, required to expose alleged wrongdoing, even if such disclosure means sharing client confidences. Indeed, where public law meets private law, as in the realm of securities and tax law, public law and public policy increasingly prevail.

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[259]Brief for Relators as Amicus Curiae Supporting Motion to Dismiss Counterclaims, United States v. Cancer Treatment Ctrs. of Am., 350 F. Supp. 2d 765 (E.D. Ill. 2004) (No. 99C 8287); *see also* Town of Newton v. Rumery, 480 U.S. 386, 392 (1987) ("[A] promise is unenforceable if the interest in its enforcement is outweighed in the circumstances by a public policy harmed by enforcement of the agreement"); X Corp. v. Doe, 805 F. Supp. 1298, 1310 n.24 (E.D. Va. 1992) (noting in a case involving the FCA brought by defendant's attorney that confidentiality agreements restricting individuals from disclosing evidence of fraud to the government are void as against public policy).

[260]Brief for Relators, *supra* note 259.

[261]*See* Federal Employee Protection of Disclosures Act, S. 274, 110th Cong. (2007); Whistleblower Protection Enhancement Act of 2007, H.R. 985, 110th Cong. (as passed by House of Representatives, March 14, 2007); Floor Statement of Senator Chuck Grassley, *supra* note 4 and accompanying text; Alison Bennett, *Tax Administrator Grassley Kicks Off Whistleblower Week, Urges Support for Whistleblower Protections*, Daily Tax Rep. (BNA), May 15, 2007, at G-3.

[262]S. Rep. No. 99-345, at 1 (1986), *as reprinted in* 1986 U.S.C.C.A.N. 5266, 5266.

VIII. Conclusion

The 2006 amendments to the Service whistleblower statute created a powerful system of private enforcement of public tax laws. The centralized Whistleblower Office and substantially increased awards for informants have the potential to improve greatly the monitoring and enforcement of government tax compliance efforts. Allowing private citizens to prosecute alleged tax abuses in the form of *qui tam* litigation would inject an additional element of risk into a taxpayer's evaluation of how to comply with the tax law, and could greatly alter tax compliance norms within organizations, deterring overaggressive tax planning at the source. Private enforcement and prosecution of public law can be an especially effective compliance mechanism in the area of tax regulation where tax officials face unusually steep information deficits, active concealment by taxpayers, and insufficient resources to enforce the tax laws. Though critics of the enhanced tax whistleblower statute have suggested that it threatens to undermine confidentiality obligations by encouraging tax professionals and employees to expose tax-deviant clients and employers, the new law reflects a trend in federal securities and tax regulation emphasizing disclosure and transparency even when such disclosure conflicts with traditional obligations of confidentiality.