

## **Bloomberg Reporter Peter Green Wins 3rd Annual Christopher J. Welles Memorial Prize For Tough, Savvy Series on Corporate Tax Cheating and Limited IRS Use of Whistle Blowers**

NEW YORK, Oct. 1, 2012 /PRNewswire/ -- The Knight-Bagehot Fellowship at Columbia University's Graduate School of Journalism today announced that Bloomberg News reporter and Knight-Bagehot alumnus Peter S. Green ('2004) has won the third annual Christopher J. Welles Memorial Prize. The award recognizes Mr. Green's sophisticated and influential coverage of widespread tax avoidance among US corporations amid ambivalent, ineffectual use by the Internal Revenue Service of the whistleblower program that Congress created to assist the agency in 2006. In a pair of major feature stories in 2011 and 2012, and follow-up news coverage this year: In July, 2011, he exposed the corporate problem by highlighting a whistle blower suit charging that construction equipment giant Caterpillar Inc.'s avoided \$2 billion of taxes from 2000 to 2009 by improperly attributing to a Swiss unit at least \$5.6 billion of profits from its lucrative parts business, even though the profits came from sales and shipments made by US employees, from a US warehouse. (see: <http://www.bloomberg.com/news/2011-07-08/caterpillar-accused-of-demoting-taxwhistleblower.html>); June 19 this year, Peter and Bloomberg reporter-at-large Jesse Drucker examined IRS resistance to actively using the 1300 whistle blowers who have come forward under the Congressionally-mandated program. They found IRS fears of violating privacy laws, worry over Congressional badgering in behalf of influential constituents under investigation, and concerns over critical staff shortages. "Just three awards (to whistle blowers) have been paid" despite the IRS admitting taxpayers owe \$385 billion a year more than it has been able to collect, or more than a third of the estimated US budget deficit. (See: <http://www.bloomberg.com/news/2012-06-19/irs-resists-whistleblowersdespite-wide-u-s-tax-gap.html>); In July Mr. Green wrote about a June 20 staff memo from the IRS director promised improvement on the use of the whistle blower program, which the Bloomberg story had called "the place where allegations of tax avoidance go to die." In July, he got a copy of a June 21 letter from the whistle blower program cosponsor in 2006, Sen. Charles Grassley (R-IA) to IRS Commissioner Douglas Shulman and his boss, Treasury Secretary Timothy Geithner. Deriding limited IRS use of the program, he demanded a "comprehensive review." The letter still wasn't answered by either official after more than two weeks, and Sen. Grassley told Mr. Green he'd hold up required Senate hearings on two pending Treasury appointments until it was. Mr. Green will receive the Welles Prize at the Knight-Bagehot Fellowship's 37th anniversary dinner on Wednesday, October 24, in New York. Preceded by a cocktail reception and followed by a dessert reception, the dinner has become one of New York's prime media-networking events. It is chaired this year by Time Warner Inc. chairman and CEO Jeff Bewkes and will be addressed by keynote speaker Gillian Tett, assistant editor of the Financial Times. The Christopher J. Welles Memorial Prize memorializes the former Business Week columnist and editor -- and Knight-Bagehot Advisory Board Member -- who died in June, 2010, at age 72. It is awarded for any story or series produced by a graduate of the Knight-Bagehot program that best reflect business and financial sophistication and epitomizes the late Mr. Welles' ideals of thorough

reporting, good storytelling and timeliness. "Peter's great work exemplifies the reportorial sophistication and insight that this fellowship was created to impart. We're very proud of him," said Knight-Bagehot Director Terri Thompson. SOURCE Knight-Bagehot Find this article at: <http://www.prnewswire.com/news-releases/bloomberg-reporter-peter-green-wins-3rd-annual-christopher-j-wellesmemorial-prize-for-tough-savvy-series-on-corporate-tax-cheating-and-limited-irs-use-of-whistle-blowers-172091681.html>

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## **Caterpillar Accused of Demoting CPA Discovering Tax Dodge (1) 2011-07-08 19:23:46.653 GMT**

(Adds details on share price in eighth paragraph and trial date under subheading "Remains Employed.")

By Peter S. Green

July 8 (Bloomberg) -- Caterpillar Inc. used offshore subsidiaries in Switzerland and Bermuda to avoid about \$2 billion in U.S. taxes from 2000 to 2009, boosting its earnings through a "tax and financial statement fraud," according to a Caterpillar executive's lawsuit.

The company, the world's largest construction-equipment maker, sold and shipped spare parts globally from an Illinois warehouse while improperly attributing at least \$5.6 billion of profits from those sales to a unit in Geneva, according to the suit filed by Daniel J. Schlicksup. He was a global tax strategy manager for Caterpillar from 2005 to 2008.

Schlicksup, 49, sued in U.S. District Court in Peoria, Illinois, in 2009, claiming he was moved to a job that limits his career opportunities because he complained to superiors that the "Swiss Structure" ran afoul of U.S. tax rules. He's seeking a court order to give him back his old job and prevent any retaliation. He also seeks stock options that he claims were wrongly withheld as well as legal fees and punitive damages.

His lawsuit, which calls the structure a "tax dodge," followed a request for job protection he filed with the U.S. Department of Labor under provisions of the Sarbanes-Oxley Act, court records show. The law bars retaliation against corporate whistleblowers. Schlicksup declined to comment for this story. His attorney, Dan O'Day, declined to say whether Schlicksup has taken his concerns to the Internal Revenue Service.

Complies With Laws

Caterpillar spokesman Jim Dugan said the company has engaged in no wrongdoing, and its attorneys said in a court filing that Schlicksup's transfer wasn't a demotion. Dugan declined to comment on the suit's specific allegations, saying Caterpillar "complies with applicable tax laws and regulations."

It could be difficult to prove the company underpaid U.S. taxes, said Reuven Avi-Yonah, director of the international tax law program at the University of Michigan Law School in Ann Arbor. IRS officials have had only mixed success recovering large settlements in corporate income-tax cases, and "\$2 billion would be an extraordinarily large recovery," said Edward Kleinbard, a law professor at the University of Southern California in Los Angeles and a former corporate tax attorney at Cleary Gottlieb Steen & Hamilton LLP.

Peoria-based Caterpillar, which reported year over year earnings growth exceeding 250 percent in each of the last two quarters, is among several U.S. multinationals asking Congress to end U.S. corporate income taxes on profits earned abroad. The company had \$3.7 billion of pretax income last year on \$42.6 billion in revenue, 68 percent of which came from offshore.

#### 'Level Playing Field'

"What we are asking for is a level playing field when we compete with foreign competitors," said Edward Rapp, the company's chief financial officer, in testimony to a congressional committee May 12. The company's shares fell as much as 3.4 percent in New York Stock Exchange trading today.

Caterpillar's Swiss strategy, as described in depositions and exhibits attached to Schlicksup's lawsuit, reflects one way U.S. corporations reduce their actual tax rates. Aided by lower taxes overseas, the company had an overall effective tax rate of about 26 percent on about \$27 billion of pretax income from 2000 through 2009, based on data compiled by Bloomberg from the company's disclosures. The top federal corporate income tax rate in the U.S. is 35 percent.

U.S. multinationals including Google also report overall effective tax rates that are lower than the U.S. rate -- partly because of the effect of their overseas operations. Google's overall effective rate for 2007 through 2009 was about 25 percent, based on disclosures in its annual reports. Its overseas tax rate for the period was 2.4 percent.

#### Taxed at 10 Percent

Caterpillar's Swiss income is subject to a 10 percent tax rate, according to a legal document filed in the case and provided to Bloomberg News by O'Day, Schlicksup's attorney. While the combined federal, state and local tax rate in Geneva

is about 24 percent, companies frequently receive exemptions, according to the Geneva Economic Development Office.

The company said in the document that one purpose of the Swiss structure is to lower its taxes. It also agreed that “Caterpillar pays more tax to Switzerland and less tax to the United States than it would have without” the strategy, according to the document.

Around 1999, the U.S. parent company transferred the role of “global purchaser” of spare parts from third-party manufacturers from itself to the Swiss unit, according to a memo prepared in 2006 by PricewaterhouseCoopers LLP, the New York-based accounting firm that designed the strategy.

#### Illinois Warehouse

The Geneva subsidiary, Caterpillar SARL, or CSARL, had no spare-parts employees and did no work to sell or ship the parts, Schlicksup claims in the lawsuit. The parts are shipped to dealers around the globe from a warehouse in Morton, Illinois, about 10 miles southeast of Caterpillar’s Peoria headquarters, according to the lawsuit, which also describes the spare-parts business as the company’s most profitable line.

“In order to shift profit to Switzerland, Caterpillar pretended to shift the management and control of a large portion of its most profitable business segment to Switzerland, but in reality the management and control of this business remains in the United States,” Schlicksup said in an 88-page declaration he filed as part of the suit.

“Everything is done the same way it was done before except that on paper, now CSARL is doing it, not Cat, while in practice Cat is doing everything,” O’Day said in an interview. While the Swiss unit nominally buys the parts from suppliers, it maintains its inventory in the U.S. unit’s Morton warehouse, where Caterpillar Inc. employees ship it and send invoices, he said.

#### No Business Purpose

Schlicksup’s lawsuit, which is in the evidence-gathering phase, alleges that the Swiss structure is improper because it has no legitimate business purpose beyond cutting Caterpillar’s U.S. tax bills.

“They didn’t set up the minimal physical structure to give it economic substance,” O’Day said.

Courts have generally sided with taxpayers who use foreign subsidiaries, said Stephen Shay, a professor at Harvard Law School in Cambridge, Massachusetts, and a former assistant U.S. Treasury secretary for international tax matters. “You don’t need much substance in the foreign corporation for it to be accepted under current rules, and frankly that’s a problem,” he said.

To survive a challenge, a taxpayer must show that transactions between the subsidiary and its parent were done with the intent of making a profit, whatever the tax consequences, and had realistic potential to create income, said Michigan's Avi-Yonah.

#### 'Clearly Profitable'

"The sale of parts was clearly profitable, so the question is whether a court would be satisfied with that or ask whether routing the sales via Switzerland had to have its own separate economic substance," Avi-Yonah said. "I suspect the likely answer is that the transaction satisfies economic substance as a whole, but it's hard to tell without knowing more facts."

Still, if the inventory is maintained in the U.S., that would raise questions of whether Caterpillar Inc. is deriving taxable income from it, said Avi-Yonah.

O'Day said the IRS and tax courts will find that the Swiss subsidiary doesn't handle the spare parts transactions themselves -- and thus doesn't meet the standard.

Most cases "will say that even if an entity has substance you will look to see if its transactions have substance," he said.

#### 'Bermuda Strategy'

While the Swiss structure moved income to Geneva, Caterpillar had New York-based accounting firm Ernst & Young LLP devise a complementary "Bermuda strategy" aimed at returning some cash to the U.S. without paying tax on it, according to a Nov. 13, 2006 memo from Pricewaterhouse and internal corporate tax summaries from 2006 and 2007 written by Schlicksup's then-boss, Robin Beran, Caterpillar's chief of global taxation. The documents are filed as exhibits to the lawsuit.

Under current law, American companies can defer federal income taxes on most overseas earnings as long as the money remains abroad. Foreign income brought to the U.S. is subject to tax at the 35 percent rate -- with credits for overseas taxes paid. Congress is considering a one-time tax holiday that would reduce the rate to 5.25 percent.

Spokesmen for PricewaterhouseCoopers and Ernst & Young said their firms don't comment on client matters.

Caterpillar reported total expenses of \$3.68 billion for U.S. federal taxes on \$12.3 billion in pretax U.S. profit from 2000 through 2009, an effective rate of 30 percent. It reported \$2.97 billion for taxes on \$14.4 billion of non-U.S. pretax profits, a rate of 20.6 percent on foreign income.

#### Effective Tax Rate

Overall, including U.S. state taxes, Caterpillar reported an effective tax rate for the period of 26 percent, or \$6.9 billion on pre-tax profits of \$26.8 billion, based on its disclosures.

Caterpillar's U.S. federal income tax return for 2003 reflects far lower numbers: \$4,667 in tax on taxable income of \$18 million and revenue of \$22.8 billion. Dugan, the Caterpillar spokesman, declined to comment on the 2003 return, which was filed as an exhibit to Schlicksup's complaint.

Schlicksup, a lawyer and a certified public accountant with a master's degree in tax law, tried for two years, beginning in 2007, to persuade senior Caterpillar executives that the Swiss plan might violate U.S. law, according to e-mails filed as evidence in his suit. A Caterpillar employee since 1992, he became concerned after researching the "economic substance" issue in late 2006, he said in a declaration filed with his suit.

#### Rejected as Unfounded

His bosses, Caterpillar's general counsel and its chief compliance and ethics officers, rejected his concerns as unfounded, e-mails show.

"Dan, I think this really is a non issue," Beran wrote in a Jan. 19, 2007, e-mail filed in the court case.

In subsequent e-mails to various executives, Schlicksup wrote that Caterpillar had not set aside enough cash in the event the IRS disallowed the Swiss strategy. In response, Debra Kuper, the company's senior corporate counsel, told him that executives had reviewed his concerns. They were "satisfied that the matter was adequately addressed and handled appropriately," she wrote. "This matter is therefore closed."

Kuper, now vice president, general counsel and corporate secretary of AGCO Corp. of Duluth, Georgia, declined to comment.

Ultimately Schlicksup summarized his concerns in a 15-page May 2008 memo to Rapp and Douglas R. Oberhelman, now Caterpillar's chief executive officer. He warned of what he called "serious shareholder fraud" involving overstated income, according to the declaration he filed in court in December 2009.

#### Transfer or Leave

The executives did not respond, according to his complaint. Then, in August of 2008, a human resources executive told Schlicksup that he could transfer to Caterpillar's information technology division or leave the company, his complaint says.

The new job involved overseeing implementation of a computer system he knew nothing about, his suit claims, for less pay and a smaller bonus target. Schlicksup called it a demotion.

After a meeting with Caterpillar's human resources department, his pay was restored, according to the lawsuit, though he says the transfer out of his area of expertise makes him unlikely to be promoted.

In September 2008, Schlicksup's new boss, Chief Information Officer John Heller, gave him a draft agreement to restore his compensation, according to the lawsuit. It required Schlicksup to stop accusing Caterpillar of any "unlawful, unethical or improper conduct," according to a copy of the draft filed as an exhibit in the suit.

#### Remains Employed

Schlicksup demanded changes, including a payment to make up for lost promotions. Heller responded in a Nov. 12, 2008, e-mail that the company was no longer pursuing the agreement. Schlicksup remains employed by Caterpillar's information services division, O'Day said.

The company said it hadn't retaliated against Schlicksup. In asking the court to dismiss the case, Caterpillar's lawyers wrote that by Oct. 1, 2008, he had received a \$14,292 raise.

Magistrate Judge Byron G. Cudmore has ordered the pre-trial exchange of evidence to continue, and according to court records, a trial date has been set for Jan. 16, 2012 before U.S. District Judge Michael M. Mihm.

The case is Schlicksup v. Caterpillar Inc., et al, 09-01208, U.S. District Court for the Central District of Illinois (Peoria).

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## **Whistle-Blower Claims Stall as IRS Leaves \$385 Billion on Table**

**2012-06-19 09:00:00.4 GMT**

By Jesse Drucker and Peter S. Green

June 19 (Bloomberg) -- Alliantgroup LP is a politically connected advisory firm that helps companies apply for lucrative tax credits. Clients have ranged from Oscar de la Renta to an Arkansas candle maker.

The firm also helps companies sidestep taxes, two former employees alleged in July 2009. In a 32-page submission filed with the Internal Revenue Service, along with internal e-mails and documents, they claimed Alliantgroup's clients could owe the U.S. Treasury as much as \$712.5 million in refunds over wrongly claimed tax credits. The whistle-blowers stood to make more than \$210 million, under a law that offers informers as much as 30 percent of what the government recovers from their tips.

Twenty-one months later, the IRS rejected the claim, without its auditors ever talking to the whistle-blowers and even after a request by some agents to convene a grand jury, internal agency documents show.

The IRS whistle-blower program -- created by Congress in 2006 to boost tax revenue by giving incentives to tipsters -- has become the place where allegations of tax avoidance go to die. Over the past five years, more than 1,300 claims have been filed against almost 10,000 companies and individuals, alleging tax underpayments of at least \$2 million apiece.

Just three awards have been paid. The IRS won't disclose the total dollar amount. Taxpayers annually owe \$385 billion more than the IRS is able to collect, the agency said.

#### Tipsters Unwelcome

By contrast, the U.S. Treasury has recovered more than \$21 billion since 1986 due to whistle-blower tips under a similar law that covers other federal agencies. Last month, the Department of Justice announced that Abbott Laboratories would pay \$1.5 billion to settle federal and state claims that it illegally promoted an anti-seizure medication. Information from four whistle-blowers helped prompt the investigation.

The IRS is "demoralizing whistle-blowers" Senator Charles Grassley, who sponsored the whistle-blower law, wrote to Treasury Secretary Timothy F. Geithner in April. "The IRS does not have a problem attracting whistle-blowers. The IRS's current problem is processing and compensating whistle-blowers in a timely manner," said Grassley, an Iowa Republican. As a result, "I am now concerned that whistle-blowers will stop coming forward."

Even as the U.S. grapples with a \$1.2 trillion budget deficit, the IRS won't aggressively pursue whistle-blower tips because of fears that will spur accusations from Congress of heavy-handed enforcement, said Bryan Skarlatos, a tax-litigation lawyer at Kostelanetz & Fink LLP.

#### Lengthy Process

Whistle-blower claims “can take years to go through the IRS review and award determination process,” and the IRS doesn’t collect enough information on why claims are rejected, the Government Accountability Office said in a report last year.

The program hasn’t met expectations, IRS officials said. “It’s fair to say the whistleblower program isn’t where we would like it yet,” said Steven T. Miller, IRS deputy commissioner for services and enforcement, who oversees the whistle-blower office. “And I think it’s fair to say we are working hard on it.”

The IRS doesn’t talk to whistle-blowers more frequently because of concerns about violating strict laws protecting taxpayer privacy, Miller said. He attributed the slow pace to taxpayers appealing IRS rulings. The agency says prospective whistle-blowers should expect to wait as long as seven years for an award.

“It is not an incredibly fast process,” Miller said. The agency expects to pay out another three to five awards this year, he said.

#### Filed Confidentially

Whistle-blower allegations are filed confidentially and the IRS never tells the subject that a claim exists. Informed of the allegations by Bloomberg News, Alliantgroup denied them.

Alliantgroup is “proud of its success in helping thousands of small and medium businesses across the country benefit from tax credits and incentives,” the company said in a statement. Alliantgroup’s directors and advisory board include a former senator, three former congressmen, a former IRS commissioner and several former congressional tax-staff members.

Spurned whistleblowers include a California environmental activist, John Hansen. He filed an IRS whistle-blower submission that claimed the value of salt flats sold by Cargill Inc. had been exaggerated by appraisers, inflating charitable donation deductions. A California judge found the property’s appraiser had overvalued the land.

While the IRS reduced Cargill’s deductions, it rejected Hansen’s claim without speaking to him even though he had more information, Hansen said. Cargill accepted the IRS’s reduced deduction, said Lori Johnson, a spokeswoman for the agriculture company.

#### Odyssey Begins

The Alliantgroup whistle-blowers’ odyssey began in July 2009 when they submitted their claim to the IRS.

The ex-employees permitted Bloomberg News to review their allegations and requested anonymity because the IRS doesn’t disclose whistle-blowers’ names. One of them works for a firm

that advises companies on tax credits. The two former employees spent a combined six years working at Alliantgroup's headquarters in Houston; one is a tax attorney.

The IRS has challenged research credits claimed by some of Alliantgroup's clients.

In March, U.S. Tax Court Judge Diane L. Kroupa rejected tax credits by an Alliantgroup client and said the firm had shown no proof that wages paid to two top executives of hair-care products maker Farouk Systems Inc. qualified as research expenses.

### 'Self-Serving'

"The inadequate substantiation prevents any amount of the relevant wages from qualifying for the research credit," the judge wrote. She called the testimony from Farouk's witnesses "self-serving and unreliable."

While Alliantgroup said in a statement that Judge Kroupa's findings were "unfortunate," it said "there is no question" that Farouk Systems' founder and employees engaged in research.

In the whistle-blower claim, the former employees alleged Alliantgroup inflated research expenses by saying top managers spent large portions of their time working on such projects. That enabled more of their salaries to count as costs eligible for the credit.

The whistle-blowers included an internal e-mail that showed -- after the IRS began examining one client -- Alliantgroup manager Amol Gavankar suggested changing the job description of a purchasing manager.

"Obviously in software design, purchasing has no qualification in R&D," Gavankar wrote. "I need you to decide whether we should modify the title or figure out a better job description."

### Job Descriptions

In an interview, Gavankar, who left the company in 2008, said that while he didn't recall the specific e-mail exchanges, it was common to shoehorn employees' job descriptions into positions that would help generate credits.

"I wasn't comfortable with that," he said. "Not having a formal tax background, we did what the partners taught us to do." Gavankar previously worked as a software engineer.

"Alliantgroup does all it can to provide accurate job titles to the IRS," the company said in a statement. Clients must "provide confirmation of allocations and costs before information is placed into" their studies. The company says 93 percent of the research credit dollars claimed by clients and audited by the IRS or state tax administrators since January 2009 have been upheld.

## Overworked Auditors

In August 2009, a week after receiving the whistle-blowers' file, Katherine Onken, an IRS analyst, began working the phones.

The 35 staff members in the IRS whistleblower office don't pursue claims themselves. Instead, they try to enlist overworked auditors on the IRS's enforcement staff, whose ranks dropped by more than 500 agents and revenue officers last year.

Reached by telephone, Onken declined to be interviewed.

Onken learned the IRS had previous disputes with Alliantgroup's clients. Agency officials in Houston "have had many cases with this group," according to an e-mail to Onken from a colleague on Aug. 10, 2009. She also found out Alliantgroup was in negotiations with the IRS over a proposed penalty of about \$250,000 for allegedly preparing false tax returns. The company says it hasn't paid any penalty.

In November, three months after filing their claim, the whistle-blowers hadn't received any IRS response, other than an acknowledgement it was received. Their attorney, Joel Androphy, arranged a meeting with two agents from the IRS's criminal division in Houston.

The meeting lasted the better part of a day. The IRS agents started a preliminary investigation into Alliantgroup and requested the convening of a grand jury, according to an internal agency memorandum from Jan. 5, 2010.

## Request Denied

That request was denied after discussions between the criminal division and the IRS chief counsel's office, according to the memorandum. The file was passed back to Onken at the whistleblower office.

On the same date, Onken e-mailed a description of the allegations to her boss. The whistle-blower office's director, Stephen Whitlock, wrote back quickly that there might be a case to be pursued against Alliantgroup.

He also cautioned in an e-mail: "Sounds like this would be very resource intensive."

Alliantgroup's political connections were also raised in several internal IRS memos.

Alliantgroup's vice chairman is former IRS Commissioner Mark W. Everson, who ran the agency under George W. Bush from 2003 to 2007. Its national managing director is Dean Zerbe, former senior counsel to the Senate finance committee, who worked for Grassley and helped write the legislation that set up the whistle-blower office. He has represented several tax whistle-blowers, including former UBS AG banker Bradley Birkenfeld.

## Keeping Tabs

Everson and Zerbe keep tabs on federal tax developments and update the company's clients on potential changes and legislation.

Following a conference call on the allegations about Alliantgroup, Onken, the IRS analyst, scrawled one word next to Everson's name in a handwritten memo: "Concern."

That concern was heightened in May 2010 when Onken received a phone call from her boss, Whitlock. He told her Zerbe and Everson were meeting with the IRS later that week, according to Onken's notes. "He didn't know what the topic/purpose of the mtg was," she wrote.

Everson and Zerbe met with five top officials at the IRS that month, an agency spokeswoman said, including Commissioner Douglas Shulman and Miller, the deputy commissioner for services and enforcement.

## Presenting Views

The meeting was requested by Alliantgroup to "present its views of issues and challenges faced by small- to mid-sized accounting firms," said an agency spokesman. It didn't address the whistle-blower office, the agency said.

The IRS's "determination of any case is based on the law and the facts as they are presented -- period," said Terry Lemons, an IRS spokesman. "Our agents are trained to avoid any inappropriate influence by a taxpayer's representative. We have multiple reviews in place throughout the IRS to ensure decisions are based solely on the facts and circumstances of the case."

Meanwhile, the Alliantgroup file had been given to an IRS technical adviser. While he dismissed some of the allegations, a few were "troublesome," he wrote. They included the allegation that Alliantgroup changed job titles of clients' employees to qualify for more research tax credits.

## 'Intentional Act'

"The changing of job titles and use of generic descriptions seem at first glance to have been an intentional act to disregard of [sic] the rules," wrote the IRS official, Paul Coates in his May 20, 2010 memorandum. He recommended passing on those allegations to field agents and said a penalty against the firm may be warranted.

Nevertheless, analysts and examiners whose job it is to audit companies like Alliantgroup resisted pursuing the allegations. A team already auditing Alliantgroup as part of a broader examination of research tax credits "doesn't want to look at the [whistle-blower] info because they think they have the same or similar info," Onken wrote in a June 2010 memo.

“I don’t understand why the team wouldn’t want to look at the info,” Onken wrote.

Soon after, one of the whistle-blowers called Onken to say he still hadn’t heard back from the IRS, a year after filing his claim. She said she couldn’t tell him anything other than that his claim was being considered, according to her notes of the conversation.

### IRS Reluctance

The reluctance of the IRS to talk directly to whistle-blowers is common, according to lawyers who file such claims.

“You have an agency that is virtually completely non-communicative,” said Erika A. Kelton, an attorney at Phillips & Cohen LLP in Washington, which represents about 40 tax whistle-blowers. Since sophisticated tax shelters are complex, “when you have an insider who can shortcut things for you, why not take him up on it?”

The IRS generally doesn’t permit its most knowledgeable examiners -- field agents handling audits -- to speak to the whistle-blowers at all, the agency says. That is because of fears of accidentally sharing confidential information with whistle-blowers, said Marty Basson, an attorney who retired last year from the IRS office that handles those claims.

As the agency debated what to do about Alliantgroup, one IRS official expressed misgivings, according to internal correspondence.

“On one hand it makes sense to reject” the claim, wrote manager Amy Liberator in a June 16, 2010 e-mail. “On the other, they’re (Alliantgroup) getting just what they want because they know we probably won’t audit these mid-size” companies.

Liberator declined to comment.

### Broader Issues

An IRS analyst who had been looking at the broader issue of abuses of research tax credits -- identified by the IRS in 2007 as a top audit priority -- wrote in a memo that he didn’t feel pursuing the allegations against Alliantgroup “would be an efficient use of resources.” Onken forwarded this information to her bosses.

A few months later, on April 26, 2011, the IRS sent brief rejection form letters to the whistle-blowers.

“Although the information you submitted did not qualify for an award,” it read, “thank you for your interest in the administration of the internal revenue laws.”

The two whistle-blowers have filed a petition, under seal, in U.S. Tax Court challenging the rejection of their claim.

“This could have been used to refund other taxpayers, or

pay down the national debt,” said one of them, the former Alliantgroup tax attorney. “Instead, the IRS completely dropped the ball. They wouldn’t spend the time and money to go after it.”

--With assistance from Martin Z. Braun in New York. Editors: Daniel Golden, Chris Staiti

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## **IRS Says It Will Improve Whistle-Blower Program Amid Outcry**

2012-06-21 15:12:20.572 GMT

By Peter S. Green and Jesse Drucker

June 21 (Bloomberg) -- The Internal Revenue Service will review its tax whistle-blower program to improve its backlog and working practices, after the program came under fire from politicians and lawyers.

The IRS will work with “internal and external stakeholders” on a “comprehensive review” of the agency’s guidelines and procedures for handling whistle-blower complaints, Deputy Commissioner for Services and Enforcement Steven T. Miller said in a two-page memo to senior IRS officials posted on the agency’s website yesterday.

Miller also set 90-day deadlines for the agency to review whistle-blower claims, which can take at least seven years to resolve.

The IRS whistle-blower program was created by Congress in 2006 to boost tax revenue by rewarding tipsters for information. Instead, it’s become the place where allegations of tax avoidance go to die, Bloomberg reported on June 19.

Over the past five years, more than 1,300 claims have been filed regarding almost 10,000 companies and individuals, alleging tax underpayments of at least \$2 million apiece. Just three awards have been paid. Taxpayers annually owe \$385 billion more than the IRS is able to collect, the agency has said.

“Whistle-blowers can provide valuable leads and often offer unique insights into taxpayer activity,” Miller wrote. He said timely action is essential and debriefing of whistle-blowers will “be the rule, not the exception.”

## 'One-Bite Rule'

Under existing guidelines, IRS agents typically speak to whistle-blowers only once because of concern about divulging confidential information to informers, a procedure the IRS refers to as the "one-bite rule."

The whistle-blower office and the field agents and criminal investigators to whom it refers cases will each have 90 days to complete initial reviews of cases brought by whistle-blowers, the memo says. When taxes and penalties are collected, tipsters are to be notified within 90 days, so they can claim their rewards.

Internal performance reviews for IRS agents and offices involved in whistle-blower cases will now include information on whether the deadlines were adhered to.

"The IRS does not have a problem attracting whistle-blowers," Senator Charles Grassley, the Iowa Republican who sponsored the whistle-blower law, wrote to Treasury Secretary Timothy F. Geithner in April. "The IRS's current problem is processing and compensating whistle-blowers in a timely manner. I am now concerned that whistle-blowers will stop coming forward."

While advocacy groups applaud the changes, they're calling for IRS Commissioner Douglas Shulman to voice more support for the whistle-blower office.

"Those are pretty big moves," said Patrick Burns, a spokesman for Taxpayers Against Fraud, a Washington interest group that promotes IRS reform and encourages whistle-blowers. "The question is when will Commissioner Shulman stand up and speak out in support of the whistle-blower program. Silence speaks very loudly at this point."

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**Filling Treasury Jobs Delayed Over IRS Whistleblower Concerns**  
**2012-07-11 21:29:03.253 GMT**

By Peter S. Green

July 11 (Bloomberg) -- Senator Charles Grassley said he'll block the confirmation of two assistant secretaries of the Treasury until the Internal Revenue Service improves its program to reward whistleblowers who inform on tax cheats and scofflaws.

Grassley, an Iowa Republican who wrote a 2006 law overhauling the IRS whistle-blower program, said in a statement that he won't approve the nominations of Mark Mazur and Matthew Rutherford until he gets answers to a June 21 letter. He sent the letter about the program to Treasury Secretary Timothy Geithner and IRS Commissioner Douglas Shulman.

"I rewrote the statute in 2006 to encourage whistleblowing on big-dollar tax cheats," Grassley said in a statement today. "However, nearly six years since those changes were enacted, Treasury has yet to issue much needed regulations and IRS has paid less than a half dozen awards under the new program."

Grassley cited a June 19 Bloomberg News report that the IRS had received 1,300 claims against more than 10,000 companies since 2006, and issued three awards. The following day, IRS Deputy Commissioner for Services and Enforcement Steven T. Miller sent a two-page memo to senior agency officials ordering them to work closely with whistleblowers and pledging a "comprehensive review" of the agency's guidelines and procedures for handling whistle-blower complaints.

Grassley said in today's statement that he is waiting for promised replies from Geithner and Shulman. "Until I receive those responses, I will object to proceeding with the nominations of Mr. Rutherford and Dr. Mazur," he wrote.

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**IRS Rewards 3-Time Whistleblower With \$2m in Illinois Tool Case**  
**2012-10-04 15:19:23.204 GMT**

By Peter S. Green

Oct. 4 (Bloomberg) -- Unidentified whistleblower wins third 7-figure award from IRS after exposing alleged tax avoidance scheme by Illinois Tool Works Inc., whistleblower's attorneys Phillips & Cohen of Washington DC, say in e-mailed statement.

\* Tax avoidance plan allegedly involved Swiss bank helping firm to avoid taxes; cost U.S. Treasury "hundreds of millions of dollars" in taxes

\* ITW spokeswoman was not immediately able to comment

\* NOTE: Award comes as IRS tax whistleblower program is under scrutiny from Congress; follows \$104 whistleblower award announced in September in Swiss banking case involving UBS  
Link to law firm website: <http://bit.ly/na65rW>

## **UBS Whistle-Blower's Ex-Lawyers Seek Share of \$104 Million Award** **2012-10-16 04:00:01.3 GMT**

By David Voreacos and Peter S. Green

Oct. 16 (Bloomberg) -- A Washington law firm that worked for Bradley Birkenfeld, the former UBS AG banker who exposed how the Swiss lender helped Americans evade taxes, claims it's owed \$13 million of his \$104 million whistle-blower award.

Birkenfeld hired Schertler & Onorato LLP in 2006 to help him tell the U.S. how UBS used Swiss bank secrecy to cheat the Internal Revenue Service. Birkenfeld, now 47, told his story the next year to the IRS, the U.S. Justice Department, the U.S. Senate and the Securities and Exchange Commission. He agreed in October 2007 to pay the law firm 12.5 percent of any IRS whistle-blower award, according to court documents.

Birkenfeld served 31 months in prison after pleading guilty to conspiracy and was released on Aug. 1, six weeks before the IRS gave him the largest federal whistle-blower award for an individual. Birkenfeld had fired Schertler & Onorato in 2008, and his new law firm says the 12.5 percent accord is no longer binding.

"I hereby request that you confirm in writing that your firm does not assert any financial interest in any whistle-blower claim that Mr. Birkenfeld may have related to his allegations against UBS," attorney David C. Colapinto of Washington-based Kohn, Kohn & Colapinto LLP wrote to the Schertler firm in December 2010.

Attorney David Schertler refused to waive his firm's financial claim. Last year, before it was clear that Birkenfeld would ever see his big payday, a federal judge referred the matter to an arbitrator. The arbitrator has yet to rule.

Undisputed Impact

Birkenfeld's impact on Zurich-based UBS, the largest bank in Switzerland, is undisputed. A neurosurgeon's son from Brookline, Massachusetts, he spent 15 years in Swiss banking, including five at UBS. He was one of as many as 60 UBS employees who trolled the U.S. for rich clients, even though the bankers lacked required SEC licenses, he told Senate investigators. They visited art shows, yachting regattas and golf and tennis tournaments, he said.

Prosecutors have said Birkenfeld's disclosures led them to charge UBS in 2009 with conspiracy. The bank avoided prosecution by paying \$780 million, admitting it fostered tax evasion from 2000 to 2007, and turning over data on 250 Swiss accounts. UBS later agreed to provide information on another 4,450 accounts. Since then, at least 33,000 Americans voluntarily disclosed offshore accounts to the IRS, generating more than \$5 billion in tax revenue.

The IRS said Birkenfeld provided "exceptional cooperation," gave information on taxpayer behavior that the agency hadn't detected, and led to substantial changes in UBS practices, according to an agency explanation released by Stephen Kohn of Kohn, Kohn & Colapinto.

#### 'Unprecedented Actions'

"While the IRS was aware of tax compliance issues related to secret bank accounts in Switzerland and elsewhere," Birkenfeld's disclosures "formed the basis for unprecedented actions against UBS," according to the IRS document.

While he sat in prison in Minersville, Pennsylvania, Birkenfeld filed a lawsuit accusing Schertler & Onorato of malpractice and breach of fiduciary duty. The complaint, filed in August 2011 without a lawyer in Superior Court in Washington, sought \$10 million in damages.

Birkenfeld claimed the firm mishandled negotiations with the Justice Department, which refused in 2007 to grant him either immunity or a subpoena he said he needed to reveal information otherwise protected by Swiss law.

When prosecutors charged him in 2008, they said he wasn't truthful about his own role in helping a billionaire client break the law.

#### Federal Case

Birkenfeld also sued in federal court in Washington, claiming Schertler & Onorato violated his constitutional rights in May 2008 when he met with prosecutors two days after his arrest. At that meeting and in other instances, Birkenfeld claimed, a prosecutor said he couldn't meet with Senate or SEC investigators, and his lawyer didn't respond, violating

Birkenfeld's right to free speech and his right to due process.

In October 2011, Schertler & Onorato denied Birkenfeld's allegations and filed a counterclaim, saying he didn't give his lawyers "complete information about the extent of his illegal conduct and activities."

That counterclaim said a Schertler lawyer gave a Form 211, titled an "Application for Reward for Original Information," to IRS agent Matthew Kutz at a meeting on June 12, 2007. A copy of the form, provided to Bloomberg News by Schertler & Onorato, shows it was signed by Birkenfeld and given "through counsel" to Kutz "in person."

### 'Evolving' Process

Schertler & Onorato helped Birkenfeld "navigate the complex and evolving" process at the "newly formed IRS Whistleblower Office," according an October 2011 court filing by the firm.

A retainer letter, sent on Oct. 23, 2007, outlined the 12.5 percent whistle-blower fee and a cap on hourly fees at \$80,000, according to the firm's counterclaim.

Birkenfeld also signed a second representation letter on May 9, 2008, for the firm to represent him after his arrest. It called for an advance of \$50,000.

In his December 2010 letter to Schertler, Colapinto said Birkenfeld's second retainer letter superseded the first one, which meant the firm "relinquished its financial interest" in the whistle-blower award. It also referenced an IRS Form 211 filed in 2007.

"There is no evidence that your firm performed any work on that claim or that your firm perfected the claim as required by either the statute or IRS regulations governing the whistle-blower reward program," Colapinto wrote.

### Whistleblower Office

In an interview last month, Stephen Kohn said that his firm filed the official Form 211 with the IRS Whistleblower Office.

"Schertler never filed a 211," Kohn said. "Whether Brad did or not is a secondary issue. Schertler never met with the office until we got involved, and the lawyers, to the best of our knowledge, didn't meet with the office. We filed the claim."

Schertler disputed Kohn's account.

"It is indisputable that Schertler & Onorato communicated directly with the IRS Whistleblower Office and followed the explicit instructions received from that office on how to properly register Mr. Birkenfeld as a whistle-blower," Schertler said in an e-mail yesterday.

The IRS also told the firm how to ensure that what he gave

Kutz “would qualify for treatment as information provided to the IRS under the Whistleblower Program.”

Dean Patterson, an IRS spokesman, declined to comment on the case.

#### Federal Law

“Federal law prohibits the IRS from discussing specific taxpayers or situations,” he said in an e-mail.

Birkenfeld’s brother, Doug, didn’t respond to an e-mail asking whether Bradley would comment on the fee dispute.

Kohn, Kohn & Colapinto has declined to say how much of the whistle-blower award it will receive for work on Birkenfeld’s behalf.

In November 2011, lawyers from Kohn, Kohn & Colapinto moved on Birkenfeld’s behalf to voluntarily dismiss both the Superior Court and federal lawsuits he originally filed without an attorney. Schertler & Onorato’s counterclaim is still pending.

U.S. District Judge Robert L. Wilkins dismissed the federal case, ordering that Kohn, Kohn & Colapinto place any IRS whistle-blower payments in a trust account and segregate 12.5 percent, as well as \$77,024, “until the fee dispute is resolved.”

The judge said that the Attorney-Client Arbitration Board of the District of Columbia Bar should handle the matter.

The cases are Birkenfeld v. Schertler & Onorato, 11-cv-1529, U.S. District Court, District of Columbia (Washington); and Birkenfeld v. Schertler & Onorato LLP, 2011-CA-6905, District of Columbia Superior Court (Washington).

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**Tax Snitches Can’t Escape Budget Cuts as IRS Bounties Shrink (1)**

**2013-03-05 21:00:19.65 GMT**

(Updates with Senator Grassley's comment in third paragraph. For more on the budget, see EXT7.)

By Kasia Klimasinska and Peter S. Green

March 5 (Bloomberg) -- Turning in tax dodgers to the U.S. government just got a little less lucrative.

The Internal Revenue Service, in a notice on its website yesterday, said whistle-blower awards will be reduced by 8.7 percent under automatic spending cuts that kicked in this month. The cutback applies to the IRS payout of as much as 30 percent of the additional tax, penalty and other amounts it recovers from scofflaws.

Under budget cuts known as sequestration, the U.S. is trimming \$85 billion from federal spending in the remaining seven months of the current fiscal year.

The fiscal reductions may stay in place for weeks as Congress and the administration of President Barack Obama negotiate over a fresh deadline of March 27, when the government's authority to spend money expires.

"I have more questions than answers," Senator Charles Grassley, the Iowa Republican who wrote the 2006 law updating the IRS whistle-blower rules, said in an e-mail today. The payments are made by the IRS, using money collected from companies and individuals who committed tax fraud, and cutting rewards would undermine the program, he wrote. "What's the legal rationale for cutting the whistle-blower payments?"

### 'Baffling'

Erika Kelton, an attorney with Phillips & Cohen LLP in Washington who represents tax and other whistle-blowers, called the IRS decision "completely baffling."

Given the rarity of IRS whistle-blower awards -- fewer than a dozen have been publicly announced out of more than 1,200 claims filed -- Kelton said it's unlikely the IRS will make any awards before the budget standoff is resolved.

"After all, an 8.7 percent reduction of nothing is still nothing," she wrote.

Among recent beneficiaries of IRS whistle-blower awards was Bradley Birkenfeld, a former UBS AG employee who received \$104 million last year after telling the government the bank helped thousands of Americans evade taxes.

The IRS paid 128 awards worth a total of \$125.4 million in fiscal 2012 to whistle-blowers who helped collect \$592.5 million in revenue, according to a report on the IRS website.

The Treasury Department, which oversees the IRS, also said it will reduce some awards for the installation of renewable energy sources by 8.7 percent as a part of the across-the-board

cuts.

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