

October 19, 2014

Jane J. Kim
IRS Office of Chief Counsel, SBSE

Dear: Treasury Secretary Jack Lew,
IRS Commissioner John A. Koskinen, and
IRS Chief Counsel William J. Wilkins:

This is Jane J. Kim, attorney in the IRS Office of Chief Counsel, New York City (NYC). On March 18, 2014, I sent a letter outlining IRS Management abuse addressed to ten Senators. On May 5, 2014, I sent a second letter outlining IRS Union abuse. Both events were reported by David Cay Johnston in *Tax Notes Today*.¹

While I am deeply concerned about these management issues and hope they will be addressed, this letter focuses on another disturbing issue brought to my attention by IRS and private sector attorneys, which include two seemingly deliberate multi-billion dollar tax giveaway schemes conducted within the IRS. First, IRS executives appear to have intentionally undermined the authority of the IRS Whistleblower Office (“IRS WO” - the office tasked with collecting taxes from fraudulent schemes, whereby the whistleblower is to receive 15-30% of what the Service collects), so that no action is taken in cases involving billions in corporate taxes due. Second, the IRS gives away billions to large corporate taxpayers through lax enforcement of laws that are otherwise applied with draconian strictness to small businesses, the self-employed, and wage earning individuals.

I. IRS Whistleblowing Office (IRS WO)

These are a few examples of cases from one whistleblower attorney recounting his experience with the IRS WO.² Of note, there is no violation of I.R.C. § 6103 in the sharing of this information. I explicitly requested that the attorney discuss only the fact patterns of the tax schemes in our communications, and to leave out all identifying information, including names, industry identification, cities, and states. The whistleblower clients represented by the attorney are highly

¹ All citations list electronic versions of the articles only, i.e., no substantive citations, checked as of September 21, 2014.
<http://www.taxanalysts.com/www/features.nsf/Articles/3E1959AFF1A76BC485257CA00045ACC6?OpenDocument>;
<http://www.taxanalysts.com/www/features.nsf/Features/4C3D74C1C8E3512385257CD0004866FD?OpenDocument>.

² A private sector attorney, who represents whistleblowers and their cases before the IRS, contacted me after publication of my March 18, 2014 letter in *Tax Notes Today*. The attorney, who currently does not wish to be identified, discussed at length the problems that he and numerous other attorneys, who submitted claims to the IRS WO, have faced in terms of complete silence and lack of movement on their cases.

sophisticated employees with extensive knowledge of the facts, law, and the restructuring and accounting methods of the companies they are calling to task.

Whistleblower 1 ("W1"): W1 filed a claim for nearly \$10 billion in tax for a U.S. Corporation 1 (Co.1) that under-reports its U.S. profits by nearly \$3 billion annually. Co.1 accomplishes this by arbitrarily over-allocating profits to an offshore subsidiary located in a low-tax jurisdiction. W1, an experienced professional with first hand knowledge of the situation, submitted to the IRS WO all facts, documents, law, legal analysis, and conclusions of law, as well as a thoroughly written report drafted on behalf of the IRS. W1 marked the claim "expedite," as several of Co.1's years were already being examined by the IRS, irrespective of the whistleblowing issue. Although the statute of limitations remained open for the years that were under examination at the time the claim was submitted, and the exam team was made aware of W1's claim, the IRS closed its audit without ever asking a question or reviewing the documents submitted by W1. The IRS walked away from \$4 billion in taxes due.

Whistleblower 2 ("W2"): W2 filed a claim for several billion dollars based on the actual identified brokerage accounts owned by foreign individuals for which the taxpayer (Co.2) is a withholding agent. Co.2 failed to maintain proper records requiring it to withhold U.S. tax on U.S. source income, which the law (I.R.C. § 1441) makes the withholding agent liable for failure to withhold and remit from the foreign person. Co.2 had come forward for prior tax years in an IRS voluntary compliance (i.e., amnesty) program for failure to comply with the laws for which W2 was now coming forward. Hence Co.2 was knowingly failing to comply with the tax laws. W2 and his attorney were informed by IRS criminal investigation agents that this was a solid case. An Assistant U.S. attorney was on standby to convene a grand jury on the matter, and they simply needed approval to move forward. The promising IRS criminal investigation was inexplicably shut down. During a civil examination, the IRS accepted Co.2's claim that, because there were too many accounts owned by foreign persons, the audit should consist of a sample of 'random' customer accounts from which they could extrapolate the results. Co.2 manipulated the 'random sampling' to the IRS to hide all malfeasance. Ignoring W2's detailed evidence regarding fraud in hundreds to thousands of specific accounts, the IRS rejected W2's whistleblowing claim stating that it failed to collect any tax for which W2 had provided information. The total uncollected tax was approximately \$6 billion.

Whistleblower 3 ("W3"): W3 filed a claim for over \$3 billion, which increases every year since Co.3 continues its scheme unabated. An accounting firm sold Co.3 a scheme to establish multiple foreign jurisdictions purely on paper, as in reality none of its operations changed and no activity occurs in the foreign jurisdictions. But upon entering the tax scheme, Co.3 claims to the U.S. that all of its profits are earned outside of the U.S. and are permanently invested overseas. To foreign jurisdictions, Co.3 claims that nothing is earned therein. Hence Co.3 has

established the concept of "nowhere income," i.e., income that is not earned or taxed in any jurisdiction, despite U.S. laws fundamentally taxing its citizens on worldwide income. Again, the IRS was examining several of Co.3's prior tax years and, despite knowing of W3's claims, failed to raise any of these issues and closed the examination.

Senators Carrying Out IRS WO's Duties: On March 31, 2014, Senator Levin's office issued a press release stating that Caterpillar had shifted more than \$8 billion in profits to Switzerland to avoid \$2.4 billion in U.S. tax and Senate hearings would take place the next day.³ While Senators Levin's and McCain's staff conducted the investigative work that the IRS WO failed to pursue, they could only draft a report and hope that the IRS would act on it.⁴ As of yet it remains unclear whether any tax has been collected and whether the whistleblower will receive a reward.

The IRS estimates that the U.S. loses as much as \$450 billion in tax evasion per year.⁵ Congress created the IRS WO in 2006, promulgating a law by which whistleblowers would receive 15-30% of amounts collected. I.R.C. §7623(b). The IRS Office of Chief Counsel, in interpreting the laws and regulations, took wide latitude to seemingly thwart the Office's effectiveness and mandate. The IRS Chief Counsel Donald Korb, under whose tenure the Office was created, openly expressed his views on this issue when stating, "The new whistleblower provisions Congress enacted a couple of years ago have the potential to be a real disaster for the tax system. I believe that it is unseemly in this country to encourage people to turn in their neighbors and employers to the IRS as contemplated by this particular program. The IRS didn't ask for these rules; they were forced on it by the Congress."⁶

Consequently, the IRS came up with confounding policies such as:

(1) the "one bite at the apple" rule, allowing a whistleblower to have only one meeting with the IRS. Whereas the Department of Justice interviews

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<http://www.levin.senate.gov/newsroom/press/release/subcommittee-exposes-caterpillar-offshore-profit-shifting>.

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[file:///home/chronos/user/Downloads/Caterpillar's%20Offshore%20Tax%20Strategy%20\(3-30-14\).pdf](file:///home/chronos/user/Downloads/Caterpillar's%20Offshore%20Tax%20Strategy%20(3-30-14).pdf).

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<http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study>.

⁶ <http://www.washingtonpost.com/wp-dyn/content/article/2010/06/30/AR2010063005349.html>.

the whistleblower numerous times and is allowed to litigate in tandem with the whistleblower's attorney;⁷

(2) refusing to grant a monetary reward if the whistleblower's tip results in the denial of a refund, rather than the collection of taxes due, even though the end savings to the fisc is the same;⁸

(3) citing a tainted attorney-client privilege to refuse examination of cases coming from a whistleblower with a law degree, even if the individual did not act in an attorney capacity;⁹ and

(4) most damaging, even though I.R.C. § 6103 (restriction on revealing taxpayer information) was amended to allow the IRS to enter confidentiality agreements with whistleblowers and their attorneys, not using this exception to establish a relationship with whistleblowers in order to pursue cases.¹⁰

These policies do not form a working mechanism to root out wrongdoing. Moreover, despite the WO's annual reporting requirement to Congress, there seems to be a lack of oversight by which the IRS is required to show Congress that it has set up a mechanism for accomplishing what it was mandated by Congress to do. If the intent of the IRS executive offices was to emasculate the WO, they seem largely to have succeeded. The Office seems to be drowning in thousands of untouched high quality tips per year and multi-billion dollar cases its small workforce of 36 staff members is incapable of properly vetting.¹¹

Whistleblowers who do come forward have had their careers destroyed due to IRS inaction.¹² When the IRS does collect money, the 15-30% due to the whistleblower is not paid out.¹³ This directly create a disincentive for others to come forward. IRS Commissioner Koskinen and the Deputy Commissioner for Services and Enforcement recently issued statements regarding the IRS WO's office.¹⁴ Nothing shows that these statements are not mere reiterations of already

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<http://www.truth-out.org/news/item/472:solution-dont-let-wall-street-get-away-with-it-protect-and-reward-sec-whistleblowers>.

⁸ See Footnote 6.

⁹ Based on statements made by an employee in the IRS WO.

¹⁰ See Footnote 2; 26 C.F.R. Section 301.6103(n)-2.

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http://www.irs.gov/pub/whistleblower/2012%20IRS%20Annual%20Whistleblower%20Report%20to%20Congress_mv.w.pdf;

http://www.irs.gov/pub/whistleblower/Whistleblower_Annual_report_FY_13_3_7_14_52549.pdf.

¹² http://www.nytimes.com/2014/02/09/business/sounding-the-tax-alarm-to-little-applause.html?_r=2.

¹³ Id.

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[http://www.irs.gov/pub/whistleblower/Koskinen%20whistleblower%20statement%20-%20version%20082014%20\(2\).pdf](http://www.irs.gov/pub/whistleblower/Koskinen%20whistleblower%20statement%20-%20version%20082014%20(2).pdf);

existing, but unenforced policies, as discussed above.¹⁵ While the Commissioner touts the “collection of more than \$1 billion based on whistleblower information” over “the last three fiscal years,”¹⁶ that is a far cry from the thousands of whistleblower tips the IRS receives each year, and the multi-billions based on just three sample cases, from just one whistleblower attorney discussed herein.

II. Lax Enforcement of Corporate Tax Regimes

IRS’s Lax and Disparate Enforcement of Tax Laws: Irrespective of the IRS WO, and contrary to law, the IRS appears to have implemented a lax and disparate enforcement of the corporate tax regime with respect to ‘favored’ taxpayers. Public examples of the IRS’s lax enforcement of corporate tax fraud are by large energy corporations. IRS attorney Bill Henck has been attempting to expose the IRS’s concession to two energy tax scams -- the Synfuel and black liquor scams -- since 2003.¹⁷ For his efforts, he and his wife were subjected to a retaliatory audit of their tax returns, and further audit even after their returns were deemed clean.¹⁸ These are just two public, concrete examples of this issue.

Synfuel: ‘Synfuel’ is a tax credit to incentivize coal energy innovation in the U.S., and to reduce our country’s dependence on foreign oil.¹⁹ Companies that used technology to transform raw coal, abundant in the U.S., into a new and better synthetic fuel could qualify for the credit, which offers a dollar for dollar reduction in tax liability, and can even result in a refund check from the Treasury. Rather than innovate new technology, companies began to “spray and pray.” They sprayed the equivalent of watered down Elmer’s glue on clean coal to claim that the process of spraying changed the chemical composition of the coal, and thereby ‘qualify’ for the credit, and pray that the IRS wouldn’t audit.²⁰ An energy consultant was quoted as saying, “A dog could walk by and raise his leg over a piece of coal and it would qualify.”²¹

[http://www.irs.gov/pub/whistleblower/IRS%20Whistleblower%20Program%20Memorandum%20\(signed%20by%20DCSE\).pdf](http://www.irs.gov/pub/whistleblower/IRS%20Whistleblower%20Program%20Memorandum%20(signed%20by%20DCSE).pdf).

¹⁵ <http://www.irs.gov/pub/whistleblower>.

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[http://www.irs.gov/pub/whistleblower/Koskinen%20whistleblower%20statement%20-%20version%20082014%20\(2\).pdf](http://www.irs.gov/pub/whistleblower/Koskinen%20whistleblower%20statement%20-%20version%20082014%20(2).pdf).

¹⁷ <http://online.wsj.com/articles/SB10699830445954400>;

http://www.washingtonpost.com/business/economy/when-it-comes-to-the-paper-industry-and-fuel-tax-credits-irs-looks-like-a-soft-touch/2013/07/18/e1040fa8-bcdf-11e2-97d4-a479289a31f9_story.html;

<http://www.powerlineblog.com/archives/2014/02/bill-henck-inside-the-irs.php>;

<http://www.powerlineblog.com/archives/2014/05/bill-henck-inside-the-irs-part-2.php>.

¹⁸ <http://www.powerlineblog.com/archives/2014/02/bill-henck-inside-the-irs.php>.

¹⁹ <http://content.time.com/time/magazine/article/0,9171,493241,00.html>.

²⁰ Id. and <http://online.wsj.com/articles/SB10699830445954400>.

²¹ <http://www.forbes.com/forbes/2001/0122/102.html>.

The players buying into the scam included energy companies, one of the largest hotel corporations and an electronic and appliance store chain.²² So profitable were the credits, that one corporation lowered its effective tax rate to 17%.²³ Companies that had reached the maximum benefit of the credit, sold off portions to other undisclosed companies for use in their accounting.²⁴ The IRS began to audit the "scientific validity of the test procedures," but seemed to have stopped pursuant to corporate telephone calls of protest, to a scam that cost Americans \$1 to \$2 (by some estimates \$10) billion per year, including \$9 billion between 2003 - 2005.²⁵

Black Liquor: A 2005 refundable energy credit ("2005 credit") was created to incentivize use of 'cleaner' liquid oil, derived from biomass, i.e., plant matter.²⁶ The paper industry has been burning black liquor, a by-product of the paper industry, since the 1930s.²⁷ The industry added diesel (an even dirtier fuel) to its black liquor to "qualify" for the credit.²⁸ In the fourth quarter of 2008, the beginning of the Great Recession, Verso Paper (majority owned by Apollo Management) received \$29.7 million payment from the IRS for a one-month credit for only one of its four paper mills.²⁹ International Paper received \$79.1 million for a one-month payment, with as much as \$1.06 billion in 2009, and up to \$3.7 billion in total.³⁰ By the end of fiscal year 2009, black liquor cost American taxpayers \$4 billion.³¹ Being a refundable credit, the Treasury would have actually written out checks to these corporations.

Son of Black Liquor: This \$.50 per gallon loophole was closed in 2007, but the paper industry convinced the IRS that black liquor qualified for the more lucrative \$1.01 per gallon cellulosic biofuels credit (CBC).³² Not being a refundable credit, CBC was of use to profitable companies,³³ which could conceivably reduce their tax

²² See Footnote 19.

²³ Id.

²⁴ Id.

²⁵ Id.; <http://online.wsj.com/articles/SB10699830445954400>;

<http://content.time.com/time/magazine/article/0,9171,1167738,00.html>;

<http://www.nytimes.com/2003/07/05/business/irs-inquiry-creates-anxiety-in-synthetic-fuel-industry.html>.

²⁶ <http://www.washingtonpost.com/wp-dyn/content/article/2009/03/27/AR2009032703116.html>.

²⁷ <http://www.taxanalysts.com/www/features.nsf/Features/2318FE19F7F9142685257CB50044D536?OpenDocument>.

²⁸

http://www.washingtonpost.com/business/economy/when-it-comes-to-the-paper-industry-and-fuel-tax-credits-irs-looks-like-a-soft-touch/2013/07/18/e1040fa8-bcdf-11e2-97d4-a479289a31f9_story.html.

²⁹ <http://www.washingtonpost.com/wp-dyn/content/article/2009/03/27/AR2009032703116.html>.

³⁰ Id.

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http://www.washingtonpost.com/business/economy/paper-industry-pushed-further-into-the-black-by-black-liquor-tax-credits/2011/04/19/AFdkrMtE_story.html.

³² See Footnote 28.

³³ Id.

liabilities to zero. Companies therefore could use a combination of the 2005 credit and CBC for maximum benefit, i.e., CBC to reduce a tax liability to zero and the 2005 credit to receive a refund.

Grandson of Black Liquor: IRS executives extended the black liquor giveaway a third generation by deeming what is an otherwise taxable 2005 refund credit, as nontaxable to the paper industry.³⁴ A farmer who received a refund check for the 2005 credit, must then report the refund as taxable income and pay tax on it, but not so for the corporations.³⁵ IRS attorney Bill Henck questioned the Service's disparate treatment of taxpayers, i.e., if you are a farmer you pay the tax, but if you're a corporate client with inside access to the IRS, you do not.³⁶ A corporate executive of a paper company directed Mr. Henck to contact a high level IRS Chief Counsel executive.³⁷ Mr. Henck requested that the IRS put its disparate treatment of taxpayers into writing, "because the exam team was being asked to take a position that was contrary to the law and to published IRS guidance."³⁸ The IRS executive stated that an order came from "the Chief Counsel level" that nothing be put into writing.³⁹ Industry-wide, black liquor may have cost taxpayers upwards of \$25 billion.⁴⁰

I ask that your offices request that the Senate and House hold hearings and conduct a serious and thorough audit of the IRS. As IRS Commissioner Koskinen recently stated, "Average taxpayers who play by the rules must be confident that corporations and wealthy individuals cannot avoid paying their fair share of tax through the creation and use of complicated financial structures that exploit the tax law."⁴¹ Indeed, this is not a partisan issue, but a 99% versus 1% issue, in which the IRS seems to be placing 99% of American taxpayers on a grossly uneven playing field.

Respectfully, Jane J. Kim

CC: Senators Elizabeth Warren, Bernie Sanders, Charles Grassley, Mike Lee, Rand Paul, and Ted Cruz;
Congressional members Maxine Waters, Alan Grayson; and
Jason Foster (Chief Investigative Counsel, Committee on the Judiciary, U.S. Senate)

³⁴ Id.

³⁵ Id.

³⁶ Id.; Footnote 27; <http://www.powerlineblog.com/archives/2014/02/bill-henck-inside-the-irs.php>; <http://www.powerlineblog.com/archives/2014/05/bill-henck-inside-the-irs-part-2.php>.

³⁷ Id.

³⁸ Id.

³⁹ Id.

⁴⁰ See Footnote 27.

⁴¹ See Footnote 16.