

Tax and Corporate Whistleblower Protections

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1. Introduction

I have appeared at previous Parliamentary inquiries including the Senate Select Committee on Public Interest Whistleblowing (1994), the Senate Select Committee on Unresolved Whistleblower Cases (1995) and the House Committee on Legal and Constitutional Affairs Inquiry into Whistleblowing Protections within the Australian Government Public Sector (2008). My papers related to whistleblowing include Lincoln's Law: An Analysis of an Australian False Claims Act², The Necessary Illegitimacy of the Whistleblower (with J. Johnson and M. Holub)³, The Independent Regulator⁴ and The Partnership Called Whistleblowing⁵.

I have read the discussion paper Review of Tax and Corporate Whistleblower Protections in Australia. In the closing section of this submission I address some of the questions in that paper. Principally this submission supports an Australian False Claims Act. I have advocated for such an Act since 1996 in academic writings and conferences, in newspapers and the electronic media, and in submissions to Parliamentary inquiries. This review is an opportunity to introduce an act which harmonises whistleblowing in the public and private sectors. The principle is simple. *Any knowingly false claim on the Commonwealth will be subject to the False Claims Act.* A False Claims Act is long overdue. If it had been implemented in 1996, it would have saved this country billions of dollars, and deterred billions of dollars more of fraudulent claims. The False Claims Act is the most effective whistleblowing legislation in the world because

- (i) It is simple.
- (ii) It formalises the partnership of the government and whistleblowers.
- (iii) It incentivizes whistleblowing.
- (iv) It deters fraud.
- (v) It is cost effective.

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² https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1923412

³ Business & Professional Ethics Journal, Vol. 29, No. 1/4 (2010), pp. 85-107.

⁴ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2711537

⁵ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2437407

2. Principles of Whistleblowing Legislation

The importance of whistleblowing is recognised in many studies. Dyck, Morse and Zingales (2007)⁶ conducted a study of all reported cases of US corporate fraud between 1996 and 2004. They found that only 6% of the frauds were revealed by the Securities Exchange Commission and 14% by auditors. The media (14%) and industry regulators (16%) were more important regulators, but the most important regulators were the employees (19%).

Whistleblowers are independent regulators, but the regulatory market is so inefficient that it has not been able to compensate them for the risks incurred. Whistleblowing results in benefits to governments but there has been no cost-benefit analysis of whistleblowing. Rather, the approach has been to establish a patchwork quilt of legislation designed to protect whistleblowers when they can never be so protected. To protect whistleblowers requires recognition of the benefits of whistleblowing, of the risks of whistleblowing and of the need to compensate them for those risks. To protect whistleblowers requires a market-based approach which formalises the private-public partnership between whistleblowers and the government.

A study by Vaughn, Devine, and Henderson (2003)⁷ attempted to answer the question *What is an Ideal Whistleblowing Law?* They emphasised seven principles

- (i) Focus on the information disclosed, not the informant
- (ii) Relate the law to freedom of expression laws
- (iii) Permit disclosure to different agencies in different forms
- (iv) Include compensation or incentives for disclosure
- (v) Protect any disclosure, whether internal or external, whether by citizen or employee
- (vi) Involve whistleblowers in the process of the evaluation of their disclosure
- (vii) Have standards of disclosure.

These principles are the principles of experienced whistleblowing advocates. They provide a standard against which whistleblowing laws should be benchmarked.

⁶ Dyck, A., Morse, A. and L. Zingales (2007) "Who Blows the Whistle on Corporate Fraud?" *University of Chicago CRSP Working Paper No. 618*.

⁷ Vaughn, R., Devine, T. and K. Henderson: 2003, 'The Whistleblower Statute Prepared for the Organization of American States and the Global Legal Revolution Protecting Whistleblowers', *The George Washington International Law Review* 35(4), 857-902.

The principles which underscore this submission are

2.1 Simplicity

Whistleblowing legislation must be simple. Simplicity makes disclosures more efficient.

2.2 Uniformity

Whistleblowing legislation should be uniform across jurisdictions. Uniformity is important because a given whistleblowing case will often overlap different jurisdictions.

2.3 Information not the Informant

It is the information that matters, not the informant. Standards of disclosure should always emphasise the materiality of the information disclosed, not the motivation of the informant.

2.4 Transparency

Whistleblowing cases need to be regulated as transparently as possible. Rather than seal whistleblowing cases, it is better for the cases to be used as the precedents for the future.

2.5 Compensation

Whistleblowers must be compensated for the risks incurred. Every other market compensates for risk; it should be the same for whistleblowing. Whistleblowers should be compensated but not over-compensated. The level of compensation is important so as to incentivise whistleblowing without encouraging bounty hunting.⁸ There are currently no incentives for Australian whistleblowers.

2.6 Competitive Regulation

A common refrain of whistleblowers is that regulators lack independence. The regulatory model should be a competitive model so that regulators are regulated by competition. The implication is that whistleblowers should be able to disclose to more than one regulator.

2.7 Legislation is not enough

Legislation acts as a deterrent but, without a prosecution, it is legislation in name only. Real legislation requires prosecutions for retaliation against whistleblowers. Without prosecutions, no whistleblower is protected.

⁸ The US False Claims Act was amended in 1986 precisely because the incentives were too low.

3 An Australian False Claims Act⁹

Australia needs a stand-alone whistleblowing law. Globally, the most powerful whistleblowing law is the US False Claims Act (FCA). It should be adopted here. The FCA was enacted in 1863 to enable individuals to litigate on behalf of the government to prosecute fraudulent claims against the government. The individuals who litigate are whistleblowers who provide the information necessary to prosecute; the FCA is a whistleblowing act which prosecutes fraud and compensates whistleblowers. The FCA allows individuals to take the risk of prosecuting those who make false claims against the government and to be compensated for that risk. The history of the FCA has shown that as individuals are compensated more, so more fraudulent claims are prosecuted. Incentives have been shown to work. After a century and a half of history, the FCA is now regarded as the most effective legislation for combating fraud on the US government.

The FCA is a public-private partnership between the government and whistleblowers. For the government, the partnership with whistleblowers confers the following benefits

- (1) The most important tangible benefit of the FCA is the recovery of fraud against the government. Since the FCA was amended in 1986, qui tam actions have accounted for two-thirds of US government fraud recovered. Qui tam actions are increasingly important. By 1991, they amounted to 13.5% of all fraud recoveries, by 1996 for 33% of all recoveries, and in 2014-6 for 80% of all recoveries.
- (2) The FCA also confers a substantial intangible benefit as a deterrent against fraud. The value of this deterrence is difficult to estimate. One estimate commissioned by the Taxpayers Against Fraud Center in Washington is that the FCA Amendments of 1986 have deterred more than a hundred billion dollars of fraud.
- (3) The FCA is a cost efficient mechanism for recovering fraud. In the health sector, for example, the US government is estimated to be recovering \$15 for every \$1 invested in FCA investigations and prosecutions.
- (4) The FCA encourages better contract design and contract compliance. Written into government contracts is the stipulation that the contract is subject to the provisions of the False Claims Act which represents a strong deterrent to contract violations. It can also be written into the tax code.
- (5) The existence of precedent qui tam cases allows for better determination of future qui tam cases, and for better design of future contracts. And qui tam cases provide for greater transparency in the recovery of fraud than aggregate statistics.

⁹ Much of this section is extracted from my paper Lincoln's Law: An Analysis of an Australian False Claims Act.

For whistleblowers, the partnership with the government confers the following benefits

- (1) A qui tam plaintiff is provided specific whistleblower protection against any form of discrimination in the terms of their employment, including restitution to their previous employment status, compensation for any damages resulting from the discrimination and any litigation costs.
- (2) As a civil law statute, the FCA operates under the lowered evidence standard of preponderance of evidence. This is important because financial arrangements and intermediate transactions often render proof of guilt beyond reasonable doubt an onerous burden. The probability of a successful action is increased by the civil statute. There is a provision for criminal actions in Section 287 of the US FCA, but it is used relatively little in comparison.
- (3) Qui tam actions reverse the onus of proof. The plaintiff is the Department of Justice (DOJ) or the whistleblower, the defendant the false claimant.
- (4) When the DOJ intervenes, whistleblowers' litigations costs are met by the government. This lowers the litigation risk for the whistleblower. For whistleblowers, litigation risk is one of the most important factors determining whether they blow the whistle.
- (5) The whistleblower is guaranteed a share of the government's recovery of fraud in a successful prosecution. Payments to qui tam plaintiffs average more than 16% of the proceeds of the actions.
- (6) The FCA integrates fraud recovery and whistleblowing. The benefits conferred by whistleblowing become observable. It may be argued that the incentives are too high. But it is hard to argue that \$40 billion of fraud recovery does not underline the value of whistleblowers. The enhancement of the role of whistleblowers is one of the most important consequences of the FCA.

A False Claims Act should be introduced into Australia as the signature whistleblowing act. Analogous to the US we define claim, false claim, protected disclosure and possible incentives.

Claim

A claim refers to any request or demand, whether under a contract or otherwise, for money or property which is made to the contractor, taxpayer or otherwise, where the Commonwealth provides any portion of the money or property requested or demanded. The definition of a claim can be generalised to allow for a tax obligation.

False Claim

A False Claim refers to any claim on the Commonwealth which is knowingly false, meaning

- (i) Knowingly failing to fulfil a tax obligation to the Commonwealth;
- (ii) Knowingly failing to comply with a contractual obligation;
- (iii) Knowingly overcharging;
- (iv) Failure to exercise due diligence.

Knowingly is defined to mean that a person, with respect to information

- (i) Has actual knowledge of the information;
- (ii) Acts in deliberate ignorance of the truth or falsity of the information; or
- (iii) Acts in reckless disregard of the truth or falsity of the information.

Protected Disclosures

Protected disclosures should include, but not be limited to, serious matters related to

- Illegal activity
- Wastage of public funds
- False claims
- Tax obligations
- Risk to health, safety and the environment
- Retaliation against those who make public disclosures

Who Can Make Disclosures?

All Australian residents, and all who contract with or have contracted with the Commonwealth, regardless of residency, are entitled to make a protected disclosure.

Incentives

An Australian False Claims Act should follow the US model, so that a complainant can file in camera to a court and submit a written disclosure of their information to an integrity agency. The integrity agency must investigate the complaint which remains under seal for a prescribed minimum period. The integrity agency can request an extension of the period. An example of an incentive structure is given below

- (1) If the integrity agency intervenes and the action is successful, the whistleblower is entitled to between 10 and 15 percent of the proceeds of the action or settlement of the claim. If the action is unsuccessful, the whistleblower is not liable for litigation costs.
- (2) If the integrity agency declines to intervene, the whistleblower may pursue the action on behalf of the government and, if successful, is entitled to between 15 and 20 percent of the proceeds of the action or settlement of the claim. If the action is unsuccessful, the whistleblower is liable for litigation costs.
- (3) The integrity agency may move to dismiss the action either because there is no case or the case conflicts with statutory or policy interests of the Commonwealth.

In a successful action, whether the integrity agency intervenes or not, the defendant is liable for the damages incurred by the Commonwealth and a maximum fine for each fraudulent claim. The protection of whistleblowers should be analogous to that provided by the US False Claims Act. Any employee who is discriminated against in the terms and conditions of employment by their employer because of a *False Claims* action shall be entitled to all relief necessary to make the employee whole, including reinstatement with the same seniority status, back pay, and compensation for any special damages sustained.

4 Analysis of an Australian False Claims Act

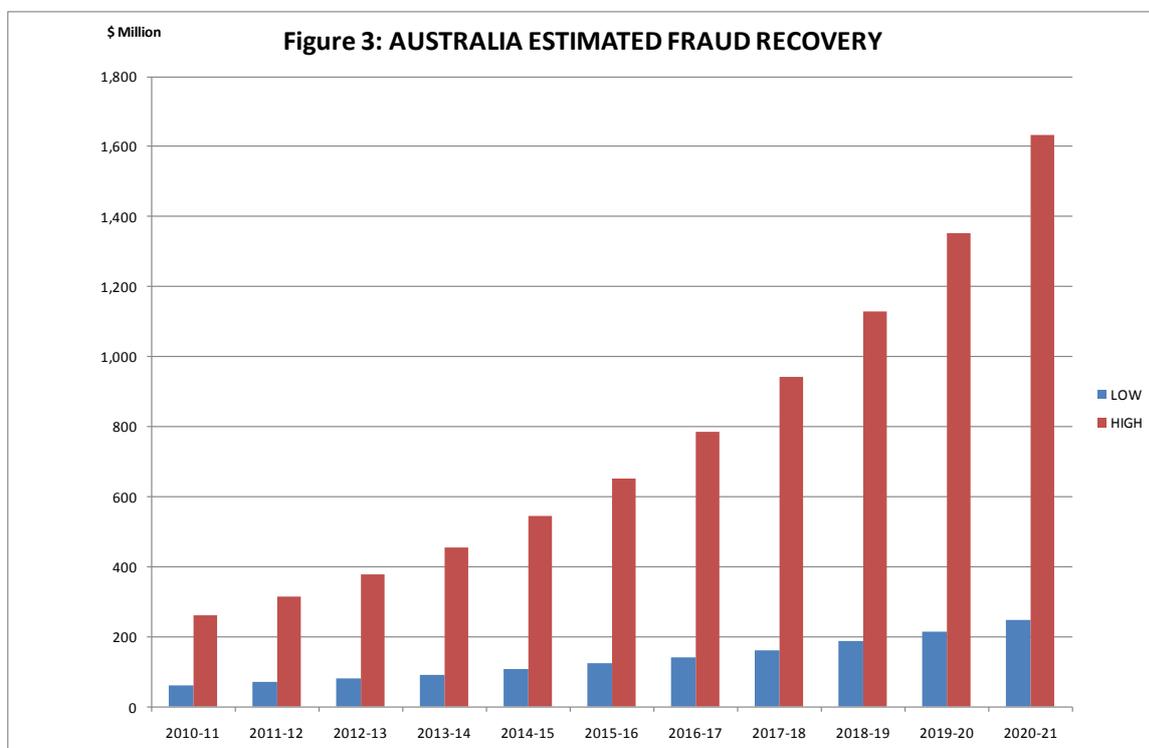
In 2011 in my paper *Lincoln's Law: An Analysis of an Australian False Claims Act*, I constructed an estimate of the likely effects of an Australian FCA from 2010-11 until 2020-21. Perforce, this analysis does not reference tax liabilities but it could be extended to an analysis of those liabilities. The FCA has two effects on fraud

- (1) A direct effect in terms of fraud recovery
- (2) An indirect effect in terms of the deterrence of fraud.

In order to estimate direct effects, assumptions were required as to

- (1) An estimate of the value of false claims on Commonwealth outlays in 2010-11.
- (2) An estimate of the growth rate in the value of False claims from 2010-11 to 2020-21.
- (3) The base recovery rate using a FCA.
- (4) The growth rate in recoveries.

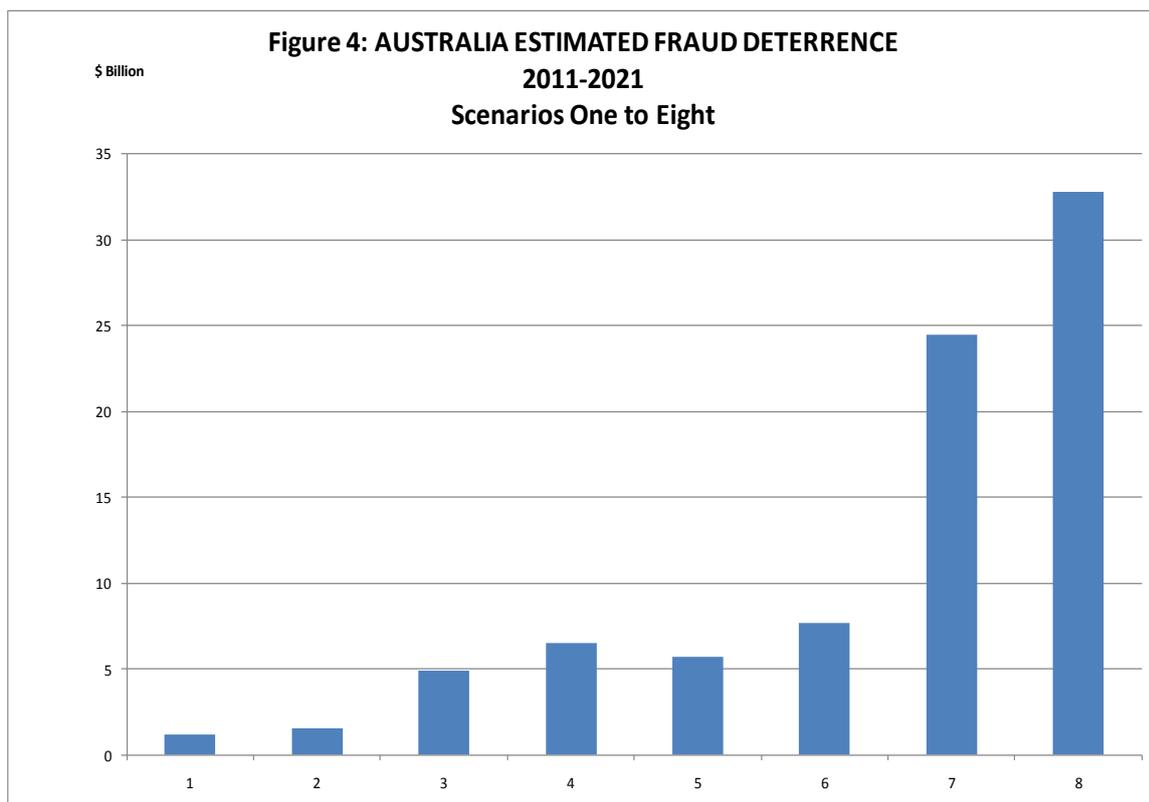
The value of false claims in 2010-11 was estimated from Commonwealth outlays of \$352 billion. In the US, a typical assumption for the percentage of false claims ranges from 1 percent to 10 percent.¹⁰ Surveys of international fraud find that large corporations are typically exposed to a fraud risk of 5 percent on revenues. As a consequence, two possibilities are considered for the base estimate of fraud in 2010-11, namely 1 percent of Commonwealth outlays and 5 percent of Commonwealth outlays. A conservative assumption of a 3 percent annual growth rate in fraud is used for the period 2010-11 to 2020-21. This is below most estimates, but is sufficient to illustrate the direct effects. For the base recovery rate, two assumptions are used; 0.35% in the base year which is consistent with the recovery rate in the first three years of the US FCA after the amendments and 1.5% which is the recovery rate in the second decade US FCA after the amendments. Finally the growth rate in recoveries is assumed to have two values, 15% and 20% which are consistent with the growth rate in US recoveries from 1986 to 2010. These four sets of assumptions generate eight scenarios for fraud recovery from 2010-11 to 2020-21. The lowest recovery scenario corresponds to fraud amounting to 1% of Commonwealth outlays, a base rate of recovery of 0.35%, and a growth rate in recoveries of 15%. The highest recovery scenario corresponds to fraud amounting to 5% of Commonwealth outlays, a base rate of recovery of 1.5%, and a growth rate in recoveries of 20%. The recovery of fraud from these low and high scenarios is presented in the Figure below.



¹⁰ This is the assumption that the DOJ originally used in testifying to the House Appropriations Subcommittee in 1980.

Under these assumptions, cumulative fraud recovery over the decade ranges from a low estimate of \$300 million to a high of \$8.5 billion. The cumulative recovery exceeds \$1 billion in six of the eight scenarios and, given the US experience, this would appear to be a reasonable expectation for the fraud recovered.

To estimate the deterrent effect, we employ a model proposed by Stringer¹¹ with the same assumptions as used by Stringer. The estimated deterrent effects for the eight scenarios of fraud recovery are presented in Figure 4.



Under these assumptions, cumulative deterrence of fraud over the decade ranges from a low estimate of \$1 billion to a high exceeding \$30 billion. The unobservable deterrent effects of an FCA are substantially higher than the observed recoveries of fraud. The FCA deters fraudulent claims because of the risk of being observed; and this applies equally to a tax liability as to a claim associated with a contract.

The FCA increases the risk of non-compliance and reduces the risk for whistleblowers. It underwrites a culture of compliance.

¹¹ W. Stringer (1996) *The 1986 False Claims Act Amendments: An Assessment of Economic Impact, An Economic Study Commissioned by Taxpayers Against Fraud, The False Claims Act Legal Center.*

5 Questions in the Discussion Paper

Questions 1-3

Whistleblowers should not be categorised; it is the information not the informant that matters.

Question 4

Disclosures should apply to all the matters listed on p.6.

Question 5

The motivation of the informant is irrelevant.

Question 6

Whistleblowers should be able to disclose to more than one agency.

Questions 10-14

The third party issue is too complex to be addressed in a simple answer. Whistleblowers nearly always seek advice from third parties. They should not lose their protection provided they have followed due process in disclosing to the prescribed agencies.

Question 20

Some consideration must be given to a tort of victimisation in relation to retaliation.

Questions 21-25

Compensation and litigation costs should be addressed through a FCA.

Questions 26-28

It is compensation for risk; not a reward.

Question 29

Companies should be required to have an internal disclosure system.

Question 33

There should be an agency that is an advisory body on whistleblowing.

Questions 38 onwards

There should be uniformity between tax whistleblowing and other forms of whistleblowing.

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