

Testimony of Dean Zerbe

“Action Through Innovation: Private Sector Solutions to Recouping Stolen Pandemic Loan Funds”
Committee on Small Business, House of Representatives
September 27, 2023

Chairman Williams and Ranking Member Velazquez:

Thank you for the invitation to speak at today’s important hearing to explore ways that we can look to private sector solutions to assist in recouping stolen pandemic loan funds – in particular the SBA administered programs of Paycheck Protection Program (PPP) and Covid-19 Economic Injury Disaster Loan (EIDL).

I commend the Committee for wanting to explore new ways to address these concerns of lost taxpayer funds. My testimony will focus on a proven bipartisan way of helping the government uncover fraud and recover taxpayer funds – utilizing and incentivizing whistleblowers to come forward and identify fraud and assist the government in bringing actions against the bad actors.

As the Committee knows, the Small Business Administration (SBA) Inspector General (IG) has reported in its White Paper Report 23-09 “Covid-19 Pandemic EIDL and PPP Loan Fraud Landscape” dated June 27, 2023 (“White Paper”) that there has been extensive fraud in these programs. The IG’s findings of the loss of taxpayer dollars is supported by the GAO’s May 2023 report: “Covid Relief: Fraud Schemes and Indicators in SBA Pandemic Programs. The amount of fraud is certainly eye-blinking – and the Committee is right to want to see if there are new tools that can be utilized in the fight to recover taxpayer funds.

Let me be clear though – I don't consider this a partisan exercise. The efforts to provide Covid relief to small businesses was certainly a well-meaning bipartisan effort. The difficulties of trying to balance the need to quickly move out relief funds and protection of funds were significant – and a challenge to the previous administration and the current administration. It is right, that we look to solutions in a bipartisan manner as well.

Finally, I would note that this problem of significant covid-related fraud is not limited to the SBA. In my work as national managing director of alliantgroup – a nationwide tax services firm – we are helping clients to get right with the IRS and the employee retention credit (ERC). ERC is another covid-related relief program that has unfortunately been subject to a host of pop-up shops hawking snake oil. Our work at alliantgroup, involves either making sure their application for ERC meets all the bells and whistles – and now more and more helping folks clean up inaccurate or incomplete filings made to the IRS because they listened to the siren songs of promoters and filed highly questionable tax refund claims. In short, the problems facing SBA are not unique.

Whistleblower Programs – Tradition of Bipartisan Support

Happily, the solution I discuss today – encouraging and incentivizing whistleblowers – has a long and distinguished bipartisan and bicameral tradition. My former boss Senator Charles Grassley (R-IA) worked hand-in-hand with former Congressman Howard Berman (D-CA) in the 1980s to pass the modernization of the False Claims Act – the grandfather of the whistleblower award programs that has saved taxpayers over \$70 billion dollars.

When I served as senior counsel and tax counsel for the Senate Finance Committee, I was the lead staffer for then-Chairman Grassley to pass the 2006 amendments that modernized the IRS whistleblower statute – that has brought in over \$6 billion dollars (a number I believe is markedly underestimated). We worked very closely with then-Ranking Member Baucus (D-MT) and his staff on passing these important reforms for the IRS whistleblower program.

Similarly, the SEC and CFTC whistleblower award programs – modeled after the IRS program – all enjoyed bipartisan support.

More recently, Congresswoman Alma Adams (D-NC) and Congressman Anthony Gonzalez (R-OH) successfully sponsored the Anti Money Laundering (AML) Whistleblower Program HR 7195 – which has provided much-needed reform of that whistleblower program.

Bipartisan support for whistleblower award programs has a long tradition – and my hope would be that the Committee would continue that good tradition as it considers similar legislation to create a whistleblower award program for the SBA.

The Benefits of Encouraging Whistleblowers to Come Forward

The GAO report on fraud and the SBA covid-relief programs made the clear point: “Fraud is challenging to detect because of its deceptive nature.” (p. 12). That is exactly right – the mischief makers and fraudsters are purposefully hiding and [reward laws](#) are key to exposing them.

The National Whistleblower Center (NWC) -- where I serve as a voluntary senior policy advisor -- has done a first-rate job of [highlighting](#) major studies showing that whistleblowers are

vital in uncovering and discovering fraud. The NWC highlighted studies include: a 2007 [study](#) by PricewaterhouseCoopers “*Economic Crime: people, culture and controls*” found that professional auditors only detected 19% of fraudulent activities at private corporations, while whistleblowers detected and exposed 43%.

A 2006 [study](#) from the University of Chicago Booth School of Business, “*Who Blows the Whistle on Corporate Fraud?*” found that employees “clearly have the best access to information. Few, if any, fraud can be committed without the knowledge and often the support of several of them. Some might be accomplices . . .but most are not.”

As another NWC paper notes -- the use of [reward laws](#) (see National Whistleblower Center: *Importance of Awards*) has been vital in terms of encouraging whistleblowers to come forward – whistleblowers who are often putting much at risk in terms of career and family – and in some cases may face physical threats for doing so. Rewards have been [shown](#) to be extremely effective in generating high quality information about fraud that leads to successful prosecutions. (Steve Kohn Executive Director National Whistleblower Center – Testimony December 1, 2016 Before Oversight and Government Reform).

From my own work in tax, I’ve seen first-hand that the IRS whistleblower award program has been critical in assisting the IRS in dealing with the most difficult areas of tax fraud— especially undeclared overseas accounts by the wealthiest individuals. As I noted in a 2021 Tax Notes [article](#), “*Shrink the Tax Gap by Strengthening the IRS Whistleblower Program*” -- a National Bureau of Economic Research (NBER) [paper](#) “*Tax Evasion at the Top of the Income Distribution: Theory and Evidence*” – found that the IRS in expansive individual audits the IRS

was able to uncover undeclared offshore accounts only 7 percent of the time (and these were highly invasive audits

So what did work for the IRS in finding undeclared accounts offshore? Whistleblowers. An academic [paper](#) “*Taxing Hidden Wealth: The Consequences of US Enforcement Initiatives on Evasive Foreign Accounts*” (p. 316) – discusses the pivotal role of my client, Bradley Birkenfeld – the UBS whistleblower as breaking open secret Swiss banking. Thanks to Brad coming forward – the U.S. government has recovered billions of dollars from wealthy Americans evading taxes with secret offshore accounts.

Finally, in addition, to the studies and analysis supporting the importance of whistleblowers and incentivizing whistleblowers – the numbers themselves speak volumes. I already spoke of the \$70 billion from the False Claims Act and \$6 billion from the IRS whistleblower program – but also over \$6 billion from the SEC whistleblower program; in 2022 alone the CFTC whistleblower program brought in over \$2.2 billion in restitution orders. Clearly, the whistleblower incentives programs are working – identifying fraud that would otherwise go undetected – and as discussed further below – enabling and assisting the work of government.

Deterrent Impact

In addition to helping recover funds, it shouldn’t be overlooked how much incentivizing whistleblowers also serves as a significant deterrent effect on fraudsters. In a 2014 Villanova Law Review [article](#), law professor Dennis Ventry (and one-time Chairman of the IRS Advisory Council) -- “*Not Just Whistling Dixie: The Case for Tax Whistleblowers in the States*” – states:

“Whistleblowers can do more than just uncover and report knowing violations of the law. They can also prevent noncompliance from happening in the first place. An effective whistleblower program . . . would add significant risk to noncompliance by increasing the probability of detection and the likelihood of potential penalties, the two most important variables in traditional tax deterrence models.”

I have seen this in my own work in tax compliance – where fraudsters are having to calculate not only can they get their snake oil by the IRS – but can they trust everyone involved – the bankers, the secretaries, etc. Similarly, the False Claims Act has had a marked impact in deterring fraud in health care and defense spending (yes, still a ways to go). These industries are well aware of the high risk they face of being exposed for fraud – thanks to whistleblowers. A whistleblower incentive program can not only recover funds – but also serve to put a dampener on future fraud.

Why A Whistleblower Award Program Makes Sense For SBA

Does a whistleblower award program make sense for SBA? Yes. Given the overwhelming amount of fraud and the reality of limited government resources –incentivizing whistleblowers will be an important addition. In short, harnessing the private sector to assist the SBA in its work of recovering taxpayer funds provides an important new tool in combatting fraud.

It is fair to ask whether an SBA whistleblower award program is necessary when whistleblowers can (and have) utilized the False Claims Act (qui tam) to identify and go after

fraud in the SBA covid-relief program. While there has been some use of the False Claims Act to go after PPP fraud in particular – the number of filings has been limited in relation to the amount of fraud. I would note though that those filings have seen success in recovering funds for the taxpayer.

In discussions with practitioners – I believe the limited amount of False Claims Act filings has been due to the fact that the amount of fraud in each individual case is smaller and the potential recovery by the whistleblower is overtaken by the significant costs, time and expense involved in bringing a False Claims Act case. In addition, the proof required in a False Claims Act case, as well as the possibility of the whistleblower being identified all serve to discourage bringing a False Claims Act.

Allowing for both avenues – for a whistleblower to go to the SBA directly or to bring a False Claims Act – is beneficial, giving whistleblowers a choice.

I would underscore that the great benefit of a whistleblower award program is to help the SBA perform its work more effectively and efficiently – and better target the worst actors – saving significant government resources.

In an excellent [speech](#) by Andrew Ceresney, Director, Division of Enforcement at the SEC discusses the benefits of the SEC whistleblower program – particularly in terms of fraud: “These [whistleblower] investigations typically involve misconduct that is hard to spot and are typically very document-intensive, involving sophisticated defense counsel. Whistleblowers – particularly company insiders – are able to provide us with a roadmap of the potential

misconduct that can save us months of sifting through documents and complex accounting records. They can also give us a description of the types of documents to request and the types of analyses to conduct.”

Similarly, the Treasury Inspector General for Tax Administration (TIGTA) in a 2006 study found (even under the less robust pre-2006 IRS discretionary award program) that “the cost/benefit ratio of the [whistleblower] Program compared favorably with other IRS enforcement programs.” The report found that the IRS incurred slightly more than 4 cents in costs for each dollar collected from the whistleblower program, compared to a cost of greater than 10 cents per dollar for all enforcement programs.

Further, the TIGTA report found that “examinations initiated based on informant information had a higher dollar yield per hour and a lower no-change rate when compared to returns selected using the IRS’ primary method of selecting returns, the Discriminant Index Function [DIF].” The whistleblower-based examinations were found to bring in \$946 per hour as opposed to DIF-selected returns that brought in only \$548 per hour. Similarly, the no-change rate was only 12 percent for the whistleblower-based audit, while it was 17 percent for DIF-selected audits – finally TIGTA found that whistleblower-based cases brought in \$688 per hour compared to \$382 per hour for DIF cases.

Most importantly, there was a markedly lower no-change rate for whistleblower-based cases as opposed to DIF cases – meaning that whistleblower selected cases were better at focusing limited IRS resources on the worst actors – and leaving honest taxpayers alone.

In sum, whistleblower award programs are the great friend to honest taxpayers – first, in recovering taxpayer dollars and second, better targeting government enforcement efforts on those individuals seeking to engage in fraud and evasion.

All this speaks to the fact that bringing whistleblowers in to the work of the SBA will help stretch and extend limited existing SBA staff resources – and better focus those resources to be more effective.

SBA IG Embraces Whistleblowers

A key reason that I think a whistleblower program would be a success at the SBA is that the SBA IG, to its credit, already has a good culture when it comes to working with whistleblowers. I was very taken by the strong number of phone calls that the SBA IG in its white paper stated that it has received from whistleblowers already on its hotline – and the number of those whistleblower calls that have led to enforcement action.

The SBA IG white paper highlights that SBA OIG received more than 250,000 calls on its hotline – and that it lead to 90,000 actionable leads. The white paper highlights one case that started out from a hotline complaint as a \$500,000 Covid EIDL and PPP fraud involving: “three suspects led us to trace the movement of funds among several co-conspirators’. This ultimately revealed a sprawling conspiracy involving over 1300 non-existent business and up to \$140 million in potential fraud. Our data analytics team indicates this one case could further reveal about \$625 million in potential fraud.” One whistleblower. One case.

Some might say – “well why do an award program – they are coming in already.” The reason is that you want more of these high quality cases (many more) and more importantly – by providing an award you are encouraging whistleblowers (who commonly then can bring in counsel – who help improve their filing to be more responsive to the agency’s needs and requirements and who also serve essentially as a screener for the agency) to provide a much more robust and detailed filing with the agency.

By bringing in a whistleblower award program that is mandatory – the IRS program changed overnight from being commonly disgruntled prisoners and unhappy former spouses – to senior tax advisors at Fortune 500 companies and bank officers – informed, knowledgeable, insiders – with detailed information and documents. Most importantly – with a whistleblower incentive program you are encouraging whistleblowers and their advisors to spend the necessary time, cost and energy to make a strong filing that is of immediate use to the agency (documents, suggested information/discovery requests, names of additional people to contact, client lists, etc.). The goal of a good whistleblower filing is to – as much as possible – put the fraud on a t-ball for the agency to hit.

Mr. Chairman, as I’m sure you know, the benefits of incentivizing people through a commission or a reward if they meet success is a powerful motivator for hard work and going the extra mile. True for a salesman. True for a whistleblower.

Having a whistleblower incentive program will build on the good foundation of the SBA IG – by encouraging knowledgeable, informed whistleblowers (particularly insiders) to come

forward and for them to file detailed submissions – and as important for the whistleblowers and their advisors to work hand-in-hand with the SBA IG (as needed) going forward.

The SBA IG has a welcoming attitude to whistleblowers – and a culture of openness to whistleblowers. That gives me good confidence of the success of a whistleblower award program at SBA.

The Blueprint For A Good Whistleblower Incentives Bill

As I mentioned in my biography, I was the counsel for the Senate Finance Committee responsible for drafting the IRS whistleblower award program that became law in 2006 – essentially updating, modernizing a whistleblower award program that had been in place since 1867. The 2006 legislation was based largely on the False Claims Act (and the experience of that legislation in practice) – and the IRS whistleblower law served as the model for the SEC, CFTC and other whistleblower award statutes.

What works? What do you need in statute for a whistleblower award program to be successful? A few key points – most of these, if not all are found in the IRS WB bill as well as SEC, CFTC and AML whistleblower bills:

- 1) Mandatory awards. The whistleblower is not only putting a lot of time, energy and effort into filing – they also may be putting career and livelihood at risk. The whistleblower needs to know that if the SBA uses their information, that the information is material to the government’s work and results in funds brought back to the government (or prevention of a payment that otherwise would have been made – protecting revenues) – that the whistleblower will receive an award. That award should

be a percentage (floor and ceiling – commonly 15 – 30%) of the amount returned to the government.

- 2) The payment of awards should come from proceeds collected thanks to the whistleblower – and should be available and dedicated for that purpose. In short, you want award payments to be a mandatory payment – not subject to appropriations.
- 3) Create an office at SBA dedicated to engaging with whistleblowers and managing the whistleblower program. Having it within the SBA IG is ideal – given that it will allow the office to work closely with those directly involved with the investigators. The office can also serve as a champion of whistleblowers – to ensure that good cases are being worked and that whistleblowers are being treated fairly and there is good communication with whistleblowers on the status of their submission. Allow the office to publicize awards. Nothing will get whistleblowers to come forward like hearing about other awards. Suggest imposing consideration of a timeline that awards must be made within one year of proceeds collected and rights to appeal by the target have ended.
- 4) Bad actors – limitations or denials for bad actors. It is well-known that many whistleblowers are not coming from choir practice on their way to the scouts meeting. You are getting (and want to encourage) angels with dirty faces. You want those that are in the room where it happened to blow the whistle. That said, limiting awards for those who planned *and* initiated bad actions and denying an award for those convicted of a crime for the actions they are blowing the whistle is a good balance.
- 5) Anonymity. While consideration for filing anonymous (but only if have representation – as the SEC does) but regardless, the whistleblower should be protected from his/her

name being disclosed through FOIA or discovery. SBA IG may already have in place such protections given their current active dealings with whistleblowers.

- 6) Allow for whistleblower to have an independent review. Trust but verify.

Whistleblowers will have much greater confidence in the fairness of the program if they are able to receive an independent, de novo review by an outside, separate entity – such as a federal district court. You do not want whistleblower awards to be at the whim of the agency. Independent review gives greater confidence and fairness to the entire whistleblower award program.

- 7) The proceeds that the government recovers thanks to the whistleblower should be broadly defined to cover all funds recovered (including in related actions) – civil, criminal, disgorgement, etc. The government has wide authority on how it wants to be paid back – how the government gets its money back shouldn't decide the size of the whistleblower's award. Similarly, a whistleblower's value is that their whistleblowing can directly lead to other cases and other recoveries – and the award should be based on the full value the whistleblower has provided.

- 8) Consider whistleblower protections from retaliation. The Congress recently added 7623(d) to the IRS whistleblower law – and this provides standard language against retaliation to whistleblowers.

- 9) Consider effective date. While commonly its date of enactment for these matters (information provided after date of enactment) – I would encourage given the desire to be aggressive in combatting fraud – look at having the effective date be today's hearing.

Don't have whistleblowers wait on the sidelines until the provision becomes law. We want them providing information now.

In discussions with Committee staff, I think they have a solid understanding of the framework for a good whistleblower bill and their draft will deserve the Committee's close consideration. I am happy to assist in any way or answer any questions in that good effort.

Conclusion

Mr. Chairman, Ranking Member – thank you for the time and courtesy of allowing me to testify today. I applaud you for considering a whistleblower incentive program as a critical tool to protect the taxpayer. I believe you are very much on the right path.