

Memo – Limiting Whistleblower Awards

Securities and Exchange Commission

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I am responding to the SEC announcement requesting comments on a proposal to cap “Whistleblower Awards” at \$30 million. I believe the example used was a fine of \$100 million that resulted in a Whistleblower award of \$30 million – resulting in a payout ratio of 30%. The SEC is considering capping these awards at \$30 million. I am suggesting that the SEC should review this proposal more closely to include the evitable tax impact on the Whistleblower. The SEC should be keen aware of just how much of the actual award reaches the whistleblowers’ pocket. The tax impact on Whistleblower’s Awards – at the margin – in excess of \$30 million in the current configuration of the program can be easily model on a simple spreadsheet. Obviously, tax considerations have a large impact on the funds received by Whistleblowers. Not surprisingly, the Whistleblower’s actual share is not 30 cents on the dollar as advertised. More importantly, the Federal Government’s share is not limited to 70 cents on the dollar as advertised in most publications.

What was not reported – but should be given consideration – the awards create a tax event of some significance by creating a number of stakeholders or beneficiaries – besides the Whistleblowers. This is especially true when one examines the awards in excess of \$30 million – at the margin – that are targeted in this proposal. The awards are subject to Federal & State taxes – taxed at the highest rates for ordinary income (37% - at the Federal Level & 13% in California). Consequently, the "effective combined tax rates" are well over 40% when state taxes are given consideration. In high tax states like California, New York, etc., the combine tax impact will be roughly 50%. I provided the table below to make the equation more intuitive on the portion of awards in excess of \$30 million.

	Beneficiaries Share	SEC Award	Share % SEC 30% Award
Federal Taxes	0.37	30%	0.11
California Taxes	0.13	30%	0.04
Total Tax Treatment	50%		0.15
Attorney Fees	33%		0.05
Total Expenses – Deducted from the SEC Award			-0.20
SEC Award			0.30
Whistleblower’s Share			0.10

Whistleblowers are frequently represented by attorneys which suggested that another 33-40% will never make it to the actual whistleblower's pocket – most attorneys require 35-40%. In most cases, even when the maximum award (30%) is provided, the whistleblower will receive roughly 10% or less of the award after all considerations are deducted. When state taxes are reduced, the savings are largely offset by the attorney’s cut which is a percentage.

It becomes readily apparent that The Federal Government is already taking back a sizable "chunk of change" of the awards due to the tax event. Therefore, the Federal Government's share – after taxes – is not 70%, but estimated at over 80% ($70\% + 11\% = 81\%$). The result is robust. The estimate for Federal Taxes does not change with variations in the assumptions found in the table. In most scenarios, the Federal Government is the largest beneficiary of the Whistleblower's award – even when the SEC awards are maximized at 30%.

The configuration in the table above is for California with attorney fees quoted conservatively at 33%. Using the table above – that quotes attorney fees at 33% – state taxes must fall below 7% before the Whistleblower's share becomes approximately the same as the Federal taxes. State taxes have to go down to 2.5% for the Whistleblower's share to become 12.1% - one percentage point higher the Federal Taxes. Federal Taxes are clear beneficiaries of these awards without having to cap the awards. Under the current configuration, we can easily estimate that the Federal Government's share of the fines is not 70% - but 81.1% after taxes. The Whistleblower's share is 10% or less in most scenarios when attorneys are involved. Without attorneys, the Whistleblower's share of the award in the table equates to the tax burden – 50% goes to taxes and 50% goes to the Whistleblower.

I hope this analysis is helpful – at least to the extent that the SEC should have consideration of the tax impact of these awards on Whistleblowers.

Sincerely,

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