

TAX REPORT

By TOM HERMAN



Tipster Rewards Require Patience

**Law Boosts Payouts
For IRS Informants
In Large Tax Cases**

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Blowing the whistle on big-time tax cheats could make some informants wealthy -- as long as they have hard evidence and plenty of patience.

Just over a year ago, President Bush signed legislation authorizing the Internal Revenue Service to pay sharply higher rewards to tipsters in cases involving large amounts of money. In some cases, the reward could be as high as 30% of whatever the IRS collects.

The idea behind the whistleblower law is simple: Congress hopes the lure of much bigger rewards will prompt more informants to offer better tips and help the IRS reduce the nation's \$290 billion tax gap, the difference between what the agency collects each year and what it thinks it should be collecting.

Since the law was enacted, the IRS has received some large tips -- including one from someone who alleges that one of the world's biggest companies underpaid its U.S. taxes by more than \$2 billion, including penalties and interest. That claim was filed just a few weeks ago on behalf of the informant by two Washington tax lawyers, Greg Lynam and Scott Knott, who have given up their regular jobs at well-known law firms in order to pursue major tax-whistleblower cases on a full-time basis at the Ferraro Law Firm, which has offices in Washington, D.C., and Miami.

Messrs. Lynam and Knott say they already have filed at least five other separate claims with the IRS. One alleges that "a Fortune 500 company" entered into a series of transactions to improperly slash its taxes by more than \$1 billion, including penalties and interest. The two lawyers say they are working on an additional half-dozen or so cases.

Messrs. Lynam and Knott tell clients not to expect speedy payouts since the IRS can't pay a reward until it actually collects and the case is officially over. Informants generally should expect "somewhere between four and seven years to get paid," says Mr. Knott. They won't identify any of their clients or the targets.

Separately, Bryan C. Skarlatos, a New York lawyer at Kostelanetz & Fink LLP, says he has filed eight claims on behalf of clients since early February. Most of those claims involve companies but some involve individuals, he says. One alleges that a publicly traded company underpaid its taxes by more than \$350 million over several years. He says he is evaluating two other claims to see whether they fit within the IRS guidelines and have sufficient documentation. "Tax cases are based on documents, and without the documents you don't have a case," he says.

So far, the IRS has received "a little over 80" reward claims under the new law, says Stephen Whitlock, director of the IRS's whistleblower office. About half of those have poured in during just the past 2½ months, he says. While there are "variations" in the quality of the claims, Mr. Whitlock says the agency is receiving "some very good claims with good support and very promising leads."

He declined to give details, but did offer thoughts on what makes a good or bad claim. "Bad claims are speculative -- not a lot of evidence," Mr. Whitlock says. A weak claim would involve someone who says he or she suspects that something bad happened but doesn't have any documentation. A good claim has "documentation of transactions, or good, solid paper trails," he says. If you are considering filing a claim under the new program, take a look at the IRS's recently issued guidance (IRS Notice 2008-4) at the Web site, irs.gov. As the notice points out, the new program is limited to very large cases.

Under the new procedure, the amount of award generally will be at least 15%, but not more than 30%, of the collected proceeds in cases in which the IRS decides the information submitted by the informant "substantially contributed" to collection of tax, the agency says. But the IRS can hand out smaller percentages in certain cases.

To be eligible for an award under the new program, the total amount of taxes, penalties, interest and additional amounts in dispute must exceed \$2 million. And if the "allegedly noncompliant person" is an individual, that person's gross income must exceed \$200,000 for any taxable year at issue in a claim, according to the IRS notice. Fill out Form 211, which also is available on the IRS Web site. Any claims must be submitted as a statement under penalty of perjury.

If you aren't eligible to file under the new law, you may still be eligible for a reward under an old program, where rewards typically can't exceed 15% of the amount recovered. The ceiling on rewards has generally been \$10 million in recent years, but the ceiling and percentage may be increased under a special agreement. According to IRS data, fewer than 8% of the nearly 265,000 claims filed since the late 1960s under the old program have resulted in a reward.

BEWARE OF making "frivolous" arguments, the IRS says.

Despite repeated warnings over the years from the IRS and courts, some people continue to espouse such theories as "paying taxes somehow is voluntary," or "only foreign-source income is taxable." That's a great way to attract the IRS's attention.

The IRS recently released an updated report with responses to some of the more common "frivolous" legal arguments by individuals and groups who oppose compliance with federal tax laws. The summary (www.irs.gov) is called "The Truth About Frivolous Tax Arguments."

Penalties for making these kinds of arguments can be stiff. A 2006 law raised the frivolity penalty to \$5,000 from \$500. Tax Court judges sometimes impose penalties of as much as \$25,000.

"Taxpayers should be careful in making frivolous arguments since courts have routinely rejected them," says IRS Chief Counsel Donald L. Korb.

THE IRS shoots down a tax strategy.

More than four years ago, this column raised a question that several readers had asked about a possible way to dodge the so-called wash-sale rule. A wash sale typically happens when you sell a stock or some other security at a loss and buy the same thing, or something substantially identical, within 30 days. (That means 30 days before or after the sale.) If you violate the rule, you can't deduct the loss. Instead, you add the disallowed loss to the cost of the new securities.

But suppose you sell a stock at a loss in your regular brokerage account. Can you immediately repurchase that same stock in your individual retirement account without running afoul of the wash-sale rule?

Several years ago, some accountants said such a move would violate the rule, but others weren't sure. After considering the subject at length back in 2003, a Treasury Department official declined to comment.

But in a recent ruling, the IRS said buying the same security for an IRA or a Roth IRA within the specified period would indeed violate the wash-sale rule. Moreover, the agency said, you couldn't add the disallowed loss to the cost of the IRA.

"It seems a safe bet to predict that this strategy will no longer be high on the list of those year-end strategies that advisers will be dispensing to their clients and prospective clients," says Robert Willens, a tax and accounting analyst at Lehman Brothers.

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