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Collection: IRS Doubles Whistleblower Collections In 2010 While Tipsters Wait for Payouts

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Tax Collection

IRS Doubles Whistleblower Collections In 2010 While Tipsters Wait for Payouts

The Internal Revenue Service collected \$464.6 million as a result of whistleblower claims in fiscal year 2010, more than twice what it collected in 2009, although whistleblowers received only \$18.7 million in awards, the annual whistleblower report to Congress revealed.

Whistleblower attorneys told BNA July 20 that the increase in amounts collected shows that the program is working, but that it is taking too long for claims to be paid out.

In 2009, the IRS collected \$206 million from tips on tax evaders and paid \$5.8 million in awards. However, that year the IRS changed its policy on the definition of the point at which proceeds in a tax case are available to be made for an award. This resulted in lower payments, the service said.

New Policy Delays Payout

The Office of Chief Counsel at IRS determined that it should not pay claims even when the taxpayer has not filed an appeal until the period for filing an appeal has lapsed. Therefore, the service did not pay some claims that it would otherwise have paid in fiscal year 2009 until FY 2010 or FY 2011, the report said.

While the amounts IRS collected between FY 2008 and FY 2009 stayed about the same, \$155.9 million and \$206 million respectively, the amounts awarded to whistleblowers in FY 2009 dropped significantly, from \$22.3 million to \$5.8 million.

"IRS said we are no longer going to issue award determinations until both the [tax code Section] 6501 and [Section]6511 period of limitations are closed, and because of that you saw a huge dip in the FY 2009 award determinations," Scott Knott, a tax partner at the Ferraro Law Firm in Washington, said.

The IRS collected the money in 2009, but made whistleblowers wait until the period of limitations on refunds had closed before they paid an award. "They have added up to two years to the time it takes for the case to pay out," he said. According to Knott, the policy should be changed back to what it was prior to July 2009.

FY 2010 Claims

In FY 2010, the IRS received 431 whistleblower submissions relating to 5,429 taxpayers that appeared to meet the \$2 million tax, penalties and interest, and additions to tax threshold in Section 7623(b). IRS said many who submitted information to the IRS claimed to have inside knowledge of the reported transaction often with extensive documentation to support their claims.

Only nine of 97 fully paid claims in FY 2010 involved collections of more than \$2 million. However, because whistleblowers submitted all of the claims paid in 2010 under an old Informant Award Program, IRS said it is difficult to estimate how claims will fare under the new statute enacted by the Tax Relief and Health Care Act of 2006, IRS said.

Definitions Need Clarification

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For the IRS's part, the report expressed concerns about the undefined nature of some of the definitions relating to whistleblower claims. IRS said the lack of definition creates uncertainty for administration of the program and determining whether the U.S. Tax Court has jurisdiction to consider appeal.

"The individual's 'gross income limitation' was apparently included in the law to ensure that the focus of the award program under Section 7623(b) is on relatively high income taxpayers," IRS said.

However, in the absence of a definition, IRS said it must look to other provisions of the Internal Revenue Code to determine how to calculate gross income.

"The IRS questions whether this effort is intended or justified, given that failure to satisfy the gross income threshold generally shifts the claim from a mandatory Section 7623(b) claim to a discretionary Section 7623(a) claim," the report said.

Collected Proceeds and NOLs

Another IRS administration issue was that the definition of collected proceeds does not extend to all recoveries from taxpayers.

Potential taxpayer liabilities are sometimes resolved in a manner that does not result in collected proceeds from which an award can be paid. IRS said this occurs when the taxpayer has a net loss carried forward from a prior period or carried back from a subsequent period.

Erika Kelton, attorney with Phillips & Cohen in Washington, told BNA that the whistleblower office is apparently dissatisfied that the definition of collected proceeds is not being extended to all taxpayers.

Net operating losses may be extinguished in the process of resolving a whistleblower claim and the Treasury Department may not collect cash but there is a net gain to the Treasury because NOLs are being reduced or extinguished, Kelton said.

"In other areas of law where there are whistleblower programs that kind of noncash recovery is a basis for a whistleblower reward and this has been an area of contention," she said. The Whistleblower Office may feel that where there is a net gain to the Treasury in collected proceeds—even if it is noncash gain—that should result in an award to the whistleblower.

Claims Under 7623(b)

In FY 2011 the IRS will begin paying awards for claims made under Section 7623(b). In June 2010, the IRS published procedures and criteria for making award determinations under 2006 amendments to the statute. As a result whistleblowers will be given an opportunity to comment on award recommendations before a final award determination is made.

IRS said it is a top priority to update formal published guidance on Section 7623, and this includes much-publicized efforts to finalize rules on collected proceeds.

By Diane Freda

Text of the Fiscal Year 2010 Report to the Congress on the Use of Section 7623 can be found on the web at http://www.irs.gov/pub/whistleblower/annual_report_to_congress_fy_2010.pdf