

JUNE 18, 2010, 6:03 P.M. ET

IRS Whistleblower Guidelines Spark Criticism

By Martin Vaughan Of DOW JONES NEWSWIRES

WASHINGTON (Dow Jones)--New IRS guidelines on how to process and pay rewards to whistleblowers are drawing criticism from a leading U.S. senator, who says they don't do enough to encourage informants to come forward.

Sen. Charles Grassley (R., Iowa), was one of the main architects of a 2006 law that requires payouts to whistleblowers of 15% to 30% of the funds the IRS recovers based on their tips.

"These changes appear to be limiting the scope of whistleblowers and the type of recoveries that would be eligible for an award," Grassley said in a statement Friday to Dow Jones Newswires.

"The fewer people eligible for rewards, the fewer people coming forward with information that might check out as tax fraud," he said.

The IRS has yet to pay out any awards under the new program. But the guidelines to IRS employees bring closer to fruition the payment of tens of millions of dollars in claims, tax practitioners say.

"This was the last thing the IRS needed in place before they could start paying awards," said Gregory Lynam, a partner at the Ferraro Law Firm.

Lynam, whose firm has already filed \$45 billion in IRS whistleblower claims on behalf of potential informants, said the IRS did a good job of establishing a process to evaluate and pay out claims.

Whistleblower claims could come from a wide spectrum of informants--from a corporate accountant spilling the beans on improper tax claims by an employer, to a banker who hands over information on offshore tax evasion by clients, to a member of the public who discovers evidence of fraud through a review of public records.

Of particular concern to Grassley, the IRS said it will not pay whistleblowers for information that leads to a denial of a refund claim.

For example, an employee that alerts the IRS that a corporation has underpaid taxes may claim a portion of whatever the IRS recovers. But an employee that blows the whistle on the boss's improper net operating loss refund claim, causing the IRS to deny the refund, will reap no financial reward.

An IRS spokeswoman said the agency is bound by the language of the statute, which authorizes claims for "collected proceeds." In a refund denial, there are no proceeds to collect, she said.

Some tax lawyers also said they were disappointed that whistleblowers will not get a cut of criminal penalties collected.

But H. David Rosenbloom, an attorney at Caplin and Drysdale, said that call has little downside as a practical matter because the vast majority of IRS disputes, including those involving secret offshore accounts, are resolved without criminal prosecution.

"The much harder question, which isn't addressed here, is what do you do when you've initiated the whistleblower action and the IRS for one reason or another chooses not to proceed?" Rosenbloom said. He said the new, more generous awards are likely to lead to a surge of claims that the IRS will have limited ability to investigate.

The guidelines list factors the IRS will use to determine how much of an award to pay out along the 15% to 30% scale. Those include to what degree the informant was culpable in the scheme, and whether the claim includes technical and legal analysis of the tax scam.

The more supporting detail, the higher the potential payout, said Ferraro's Lynam. "We have thought from the beginning that the way to 30% was to wrap it up in a bow," he said.

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