



## Tax Notes Today

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### IRS Whistleblower Office Reports High Submissions, Omits Controversial Issues

by Jeremiah Coder

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Summary by **taxanalysts**

In its annual report submitted to Congress December 13, the IRS Whistleblower Office said that out of over 5,000 cases it received in fiscal 2009, 460 cases might qualify for a higher payout amount under a new framework, but it failed to acknowledge several sensitive issues that have not been resolved.

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In its annual report submitted to Congress and posted to the IRS website December 13, the IRS Whistleblower Office said that out of over 5,000 cases it received in fiscal 2009, 460 cases might qualify for a higher payout amount under a new framework instituted under 2006 legislation. But the report failed to acknowledge several sensitive issues that have not been resolved internally, are awaiting public guidance, or have been criticized by practitioners.

Generally, whistleblowers whose claims meet the criteria of section 7623(b) are eligible for a monetary award between 15 and 30 percent of the tax amounts collected by the government once a successful final determination has been made by the IRS Whistleblower Office. Enacted as part of the Tax Relief and Health Care Act of 2006, the new rewards are available to a whistleblower only if, in the case of a reported individual, that individual's gross income for the year exceeds \$200,000 and the amount of tax (plus penalties, interest, and additions to tax) in dispute exceeds \$2 million. While the high number of case submissions under section 7623(b) could lead to large payouts by the IRS, the report stated that to date, no awards have been made under the revised statutory award program. (For the report, see *Doc 2010-26593* .)

There is a sense among tax practitioners handling whistleblower claims that the IRS will be making section 7623(b) awards soon. "We believe that the IRS is on the verge of making payments under the new program, and when they do, informants will rush into the marketplace," Gregory S. Lynam, a tax partner at the Ferraro Law Firm, told Tax Analysts. "Anyone who is coming forward now, before the potential rush, will be in a better position to get an award."

Although the fiscal 2009 submission rate showed a slight decline from the 476 cases submitted in fiscal 2008, Lynam predicted that the IRS could have a hard time handling all of the submissions it will receive soon. "Once the awards start getting paid, the floodgates will open," he predicted.

According to the Ferraro Law Firm's proprietary analysis of the tax reserves of *Fortune* 500 companies, nearly \$200 billion in uncertain tax positions exist that represent opportunities for whistleblowers to identify significant tax underpayments. "Now is the time for individuals to come forward with information, because awards are based on time of filing," said Scott A. Knott, also a tax partner at the Ferraro firm. (For prior coverage, see *Doc 2010-19323* or *2010 TNT 170-1* .)

George M. Clarke III of Miller & Chevalier said the report's statement that informants were offering the agency inside knowledge of corporate transactions along with extensive documentation should worry companies, because it shows that "these are corporate taxpayers with moles inside providing information to the IRS."

#### Possible Award Delays

The report indicated a new administrative wrinkle that could delay the payment of awards to informants. In the past, the IRS made sure that the unreported tax liabilities mentioned in the whistleblower claim had been collected before it processed an award determination. However, the agency is now waiting until the time a taxpayer has to file an appeal seeking a refund has passed, which is generally two years after the last tax payment made. That change likely resulted in lower fiscal 2009 award payments, the report said.

Bryan C. Skarlatos of Kostelanetz & Fink LLP said that the added wait time is probably sensible on the IRS's part, but he added that "at the same time, it means that it will take many years -- perhaps six to 10 years, or longer -- from claim to award, in many cases." That delay could discourage some whistleblowers, he said.

Still, Skarlatos agreed that big payments under the higher award provisions could capture the public's attention. "When the Whistleblower Office pays the first large award next year, whistleblower claims will increase dramatically as whistleblowers perceive that there is real money to be made -- in some cases," he said.

### Judicial Review

Although not mentioned in the report, an important case regarding potential appeals of award determinations was decided earlier this year when the U.S. Tax Court held that it had jurisdiction to review the Whistleblower Office's decision to deny an award. (For *William Prentice Cooper III v. Commissioner*, 135 T.C. No. 4 (July 8, 2010), see [Doc 2010-15202](#) or [2010 TNT 131-3](#).)

Skarlatos said the annual report incorporates the judicial decision by making a distinction between whistleblower determinations, which can be appealed to the Tax Court, and tax administration decisions, which the IRS will argue cannot be appealed to the Tax Court.

"This is a logical distinction, but more importantly, if the Tax Court agrees with this distinction, it will prevent taxpayers from appealing the IRS's decisions on whether or not to audit a taxpayer or assert a deficiency," Skarlatos said. It would be difficult for the Tax Court to review the IRS's decision on whether to audit a taxpayer or assert a deficiency, and it would be difficult to maintain taxpayer confidentiality while allowing whistleblowers to litigate whether or not the IRS should have asserted a deficiency, he said.

"Yet, in the *qui tam* context, these are precisely the types of issues that are litigated by the whistleblower," Skarlatos said. "One of the most important issues to be resolved as the whistleblower program matures is how much these cases will follow traditional *qui tam* type procedures and how to reconcile those procedures with issues surrounding taxpayer confidentiality."

### Calculating the Award

An issue not addressed in the report is what figure the IRS uses as a base amount to determine how much of an award an informant will receive, once an applicable percentage has been settled on. A point of contention between the IRS and practitioners and lawmakers has been in defining what constitutes collected proceeds. In its revised Internal Revenue Manual provisions covering section 7623, the IRS said in June that "collected proceeds" do not include offsets, application of net operating losses, refunds, or other amounts that might reduce a tax liability. (For the relevant IRM sections, see [Doc 2010-13536](#) or [2010 TNT 117-20](#). For prior coverage, see [Doc 2010-13529](#) or [2010 TNT 117-2](#).)

That determination provoked Senate Finance Committee ranking minority member Chuck Grassley, R-Iowa, to send a letter to Treasury in which he questioned the IRS's interpretation of the statute. Denying an award when information leads the agency to withhold a requested refund creates "a perverse incentive for the whistleblower to wait until the IRS has paid an improper refund," Grassley wrote. (For the letter, see [Doc 2010-14794](#) or [2010 TNT 128-70](#).)

Skarlatos said that the IRS's decision to allow the Whistleblower Office to take into account any refunds or credits that the taxpayer may have to reduce the amount of the ultimate tax payment in determining the amount of the award would likely be challenged in the Tax Court. The provision is "very unfair because the IRS benefits from an underpayment, whether the tax is paid currently or is used to reduce an otherwise available NOL or credit," he said.

### Expected Guidance

An additional problem is that appealing an award determination will likely require the informant to have access to taxpayer information that is withheld under section 6103. "That is something that requires more attention and guidance," Skarlatos said.

Confidential information is but one of several important subjects expected to be addressed in coming guidance. Other areas that the Whistleblower Office is still waiting on Treasury to address in regulations include award determination criteria and the award process as an administrative proceeding. That guidance is listed on the 2010-2011 priority guidance plan. (For the guidance plan, see *Doc 2010-26040* or *2010 TNT 235-25*.)

### Office Operations

The IRS paid out over \$5.8 million in whistleblower awards in 2009 in 110 cases, from \$206 million collected. In 2008 the agency made award payments of \$22.3 million in 198 cases from \$155.6 million collected.

In revealing that the IRS received a total of 5,678 submissions covering both section 7623(a) and (b) claims, of which only 8 percent (460 cases) met the 7623(b) criteria, the agency indicated that a majority of the claims are not likely of high value in ferreting out significant tax underpayment activity.

The Whistleblower Office reported that it increased its staffing level to 17 employees, up from 14 the previous year. Several of its top internal operating priorities for fiscal 2010 include developing better performance measures and improving communications among IRS employees who work on whistleblower issues.

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#### Tax Analysts Information

**Code Sections:** Section 7623 -- Expenses of Detecting Frauds  
Section 6103 -- Tax Return Disclosure

**Jurisdiction:** United States

**Subject Areas:** Compliance  
Information disclosure  
Practice and procedure  
Fraud, civil and criminal

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