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92 DTR G-4

*Tax Compliance*

### **Officials Clarify Net Operating Losses Role In Reward Calculations for Whistleblowers**

The proposed regulations (REG-131151-10) on valuing rewards for whistleblowers is not intended to focus on specific elements, like net operating losses, of the collected proceeds, an IRS official said at a hearing on the regulations May 11.

Prior to the hearing, several practitioners had written comments addressing concern over the exclusion of net operating losses from the definition of collected proceeds in the regulations, published in the *Federal Register* Jan. 18 (81 DTR G-1, 4/27/11). Net operating losses should be explicitly included in the guidance to prevent confusion, said Linda Stengle, a lawyer with Kenney & McCafferty PC in Philadelphia at the hearing.

A net operating loss is a deduction that goes into the calculation of the tax liability, which is equated to collected proceeds when an assessment has been made, said Thomas Kane, senior level counsel in IRS's Office of Associate Chief Counsel (Procedure and Administration). Because the net operating loss is a deduction, not a credit, there is no dollar-for-dollar equation, he said. The proposed regulation is intended to focus on certain elements of collected proceeds, which is the money at the end, not specific aspects or tax attributes that went into the calculation, he said.

Their explicit exclusion from the regulation should not be a concern, he said. If a whistleblower's information affects a net operating loss deduction, the whistleblower will be entitled to an award based on that contribution.

"We're not trying to do anything differently," Kane said. "We're not eliminating its ability to be used."

Net operating losses will be addressed in future guidance, Kane said.

### **Practitioners Ask for Clarification on Collected Proceeds**

If the definition of collected proceeds is not expanded to make clear how whistleblowers will be incentivized with a monetary award, then the disincentives will outweigh the reasons to step forward, Stengle said. While the proposed regulations are a good step forward, the definition of collected proceeds needs to be broadened, she said.

"It was the plain intent of Congress to expand the number and types of whistleblower claims that the IRS would receive and ultimately be able to pursue," said Michael Sullivan, of Finch McCranie LLP in Atlanta.

There is no definition of collected proceeds in the Internal Revenue Code or regulations, said Richard Rubin, of Finch McCranie LLP in Atlanta. The code lists what can be included in collected proceeds but there is no definition of the term, he said.

"I think that is fundamental to the problem that we have because if one has a suitable and sufficient definition of collected proceeds, I think a lot of these issues ... would be covered," Rubin said.

### **Definition Should Include Benefit to Government**

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A good definition would be “net benefit to the treasury,” Rubin said. Ultimately, the term should look at whether there was a net benefit to the government, practitioners said.

“I think net positive effect are three good words that should be used to define collected proceeds,” said Thomas Pliske, of the Tax Whistleblower Law Firm in St. Louis.

The key issue is whether there was a positive net effect on the Treasury, and it should be the basis for calculating the reward to the whistleblower, Stengle said. Broadening the definition this way will make it easier for the whistleblower office to calculate the reward, she said.

### **Industry Concerned Over Narrow Credit Provisions**

Several speakers questioned the type of credit balance language used in the proposed regulation. The guidance uses the term “overpayment credit balance,” a narrow area of credit balances, practitioners said.

“Credit balances are credit balances,” Stengle said. The use of the word “overpayment” can cause confusion over what kind of credit balances qualify and what kind of credit balances don’t qualify, she said. “It’s an unnecessary obfuscation of the term.”

The guidance cannot ignore credit balance overall, said Scott Knott of the Ferraro Law Firm in Miami. There are many more credit balance situations than just overpayment credit balance, and including the specific term raises questions about whether collected proceeds are limited to overpayment credit balance, he said.

### **Use of Criminal Fines Also Questioned**

In prior practice, criminal fines were included in the equation for collected proceeds, Stengle said. Similarly, the IRS was not acting illegally when the Internal Revenue Manual mentioned the ability to pay from criminal fines in 2006, Sullivan said.

There has been a misconception about the use of criminal fines in collected proceeds, Kane said. The agency has addressed a narrow example of when the fines cannot be used because the funds are put into a separate account under Title 18 that the IRS cannot access, he said.

Based on Chief Counsel Advice, any funds that are included in the Crime Victims Fund are outside the scope of the Whistleblower Office and cannot be used in the collected proceed calculation, said Stephen Whitlock, director of the IRS’s Whistleblower Office (79 DTR K-1, 4/25/11).

The IRS would be the victim in the case of tax fraud or evasion, said Pliske, and therefore should be able to access the fund and make it available to the whistleblower for reward.

The IRS is not finished with addressing the criminal fine issue, Kane said.

A transcript of the hearing will be in TaxCore.