IRS WHISTLEBLOWER PROGRAM

There is More Work to be Done

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I. Introduction

Every year around tax time, large corporations and individual taxpayers alike are faced with the temptation to cheat on their taxes. After all, most people do not enjoy giving their hard earned money to the IRS, so if there is a way to pay less tax—even if it is illegal—certainly some taxpayers are going to consider it. Regardless of the temptation, however, the age-old lesson that cheating doesn't pay is still true. If one is a tax whistleblower[1] though, cheating *can* pay—as long as it is someone else who is doing the cheating—and the government is footing the bill.

Thanks to the Internal Revenue Service ("Service" or "IRS") whistleblower program, the government is paying awards to individuals who provide the Secretary of the Treasury with information about those who do not pay the taxes they owe.[2] Over the last several years the IRS whistleblower program has undergone significant changes, most importantly the addition of section 7623(b) to the Internal Revenue Code.[3] These changes have led tax whistleblowing to become a more powerful enforcement tool than ever before. Indeed, it was a whistleblower who ultimately caused the entire Swiss banking industry to cease helping U.S. persons evade taxes.[4]

Despite the recent attention the IRS whistleblower program has received, the idea of rewarding someone for blowing the whistle on those who have been underpaying their taxes is not a new development.[5] Laws allowing the Secretary of the Treasury to pay amounts he deems necessary for "detecting and bringing to trial and punishment persons guilty of violating the

[1] The term whistleblower is interchangeable with *informant* and *claimant* throughout this paper.
[2] 26 U.S.C.A. § 7623 (West 2012).
[3] Tax Relief and Health Care Act of 2006, Pub.L. 109–432, div. A, § 406, 120 Stat. 2958 (effective Dec. 20, 2006) (amending I.R.C. § 7623) [hereinafter TRHCA].
[4] Robert W. Wood, *Want To Be An IRS Whistleblower? Be Patient*, Forbes, Jul. 28, 2011, http://www.forbes.com/sites/robertwood/2011/07/28/want-to-be-an-irs-whistleblower-be-patient/ (last visited Feb. 1, 2012).
[5] IRS, *History of the Whistleblower/Informant Program* (Feb. 10, 2012), available at http://www.irs.gov/compliance/article/0,,id=181294,00.html.

internal revenue laws or conniving at the same"[6] have been on the books for more than 140 years.[7] As with most laws, though, the tax whistleblowing laws have faced their fair share of criticism and controversy, including proposals to be eliminated.[8] Instead of eliminating the IRS whistleblower program, however, Congress modified the program in 2006 to increase the Service's authority to pay cash awards to tax whistleblowers.[9]

There is little doubt that the 2006 amendments have strengthened the IRS whistleblower program. However, the program has been hindered by several things, including the Service's own inefficiencies, taxpayer privacy rules, and Service management's ability to say "no thanks" to a whistleblower's information, even when the whistleblower office believes the claim has merit. This paper addresses the changes that the IRS whistleblower program has undergone and considers whether more improvements are necessary. Specifically, this paper examines not only the difficulties that the IRS whistleblower program faces, but also the difficulties that informants face when filing a claim with the whistleblower office. Part II details the history of the IRS whistleblower program. Part III describes the 2006 amendments to the whistleblower program. Part IV discusses the challenges the IRS whistleblower program still faces. Part V discusses the challenges tax whistleblowers face, including factors one must consider when deciding whether to file a claim. Finally, Part VI recommends improvements that should be made to the whistleblower program for the benefit of the Service and whistleblowers.

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[6] 26 U.S.C.A. § 7623(a)(2) (West 2012).
[7] Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473 (codified by ch. 11, §3463, 35 Rev. Stat. 686 (1873-74)). Codified as I.R.C. § 7623 (1954).
[8] "During the debate of the 1998 Internal Revenue Service Restructuring and Reform Act, Senator Harry Reid (D-Nev.) proposed to eliminate the Service whistleblower program, which he referred to as the 'Award for Rats Program' and the 'Snitch Program.' Senator Reid found the idea of the Service paying 'snitches' to rat on their 'associates, employers, relatives, and others' as 'unseemly, distasteful, and just wrong.'" Michelle M. Kwon, *Whistling Dixie About the IRS Whistleblower Program Thanks to the IRC Confidentiality Restrictions*, 29 VA. TAX. REV. 447, 448 (Winter 2010) (citing 144 Cong. Rec. S4379-05, at S4379-98).
[9] Kwon, *supra* note 8, at 448 (citing TRHCA).

II. History of the IRS Whistleblower Program

A. Voluntary Compliance and Our Federal Income Tax System

Self-assessment is a time-honored and essential aspect of the United States' federal income tax system.[10] The self-assessment, or voluntary compliance, system does not mean that paying taxes is optional.[11] Instead, voluntary compliance means that the Service does not compute taxpayers' tax liabilities in the first instance.[12] Rather, the Internal Revenue Code requires that taxpayers file timely and accurate returns of their taxable income and pay the taxes due.[13] A byproduct of the voluntary compliance system is that a "tax gap"[14] is created whenever a taxpayer, whether intentionally or unintentionally, reports and pays less tax than would have been required had the law been correctly applied.[15] The U.S. Code contains monetary penalties and the potential for incarceration is in place to encourage taxpayers to follow the Internal Revenue Code's requirement to file and pay one's taxes.[16] Nonetheless, the effectiveness of penalties to deter noncompliance is ultimately linked to prospects for enforcement, which relies on discovery of noncompliance.[17]

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[10] *See Millsap v. Comm'r*, 91 T.C. 926, 931 n. 10 (1988) (the court stated: This concept [that a return is required, upon which an assessment of federal income tax will be based,] is deeply rooted in our history. In part, our country was founded as the result of tax revolt wherein citizens protested being taxed without their consent. Our tax system is rooted in the concept of voluntary compliance which does not permit the government to arbitrarily assess tax without a proper list or report.).

[11] Leandra Lederman & Stephen W. Mazza, *Tax Controversies: Practice and Procedure* 10 (3d ed. 2010).

[12] *Id.*

[13] *See* I.R.C. § 6001 (West 2012) (imposes a general obligation to keep records and make returns); § 6012 (requires income tax returns); § 6072 (notes the time for filing income tax returns); § 6151 (notes the time and place for paying taxes).

[14] The tax gap is defined as the amount of tax liability faced by taxpayers that is not paid on time. *See* IRS, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study* (Jan. 6, 2012), available at http://www.irs.gov/newsroom/article/0,,id=252038,00.html.

[15] Edward A. Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the "Tax Gap"*, 24 AKRON TAX J. 1, 2 (2009).

[16] I.R.C. § 6651 (failure to file penalty); I.R.C. § 6662 (accuracy-related penalties); I.R.C. § 6662(a) (special accuracy-related penalties regarding reportable transactions); I.R.C. § 6663 (fraud penalty). *See* I.R.C. §§ 77201-07 for criminal provisions applicable to taxpayers.

[17] Morse, *supra* note 15, at 2.

In an effort to reduce the tax gap, which by most recent estimates exceeds $385 billion per year,[18] the Federal government has several methods to discover noncompliance by taxpayers and to enforce the tax laws. One of the primary functions the government uses to discover noncompliance is its examination powers, which allow the government to audit a taxpayer's otherwise private information to determine whether a taxpayer's positions on their return comply with the law.[19] Presumably, the risk of examination reinforces voluntary compliance.[20] Additionally, information that is gathered from the examination of taxpayer returns may help to enhance prospects for accurately targeting taxpayers who are likely to be noncompliant as well as particular noncompliant practices.[21]

There is no question that enforcement efforts can be costly to both the government and the affected taxpayers.[22] This is especially true when an examination does not lead to any changes in a taxpayer's return, meaning that both parties incurred costs without the recovery of additional tax revenue.[23] As a result, it makes sense that targeting enforcement efforts towards those who are likely to be noncompliant would be the best use of government resources. How does the government know who is noncompliant though? One way to find out is through the use of whistleblowers, who "potentially enhance the effectiveness of examinations based on access

[18] On January 6, 2012, the IRS released a new set of tax gap estimates for tax year 2006. The net tax gap for tax year 2006 is estimated to be $385 billion. This compares to tax year 2001 when the estimated net tax gap was $290 billion. *See* IRS, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study* (Jan. 6, 2012), available at http://www.irs.gov/newsroom/article/0,,id=252038,00.html.
[19] I.R.C. § 7602 (authorizing the Secretary "to examine any books, papers, records, or other data which may be relevant or material" to ascertain the correctness of a return or determine the tax liability of any person.).
[20] Morse, *supra* note 15, at 3
[21] *Id.*
[22] *Id.*
[23] *Id.*

to inside information."[24] Whistleblowers effectively become "a tool for peeking inside the otherwise private zone of voluntary compliance."[25]

B. IRS Whistleblower Award Regime Before the 2006 Amendments to Section 7623

As early as 1867, the federal government has been authorized by statute to pay awards to whistleblowers.[26] However, "[t]he statute authorizing the informant program remained separate from the revenue acts until Congress enacted section 3792 of the Revenue Act of 1934, providing expenses for the "detection and punishment of frauds" related to the internal revenue laws."[27] The statute was recodified as section 7623 in 1954, "where it remained largely unchanged, underutilized, and unknown" until its amendment at the end of 2006.[28]

III. The Revamped Whistleblower Program

A. What Prompted Changes?

Before examining the all-new whistleblower program, it is important to understand what led Congress to make changes. There are three main reasons that explain why Congress passed the 2006 amendment to the IRS whistleblower program.[29] First, the existing IRS whistleblower

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[24] *Id.*
[25] *Id.*
[26] *Supra* note 7.
[27] Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357 (Winter 2008) (citing Revenue Act of 1934, ch. 3792, 48 Stat. 680.).
[28] *See* I.R.C. § 7623 (1954). Prior to the 2006 amendments to section 7623, the only material change after 1954 involved the 1996 amendments, which included for the first time "detecting underpayments of tax" as a criterion for awarding payments to informants, adding to the existing "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same." Detecting Underpayments of Tax, Pub. L. No. 104-168, § 1209(a), 110 Stat. 1452 (2006)). Ventry, *supra* note 27, at 361 n. 18.
[29] This section discusses the three primary reasons for the amendment to the IRS whistleblower program; however, there are a host of other concerns supporting the amendment that should not go without mention. These include: (1) the IRS's desire to undermine large corporate taxpayers' ability to "cheat" on their taxes by controlling their employees; (2) utilizing the whistleblower program as a means of minimizing the potential of IRS favoritism towards large, powerful employers; and (3) adjusting the power relationship between the large, powerful employers and their knowledgeable employees.

program was broken.[30] A report issued by the Treasury Inspector General for Tax Administration ("TIGTA") in June 2006 detailed the different shortcomings of the whistleblower program (TIGTA was uniquely qualified to do so because it had previously administered the authority provided under section 7623).[31] "The program suffered from decentralized management, poor oversight, lack of standardization with respect to informant tips and Service payments, and inefficient processing of claims."[32] Specifically, TIGTA concluded that the program was being managed in "an ad hoc fashion by Service campuses spread throughout the country, each of which had 'traditionally operated as a semi-autonomous entity.'"[33] For example, the five Informants' Claims Examiner ("ICE") units that were located throughout the country all used different procedures to process and track claims, and there was no type of oversight program in place, such as management assistance or operational reviews, to monitor performance of ICE units.[34] Furthermore, there was no nationwide database in place to allow management to track and monitor claims on a national level, which resulted in severe inconsistencies regarding how claims and payments were handled.[35]

Moreover, TIGTA reported that on average "over 7 ½ years passed between the filing of the initial claim by the informant and the payment of the reward."[36] However, much of this delay, TIGTA reported, could be attributed to "the fact that the law require[d] that rewards be paid only once the additional taxes, fines, and penalties had been collected from the taxpayers."[37]

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[30] Ventry, *supra* note 27, at 362.
[31] *Id.* at 362-63 n. 33.
[32] *Id.* at 363.
[33] *Id.* (citing Treasury Inspector Gen. for Tax Admin. Rept. 2006–30–092, *The Informants' Rewards Program Needs More Centralized Management Oversight* (June 2006) [hereinafter 2006 TIGTA Report]).
[34] 2006 TIGTA Report, *supra* note 33, at 5-6.
[35] *Id.* at 6-7.
[36] *Id.* at 8.
[37] *Id.* at 8-9. *See* Ventry, *supra* note 27, at n. 35. *See also* Treas. Reg. § 301.7623-1(a) (rewards provided by section 7623 and the regulations will be paid from the proceeds of amounts, other than interest, collected by reason of the information provided).

Still, TIGTA states that when "claims are not timely processed, the rewards may lose some of their motivating value."[38] After all, the rewards are offered not only to encourage informants to come forward with information, but in some cases also as a means to compensate informants for risking "their personal and business relationships by providing the information."[39]

Another shortcoming of the whistleblower program was that the IRS did not openly promote it.[40] For a program whose primary objective includes providing incentives for private enforcement of the tax laws, most taxpayers were not aware that the program even existed.[41] The Service's public website (irs.gov) did not contain any information that explained the program, and the existing webpage that was used to report tax fraud did not mention that rewards were available.[42]

The second reason for the 2006 amendments to the whistleblower program is that "legislators recognized that an improved whistleblower statute could be an effective weapon against noncompliance."[43] TIGTA's June 2006 report noted that although there was room for improvement, the Informants' Rewards Program had "significantly contributed to the IRS' efforts to enforce tax laws," and "additional management focus could enhance the effectiveness of the Program as an enforcement tool" as well as make the process more "accommodating to informants."[44] Furthermore, when examinations of taxpayer returns were initiated as a result of information provided by informants, they were almost twice as efficient and effective (measured

[38] 2006 TIGTA Report, *supra* note 33, at 8.
[39] *Id.*
[40] *Id.* at 2.
[41] *Id.*
[42] *Id.*
[43] Ventry, *supra* note 27, at 365.
[44] 2006 TIGTA Report, *supra* note 33, at 1.

by dollar yield per hour of examination time) than examinations initiated by the Service's DIF[45] method for choosing returns.[46] For many legislators, the program's potential effectiveness as a compliance tool was viewed as a way to close the tax gap, something that Congress had been working on for the last year.[47]

Finally, the third reason that Congress amended the IRS whistleblower program can be attributed to the efforts of Senator Charles Grassley (R-IA).[48] Grassley had long advocated for strengthening whistleblower statutes and he had played a large role in amending the False Claims Act in 1986 to transform the statute into "the government's most powerful mechanism for private enforcement of public laws."[49] Additionally, in 2004, Grassley championed for an office within the Service whose duty was to oversee whistleblower claims and awards.[50] Moreover, Grassley used TIGTA's June 2006 report as an opportunity to convince Congress and the IRS of the importance of overhauling the whistleblower program. Grassley and his office also drafted the legislation that provided the basis for the new Whistleblower Office and awards program.[51]

[45] "The IRS uses the Discriminant Index Function [DIF], which is a mathematical technique used to classify income tax returns for examination potential by assigning weights to certain basic return characteristics." *See* TIGTA, *supra* note 33, at 2 n. 1. "It is important to note that the selection criteria for informant claims cases, if applied properly, would *always* result in informant claims cases yielding more effective returns that DIF selected cases. The Service pursues cases based on informant leads that appear more likely to yield productive results that cases based on other sources, including DIF selected cases. Thus, an informant lead that appears less productive than a DIF lead will not be pursued by the Service." *See* Ventry, *supra* note 27, n. 49.
[46] *See* 2006 TIGTA Report, *supra* note 33, at 4 fig. 2 (showing that informant initiated examinations yielded $946 dollars per hour whereas DIF selected examinations yielded $548 dollars per hour).
[47] Ventry, *supra* note 27, at 366 n. 50.
[48] *Id.* at 367.
[49] *Id.*
[50] *Id.*
[51] *Id.*

B. Summary of Section 7623(b)

The Tax Relief and Healthcare Act of 2006[52] was responsible for amending section 7623. The key change in the law was the addition of a new section, 7623(b) *Awards to Whistleblowers*, under which awards are no longer discretionary.[53] Under section 7623(b), the Secretary shall pay whistleblowers "an award [of] at least 15 percent but not more than 30 percent of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action."[54] To qualify for the section 7623(b) award program, a whistleblower must first meet some conditions. The informant is eligible to make a claim under section 7623(b) only if the information provided relates to a tax noncompliance matter in which "the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000" and to a taxpayer, in the case of any individual, "if such individual's gross income exceeds $200,000 for any taxable year" in question.[55] If the informant meets these conditions and substantially contributes to "a decision to take administrative or judicial action that results in the collection of tax penalties, interest, additions to tax, or additional amounts," the IRS will pay the award of 15 to 30 percent[56] of the collected proceeds.[57] Award amounts are determined and paid "in proportion to the value of information furnished voluntarily with respect to proceeds collected, including penalties, interest, additions to tax, and additional amounts."[58]

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[52] TRHCA *supra* note 3, at § 406, 120 Stat. 2958-60 (2006).
[53] *Id.* at § 406(a)(1)(D), 120 Stat. 2922 (2006) (added subsection (b)).
[54] I.R.C. § 7623(b)(1).
[55] I.R.C. §§ 7623(b)(5)(B) and 7623(b)(5)(A).
[56] *See* I.R.M. § 25.2.2.9.2 for factors used to determine 15-30%.
[57] IRS Whistleblower Office Fiscal Year 2010 Report to the Congress on the Use of Section 7623 (issued September 2011) [hereinafter Fiscal Year 2010 Report], available at http://www.irs.gov/pub/whistleblower/annual_report_to_congress_fy_2010.pdf.
[58] I.R.C. Notice 2008-4, 2008-2 I.R.B. 253 (Dec. 19 2007) [hereinafter Notice 2008-4], available at 2007 WL 4427860.

"Prior law made the payments discretionary, depending on what the [IRS] District Director 'deem[ed] to be adequate compensation in the particular case,' which generally did not equate to 15% of the amounts collected."[59] The old law also capped rewards at $2 million (the cap was $50,000 as late as 1989),[60] whereas the amended law has no cap on the absolute dollar amount that can be awarded.[61] Furthermore, the new statute provides for reduced awards in cases of "less substantial contribution."[62] Generally, cases of less substantial contribution are cases that involve previously disclosed public information or allegations.[63] In these cases, the "Whistleblower Office may award such sums as it considers appropriate, but in no case more than 10 percent of the collected proceeds (including penalties, interest, additions to tax, and additional amounts)."[64] In the event the Whistleblower Office determines that a claim for an award is brought by an individual who "planned and initiated the actions that led to the underpayment of tax," then the award may be reduced.[65] Finally, in the event an award is paid, whistleblowers may take an above the line deduction for attorneys' fees and costs paid to recover the award.[66]

Even with the amendments brought on by the Tax Relief and Healthcare Act of 2006, section 7623(a) still exists (originally it was codified as section 7623) to process claims that do not qualify under section 7623(b).[67] The awards paid under section 7623(a) are known as discretionary awards because the award in these cases is at the discretion of the Service, and

[59] Ventry, *supra* note 27, at 362 (quoting Treas. Reg. § 301.7623-1(c)).
[60] Ventry, *supra* note 27, at 362.
[61] *Id.*
[62] I.R.C. § 7623(b)(2)(A).
[63] *Id.*
[64] *Id.*
[65] I.R.C. § 7623(b)(3).
[66] I.R.C. § 62(a)(21).
[67] I.R.C. § 7623(a).

there is no requirement that an award be issued.[68] The awards through this program are less, with a maximum award of 15 percent up to $10 million.[69] Additionally, section 7623(a) does not include an appeal provision allowing the informant to dispute the outcome of the claim in Tax Court.[70]

As mentioned above, it is the Whistleblower Office that is entrusted with the authority and discretion to pay awards. The creation of the IRS Whistleblower Office was another change brought on by The Tax Relief and Healthcare Act of 2006.[71] The Whistleblower Office was established to "process tips received from individuals who spot tax problems in their workplace, while conducting day-to day personal business or anywhere else they may be encountered."[72] The responsibilities of the new office include determining whether to investigate the matter itself or assign it to another Service office, and monitoring actions taken by the Service with respect to informant information.[73] Additionally, the office assumed the responsibility of determining whether and how much to pay informants, a job that was previously done by Service District Directors.[74] In February 2007, the new Whistleblower Office opened for business with Stephen Whitlock, the former head of the Internal Revenue Service Office of Professional Responsibility, taking over as its first director.[75]

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[68] IRS, *Internal Revenue Code IRC 7623(a)* (Feb. 10, 2012), available at http://www.irs.gov/compliance/article/0,,id=180174,00.html
[69] IRS, *Whistleblower – Informant Award* (Mar. 1, 2012), available at http://www.irs.gov/compliance/article/0,,id=180171,00.html
[70] IRS, *Internal Revenue Code IRC 7623(a)* (Feb. 10, 2012), available at http://www.irs.gov/compliance/article/0,,id=180174,00.html
[71] IRS, *IRS Begins Work on Whistleblower Office; Whitlock Named First Director* (Feb. 2, 2007), available at http://www.irs.gov/newsroom/article/0,,id=167542,00.html
[72] *Id.*
[73] Ventry, *supra* note 27, at 361.
[74] *Id.*
[75] IRS, *IRS Begins Work on Whistleblower Office; Whitlock Named First Director* (Feb. 2, 2007), available at http://www.irs.gov/newsroom/article/0,,id=167542,00.html

C. Procedures for Filing a Whistleblower Claim

1. Notice 2008-4

With the amended law in effect, it is important to understand the mechanics behind how informants submit whistleblower information to the Service. On December 19, 2007, the IRS issued Notice 2008-4 to provide "guidance to the public on how to file claims under Internal Revenue Code section 7623…"[76] First, individuals submitting information under section 7623(a) or (b) must fill out IRS Form 211, Application for Award for Original Information.[77] Completion of Form 211 requires that the claimant signs the Form, and in the case of joint claims, each claimant must sign.[78] The completed Form 211 is then sent to the IRS Whistleblower Office in Washington D.C.[79] Currently, claims for awards cannot be submitted electronically or by fax.[80] In addition to submitting Form 211, all claims for awards must be submitted and signed under penalty of perjury.[81] This requirement precludes submissions by: "(1) a person serving as a representative of the claimant, or (2) an entity other than a natural person."[82] Regarding claims under section 7623(b), "the requirement to submit information under penalty of perjury precludes submissions made anonymously or under an alias."[83]

Once a whistleblower has submitted a claim, the Whistleblower Office will acknowledge receipt of the claim in writing.[84] If the Form 211 is incomplete or missing required information, the Whistleblower Office may return a Form 211 to the claimant to be completed and

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[76] Notice 2008-4, *supra* note 58.
[77] IRS Form 211 available at http://www.irs.gov/pub/irs-pdf/f211.pdf
[78] Notice 2008-4, *supra* note 58.
[79] Notice 2008-4, *supra* note 58. The issuance of Notice 2008-4 was accompanied by a revision to Form 211. *See* Fiscal Year 2010 Report, *supra* note 57.
[80] Notice 2008-4, *supra* note 58.
[81] I.R.C. § 7623(b)(6)(C).
[82] Notice 2008-4, *supra* note 58.
[83] *Id.*
[84] *Id.*

resubmitted.[85] A claim will be processed as long as there are not any grounds for not processing the claim.[86] Following submission of a claim, at its discretion, the Service may offer the claimant an opportunity to confer and discuss the claim to ensure that the Service fully understands the information that was submitted with the claim.[87] Furthermore, the Service, in its discretion, may ask the claimant or the claimant's legal representative for additional assistance. This assistance, however, is "under the direction and control of the Whistleblower Office or the office assigned to investigate the matter."[88] Finally, submitting a claim does not create an agency relationship between the Federal government and the claimant, and the claimant does not act in any way on behalf of the Federal government.[89]

2. Claim Timeline

It may seem like after a claim has been submitted, the Whistleblower Office reviews it and a determination is made as to how large the award payment will be. However, the process is much more complicated and lengthy than that. A whistleblower can make a claim pro se or they

[85] *Id.*
[86] *Id.* (listing examples of claims that will not be processed under section 7623(b) to include: "(1) claims submitted by an individual who is an employee of the Department of Treasury, or who is acting within the scope of his/her duties as an employee of any Federal, State, or Local government; (2) claims submitted by an individual who is required by Federal law or regulation to disclose the information, or by an individual who is precluded by Federal law or regulation from making the disclosure; (3) claims submitted by an individual who obtained or was furnished the information while acting in an official capacity as a member of a State body or commission having access to such materials as Federal returns, copies or abstracts; (4) claims submitted by an individual who had access to taxpayer information arising out of a contract with the Federal government that forms the basis of the claim; (5) claims that upon initial review have no merit or that lack sufficient specific and credible information; (6) claims submitted anonymously r under an alias; (7) claims filed by a person other than a natural person (such as a corporation or a partnership); and (8) the alleged noncompliant person is an individual whose gross income is below $200,000 for all taxable years at issue in a claim." *See also* IRS, *How Do You File a Whistleblower Award Claim Under Section 7623 (a) or (b)* (Feb. 10, 2012), available at http://www.irs.gov/compliance/article/0,,id=181292,00.html.
[87] Notice 2008-4, *supra* note 58.
[88] *Id.*
[89] *Id.*

can choose to obtain legal representation.[90] If an individual obtains counsel to assist them in filing a claim, at the onset, he or she will likely be advised that the process can take 4 to 7 years before the claimant will receive an award payment.[91]

To begin with, once the Form 211 is filed it takes about 30 days for the Whistleblower Office to conduct an initial claim review. Next, the claim is sent on to a Subject Matter Expert ("SME") and/or Chief Counsel[92] to be reviewed. This usually occurs about 90 days after the claim has been filed. Here, the SME is looking for any taint the claim may have, meaning that it may be subject to attorney client privilege or other legal protections that would prohibit the IRS from using the claim in an examination. If the SME finds potentially tainted information, the Office of Chief Counsel reviews the claim and conducts a risk analysis. SMEs can then request debrief meetings with whistleblowers to clarify tax noncompliance issues or to determine the source of information to make sure it is not privileged. Once a review and debrief has been completed, the SME makes a recommendation to the operating division supervisor that the claim has no merit, or that the claim warrants further investigation. It can take 3-6 months to review and screen evidence before making the decision to either reject the claim or to pass the claim onto the field for an audit by one of the operating divisions responsible for serving specific

[90] The term pro se means without a lawyer or for oneself or on one's own behalf. *Black's Law Dictionary* 575 (3d Pocket Ed. 2006). It is estimated that Pro se litigants submit more than one-half of all tax whistleblower claims. *See infra* note 91.

[91] I am thankful to Scott A. Knott for this information [hereinafter Interview with Scott Knott]. Mr. Knott practices exclusively in the area of tax whistleblower claims. In July of 2007, Mr. Knott co-established the tax group at The Ferraro Law Firm and thereafter filed hundreds of tax whistleblower submissions that cumulatively exceed $100 billion. Mr. Knott's practice before the Internal Revenue Service includes making submissions to the IRS Whistleblower Office, handling communications with the IRS through all phases of a whistleblower claim, and ultimately the filing of appeals of IRS award determinations in the U.S. Tax Court. *See* http://www.tax-whistleblower.com/attorneys/scottknott/

[92] The Chief Counsel is appointed by the President of the United States with the advice and consent of the U.S. Senate. Chief Counsel is the chief legal advisor to the IRS Commissioner on all matters pertaining to the interpretation, administration and enforcement of the Internal Revenue Laws (as well as all other legal matters). *See* IRS, *Office of Chief Counsel At-a-glance* (Oct. 26, 2011), available at http://www.irs.gov/irs/article/0,,id=140092,00.html

groups of taxpayers.[93] These divisions include Criminal Investigation, Small Business/Self-Employed, Large Business and International, Tax Exempt and Governmental Entities, and Wage and Investment.[94] At this stage, the division conducts a regular examination, the length of which depends on the scope of the audit, the complexity of the tax issues, and any complications that may arise.[95]

After the examination is complete, the IRS must first receive "collected proceeds" as a result of the whistleblower's information and then the statute of limitations on appeals or refunds must expire before a claim becomes eligible for an award under section 7623(b).[96] Once a claim becomes award eligible, the Whistleblower Office will send a preliminary letter to the whistleblower notifying him or her of the amount of their award and informing the individual of their right to administrative review and a hearing. This is the informant's opportunity to rebut the Whistleblower Office's preliminary award determination. The Whistleblower Office will then issue a final award determination and if the whistleblower agrees with the amount, the award will be paid. If the whistleblower disagrees with the final award determination, he or she has 30 days within which to file a petition to the Tax Court.[97]

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[93] Interview with Scott Knott, *supra* note 91.
[94] *See* U.S. Department of the Treasury, *Internal Revenue Service*, available at http://www.irs.gov/pub/irs-news/irs_org_chart_2012_.pdf
[95] The IRS Whistleblower Office does not have a systematic process to check in with the divisions about the time take for their initial reviews. *See* U.S. Government Accountability Office, *Tax Whistleblowers: Incomplete Data Hinders IRS's Ability to Manage Claim Processing Time and Enhance External Communication*, GAO-11-683 (Washington D.C.: August 2011) [hereinafter August 2011 GAO Report], available at http://www.gao.gov/assets/330/322595.pdf.
[96] Interview with Scott Knott, *supra* note 91.
[97] I.R.C. § 7623(b)(4).

D. Right to Appeal Award Determinations to the Tax Court

The addition of section 7623(b) gave whistleblowers the right to appeal Service award determinations to the Tax Court, which has exclusive jurisdiction.[98] To commence an action in the Tax Court, a whistleblower must file a petition containing, "among other things: the whistleblower's name and address; an explanation of why the whistleblower disagrees with the Whistleblower Office's determination; and the facts that the whistleblower relies on to support his or her determination."[99] As mentioned before, the appeal to the Tax Court must be filed within 30 days of the determination in order to be timely.[100] Moreover, a contract with the IRS is no longer necessary for any individual to obtain judicial review of an IRS whistleblower determination.[101]

When reading section 7623(b)(4) in conjunction with paragraphs (1), (2), and (3) of section 7623(b), it appears to mean that whistleblower claims may only be appealed to the Tax Court if the Service actually proceeds with an administrative or judicial action. The Tax Court in *Cooper v. Commissioner*, 136 T.C. 597 (June 21, 2011) held that it is the Commissioner's award determination, not whether to initiate an administrative or judicial proceeding, that the Tax Court has jurisdiction to consider under appeal.[102] If the Service declines to take any action based on information provided by a whistleblower, that determination is not appealable.[103] *Cooper* reasons that under section 7623(b)(1), whistleblower awards are preconditioned on the

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[98] I.R.C. § 7623(b)(4). Only claims filed under section 7623(b), and not section 7623(a), may be appealed; *see Dacosta v. United States*, 82 Fed. Cl. 549, 555 (2008) (holding that claims of informants seeking additional award amounts under [the] whistleblower statute which were based on information provided to the IRS after [the] 2006 amendments to the statute fell within [the] exclusive jurisdiction of the Tax Court).
[99] Kwon, *supra* note 8, at 464 (citing Tax Ct. R. 340-341).
[100] I.R.C. § 7623(b)(4).
[101] I.R.C. § 7623(b)(6)(A).
[102] *Cooper v. Commissioner*, 136 T.C. 597, 600 (June 21, 2011) (stating that it is only in a deficiency action, not a whistleblower action, that the Tax Court has jurisdiction to redetermine whether there is any income, estate, or gift tax due.)
[103] *Id.* at 601.

Secretary's proceeding with an administrative or judicial action. Thus, if the Secretary does not proceed, there can be no whistleblower award.[104] Additionally, if a claim lacks merit or is not processed or is rejected by the Whistleblower Office because it is not administratively perfected, it is not appealable.[105]

IV. Challenges the Whistleblower Program Faces

Without question, the IRS whistleblower program has been improved as a result of the 2006 amendments. However, the program still has many challenges it must overcome in order to be truly effective. These challenges include resistance from IRS Office of Chief Counsel, balancing taxpayer privacy and communications to whistleblowers, the Service's own inefficiencies, and the language of the final regulations.

A. Resistance from IRS Office of Chief Counsel

As the IRS Whistleblower Office does its best to encourage whistleblowers to help the government recover taxes it is owed, it has faced strong resistance from the IRS Office of Chief Counsel ("OCC").[106] The OCC "has stymied the whistleblower program by interpreting the 2006 law in ways that discourage whistleblowers and undermine the programs potential for success."[107] Namely, OCC has: (1) imposed withholding requirements on whistleblower awards; (2) defined "planners and initiators" of the tax scheme (recall that the law allows them to receive a reduced award, if any) in a way that could prohibit the receipt of an award by an employee,

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[104] *Id.* at 601.
[105] *See generally Cooper v. Commissioner*, 136 T.C. 597 (June 21, 2011).
[106] Erika Kelton, *IRS Whistleblowers See Little Reward*, FORBES, Mar. 2, 2012, http://www.forbes.com/sites/erikakelton/2012/03/02/irs-whistleblowers-see-little-reward/ (last visited Apr. 9, 2012). The Office of Chief Counsel is not involved in every whistleblower claim, but it reviews whistleblower claims for legal issues when the Whistleblower Office or operating divisions request such assistance. *See* August 2011 GAO Report, *supra* note 95.
[107] Erika Kelton, *IRS Whistleblowers See Little Reward*, FORBES, Mar. 2, 2012, http://www.forbes.com/sites/erikakelton/2012/03/02/irs-whistleblowers-see-little-reward/ (last visited Apr. 9, 2012).

even though that employees involvement is far removed from the actual persons who planned the scheme; and (3) narrowed the definition of "proceeds," the source from which whistleblower awards are paid.[108]

Additional proof of the anti-whistleblower attitude that OCC displays can be drawn from a 2010 interview with Donald Korb, former IRS Chief Counsel, in which he states:

> The new whistleblower provisions Congress enacted a couple of years ago have the potential to be a real disaster for the tax system. I believe that it is unseemly in this country to encourage people to turn in their neighbors and employers to the IRS as contemplated by this particular program. The IRS didn't ask for these rules; they were forced on it by Congress.
>
> What's going to happen is at some point, there will be some huge scandal with the program that becomes front-page news. For example, a tax director of a big company becomes dissatisfied with the company and during the course of an audit feeds the IRS information on the side. It's a ticking time bomb.[109]

Comments like this may help provide insight as to why the whistleblower program has not yet reached its full potential: it seems that not everyone at the IRS is on board.[110] Practitioners feel that "the IRS is strangling what could be a promising program to recover billions that the government is owed" and "the institutional resistance to whistleblowers at the IRS is so strong that not even numerous public comments pointing out the problems with the proposed rules persuaded the Service to modify them."[111]

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[108] *Id.* See *infra* Part IV subpart D for more on the definition of proceeds.

[109] Korb joined Sullivan & Cromwell as a partner and the head of the Firm's Tax Controversy Practice in 2009. He was the IRS Chief Counsel from 2004-2008. Jeremiah Coder, *Tax Analysts Exclusive: Conversations: Donald Korb*, 2010 TNT 11-7 (January 19, 2010).

[110] This phenomenon of apparent OCC hostility towards the whistleblower program rules probably does not come as a surprise to anyone who is familiar with the IRS. This is because the IRS, contrary to public perception, is, as an institution, extremely protective of the confidentiality of taxpayer information. The IRS does not even like to give taxpayer information to law enforcement for prosecutorial purposes. This protection is justified as necessary to protect the voluntary "self-assessment" compliance system.

[111] Jeremiah Coder, *IRS Ignores Comments in Final Definition of Proceeds for Whistleblower Awards*, 2012 TNT 35-2 (February 22, 2012) (quoting Erika Kelton of Phillips & Cohen LLP).

B. The Balance Between Taxpayer Privacy and Communicating with Whistleblowers

Section 6103 provides that tax returns and return information is confidential and the Service is prohibited from disclosing taxpayer's tax information without an explicit legislative exception.[112] However, there are a number of ways that a taxpayer's privacy could be compromised as a result of tax whistleblowers. The award determination appeal process and collaboration or communication with whistleblowers can all potentially lead to confidential taxpayer information being disclosed.

As explained earlier, a whistleblower can appeal to the Tax Court any determination regarding an award under section 7623(b). However, in order for the appeal to the Tax Court to be meaningful, disclosure to the whistleblower of the basis for the award determination is required because the amount of the award may depend on whether the IRS collected a certain amount in a settlement.[113] Thus, resolving the claim will likely require disclosure of certain information from the taxpayer in order to ensure the whistleblower that he or she has been awarded the correct amount.[114] "IRS Chief Counsel has advised that section 6103(h)(4), which permits disclosures in certain administrative and judicial proceedings, authorizes this disclosure."[115] Still, the Code does not provide an exception that expressly allows the disclosure of a taxpayer's tax information to a whistleblower.[116]

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[112] I.R.C. § 6103.
[113] Fiscal Year 2010 Report, *supra* note 57.
[114] Morse, *supra* note 15, at 26.
[115] Fiscal Year 2010 Report, *supra* note 57.
[116] PMTA 2011-31 (concluding "[e]mployees of the Whistleblower Office are authorized to disclose taxpayer return information to whistleblowers in each of the situations to which the request referred. The specific taxpayer return information that may be disclosed to a whistleblower in a particular instance, however, will depend on the facts and circumstances of the matter.") available at http://www.irs.ustreas.gov/pub/lanoa/pmta_2011-31.pdf

To the great frustration of many whistleblowers, section 6103 generally prohibits the Service from providing whistleblowers with meaningful updates and explanations regarding his or her pending claim.[117] For instance, the Service is prohibited from telling the whistleblower that his or her claim is either being actively pursued or the reason why the IRS rejected their claim. The IRS takes the position that "once a claim is submitted, the informant may be told only the status and disposition of the claim – not the action taken in the taxpayer case."[118]

Furthermore, section 6103 restricts the ability of the Service to meaningfully communicate and collaborate with whistleblowers. Consequently, the possibility of a whistleblower working with the Service to build a case against a noncompliant taxpayer, especially when it involves a complex transaction in which the informant has specific knowledge, is virtually non-existent. The IRS asserts that once a claim has been filed, the Whistleblower Office "may ask for additional assistance from the claimant or any legal representative of such individual,"[119] but may not disclose any information about the taxpayer pursuant to section 6103. However, the IRS is authorized by section 6103(n) to enter into contracts with whistleblowers, under which taxpayer information can be confidentially shared with a whistleblower to assist the IRS with the case.[120] Still, even after five years of the IRS whistleblower program acting under the enhanced section 7623, they have not entered into a single contract with a whistleblower under this provision.[121] It seems that in order to carryout its purpose of providing the IRS with information it does not have, the whistleblower program is in

[117] Kwon, *supra* note 8, at 473.
[118] IRS, Confidentiality and Disclosure for Whistleblowers (Feb. 10, 2012), available at http://www.irs.gov/compliance/article/0,,id=181291,00.html. (Essentially, the IRS will only reveal whether the claim is still open or if it has been closed).
[119] Notice 2008-4, *supra* note 58.
[120] Treas. Reg. § 301.6103(n)-2(f). Treasury issued this regulation in 2011 to clarify that the IRS can enter into section 6103(n) contracts with whistleblowers.
[121] Interview with Scott Knott, *supra* note 91.

direct conflict with taxpayer confidentiality under section 6103, and that section 6103(n) contracts with whistleblowers should be regularly utilized.

C. The Service's Own Inefficiencies

Along with institutional resistance and taxpayer privacy, the IRS whistleblower program suffers from its own inefficiencies. A report issued by the United States General Accountability Office ("GAO") in August 2011 found that "[i]ncomplete data hinders the IRS's ability to manage claim processing time and enhance external communications."[122] The study only examined the large-award, or mandatory, program laid out in section 7623(b). According to the GAO, as of April 2011 the IRS had received claims involving more than 9,500 taxpayers from 1,400 whistleblowers since the program was enacted in 2006.[123] The GAO report found that "about 66% of claims submitted in the first 2 years of the program, fiscal years 2007 and 2008, were still in process."[124]

As mentioned earlier, tax whistleblower practitioners estimate that it can take four to seven years from the time a claim is filed until an award payment is received.[125] One reason the process takes so long is because there is no accountability in the claim evaluation phase for taking many months or even years just to do the preliminary evaluation of a case by an SME. The Service's data collection system, E-TRAK, does not provide management with reports that identify weaknesses in the process.[126] Introduced by the IRS in January 2009, E-TRAK is a system designed to consistently record data for tax whistleblower claims.[127] While the system is

[122] August 2011 GAO Report, *supra* note 95.
[123] Laura Saunders, *IRS Whistleblower Program Faulted*, WALL ST. J., Sept. 10, 2011, http://online.wsj.com/article/SB10001424053111904103404576560792189138236.html (last visited Feb. 1, 2012).
[124] August 2011 GAO Report, *supra* note 95.
[125] Interview with Scott Knott, *supra* note 91.
[126] August 2011 GAO Report, *supra* note 95.
[127] *Id.*

capable of tracking some data, it is lacking in several areas. Specifically, the IRS cannot accurately track and collect complete data on the time each step of the process takes or the reasons claims are rejected or suspended.[128] This results in the IRS being unable to identify certain aspects of the program that could be improved to increase claim-processing efficiency.[129] Additionally, "not all the IRS divisions that review whistleblower claims have time targets for their subject matter expert reviews. Nor does the Whistleblower Office have a systematic process to check in with the divisions about the time taken for their initial reviews."[130] Unless change is made, these inefficiencies will continue to hinder the whistleblower program, likely to the detriment of taxpayers.

D. The Language of the Final Regulations: the Definition of Proceeds

Soon after the 2006 amendment took effect, disagreements arose as to what the definition of "proceeds" was with respect to whistleblower awards. The IRS Office of Chief Counsel seemingly complicated matters when it issued guidance that narrowed the definition.[131] Recently, however, Treasury issued final regulations that not only reversed OCC's guidance by broadening the definition of proceeds, but added some much needed clarity as well. The final regulations, which were issued on February 21, 2012, adopted without change the proposed regulations that were issued in January 2011.[132]

The improvements to the definition that the final regulations preserved seem to be generally well received by tax whistleblowers and the lawyers who represent them. The new definition of proceeds has been expanded to include not only "[t]ax, penalties, interest, additions

[128] *Id.*
[129] *Id.*
[130] *Id.*
[131] I.R.M. § 25.2.12 issued June 18, 2010. Available at http://www.irs.gov/irm/part25/irm_25-002-002.html
[132] Jeremiah Coder, *IRS Ignores Comments in Final Definition of Proceeds for Whistleblower Awards*, 2012 TNT 35-2 (February 22, 2012).

to tax, and additional amounts collected by reason of the information provided," but also "amounts collected prior to receipt of the information if the information provided results in the denial of a claim for refund that otherwise would have been paid[,] and a reduction of an overpayment credit balance used to satisfy a tax liability incurred because of the information provided."[133]

Scott A. Knott, [134] one of the most prominent practitioners representing tax whistleblowers, explains that "[t]he unchanged final regulations confirm that awards can be paid on information that leads to the denial of a claim for refund that otherwise would have been paid – which is a huge victory for whistleblowers because the IRS initially sought to make these amounts ineligible for awards."[135] Mr. Knott goes on to reiterate that "[t]he Whistleblower Office has broad authority under section 7623, and also now under the language in the final reg, to cover all the various scenarios that lead to denied refunds."[136]

While supporters of the whistleblower program are pleased with the improvements made by the final regulations, most agree that more changes are still necessary. Indeed, the final regulations dismissed considerable input from practitioners and the public on how collected proceeds should be defined.[137] The final regulations specifically rejected recommendations to include net operating losses ("NOL") in the definition of collected proceeds.[138] Although Treasury refused to make a specific reference to NOLs in the definition of collected proceeds, not all is lost. The preamble to the final regulations confirms that when a taxpayer claims an

[133] Treas. Reg. § 301.7623-1(a)(2).
[134] Interview with Scott Knott, *supra* note 91.
[135] Jeremiah Coder, *IRS Ignores Comments in Final Definition of Proceeds for Whistleblower Awards*, 2012 TNT 35-2 (February 22, 2012).
[136] *Id.*
[137] *Id.*
[138] *Id.*

NOL and it is then disallowed as a result of information provided by a whistleblower, the IRS will factor that disallowance when computing collected proceeds.[139] Still, the question remains of "what happens when an NOL carryforward does not have tax consequences until after the date the IRS computes the amount of collected proceeds."[140]

Other recommendations to the proposed regulations were also ignored. Comments regarding the removal of "the term 'overpayment' as a modifier of credit balance and adding criminal fines to the definition of collected proceeds" were unheeded.[141] Additionally, the IRS and Treasury was not clear that in cases when NOLs are reduced partly because of a whistleblower, the whistleblower should be eligible to collect an award when the company begins paying taxes again.[142] Rather than being encouraged to come forward, whistleblowers in these cases have been given mixed signals from Treasury; "[t]he Treasury and IRS missed a real opportunity" when issuing the final regulations.[143]

Moreover, the final regulations did not address the question of when whistleblower cases become award-eligible.[144] However, this issue is in part currently before the Tax Court in *Insinga v. Commissioner*, where the petitioner-whistleblower claimed that the IRS had already collected proceeds based on his information but failed to issue an award.[145] The IRS received inquiries last year as to why the IRS has not changed the outdated policies in the Internal

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[139] *Id.*
[140] *Id.* (quoting Bryan C. Skarlatos of Kostelanetz & Fink LLP).
[141] Jeremiah Coder, *IRS Ignores Comments in Final Definition of Proceeds for Whistleblower Awards*, 2012 TNT 35-2 (February 22, 2012) (noting that according to the preamble, however, restitution that a court orders to the IRS is encompassed in the definition of collected proceeds).
[142] *Id.* (citing Dean Zerbe, national managing director at Alliant Group LP and a former tax counsel to Senate Finance Committee Republicans).
[143] *Id.* (citing Dean Zerbe, national managing director at Alliant Group LP and a former tax counsel to Senate Finance Committee Republicans).
[144] *Id.* (quoting Scott A. Knott). The Service's current position is stated in Notice 2008-4, *supra* note 58.
[145] See *Joseph A. Insinga v. Commissioner*; No. 004609-12W, 2012 TNT 45-17 (Feb. 21, 2012).

Revenue Manual that often delay awards by up to two years, but there has been no response.[146] Mr. Knott suggests "the IRS could simply revoke these outdated IRM sections which are now in conflict with this final regulation."[147] While it is apparent that the exact adoption of the language of the proposed regulations has had some positive results, disappointment still exists because of the uncertainty that remains for whistleblowers.

V. Challenges Tax Whistleblowers Face

It seems that for every challenge the IRS whistleblower program must overcome, whistleblowers themselves must overcome one as well. Certainly, one of the primary objectives of the IRS whistleblower program is to encourage informants to come forward with information on those who are noncompliant with U.S. tax laws. With this, it may come as a surprise to many potential informants that the whistleblower program is scattered with nuances that are inconsistent with this objective. For instance, withholding taxes on whistleblower award payments, taking years to make a final determination on a claim, and the Service's ability to obstruct awards all seem to weigh heavily towards discouraging whistleblowers from filing claims. Additionally, whistleblowers must take precautions to protect their identity throughout the claim process.

A. Factors to Consider When Deciding Whether to Make a Claim

1. Withholding Taxes

Currently, if the IRS pays an award to a whistleblower, its policy is to withhold from the payment 28 percent in tax.[148] There is no doubt that award payments are to be treated as taxable

[146] Jeremiah Coder, *IRS Ignores Comments in Final Definition of Proceeds for Whistleblower Awards*, 2012 TNT 35-2 (February 22, 2012).
[147] *Id.*
[148] August 2011 GAO Report, *supra* note 95.

income, but much controversy surrounds the legal reasoning that the IRS is using to justify its decision to withhold.[149] The IRS announced that it would be withholding income tax on whistleblower award payments in an Office of Chief Counsel legal memorandum to its Whistleblower Office dated September 30, 2010.[150] Specifically, the withholding decision is controversial because the Service's legal reasoning is inconsistent with its approach in other tax areas.[151] The idea seems to be that large amounts subject to tax should not be allowed to leave the government's hands without the necessary tax being withheld.[152] However, based on this premise, other types of government payments, such as payments to government contractors, should be subject to withholding.[153]

The IRS reasons that "[u]nder section 7623(b), awards will be vastly larger" and therefore "the revenue consequences of nontax compliance will increase exponentially."[154] Additionally, the Service says that "there is a much greater likelihood that awards could be paid to individuals in foreign countries, who may not otherwise have had a federal income tax filing in the United States, and to other individuals who may have been less than totally compliant in their personal filing obligations."[155] The Chief Counsel memo notes that, although existing withholding practices are based on specific statutory authority, "there is no specific statutory authority to withhold on [w]histleblower awards," but there is "also no direct prohibition against

[149] Jeremiah Coder, *IRS Withholding on Whistleblower Awards Ignites Controversy*, 2011 TNT 78-1 (April 22, 2011).
[150] *Id. See also* PTMA 2010-063, available at http://www.irs.gov/pub/lanoa/pmta-2010-063.pdf
[151] Jeremiah Coder, *IRS Withholding on Whistleblower Awards Ignites Controversy*, 2011 TNT 78-1 (April 22, 2011).
[152] *Id.*
[153] *Id.* (quoting Bryan C. Skarlatos)
[154] PTMA 2010-063, available at http://www.irs.gov/pub/lanoa/pmta-2010-063.pdf
[155] *Id.*

doing so."[156] Still, the IRS argues that Congress has given it "the authority to do whatever is needed to properly enforce the tax laws."[157]

The Service's decision to withhold is detrimental to whistleblowers. A point of contention among practitioners is that there seems to be no rational basis to target this class of taxpayers for special treatment, especially because no tax debt will have accrued yet since the tax return reporting the award payment will not have been filed at the time of the award.[158] Additionally, the Service's "position will likely lead to over withholding, because the withholding structure imposed by the memo ignores any deductions a whistleblower might claim for contingent fees paid to his attorneys."[159] As a result, it is estimated that claimants will only receive an award of about half as much as expected because of over withholding that does not take into account the deduction.[160] Undoubtedly, it seems like the objective of encouraging informants to come forward was forgotten about when the IRS imposed the withholding structure.

2. Time Frame

Besides withholding, whistleblowers need to recognize that filing a whistleblower claim is not a get-rich-quick scheme. However, if an informant feels that he or she has a solid case supported by strong evidence, the time that it takes to complete the claim review process should not be a deterrent. Nonetheless, before one puts all of their eggs in the "I am going to be a tax whistleblower and get rich quick so that I can retire and not work anymore" basket, remember that patience is required. As of May 11, 2011, the IRS reported that it had only "paid a small

[156] *Id.*
[157] *Id.*
[158] Jeremiah Coder, *IRS Withholding on Whistleblower Awards Ignites Controversy*, 2011 TNT 78-1 (April 22, 2011) (quoting Bryan C. Skarlatos).
[159] *Id.* (quoting Scott A. Knott)
[160] *Id.*

number of awards" since the 2006 expansions to the program.[161] Of this small number of awards, only one award has become public when it was announced on April 8, 20011.[162] So, while the IRS has received numerous claims, it has not been quick to pay many awards.

3. IRS Roadblocks

Aside from needing patience and understanding that taxes will be withheld from an award payment, potential whistleblowers should also be aware that filing a claim that has merit does not guarantee an award. Additionally, "attorneys who represent informants worry that the Service's handling of the program creates numerous roadblocks that make it unattractive to future informants."[163] Even the person most responsible for creating the program, Senator Charles Grassley, has criticized it. Senator Grassley has expressed a concern that "IRS management might have too many opportunities to say 'no' to a whistleblower, even when the whistleblower office believes the claim has merit."[164]

As mentioned earlier, the IRS cannot be forced to act on information it receives from informants.[165] Thus, it is possible that even if the IRS receives a claim that is certain to result in the collection of tax which would result in an award—the information was provided by an insider who has specific knowledge, there is clearly a tax issue, and it is known that there are no

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[161] The Service's "view is that reporting the exact number of awards before a sufficient number of payments have been made would violate section 6103, which prohibits disclosing tax information either directly or indirectly. IRS has not yet paid a sufficient number of awards to meet the threshold for aggregate public disclosure." August 2011 GAO Report, *supra* note 95.

[162] Egan Young, *Breaking Legal News: First IRS Whistleblower Office Reward* (Apr. 8, 2011), available at http://eganyoung.com/news/press-releases/51-breaking-legal-news-first-irs-whistleblower-office-reward.html

[163] Jeremiah Coder, *Whistleblower Petitions Tax Court to Stop IRS From Obstructing Award*, 2012 TNT 45-1 (March 7, 2012).

[164] Laura Saunders, *IRS Whistleblower Program Faulted*, WALL ST. J., Sept. 10, 2011, http://online.wsj.com/article/SB10001424053111904103404576560792189138236.html (last visited Feb. 1, 2012) (quoting Senator Charles Grassley).

[165] *Cooper v. Commissioner*, 136 T.C. 597 (June 21, 2011) (holding that the Tax Court's jurisdiction in a whistleblower case does not include opening or ordering the IRS to open an administrative or judicial action to redetermine the tax liability.); *see* http://www.tax-whistleblower.com/resources/

other whistleblowers—if the IRS chooses not to move forward with the claim, there is nothing the whistleblower can do. Furthermore, "if the IRS can show that it already was in possession of information that led to the collection of proceeds, it has a basis for denying the informant's award claim."[166] It has even been alleged that the IRS has refused to issue formal determinations by reasoning that the Whistleblower Office must review closed files that might show that the IRS had other sources of information for the administrative actions against a taxpayer.[167]

B. Protections for the Whistleblower

A large percentage of whistleblowers who ultimately decide to go to the IRS with information about tax noncompliance have gained that information through their employment and are using it against their current or former employer.[168] Thus, confidentiality of the whistleblower's identity is of utmost importance. After all, in many cases, by coming forward with information, whistleblowers are risking personal and professional relationships as well as their job. In light of this, the Internal Revenue Service has stated that it will protect the identity of the whistleblower "to the fullest extent permitted by law."[169] However, the Service notes that in some circumstances, such as if the claimant is needed as a witness in a judicial proceeding, "it may not be possible to pursue the investigation or examination without revealing the claimant's identity."[170]

An additional concern regarding confidentiality is with respect to a whistleblower's identity being revealed to his or her employer. Fortunately, if this were to ever happen, there are

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[166] Jeremiah Coder, *Whistleblower Petitions Tax Court to Stop IRS From Obstructing Award*, 2012 TNT 45-1 (March 7, 2012).
[167] *Id.*
[168] Whistleblowers typically fall into a number of groups, including: insiders (both current and former), business associates, ex spouses, professional consultants (i.e., financial advisors or brokers), and those basing their claim off of things they heard or saw a taxpayer do. Interview with Scott Knott, *supra* note 91.
[169] Notice 2008-4, *supra* note 58.
[170] *Id.*

federal and state employment laws designed to prevent an employer from retaliating against whistleblowers,[171] and the provisions of Sarbanes-Oxley[172] also protect whistleblowers from retaliation. While this protection is nice, even knowing that one's job is safe may not be enough to get whistleblowers to come forward.

Another factor that discouraged whistleblowers from coming forward was the fear that their identity would be exposed if they were to challenge the IRS's determination in their case.[173] However, this recently changed when the Tax Court decided *Whistleblower 14106 10W v. C.I.R.*, 137 T.C. No. 15 (Dec. 8, 2011). In *Whistleblower 14106 10W*, the informant, a senior executive at an unnamed company, filed a whistleblower claim reporting that he or she had witnessed the company significantly reduce its tax liability through noncompliance with the tax code.[174] After reviewing the claim, the IRS concluded that there were no grounds to make an award under section 7623(b).[175] The whistleblower timely petitioned the Tax Court to review the Service's denial of an award and also "filed a motion asking for a protective order that would either seal the record or allow him to proceed anonymously."[176] Even though the whistleblower had left the company he claimed was cheating on their taxes, he argued that "revealing his identity in court would create psychological and financial harm, including potential harmful employment repercussions.[177] Ultimately, the Tax Court held "that the potential harm from disclosing a whistleblower's identity as a confidential informant outweighs the public interest in knowing the

[171] *See* http://www.employmentlawgroup.net/News/Articles/NewToolsCombatWhistleBlowerRetaliation.html. *See also Alder v. Am. Standard Corp.*, 830 F.2d 1303 (11th Cir. 1987).
[172] 18 U.S.C.A. § 1514 (West 2012).
[173] Jeremiah Coder, *Whistleblower Anonymity in Tax Court Pleases Informant Representatives*, 2011 TNT 238-5 (December 12, 2011).
[174] *Whistleblower 14106 10W v. C.I.R.*, 137 T.C. No. 15 (Dec. 8, 2011)
[175] *Id.*
[176] *Id.*
[177] *Id.*

whistleblower's identity, and that redacting identifying information adequately protects the whistleblower's legitimate privacy interests as a confidential informant."[178]

In making its decision, the court acknowledged the absence in section 7623 of explicit anti-retaliatory protections similar to those found in in other whistleblower statutes.[179] Additionally, social and professional stigmas, a credible risk of bodily harm, and case law supporting judicial anonymity were all factors that weighed in favor of granting anonymity in this case.[180] However, the majority stated in a footnote that they did "not mean to suggest that this balancing test would or should necessarily result in anonymity for all tax whistleblowers in [the Tax] Court. Ultimately, absent any legislative directive to the contrary, each request to proceed anonymously must stand upon its own."[181] Still, tax practitioners feel that this case is an important victory for all tax whistleblowers and they are happy to see that the Tax Court recognizes the importance of protecting a whistleblower's identity.[182]

VI. Proposed Solutions and Improvements

At this point, it is rather clear that the IRS whistleblower program has the potential to assist the IRS with its mission of enforcing our self-assessment system of taxation. However, while the program has undergone significant expansion and improvements, more needs to be done. Specifically, the IRS whistleblower program should welcome the help of whistleblowers when investigating a claim, restructure the way taxes are withheld from awards, implement a new system or improve the current system used to track whistleblower claims data, and strive for

[178] *See* http://www.tax-whistleblower.com/resources/ (citing *Whistleblower 14106 10W v. C.I.R.*, 137 T.C. No. 15 (Dec. 8, 2011))
[179] *Whistleblower 14106 10W v. C.I.R.*, 137 T.C. No. 15 (Dec. 8, 2011)
[180] *Id.*
[181] *Id.* at n. 29.
[182] Jeremiah Coder, *Whistleblower Anonymity in Tax Court Pleases Informant Representatives*, 2011 TNT 238-5 (December 12, 2011) (quoting Scott A. Knott).

institutional change within the IRS. These proposals will encourage more informants to come forward and help eliminate the deficiencies that plague the timely resolution of whistleblower claims.

A. Welcome the Help of Whistleblowers

Quite possibly the most important improvement that could be made to the IRS whistleblower program would be to have more interaction with whistleblowers and their representatives. The IRS has an apparent unwillingness to take advantage of whistleblowers' expertise and allow them to assist the IRS in certain, limited circumstances.[183] Currently, the Securities and Exchange Commission ("SEC"), Department of Justice ("DOJ"), and the Florida Department of Revenue allow for interaction with whistleblowers during the investigation process and that option has been rather successful.[184] In fact, '[a]n SEC enforcement official told Congress last year that high-quality whistleblower information had saved the SEC six to 12 months of investigative time on a matter the SEC only learned about from that insider."[185] Certainly the IRS could benefit in the same way.

The IRS might argue that increasing interaction with whistleblowers could lead to taxpayer information being improperly disclosed or that over reliance on whistleblower information may impact the independence of the investigation.[186] However, these potential disadvantages can be avoided. First, Congress could amend section 6103 so that the Service is

[183] Erika Kelton, *IRS Whistleblowers See Little Reward*, FORBES, Mar. 2, 2012, http://www.forbes.com/sites/erikakelton/2012/03/02/irs-whistleblowers-see-little-reward/ (last visited Apr. 9, 2012).
[184] August 2011 GAO Report, *supra* note 95. *See also* Erika Kelton, *IRS Whistleblowers See Little Reward*, FORBES, Mar. 2, 2012, http://www.forbes.com/sites/erikakelton/2012/03/02/irs-whistleblowers-see-little-reward/ (last visited Apr. 9, 2012).
[185] Erika Kelton, *IRS Whistleblowers See Little Reward*, FORBES, Mar. 2, 2012, http://www.forbes.com/sites/erikakelton/2012/03/02/irs-whistleblowers-see-little-reward/ (last visited Apr. 9, 2012).
[186] August 2011 GAO Report, *supra* note 95.

permitted to communicate and collaborate with whistleblowers.[187] Or, to avoid statutory amendments, the IRS could begin to actually utilize section 6103(n) contracts with whistleblowers to help prevent redisclosure of tax information and impose strict penalties for doing so.[188] Either of these options would give the IRS an opportunity to tap whistleblowers for their intimate knowledge of the information they provide. This could drastically reduce the time that it takes to complete an examination.

B. Restructure Withholding on Whistleblower Awards

There are a couple options the Service can look at to improve the way taxes are withheld from whistleblower awards. First, the Service could eliminate withholding on whistleblower awards altogether because there is no specific statutory authority either to withhold or not on whistleblower payments. Second, the IRS could let whistleblowers enter into withholding agreements that take into account deductions available to offset tax liability.[189] The latter option would allow the IRS to achieve its stated goal of assuring current payment of the correct amount of tax and ensure the informant receives the full amount he or she is entitled to. Additionally, this practice would be easy to implement because the IRS already uses centralized withholding agreements for nonresident aliens. Either option would likely help encourage informants to come forward, or at least not discourage potential informants.

C. Improve the Process to Track Whistleblower Claims Data

As described earlier, the Whistleblower Office does not have complete and accurate data on claims processing, nor is there a systematic process to manage the timeliness of all the

[187] Kwon, *supra* note 8, at 488.
[188] August 2011 GAO Report, *supra* note 95.
[189] Jeremiah Coder, *IRS Withholding on Whistleblower Awards Ignites Controversy*, 2011 TNT 78-1 (April 22, 2011) (quoting Scott A. Knott).

processing steps it oversees. The IRS should either implement a new system or improve the current system to track all necessary data. This would allow the Whistleblower Office and operating division management to make better decisions regarding resource allocation and the timeliness of the processing of claims, particularly those with impending statute of limitations issues.[190] For instance, if the IRS divisions that review the claims set time targets for SME reviews and then are able to track how long it takes each SME to conduct a review, management can use this data to hold SMEs accountable for either moving cases forward or rejecting them on a timely basis.[191] Additionally, "having more complete data available to Whistleblower Office management would be consistent with key internal control standards for maintaining relevant and reliable information to help agencies achieve their objectives."[192]

Once the IRS and the Whistleblower Office has implemented a better system to collect data and process claims, it would be wise to assign a higher priority to those claims that have a high likelihood of resulting in the payment of additional taxes. Currently, whistleblower cases do not automatically receive any priority treatment in the audit process because taxpayers in those cases have the same rights as taxpayers in any other case.[193] While this may be true, cases that come in with strong leads should be moved ahead in the process so that the IRS can make a determination and pay an award as quickly as possible without wasting resources. In fact, a TIGTA study revealed that whistleblower cases let to higher collections per agent hour than regular cases, so the IRS's own research supports the higher prioritization of whistleblower

[190] August 2011 GAO Report, *supra* note 95.
[191] This step in the process is a Subject Matter Expert problem and not a Whistleblower Office problem.
[192] August 2011 GAO Report, *supra* note 95.
[193] Jeremiah Coder, *IRS Whistleblower Office Implementing Improvements*, 2012 TNT 35-13 (February 22, 2012).

initiated cases.[194] This would also incentivize informants to ensure that all of their ducks are in a row before they file a claim.

D. Work Towards a Common Goal

It is hard to imagine the IRS whistleblower program becoming truly successful without the support of the Office of Chief Counsel. Consequently, it is necessary that OCC realize all of the good that can come from the program and stand behind the Whistleblower Office. The sheer size of the whistleblower claims that are being filed should be enough to convince OCC that a strong whistleblower program could quickly help reduce the tax gap.

Rather than issue guidance that continues to hinder the program, OCC should heed the advice of whistleblower practitioners and interpret the law in ways that encourage whistleblowers to come forward. After all, Congress made it clear that this is what it wanted from the IRS. Among other things, OCC could rescind its decision to delay award payments until after the section 6511 refund claim period has run, which is either three years from filing or two years from the date of payment.[195] Moreover, having OCC onboard with the goals and objectives of the program would allow for quicker implementation of other proposed improvements because it has the authority to provide guidance on issues such as withholding taxes and allowing more interaction with whistleblowers.

VII. Conclusion

From the start, the primary objective of the IRS whistleblower program has been to encourage tax whistleblowers to come forward with information relating to tax noncompliance

[194] 2006 TIGTA Report, *supra* note 33, at 4-5.
[195] Jeremiah Coder, *IRS Whistleblower Office Reports Increased Claims, Award Activity in 2010*, 2011 TNT 140-2 (July 21, 2011) (quoting Scott A. Knott).

that, collectively, could encourage greater voluntary compliance and help to reduce the tax gap. The 2006 amendments to the statute were made as an effort to enhance the program in order to better achieve this objective. There is no doubt that the program has been improved as a result of the amendment, but more change is needed to make the program even better. By creating an institutional environment that supports the program, eliminating the bureaucratic roadblocks, and welcoming the help of whistleblowers, the IRS will significantly improve informant's chances of receiving an award. These changes would not only give whistleblowers more confidence in the program, but the program would finally be able to reach its full potential.