

By-Lined Article

THE IRS WHISTLEBLOWER PROGRAM

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The recent turnover of Swiss bank account data highlights the role of whistleblowers in U.S. enforcement. There was the UBS banker, Bradley Birkenfeld, Tax Analysts' 2009 person, whose whistleblowing brought the extent of offshore tax evasion to the attention of the Department of Justice and the Internal Revenue Service (IRS). As his reward for filing a claim with the IRS for a Whistleblower reward related to his disclosures, Birkenfeld was given a 40-month sentence for conspiring to commit tax fraud because of his counseling of UBS clients. Then, there Rudolf Elmer, manager of the Caribbean operations of Julius Baer, who turned over information on more than 2,000 undeclared foreign bank accounts to WikiLeaks. It is still too early to tell whether Elmer and Birkenfeld will received whistleblower awards, but if they do, they stand to be awarded billions of dollars.

Background

The authority to pay rewards to whistleblowers has existed for many years, having its origin in Congress-enacted legislation in 1867. The original whistleblower law provided the authority "to pay such sums as [the Secretary] deems necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws" In 1996, the Taxpayer Bill of Rights expanded the statute allowing the IRS to pay awards for "detecting underpayments of tax" and changed the source of funds to pay awards from the IRS operating budget to proceeds collected from the taxpayer (other than interest). However, the payment of awards to whistleblowers and the amount were completely discretionary.

2006 Amendments to Whistleblower Statute

In 2006, the Tax Relief and Health Care Act of 2006 created provisions for mandatory awards, if the whistleblower's information met certain conditions and substantially contributed to the decision to take administrative or judicial action that results in the collection of tax penalties interest, additions to tax and additional amounts. The revisions of the Whistleblower statute were to encourage whistleblowers to come forward. Under the statute, the IRS must pay an award of at least 15 percent but not more than 30 percent, of the collected proceeds resulting from the administrative or judicial actions or from settlement in response to an administrative or judicial action. The exact amount of the award depends upon the extent to which the individual seeking the award substantially contributed to such actions. The maximum award percentage is reduced to not more than 10 percent, if the administrative or judicial action is based principally on specific allegations disclosed in certain public information sources, such as government audit reports and if the whistleblower's contribution was less than substantial.

Limitations on Awards

If the whistleblower planned and initiated the actions that led to the under payment of tax, the amount of the whistleblower award may be reduced depending on the extent of involvement of the planner or initiator. Further, if the whistleblower is convicted of criminal conduct from his or her role in planning and initiating the action that led to the under payment of tax, then the Whistleblower Office must deny any award to the individual. Also, no person who was an employee of the Treasury Department when he came into possession of the information is eligible for a whistleblower award.

Conditions to Mandatory Awards

To qualify for a mandatory award, the taxpayer who is the subject of the whistleblower's claim and the amount involved must meet certain criteria. Mandatory awards can only be awarded:

1. If the information relates to a tax noncompliance matter against any taxpayer, but for an individual taxpayer, only if the individual taxpayer's gross income exceeds \$200,000 for at least one of the tax years in question and
2. The tax, penalties, interest, additions to tax and additional amounts in dispute exceeds \$2 million.

Otherwise, an award to a whistleblower is completely within the discretion of the IRS.

Representation of Whistleblower

A legal representative can represent a whistleblower in seeking an award. The IRS has proposed regulations allowing the legal representative to charge a contingent fee in connection with a whistleblower claim. Further, a whistleblower may deduct above-the-line attorney's fees and costs paid in connection with claiming a whistleblower award up to the amount of the award.

Appeal of Award to Tax Court

In addition to creating the Whistleblower Office within the IRS to administer the submission of information for an award, the 2006 Act provided that a whistleblower can appeal a mandatory Whistleblower Office award, but not a discretionary award, to the U.S. Tax Court. The statute provides that any determination regarding a mandatory award may be appealed within 30 days of the determination to the Tax Court and that the Tax Court shall have exclusive jurisdiction of such matter. Recently, the Tax Court determined that an IRS letter denying a whistleblower-award claim qualified as a jurisdictionally, conferring determination within the meaning of the statute. The Tax Court found that its jurisdiction was not limited to reviewing only determined awards but also covered denial determinations. It is still to be determined whether a whistleblower can appeal to the Tax Court the IRS' decision on whether or not to audit a taxpayer or assert a deficiency.

Collected Proceeds

Whistleblower awards are based on a percentage of the collected proceeds from a successful administrative or judicial action based on the information a whistleblower submits. Reversing its previous position, the IRS has issued proposed regulations that include in the definition of collected proceeds "amounts collected prior to receipt of the information if the information provided results in the denial of a claim for refund that otherwise would be paid; and a reduction of an overpayment credit balance used to satisfy a tax liability incurred because of the information provided." Thus, when the regulations are finalized, collected proceeds will include offsets, application of net-operating losses (NOLs), refunds or other amounts that might reduce a tax liability. Although the statute and the proposed regulation lists penalties as collected proceeds, the Internal Revenue Manual still says that criminal penalties are not part of collected proceeds.

Procedure for Seeking an Award

The IRS issued Notice 2008-4, which provided initial guidance of how to submit information to the IRS. In addition, the IRS has revised the sections of the Internal Revenue Manual dealing with the procedures and guidance for all IRS personnel to follow when dealing with whistleblowers' claims. Individuals seeking either a mandatory or discretionary award for submitting information must send to the Whistleblower Office in Washington, D.C. a completed Form 211, The Application for Award for Original Information, executed under penalties of perjury. Form 211 may also include the submission of the information upon which the whistleblower relies. If the claim meets the criteria under the statute after an initial review, the Whistleblower Office will acknowledge receipt of the claim and identify the Whistleblower Office analyst assigned to process the claim. Further, a whistleblower must sign a confidentiality agreement before receiving access to the preliminary award report package.

Conclusion

The Whistleblower award is mandatory if certain criteria are met otherwise it is left to the discretion of the IRS. It is still too early to determine whether the mandatory Whistleblower awards will have the intended effect of having whistleblowers come forward since the Whistleblower Office has not awarded any mandatory awards to date. But, the reporting of uncertain positions by publicly traded companies may be fertile grounds for whistleblowers to identify significant tax underpayments.

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