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# PAYING THE IRS WHISTLEBLOWER: A CRITICAL ANALYSIS OF COLLECTED PROCEEDS

*Karie Davis-Nozemack\**  
*Sarah Webber\**

## INTRODUCTION

Congressional changes to the IRS Whistleblower Program were intended to induce more participation in the program by allowing larger incentives and greater certainty that whistleblowers would be paid. Since the Program was amended, tax whistleblower tips have increased 76 percent<sup>1</sup> and revenue collected due to whistleblowers has increased 79 percent.<sup>2</sup> Despite a rise in tips and revenue collected, whistleblower payments have not increased. In fact, the number of tax whistleblower awards paid has decreased 44 percent.<sup>3</sup> We hypothesize that this trend is due to the administration of the program but also to the interpretation of “collected proceeds.” Collected proceeds are tax revenues collected due to a specific whistleblower tip and comprise the pool of money from which a tax whistleblower award is made. While scholarship exists examining the Whistleblower Program amendments and their effects, no scholar has critically examined the crux of the Whistleblower Program: what should constitute collected proceeds.

This article offers critical analysis of both the Service’s interpretation of “collected proceeds” as well as proposals advanced by whistleblower advocates. Neither the IRS nor the whistleblower advocates’ interpretations offer a properly inclusive view of collected proceeds.<sup>4</sup> We suggest an

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<sup>1</sup> See IRS WHISTLEBLOWER OFFICE, FISCAL YEAR 2010 REPORT TO CONGRESS ON THE USE OF SECTION 7623, at 16 (2010), available at [http://www.irs.gov/pub/whistleblower/annual\\_report\\_to\\_congress\\_fy\\_2010.pdf](http://www.irs.gov/pub/whistleblower/annual_report_to_congress_fy_2010.pdf) (tips increased from 4295 in 2006 to 7577 in 2010).

<sup>2</sup> *Id.* (revenue collected increased from \$258 million in 2006 to \$464 million in 2010).

<sup>3</sup> *Id.* (awards paid decreased from \$24 million in 2006 to \$28 million in 2010).

<sup>4</sup> Generally, the IRS has emphasized an overly narrow interpretation of collected

alternative view of collected proceeds that balances the need for an attainable incentive,<sup>5</sup> administrable program,<sup>6</sup> and federal revenue protection.<sup>7</sup> Failing to achieve any one of these needs risks the Whistleblower Program's viability. We suggest a view of collected proceeds that builds upon the Program's successes and broadens its scope, which should lead to increased federal revenue.

Part One of this paper discusses the statutory changes to the Whistleblower Program, including the public policy behind the amendment as well as the manner in which the new IRS Whistleblower Office has administered the law.<sup>8</sup> Part Two examines the Service's interpretation of the basis of whistleblower payments,<sup>9</sup> the "proceeds of amounts collected by reason of the information provided."<sup>10</sup> This Part uses the prior and current IRS payment policy, statutory interpretation, the 2012 Final Treasury Regulation, as well as conflicts between Service guidance and the Internal Revenue Manual to conclude that the Service's interpretation of "collected proceeds" is not sufficiently inclusive.<sup>11</sup> Part Three uses similar critical analysis to view the whistleblower advocates' proposed

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proceeds, while whistleblower advocates have argued for an interpretation that is overly inclusive and ignores the need for collection of funds prior to whistleblower compensation. This paper analyzes these interpretations and the underlying interests to create a view of collected proceeds that follows the statutory language but also addresses the interests of whistleblowers and the IRS Whistleblower Program.

<sup>5</sup> See Marsh J. Ferziger and Daniel G. Currell, *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, 1999 U. ILL. L. REV. 1141, 1143, 1151-3, 1171-87 (1999) (discussing an enforcement-optimized bounty program under an economic model and stating "The potential informant's expected bounty payment may be the single most important factor in ensuring optimal disclosures.").

<sup>6</sup> *Id.* at 1158-60 ("Whether a bounty scheme is profitable overall depends partly upon the administrative costs of separating the meritorious from the nonmeritorious claims. The IRS must sort through nearly ten thousand award claims every year, evaluating the merits both of the offered information and the claim for reward."). We also believe that the complexity of the administrative structure also factors into the Program's possible success.

<sup>7</sup> See Kneave Riggall, *Should Tax Informants be Paid? The Law and Economics of a Government Monopsony*, 28 VA. TAX REV. 237, 251 (2008) ("neoclassical economic theory predicts that if the Service rewards tax informants, it would receive more tips, more tax cheats would be "outed," and tax revenues would increase."). See also Ferziger & Currell, *supra* note 5 at 1156 ("Payments out of proceeds, although introducing uncertainty, remains the best procedure for most agencies. Without this option, it is difficult to ensure a revenue-positive operation of the bounty programs.").

<sup>8</sup> See *infra* text accompanying notes 15-78.

<sup>9</sup> See *infra* text accompanying notes 81-152.

<sup>10</sup> § 7623(a). The language of § 7623(b) differs slightly. See *infra* text accompanying notes 99-106 (discussing of the difference and its ramifications).

<sup>11</sup> See *infra* text accompanying notes 81-152.

interpretation of “collected proceeds” and finds that it ignores the tax realities of many alleged underpayments.<sup>12</sup> Part Three concludes that the whistleblower advocates’ proposals for collected proceeds are overly inclusive.<sup>13</sup> Finally, in Part Four, the paper considers a more balanced approach to defining “collected proceeds.”<sup>14</sup>

## I. HISTORY OF THE IRS WHISTLEBLOWER PROGRAM

The IRS Whistleblower Program has successfully utilized a cost-effective method to recover tax revenues and close the tax gap.<sup>15</sup> While the Program recovered \$1.2 billion dollars between 2006 and 2010,<sup>16</sup> the Whistleblower Program needs further improvement to sustain and build upon its success. This Part introduces the Whistleblower Program by discussing the types of individuals involved in tax whistleblower claims,<sup>17</sup> followed by the legislative history of the whistleblower statute<sup>18</sup> and administrative difficulties identified in the Whistleblower Program.<sup>19</sup> Finally, this Part discusses improvements for the Program’s administration,<sup>20</sup> and concludes that, while administrative improvements are needed, the most pressing need lies in clarifying “collected proceeds.”

### A. Who is the Whistleblower?

The connotations associated with the whistleblower term vary significantly. There are those who view the whistleblower as a “hero” or champion protecting honest taxpayers and the tax system.<sup>21</sup> Whistleblower advocates point out that there is a huge cost to a whistleblower in coming forward.<sup>22</sup> A whistleblower providing information on tax fraud or

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<sup>12</sup> See *infra* text accompanying notes 153-277.

<sup>13</sup> See generally *infra* text accompanying notes 153-277.

<sup>14</sup> See *infra* text accompanying notes 278-314.

<sup>15</sup> Tom Herman, *Tipster Rewards Require Patience*, WALL STREET J. Dec. 26, 2007, at D3. See also Edward Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the “Tax Gap,”* 24 AKRON TAX J. 1, 11-13 (2009).

<sup>16</sup> See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 16 (stating proceeds derived from whistleblower tips 2006-2010).

<sup>17</sup> See *infra* text accompanying notes 21-33.

<sup>18</sup> See *infra* text accompanying notes 34-55.

<sup>19</sup> See *infra* text accompanying notes 56-80.

<sup>20</sup> See *infra* text accompanying notes 76-78.

<sup>21</sup> See Letter from Senator Charles Grassley, U.S. Senate, to Douglas Shulman, Commissioner, Internal Revenue Serv., at 8, Sept. 13, 2011, available at [http://www.rewardtax.com/files/grassleylettertoshulman9\\_13\\_11.pdf](http://www.rewardtax.com/files/grassleylettertoshulman9_13_11.pdf).

<sup>22</sup> See Internal Revenue Serv., *Public Hearing on Proposed Regulation 26 C.F.R. Part*

improper return positions faces risks, such as “loss of job, loss of reputation, loss of career.”<sup>23</sup>

Others take a different, and perhaps a much more negative view of whistleblowers. A whistleblower often faces the particularly distasteful distinction of being a “snitch.”<sup>24</sup> In Senate debate of the 1998 Internal Revenue Service Restructuring and Reform Act, Senator Reid suggested eliminating the IRS Whistleblower Program because a program that rewards individuals who turn in co-workers, family members and other parties is “just wrong.”<sup>25</sup> Indeed, the Service itself previously treated tax whistleblowers as “skunks at a picnic.”<sup>26</sup> The Service has diligently worked to change both its perspective and treatment of whistleblowers.

The whistleblower may be best viewed as a reluctant participant who simply does not want to participate anymore. It could be that the whistleblower has become fed up with the other participants or may be persuaded to act based on an incentive from the IRS Whistleblower Program. As eloquently stated in a comment letter, “promoters of tax shelters and tax fraud are not surrounded by boy scouts and angels.”<sup>27</sup> Rather, “whistleblowers will often not have clean hands.”<sup>28</sup> Anecdotal evidence suggests that the Service often receives tips after a relationship has gone bad, be it a familial, romantic, or business relationship. It is this type of intimate relationship that often provides for the “detailed inside knowledge that will be the most beneficial in bring forward tax fraud.”<sup>29</sup> The repercussions of whistleblowing can vastly disrupt or change a whistleblower’s employment and relationships with co-workers, friends or even family members; however, oftentimes these relationships were already in jeopardy of turning sour.

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301, “*Rewards and Awards for Information Relating to Violations of Internal Revenue Laws*,” at 13, May 11, 2011, available at TAX NOTES TODAY Doc. 2011-10193 (comments of Richard Rubin).

<sup>23</sup> See Hearing Transcript, *supra* note 22 at 2 (comments of Linda Stengle).

<sup>24</sup> 144 CONG. REC. S4379-05, at S4397-98 (Statement of Sen. Reid).

<sup>25</sup> *Id.*

<sup>26</sup> See Grassley letter, *supra* note 21, at 1.

<sup>27</sup> See Letter from Jesselyn Radack, Marsha Coleman-Adebayo, Gina Green to Douglas Shulman, Internal Revenue Serv., Commissioner (Aug. 10, 2011) (expressing concern I.R.M. factors for reducing a whistleblower award for whistleblowers who planned and initiated an action), available at <http://www.grassley.senate.gov/about/loader.cfm?csModule=security/getfile&pageid=3693>

6.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

Regardless of the positive or negative view of the whistleblower, it cannot be disputed that the Whistleblower Program has been a successful way for the Service to promote federal revenue protection.<sup>30</sup> Arguably the Program has been one the most successful, in terms of tax revenues recovered versus cost of administering the program.<sup>31</sup> The payment system for rewarding whistleblowers is discussed in detail below including its evolution<sup>32</sup> and the most recent changes to payments.<sup>33</sup>

### B. Early Incentives for Tax Whistleblowers

While the IRS Whistleblower Office is new, the idea of rewarding an individual who turns in a party who intentionally misuses the Code or misfiles taxes was authorized by statute in 1867. The original law provided the Secretary with the authority to pay awards necessary for detecting and punishing persons guilty of violating the internal revenue laws or scheming to do so.<sup>34</sup> The earliest versions of tax whistleblower awards did not provide much incentive for whistleblowers and were underutilized by the Service to attract informants.<sup>35</sup> This could be attributed to the uncertainty regarding payment amounts. Under the 1954 codification of § 7623, the Secretary was given the discretion to determine award payments,<sup>36</sup> and this discretion was upheld in numerous court opinions regarding both the decision whether to pay an award and the proper award amount.<sup>37</sup>

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<sup>30</sup> See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 16 (stating proceeds derived from whistleblower tips 2006-2010).

<sup>31</sup> *Id.* See also Morse, *supra* note 15, at 11-13.

<sup>32</sup> See *infra* text accompanying notes 34-55, 81-152.

<sup>33</sup> See *infra* text accompanying notes 153-314.

<sup>34</sup> See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 4 (citing 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 § 7623 (1954)). See also Morse, *supra* note 15 at 11-13.

<sup>35</sup> See Michelle M. Kwon, *Whistling Dixie About the IRS Whistleblower Program Thanks to the IRS Confidentiality Restrictions*, 29 VA. TAX REV. 447, 451 (Winter 2010) (citing Dennis J. Ventry, *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357, 363-64 (Winter 2008) (concluding that the law that was in effect before December 2006 had “paltry bounties, stingy administrators, inadequate protection for whistleblowers, and unreceptive courts”).

<sup>36</sup> § 7623.

<sup>37</sup> See Kwon, *supra* note 35 at 453-455 (“While few whistleblowers filed suit to challenge their award determinations, those who did had little success. . . . [T]he Service won every one of the nineteen cases that whistleblowers filed to challenge awards from 1941 to 1998). See *McGrath v. United States*, 207 Ct. Cl. 978 (Ct. Cl. 1975) and *Saracena v. United States*, 508 F.2d 1333, 1334-36 (Ct. Cl. 1975) (finding the Service had “complete discretion in the first instance to determine whether an award should be made and, in the second instance, to fix what, in [its] judgment, amounts to adequate compensation”). These

Whistleblower payments were originally paid out of appropriated funds; however, this payment system was revised in 1996 to use collected proceeds for payments.<sup>38</sup> This was a significant shift for the Whistleblower Program that forced the Whistleblower Program to have additional accountability for achieving its goal of revenue protection. The Program would need to find the proper incentives that would attract whistleblowers while still generating the maximum revenue increases. This fine-tuning of proper incentives can be seen in the subsequent modifications to § 7623 and continues in the changes to the corresponding Regulation.

The original § 7623 Regulation provided for the discretionary payment of a minimum of one percent of the collected proceeds and a maximum of fifteen percent of the collected proceeds, depending on the type of information received.<sup>39</sup> The original Regulation also capped the maximum payment to a whistleblower at \$10 million dollars.<sup>40</sup> Publication 733 lists the payment schedule as:

Information Type	Percentage of Collected Proceeds Awarded	Maximum Recovery
General Information with No Direct Relationship to the Determination of Tax Liabilities	1 Percent	\$10 Million
Information of value in the determination of tax liabilities although not specific	10 Percent	\$10 Million

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opinions were relied upon in subsequent decisions upholding the discretionary nature of the IRS Whistleblower award. See *Merrick v. United States*, 846 F.2d 725, 726 (Fed. Cir. 1988); *Carelli v. IRS*, 668 F.2d 902, 904 (6th Cir. 1982); *Destefano v. United States*, 52 Fed. Cl. 291, 293 (2002) and *Cambridge v. United States*, 558 F.3d 1331, 1333 (Fed. Cir. 2009).

<sup>38</sup> Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1209(a), 110 Stat.1473 (1996) (amending § 7623(a.)).

<sup>39</sup> Treas. Reg. § 301.7623-1(c) (as amended in 1998) (“The amount of a reward will represent what the district or service center director deems to be adequate compensation in the particular case, generally not to exceed fifteen percent of the amounts (other than interest) collected by reason of the information.”).

<sup>40</sup> *Id.* See also INTERNAL REVENUE SERV., PUBLICATION 733, REWARDS FOR INFORMATION PROVIDED BY INDIVIDUALS TO THE INTERNAL REVENUE SERVICE (Oct. 2004), available at <http://www.unclefed.com/IRS-Forms/2005/p733.pdf> and I.R.M. 25.2.2.5 (as amended Apr. 27, 1999).

Information causing investigation or materially assisted in the development of an issue resulting in a recovery	15 Percent	\$10 Million
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While the Regulation and Publication 733 offered some guidance for payment percentages and maximum award recoveries, there was still much uncertainty in determining a potential whistleblower's award.

### C. 2006 Code Changes and the Whistleblower Office Established

In response to Congress's request for review of the Whistleblower Program, the Treasury Inspector General for Tax Administration ("TIGTA") audited the Program in June 2006. The TIGTA audit showed significant economic success for the IRS Informants' Rewards Program,<sup>41</sup> despite several shortcomings in the Program's oversight and management.<sup>42</sup> The Program generated significant revenue but could potentially generate more.<sup>43</sup> The TIGTA report also highlighted the problem with the current percentage payout award structure (the 1, 10 and 15 percent structure)<sup>44</sup> and discretionary nature of payments. The TIGTA report signaled an underutilized Program that was fraught with administrative problems as well as a lack of a clearly defined incentive for potential whistleblowers. The TIGTA report served as a springboard to push legislation forward that could help strengthen the Whistleblower Program. Senator Charles Grassley, the champion of the IRS Whistleblower Program and author of the 2006 reforms, persuaded Congress to significantly overhaul the

<sup>41</sup> The IRS Informants' Rewards Program was renamed as the IRS Whistleblowers Program following the 2006 § 7623 amendments.

<sup>42</sup> TREASURY INSPECTOR GEN. FOR TAX ADMIN., *The Informants' Reward Program Needs More Centralized Management Oversight* (June 2006), available at: <http://www.treasury.gov/tigta/auditreports/2006reports/200630092fr.html>. The TIGTA report cites an internal Service study that it only cost the Treasury four cents for every dollar collected under the Whistleblower Program in comparison to ten cents per dollar collected for all other enforcement programs. See also INTERNAL REVENUE SERV., *The Informants' Project: A Study of the Present Law Reward Program* (Sept.1999).

<sup>43</sup> See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 4 (noting that the Whistleblower Program collected \$258 million in fiscal year 2006).

<sup>44</sup> See TIGTA Audit 2006, *supra* note 42 ("We were unable to determine the justification for the reward percentage awarded to the informant in 32 percent of the cases." Regarding rejected claims, the statistics were more startling. "We were unable to determine the rationale for the reviewer's decision to reject the claim in 76 percent of the cases reviewed.").



Whistleblower Program following the TIGTA report.

The Tax Relief and Health Care Act of 2006<sup>45</sup> greatly enhanced the Whistleblower Program<sup>46</sup> and created an additional subsection to the whistleblower Code provision, § 7623(b). Section 7623(b) applies in situations where the “tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$ 2,000,000.”<sup>47</sup> When the tax dispute involves an individual taxpayer instead of a business, the individual’s annual gross income must exceed \$200,000.<sup>48</sup> By adjusting the award to target high dollar tax abuses, Congress intended to use the Whistleblower Program as a way to get the maximum return in relation to the cost of the program. “Congress hope[d] the lure of much bigger rewards w[ould] prompt more informants to offer better tips and help the IRS reduce the nation’s \$290 billion tax gap, the difference between what the agency collects each year and what it thinks it should be collecting.”<sup>49</sup> Section 7623(b) also modified the payment structure for whistleblowers. The maximum payment caps were removed for § 7623(b) awards. Whistleblowers are now entitled to “receive as an award 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 (including any related actions) or from any settlement in response to such action.”<sup>50</sup> The new Code provision also acknowledged that the whistleblower may not have clean hands when blowing the whistle. An award is payable so long as the whistleblower was not convicted of a crime for his or her involvement in the tax underpayment.<sup>51</sup>

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<sup>45</sup> See Tax Relief and Health Care Act of 2006, Pub. L. 109-432, § 406(a)(1)(D), 120 Stat. 2922 (2006), codified at § 7623(b) *et seq.*

<sup>46</sup> The 2006 Act established the Whistleblower Office as a separate office within the IRS. See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 5 (“Operating at the direction of the Commissioner of the IRS, the Whistleblower Office coordinates with other divisions of the IRS, analyzes information submitted, and makes award determinations.”). Although permitted under statute, the Whistleblower Office does not currently investigate whistleblower claims. Rather, the Whistleblower Office assigns investigation of a whistleblower claim to the appropriate Service office to initial investigation.

<sup>47</sup> See Tax Relief and Health Care Act of 2006, *supra* note 45, codified at § 7623(b)(5)(B).

<sup>48</sup> § 7623(b)(5)(A).

<sup>49</sup> See Herman, *supra* note 15. See also Morse, *supra* note 15 at 3-4 (noting that the incentives provided under the 2006 changes to the whistleblower program “may indeed enhance enforcement effectiveness, but collateral impacts on other social values, including privacy and fidelity in professional relationships, also deserve consideration.”).

<sup>50</sup> § 7623(b)(1).

<sup>51</sup> § 7623(b)(3).

The 2006 changes to the Whistleblower Program greatly increased the value of awards available to the whistleblower, but also provided some degree of certainty that was not present under the previous discretionary payment system still codified in § 7623(a).<sup>52</sup> Further, the 2006 changes to the Program have led to more high quality submissions to the Service.<sup>53</sup> Despite this positive response, there remains much uncertainty in the actual payment process, especially as it relates to the terms “proceeds of amounts collected” and “collected proceeds” used within § 7623. Although the 2006 amendments offered greater predictability for award payments, whistleblowers still face uncertainty when calculating the total award payment. It is unclear what are proceeds and when they are collected. Assuming a whistleblower brought forth credible and helpful information that would generally warrant a thirty percent award, the whistleblower’s next obstacle was to determine the basis on which to calculate thirty percent. Determining the total award payment has baffled whistleblowers and their attorneys because collected proceeds has not been adequately defined.<sup>54</sup> In subsequent years, the Service has attempted to remedy this problem by issuing additional guidance; however, numerous unanswered questions remain.<sup>55</sup>

#### *D. Administrative Challenges for the IRS Whistleblower Program*

Following the 2006 amendments, the IRS received over forty new claims within a two and one-half month period under the new § 7623(b) provisions.<sup>56</sup> IRS Whistleblower Office Director Stephen Whitlock stated that although there were variations in the quality of the claims submitted, the Service received “some very good claims with good support and very

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<sup>52</sup> § 7623(a) permitted the payout of awards based on collected proceeds that are deemed sums necessary.

<sup>53</sup> Letter from Scott Knott and Gregory Lyman, *Ferraro Law Firm*, to Kristen Witter, *Internal Revenue Service* at 4 (Apr. 18, 2011), available at TAX NOTES TODAY Doc 2011-8482 (commenting on the value of awards).

<sup>54</sup> This problem is compounded by the fact that the Whistleblower Office does not remain in contact with the whistleblower once the whistleblower claim is submitted until final payment. This has been a source of frustration for whistleblowers. The Service had remained firm in limiting its contact with the whistleblower, but recently softened this approach by issuing a regulation, effective March 15, 2011, allowing for confidential disclosure to the whistleblower or the whistleblower’s legal representative regarding the status of the whistleblower’s claim when the whistleblower has entered into a written contract with the Service. See Treas. Reg. §301.6103(n)-2.

<sup>55</sup> See *infra* text accompanying notes 81-277 for a discussion of open issues.

<sup>56</sup> See Herman, *supra* note 15.

promising leads.”<sup>57</sup> The Service needs a great deal of time to build a whistleblower case and examine the underlying tax return. In 2007, Whistleblower Attorney Scott Knott suggested that the payment timeline for whistleblower claims would likely run between four and seven years before the whistleblower received any compensation.<sup>58</sup> The lengthy payment process remains a primary complaint of whistleblowers and their advocates. This timing issue has been cited as a serious concern in the administration of the Whistleblower Program.<sup>59</sup> However, some have also recognized the lengthy delay as a necessary component of the payout process.<sup>60</sup> “The IRS has been unfairly criticized for not paying any awards to date under [§] 7623 as amended in 2006 given the (i) time required to review the alleged claim, examine the alleged tax violator, settle the proposed adjustments through the appeals and/or judicial process and, finally, for the Whistleblower Office to review the case file and process the award.”<sup>61</sup>

After the 2006 TIGTA audit of the IRS Whistleblower Program, TIGTA conducted a follow-up audit in 2009. The 2009 TIGTA Audit showed that there are still many aspects that could be improved in the Whistleblower Program.<sup>62</sup> At the time of the audit, the IRS Whistleblower Office was implementing a single inventory control system and TIGTA recommended performing physical reconciliations of claims to ensure all information was captured in the new system.<sup>63</sup> TIGTA also expressed concern over the tracking of claims to ensure timely processing.<sup>64</sup> The IRS responded favorably to all of the recommendations and has implemented additional quality checks based on TIGTA’s report, yet the timeliness of administering the Program continues to be a concern.<sup>65</sup>

In its fiscal year 2010 report, the Whistleblower Office reported the number of claims submitted, number of awards paid and the dollar amount of the total awards paid. Based on the initial 2007 submissions, the Service

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<sup>57</sup> *Id.*

<sup>58</sup> *Id.* (quoting Attorney Scott Knott).

<sup>59</sup> See Grassley letter, *supra* note 21, at 1 (referring to a concern over the long timeframes for processing claims).

<sup>60</sup> Letter from Anonymous Taxpayer to Kristen Witter, *Internal Revenue Serv.*, at 1 (Mar. 23, 2011) (commenting on Prop. Reg. § 301.7623-1).

<sup>61</sup> *Id.*

<sup>62</sup> TREASURY INSPECTOR GEN FOR TAX ADMIN., 2009-30-114, DEFICIENCIES EXIST IN THE CONTROL AND TIMELY RESOLUTION OF WHISTLEBLOWER CLAIMS, 3 (Aug. 20, 2009).

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 21.

saw a significant increase in submission of § 7623(b) whistleblower claims in 2008, 2009 and 2010; however, payments under § 7623(b) have yet to occur.<sup>66</sup> These submission levels suggest that the Service has been effective in promoting the Whistleblower Program. They also indicate that the revised incentive system under the 2006 statutory changes has been successful in attracting whistleblowers to come forward.

#### § 7623(B) SUBMISSIONS BY FISCAL YEAR<sup>67</sup>

Year	Number of Submissions	Number of Taxpayers Identified
2007	49	587
2008	378	1366
2009	470	2150
2010	431	5429

#### AMOUNTS COLLECTED AND AWARDS PAID UNDER § 7623(A) FOR FISCAL YEARS 2006-2010<sup>68</sup>

	2006	2007	2008	2009	2010
Cases Received	4295	2751	3704	5678	7577
Awards Paid	220	227	198	110	97
Collections Over \$2 million	N/A	12	8	5	9
Total Amount of Awards Paid <sup>69</sup>	\$24,184,458	\$13,600,205	\$22,370,756	\$5,851,608	\$18,746,327
Amounts Collected	\$258,590,435	\$181,784,287	\$155,985,834	\$206,032,872	\$464,695,459

The data above does not present itself in perfect trends; however, a broad

<sup>66</sup> Prior to the release of the Whistleblower Office's Fiscal Year 2010 Annual Report, the press reported that one whistleblower payment under section § 7623(b) has been made. See Jeremiah Coder, *IRS Pays First Enhanced Whistleblower Award*, TAX NOTES DOC 2011-7587 (Apr. 18, 2011).

<sup>67</sup> See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 9.

<sup>68</sup> *Id.* at 16.

<sup>69</sup> The IRS paid all of the awards listed above, including those paid in 2010, based on the prior law, what is now § 7623(a). Therefore, the higher payout percentages from the 2006 § 7623(b) changes do not apply to the awards in this chart. *Id.* at 14.

view shows a sharp decline in the number of awards paid in 2009 and 2010, approximately half of the awards paid in the three previous years.<sup>70</sup> In 2010, with significantly fewer awards, record proceeds were collected: \$464 million.<sup>71</sup> Greater submissions and revenue collected but fewer awards could be a dangerous trend for the Whistleblower Program and should be corrected in subsequent years.<sup>72</sup> If potential whistleblowers believe there is little chance of receiving payment in a reasonable time or are concerned that an award may not come to fruition, the Service loses its ability to offer an effective incentive to attract submissions.

The Whistleblower Office notes several points about the data above. The first is that, “the number and amount of awards paid each year can vary significantly, especially when a small number of high-dollar claims are resolved in one year (as was the case in 2006 and 2008).”<sup>73</sup> The other important consideration to note is that during 2009 the Service changed the point at which payment can be issued to the whistleblower, requiring a longer waiting time for the two-year refund request window to close.<sup>74</sup>

Despite the failure to see any payments under § 7623(b) during the 2010 fiscal year, the Service’s data indicates an overall increase in interest in the Whistleblower Program.<sup>75</sup> Comparing 2006 to 2010, submissions have risen under both § 7623(a) and § 7623(b). The data also indicates a concern about the effectiveness of the current incentive program for whistleblowers given the fact that claims are likely on the rise yet the number of payouts have not seen a correlative increase. This award payment trend highlights the concern about the current administrable nature of the Program and whether the Service is effectively incentivizing whistleblowers.

The most recent governmental analysis of the Whistleblower Program was a report released in September 2011 from the Government Accountability Office (GAO). The GAO expressed concern over the

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<sup>70</sup> See *supra* text and charts accompanying notes 67-68.

<sup>71</sup> See *supra* text and chart accompanying note 68.

<sup>72</sup> The Service claims the trend is due solely to the time that it takes to resolve a whistleblower claim and the underlying taxpayer’s examination. If this is the case, the only concern that the trend suggest is perception of delay by whistleblowers. If, on the other hand, the mismatch of high whistleblower tips and high revenue but few whistleblower payments, then greater concern is warranted. It is unclear which is to blame.

<sup>73</sup> See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 14.

<sup>74</sup> *Id.*

<sup>75</sup> See *supra* text and charts accompanying notes 67-68 (showing increased § 7623(a) and (b) submission when comparing 2006 and 2010 submissions).

processing time for whistleblower claims.<sup>76</sup> This concern echoes the data released months prior in the 2010 Annual Report to Congress.<sup>77</sup> The GAO acknowledges that investigating a Whistleblower claim is an inherently long process, but recommended process implementation to track the timing of a submitted claim and monitor claims that lag behind time targets.<sup>78</sup> While the Service acknowledges delay problems, it remains to be seen whether the GAO's suggested changes will improve the system delays that have plagued the Whistleblower Program.

Based on the TIGTA audit, Whistleblower Office Annual Report, and GAO study, it appears that the Whistleblower Program has succeeded in identifying tax fraud, return misfilings and other abuses of the Code, but there are many areas in which the Program can be strengthened. Adding certainty to the incentives offered to whistleblowers could greatly strengthen the Whistleblower Program.<sup>79</sup> It is clear from the governmental studies conducted that the question of "when will payment occur?" has not been answered effectively through the Whistleblower Program. This administrative downfall should be reviewed and closely monitored to ensure that improvements are being made. In Part II, the Service's interpretation of collected proceeds is examined including a review of the recent Treasury Regulation, § 301.7623-1.<sup>80</sup> The Regulation has shed some light on the question of "how much" the whistleblower will be paid, but there are several deficiencies in the Service guidance to define "collected proceeds."

## II. THE SERVICE'S INTERPRETATION OF COLLECTED PROCEEDS

In spite of the dramatic revisions to the Whistleblower Office, neither the Code, Regulations, nor the Service's internal guidance have provided a precise definition of "collected proceeds." The Service, however, has delineated what it believes is and is not collected proceeds in several forums, including the Regulations, Notices, Chief Counsel's Program Manager Technical Advice Memoranda (PMTA), and orally via Service personnel at hearings.<sup>81</sup> When read together the guidance fails to cover all

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<sup>76</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-683, TAX WHISTLEBLOWERS: INCOMPLETE DATA HINDERS IRS'S ABILITY TO MANAGE CLAIM PROCESSING TIME AND ENHANCE EXTERNAL COMMUNICATION at 1 (Aug. 2011).

<sup>77</sup> Whistleblower Office FY 2010 Report, *supra* note 1.

<sup>78</sup> See GAO Report, *supra* note 76 at 1.

<sup>79</sup> See Ferziger and Currell, *supra* note 5 at 1197-1200 (discussing the importance of certainty in a bounty program).

<sup>80</sup> See *infra* text accompanying notes 81-152.

<sup>81</sup> See generally *infra* text accompanying notes 81-152.

possible scenarios and is inconsistent. These shortcomings put the entire Whistleblower Program at risk. The certainty of an incentive is a necessary component to attract potential whistleblowers to come forward with information.<sup>82</sup> Current Service policies leave significant uncertainty regarding how timing,<sup>83</sup> refunds,<sup>84</sup> credit balances,<sup>85</sup> and tax attributes<sup>86</sup> equate to collected proceeds. This uncertainty also risks adding to the already lengthy administration process if a whistleblower appeals an award decision based on the Service's inconsistent guidance.

Part II identifies and addresses questions and inconsistencies that result from the current Service interpretation of collected proceeds. This Part begins by analyzing the significance of the 1996 amendments.<sup>87</sup> The next Subpart discusses the current statutory language.<sup>88</sup> The third Subpart reviews the evolution of the Internal Revenue Manual (IRM).<sup>89</sup> The fourth and fifth Subparts analyze current Office of Chief Counsel guidance and the Regulation.<sup>90</sup> The sixth and final Subpart highlights the inconsistencies and gaps in coverage in the current Service guidance on collected proceeds.<sup>91</sup>

#### *A. 1996 Amendments and Their Significance*

Despite a long-standing statutory presence, the IRS Whistleblower Program has only recently been significantly utilized.<sup>92</sup> The increased use occurred after substantial improvements within the past fifteen years.<sup>93</sup>

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<sup>82</sup> See Ferziger and Currell, *supra* note 5 at 1181-3 (discussing certainty and its effects on government bounty programs).

<sup>83</sup> See *infra* text accompanying notes 147-152, 270-277 (discussing timing issues).

<sup>84</sup> See *infra* text accompanying notes 127-135, 147-152 (discussing inclusion of refund denials in collected proceeds).

<sup>85</sup> See *infra* text accompanying notes 127-152, 208-222 (discussing the partial inclusion of credit balances in collected proceeds).

<sup>86</sup> See *infra* text accompanying notes 175-207 (discussing exclusion of tax attributes in collected proceeds).

<sup>87</sup> See *infra* text accompanying notes 165-174 (discussing prior versions of § 7623).

<sup>88</sup> See *infra* text accompanying notes 175-207 (discussing the current § 7623 and collected proceeds).

<sup>89</sup> See *infra* text accompanying notes 208-222 (discussing collected proceeds in the context of the I.R.M.).

<sup>90</sup> See *infra* text accompanying notes 127-146 (discussing Chief Counsel guidance and Treas. Reg. § 301.7623-1).

<sup>91</sup> See *infra* text accompanying notes 147-152 (discussing inconsistencies).

<sup>92</sup> See *supra* text accompanying notes 34-55 (discussing the history of the Whistleblower Program).

<sup>93</sup> See *supra* text accompanying notes 34-55 (discussing the 1996 and 2006 amendments to § 7623 and their effect on the Whistleblower Program).

These improvements were intended to clarify and strengthen the Program but that has not always been the result.<sup>94</sup> Imprecise drafting, inconsistent sources of authority, and undefined terms still plague determinations of whistleblower awards.<sup>95</sup> In 1996, Congress changed the pool of funds that compensate a whistleblower from the Service budget to “proceeds of amounts collected.”<sup>96</sup> This change marks the beginning of the struggle to delineate the sums that should comprise collected proceeds. The 1996 amendments also added the phrase “for detecting underpayments of tax” to § 7623.<sup>97</sup> While a whistleblower award could still be made for broad violations of the tax laws, these amendments (adding “for detecting underpayments of tax” and payments made from “proceeds of collected amounts”) focused the Whistleblower Program toward maximizing revenue, not merely catching violators. The 1996 amendments led to a revision of the associated Regulation, § 301.7623-1, to clarify that whistleblower rewards were available where the information led to a denial of a refund, not merely an affirmative recovery of taxes owed.<sup>98</sup> The Regulation’s focus on revenue protection, in terms of uncollected taxes as well as improper refunds, was entirely consistent with the focus of the 1996 amendments. This represented a significant change in the Service’s whistleblower policy to reward information that produces additional federal revenues as a result

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<sup>94</sup> See *infra* text accompanying notes 136-147 (discussing the inconsistencies and questions from recent Service guidance)

<sup>95</sup> *Id.*

<sup>96</sup> IRS WHISTLEBLOWER OFFICE FISCAL YEAR 2009 REPORT TO CONGRESS ON THE USE OF SECTION 7623 at 1-2, available at <http://www.irs.gov/pub/irs-utl/whistleblowerfy09rtc.pdf>. See also § 7623, Pub. L. 104-168 (1996 amendments).

<sup>97</sup> INTERNAL REVENUE SERV., *History of Whistleblower/Informant Program*, available at <http://www.irs.gov/compliance/article/0,,id=181294,00.html>. See also Taxpayer Bill of Rights 2, Pub. Law 104-168, 110 Stat. 1452 (1996). Prior to the amendment, § 7623 stated, “The Secretary, under regulations prescribed by the Secretary, is authorized to pay such sums, not exceeding in the aggregate the sum appropriated therefore, as he may deem necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same, in cases where such expenses are not otherwise provided for by law.”

<sup>98</sup> TREASURY DECISION 8770, REWARDS FOR INFORMATION RELATING TO VIOLATIONS OF INTERNAL REVENUE LAWS, ADOPTING FINAL REGULATION (explanation of provision). See also Treas. Reg. § 301.7623-1 (amended Aug. 21, 1998) (“The rewards provided for by section 7623 and this section will be paid from the proceeds of amounts (other than interest) collected by reason of the information provided. For purposes of section 7623 and this section, proceeds of amounts (other than interest) collected by reason of the information provided include both additional amounts collected because of the information provided and amounts collected prior to receipt of the information if the information leads to the denial of a claim for refund that otherwise would have been paid.”)



of the whistleblower's information.

### *B. Statutory Interpretation of Collected Proceeds*

Following the Congressional changes in 2006 to the whistleblower statutes, there are currently two systems under which a whistleblower may be paid. The first is under § 7623(a), and the second is under the newer § 7623(b). Under subsection (a), the Service has discretion to pay a whistleblower “from the *proceeds of amounts collected* by reason of the information provided, and any amount so collected shall be available for such payments.”<sup>99</sup> Subsection (b)(1) provides for paying whistleblowers “an award 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 . . . or from any settlement in response to such action.”<sup>100</sup>

There are two distinctions here. First, the Service has the statutory discretion with regard to award payment under § 7623(a),<sup>101</sup> whereas awards meeting the criteria of § 7623(b) are mandated.<sup>102</sup> The Service has no discretion in whether to make an award under § 7623(b), so long as the statutory criteria are met. The second and far less critical difference is in the language used: § 7623(a) and (b) use different language (*proceeds of amounts collected* vs. *collected proceeds*) for the pool of money from which to pay awards. The Service has stated that “[w]hile the language of section 7623 differs slightly between subsections (a) and (b), [the Service does] not think the difference is meaningful and therefore the legal analysis . . . should be the same for subsections (a) and (b).<sup>103</sup> The Service's interpretation that the term “collected proceeds” applies under both subsections (a) and (b) is consistent with legislative history<sup>104</sup> and subsequent Congressional statements.<sup>105</sup> It appears the change in

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<sup>99</sup> § 7623(a) (emphasis added).

<sup>100</sup> § 7623(b)(1) (emphasis added).

<sup>101</sup> § 7623(a) (“The Secretary . . . is authorized to p[ay such sums as he seems necessary . . .”).

<sup>102</sup> § 7623(b)(1) (“ . . . such individual shall receive as an award . . .”).

<sup>103</sup> Program Manager Technical Assistance, PMTA 2010-62 (Sept. 1, 2010) (analyzing the payment of refund protection and credit reduction claims under § 7623).

<sup>104</sup> Little legislative history is available for the 2006 amendments. This is likely because the Whistleblower amendments were only a small, uncontroversial part of the much larger Tax Relief and Health Care Act of 2006, enacted on December 20, 2006.

<sup>105</sup> See Press Release from Senator Check Grassley (Sept. 9, 2011) (identifying self as the author of the 2006 amendments and urging the Service to working more closely with

terminology is nothing more than word economy, resulting in the same definitional analysis for both § 7623(a) and (b).<sup>106</sup>

### *C. Evolution of the Internal Revenue Manual*

The Service's whistleblower award policies have evolved over the last fifteen years. The evolution is particularly evident when viewing the three most recent versions of the Internal Revenue Manual (I.R.M.), which is a compilation of the Service's policies and procedures, including those relevant to whistleblower claims.<sup>107</sup> Because Service personnel use the I.R.M. as a daily procedure guides, changes to the I.R.M. whistleblower provisions can be viewed as manifestations of the Service's changing whistleblower policies.

The 1999 I.R.M., which was in force for the whistleblower provisions through 2008, never defined collected proceeds. In fact, the 1999 I.R.M. used other terms synonymously with collected proceeds.<sup>108</sup> This, of course, did not advance understanding of collected proceeds. Under the 1999 I.R.M., collected proceeds did not appear to be a term of art. Under the 1999 I.R.M., the Service included all criminal fines in collected proceeds.<sup>109</sup> This policy was subsequently changed in the next version. The 1999 I.R.M. further contemplated that the Service would net collected proceeds, within a tax year and among tax years lengthening the payout process for whistleblowers.<sup>110</sup> The 1999 I.R.M. also required the closing of all tax

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whistleblowers and their attorneys).

<sup>106</sup> The authors have seen no variation in the synonymous interpretation of "proceeds of amounts collected" and "collected proceeds" from either the Service or the whistleblower advocates. All references throughout this paper to collected proceeds presume to apply to both subsections (a) and (b).

<sup>107</sup> MICHAEL I. SALTZMAN, *IRS PRACTICE AND PROCEDURE*, 2<sup>nd</sup> ed., at 3-126 (2002) (discussing the Internal Revenue Manual).

<sup>108</sup> I.R.M. 25.2.2.5(1)(a), (b), and (c), Allowance Computation (04-27-1999) (using the term "amounts recovered").

<sup>109</sup> I.R.M. 25.2.2.13(a)(1), Partial Allowances (04-27-1999) ("A reward should not be paid with respect to a particular tax year until the deficiency (tax, penalties, and fines) has been paid in full for that specific tax year. *However, a partial reward may be paid if, for example, it can be ascertained in a criminal prosecution case that the conviction was directly or indirectly attributable to the informant's information. A reward allowance based on the fine when paid may be made as a partial allowance prior to the civil settlement of the tax liability.*") (emphasis added).

<sup>110</sup> I.R.M. 25.2.2.12, Offsetting Adjustments (04-27-1999) ("(1) In determining whether a reward should be allowed and, if so, the amount thereof, consideration should be given to adjustments for one year which will result in potential tax savings to the taxpayer for subsequent years or to another taxpayer for any year. (a) For example, if the closing

years before payment could be made, with limited exceptions in areas like a criminal prosecution and when a tax year's deficiency had been paid in full.<sup>111</sup> These policies required an overly broad interpretation of finality raising a concern that a whistleblower may not receive payments for an extended period of time.

The Service has twice amended the Internal Revenue Manual's whistleblower section following the 2006 statutory changes to § 7623.<sup>112</sup> The first I.R.M. amendment was published in December 2008,<sup>113</sup> and the second I.R.M. amendment was published in June 2010.<sup>114</sup> The 2008 I.R.M. amendment overhauled nearly almost every provision in the I.R.M. whistleblower section. It created new procedures for the two systems of cases and processes for administering claims.<sup>115</sup> In addition, the I.R.M. addressed the need to delay payment until appeals in the underlying case had resolved,<sup>116</sup> which was not necessarily contemplated in the prior I.R.M. version.<sup>117</sup> Despite these helpful clarifications, problems with the 2008

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inventory for one year is increased, resulting in an increase in income for that year, the opening inventory for the next succeeding year will be correspondingly increased, resulting in a decrease in income for that year. The deficiency for the first year is offset by the corresponding decrease in income for the subsequent year, usually resulting in no net tax recovery. . . . (c) Information may be furnished and claim for reward filed with respect to the returns of one taxpayer for several years. If one of the years is closed with assessment and payment of a deficiency, but the other years are still under examination, no reward should be granted for the closed year until examination of all years has been completed. This is true since adjustments made to the returns for the open years may result in offsetting adjustments, no reward should be allowed until the overall results of the information furnished may be evaluated.”)

<sup>111</sup> I.R.M. 25.2.2.12(c), Offsetting Adjustments (04-27-1999). *See also* I.R.M. 25.2.2.13(1), Partial Allowances (04-27-1999) (“(1) Partial allowance of a reward claim should be made where feasible. (a) A reward should not be paid with respect to a particular tax year until the deficiency (tax, penalties, and fines) has been paid in full for that specific tax year. However, a partial reward may be paid if, for example, it can be ascertained in a criminal prosecution case that the conviction was directly or indirectly attributable to the informant’s information. A reward allowance based on the fine when paid may be made as a partial allowance prior to the civil settlement of the tax liability.”).

<sup>112</sup> I.R.M. 25.2.2 *et seq.*

<sup>113</sup> I.R.M. 25.2.2 *et seq.* (12-30-2008).

<sup>114</sup> I.R.M. 25.2.2 *et seq.* (06-18-2010).

<sup>115</sup> I.R.M. 25.2.2 *et seq.* (12-30-2008).

<sup>116</sup> I.R.M. 25.2.2.1(5), Overview: Authority & Policy (12-30-2008) (stating “the requirement that claims be paid from collected proceeds generally means that payment cannot be made for several years after the information is submitted, because the underlying taxpayer’s case (including any appeals) must be resolved.”).

<sup>117</sup> I.R.M. 25.2.2.9, Repayment of reward in Certain Cases (04-27-1999) (contemplating circumstances and procedures for whistleblowers repaying awards if the

version of the I.R.M. whistleblower section remained. It was unclear on what basis the thresholds in (b) would be measured. Would they be measured on the allegations in the tip or on the proceeds collected? What if the Service settled the matter or allowed an offer in compromise for less than the determined deficiency? It was also unclear as to when an underlying tax case was “resolved” and collected proceeds could be ascertained.

In the most recent I.R.M. whistleblower provisions, adopted in 2010 only eighteen months after the prior version, the Service clarified a number of provisions but failed to resolve issues with others. For example, the 2010 I.R.M. added significant clarity regarding the requirement of finality before payment,<sup>118</sup> specificity in processing 7632(a) and (b) claims,<sup>119</sup> defining a related action for tips that lead to mushrooming of taxpayers, tax years, or issues,<sup>120</sup> the whistleblower administrative proceeding,<sup>121</sup> and factors in award computation.<sup>122</sup>

Unfortunately, the 2010 I.R.M. still has not offered clarity for determining how to calculate whether a tip will be paid under §7623(a) or (b). The I.R.M. now states that the Service will use “the best information available” to determine the amount in dispute in determining “ground for not processing claims for award.”<sup>123</sup> The 2010 I.R.M. also fails to address how a compromise of a deficiency by the Service will affect the calculation of collected proceeds. More importantly, despite including statements regarding finality and calculation of collected proceeds,<sup>124</sup> the Service’s only clear guidance was that it will wait until the two-year refund period

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collected proceeds were reduced.)

<sup>118</sup> I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010).

<sup>119</sup> I.R.M. 25.2.2.6, Processing of the Form 211 7623(a) Claim for Award (06-18-2010) and 25.2.2.7, Processing of the Form 211 7623(b) Claim for Award (06-18-2010).

<sup>120</sup> I.R.M. 25.2.2.2(8), General (06-18-2010).

<sup>121</sup> I.R.M. 25.2.2.8, Whistleblower Award Administrative Proceeding (06-18-2010).

<sup>122</sup> I.R.M. 25.2.2.9, Award Computation (06-18-2010).

<sup>123</sup> I.R.M. 25.2.2.5, Grounds for Not Processing Claims for Award (06-18-2010).

<sup>124</sup> I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010) (stating “The requirement that claims be paid from collected proceeds generally means that payment will not be made until there is a final determination of tax liability (including taxes, penalties, interest, additions to tax and additional amounts) owed to the Service and such amounts have been collected by the Service. A final determination of tax does not occur until the statutory period for filing a claim for refund expires or there is an agreement between the taxpayer and the Service that there has been a final determination of tax for a specific period and a waiver of the right to file a claim for refund is effective.”).

under § 6511 has passed before it will issue payment.<sup>125</sup> While definitive with respect to that narrow circumstance, it leaves open questions of when finality is achieved with respect to court proceedings, settlements, and closing agreements. The I.R.M. is utterly silent as to when “measurement” of collected proceeds will occur. Some of these open questions from the I.R.M. were addressed in the current Service guidance;<sup>126</sup> however, these attempts for clarification have also led to inconsistent guidance.

#### *D. Office of Chief Counsel Memoranda*

Despite two I.R.M. revisions in less than two years,<sup>127</sup> Service guidance is needed to further delineate collected proceeds. The Service recognizes this and has issued a few pieces of guidance.<sup>128</sup> Unfortunately, even with the additional guidance, holes remain. Worse, the guidance contradicts the most recent I.R.M.

The most recent guidance has come in the form of Office of Chief Counsel Memoranda and the Final Regulation issued in February 2012. In a 2010 internal memorandum, the IRS Office of Chief Counsel analyzed whether criminal fines should be used as part of collected proceeds.<sup>129</sup> The Office concluded, “that criminal fines, which must be deposited into the Crime Victims Fund (CVF), cannot be used for the payment of whistleblower awards.”<sup>130</sup> This response is consistent with the revisions to the 2010 I.R.M. regarding criminal fines and their exclusion from collected

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<sup>125</sup> I.R.M. 25.2.2.12(6), Funding Awards (06-18-2010) (stating “until there is a final determination of tax liability (including taxes, penalties, interest, additions to tax and additional amounts) owed to the Service and such amounts have been collected by the Service. A final determination does not occur until the statutory period for filing a claim for refund expires or there is an agreement between the taxpayer and the IRS that there has been a final determination of tax for a specific period and a waiver of the right to file a claim for refund is effective.”). See also I.R.M. 25.2.2.12(7), Funding Awards (06-18-2010) (stating “The award payment cannot be completed until the statutory period for filing a claim for refund expires or there is an agreement between the taxpayer and the IRS that there has been a final determination of tax for the specific period and the right to file a claim for a refund has been waived.”). See also I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010), *supra* note 124.

<sup>126</sup> See *supra* text accompanying notes 127-135.

<sup>127</sup> The Service amended I.R.M. 25.2.2 in December 2008 and again in June 2010.

<sup>128</sup> See Treas. Reg. § 301.7623-1 (as amended Feb. 22, 2012); Program Manager Technical Assistance, PTMA 2010-60, *Criminal Fines and Whistleblower Awards*, (Feb. 22, 2010); Program Manager Technical Assistance, PTMA 2010-62, *Payment of Refund Protection and Credit Reduction Claims*, (Sept. 1, 2010).

<sup>129</sup> See PTMA 2010-60, *supra* note 128 at 1.

<sup>130</sup> *Id.*

proceeds.<sup>131</sup>

Later in 2010, the IRS Office of Chief Counsel again clarified collected proceeds in a subsequent memorandum. PTMA 2010-62 attempted to clarify the inclusion of “Payment of Refund Protection and Credit Reduction Claims” in collected proceeds.<sup>132</sup> The memorandum considers refund denials and some credit reduction claims as part of “collected proceeds” when determining whistleblower awards.<sup>133</sup> The controversial part stated that “collected proceeds . . . include denied refunds and the reduction of an *overpayment of a credit balance* when the information provided by the whistleblower prevents the IRS from paying the refund or applying a credit balance to offset other tax liabilities.”<sup>134</sup>

Both memoranda offered guidance on specific types of collected proceeds but still failed to offer a clear and concise definition. This guidance is important because it signifies the Service’s commitment to clarifying the term “collected proceeds” as it relates to §7623. However, despite the well-meaning attempts to narrow the definition of collected proceeds, this guidance has been difficult to reconcile with the I.R.M. Indeed, the 2010 I.R.M. specifically states that refund claims and credit balances are not included in collected proceeds calculations.<sup>135</sup> Acknowledging the need for further clarification, the IRS issued Final Regulation § 301.7623-1 in February 2012 to clarify the ambiguous “proceeds” terminology.

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<sup>131</sup> See e.g. I.R.M. 25.2.2.12, Funding Awards (06-18-2010) (The 2010 I.R.M. states that “[c]riminal fines, which must be deposited into the Victims of Crime Fund, cannot be used for payment of whistleblower awards.”). Compare I.R.M. 25.2.2.13, Partial Allowances (04-27-1999) (The 1999 I.R.M. stated that “[a] reward should not be paid with respect to a particular tax year until the deficiency (tax, penalties, and fines) has been paid in full for that specific tax year. However, a partial reward may be paid if, for example, it can be ascertained in a criminal prosecution case that the conviction was directly or indirectly attributable to the informant’s information. A reward allowance based on the fine when paid may be made as a partial allowance prior to the civil settlement of the tax liability.”). See also *infra* text accompanying notes 227-231 (discussing criminal fines).

<sup>132</sup> See PTMA 2010-62, *supra* note 128.

<sup>133</sup> *Id.*

<sup>134</sup> *Id.* at 1 (emphasis added).

<sup>135</sup> I.R.M. 25.2.2.12(1), Funding Awards (06-18-2010) (states “credit balance” reduction is not within scope of collected proceeds. See also I.R.M. 25.2.2.1(7), Overview: Authority and Policy (06-18-2010) (disallowing “information which leads to denial of a clam for refund which otherwise would have been paid.”).

*E. Treasury Regulation § 301.7623-1*

Enhancing the certainty of an award for potential whistleblowers is a primary objective of an effective incentive program.<sup>136</sup> As discussed in the Program administration concerns above, the timing of the award payment is key to creating a successful incentive-based Program.<sup>137</sup> The question of when will payment occur and how much will be paid are inextricably tied. While the 2006 amendments attempted to add greater certainty to the payment percentages, the question of what is the proper basis to calculate the reward upon has yet to be properly defined. The IRS acknowledged this concern and issued a Proposed Regulation in January 2011, which it made final in February 2012. The key terms to define in the 2006 changes to §7623 are “proceeds of amounts collected” and “collected proceeds.”

The Internal Revenue Manual had generally regarded collected proceeds as “new monies collected,”<sup>138</sup> but § 301.7623-1(a)(2) builds upon the 2010 Chief Counsel guidance regarding refunds denials and overpayment credit balances.<sup>139</sup> The Regulation attempts to resolve outstanding questions regarding the definition of “proceeds of amounts collected” and “collected proceeds” for purposes of § 7623.<sup>140</sup> The refund prevention claims apply to whistleblower claims under either § 7623(a) and (b). The Regulation also provides that the reduction of an overpayment credit balance may also be used to determine proceeds of amounts collected and collected proceeds under § 7623.<sup>141</sup>

The Regulation includes as “both proceeds of amounts collected and collected proceeds . . . tax, penalties, interest, additions to tax, and

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<sup>136</sup> See Ferziger & Currell, *supra* note 5 at 1172 (“Expressed economically, an agency should increase bounty incentives until the administrative costs incurred by the marginal inflow of the tips exceed the value of the agency marginal incentive in regulatory effectiveness. Thus, agencies should maximize a potential informants discounted rewards and minimize his discounted losses without making the mix so attractive as to induce the disclosure of large amounts of bad information.” (internal citations omitted)).

<sup>137</sup> See *supra* text and charts accompanying notes 68-73.

<sup>138</sup> I.R.M. 25.2.2.1, Overview: Authority and Policy (06-18-2010).

<sup>139</sup> See PTMA 2010-62, *supra* note 128.

<sup>140</sup> See Treas. Reg. § 301.7623-1(a)(2) (as amended Feb. 22, 2012) (The Regulation defines collected proceeds to “include: tax, penalties, interest, additions to tax, and additional amounts collected by reason of the information provided; 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.”).

<sup>141</sup> See Treas. Reg. § 301.7623-1(a) (as amended Feb. 22, 2012).

additional amounts collected by reason of the information provided.”<sup>142</sup> The Regulation does not include “fines,” likely to support the Service’s position that 42 U.S.C. § 10610 does not allow the Service access to proceeds for distribution.<sup>143</sup> It also inserts interest as another item to consider as collected proceeds. This Regulation allows for a “catch all” for other sums to include in the award determination.

Following the release of the 2011 Proposed Regulation, the IRS Whistleblower Office expressed limitations that are inherent to the definition of “collected proceeds” in its 2010 Annual Report to Congress. “The definition of “collected proceeds” does not extend to all recoveries from taxpayers.”<sup>144</sup> The report cites two key areas that do not result in collected proceeds: (1) a taxpayer with a net operating loss carryforward from a prior year or carried back from a future tax year and (2) a taxpayer subject to certain criminal fines.<sup>145</sup> Under either of the two alternatives, the whistleblower’s information may prove accurate; however, the potential collection from the taxpayer is resolved in a way that does not generate proceeds as defined in § 7623 or its Regulations.<sup>146</sup> The acknowledgment from the Whistleblower Office of the limitations of the term collected proceeds for criminal fines and net operating losses is a good indication that the Service is attempting consistency throughout its internal guidance and I.R.M., but there are still concerns that not all Service explanations of collected proceeds achieve this same level of consistency.

The Service again acknowledged these issues in the preamble to Final Regulation § 301.7623-1. While the Service adopted the same language in the Final Regulation as was proposed in Proposed Regulation, the Service used the Final Regulation’s preamble to make clear that Whistleblower tips that involve net operating losses and criminal fines may not result in collected proceeds from which to pay a Whistleblower.

#### *F. Inconsistencies and Unresolved Areas of Collected Proceeds*

As stated above, the I.R.M. now states that the Service will use “the best information available” to determine the amount in dispute in determining

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<sup>142</sup> *Id.*

<sup>143</sup> See *infra* text accompanying notes 223-238 (discussing criminal fines).

<sup>144</sup> See WHISTLEBLOWER OFFICE FY 2010 REPORT, *supra* note 1 at 12 (describing “Other Issues of Interest”).

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*



“ground for not processing claims for award.”<sup>147</sup> This language is inherently vague and ambiguous. The goal of providing certainty of an incentive fails terribly under such a definition to determine when a tip does not warrant an award. Adding to the lack of certainty in the award payment is the failure to address the award calculation when the IRS calculates a total tax deficiency due from the tax wrongdoer and the deficiency calculation is greatly reduced by an offer of compromise. Not only is the award payout amount unclear, but so is the timing of when the payment will occur. This lack of finality,<sup>148</sup> as it applies to court proceedings, settlements, and closing agreements, creates significant uncertainty risk to the whistleblower. If a whistleblower is unsure when he or she will receive an award or how that award will be calculated, then that whistleblower is much less likely to come forward.<sup>149</sup>

Worse than the lack of guidance are the inconsistencies written into the I.R.M. The Service issued contrary guidance to two I.R.M. provisions mere months after it released the 2010 I.R.M. revision. I.R.M. 25.2.2.12(1) states “credit balance” reduction is not within scope of collected proceeds, and I.R.M. 25.2.2.1(7) disallows “information which leads to denial of a claim for refund which otherwise would have been paid.” Less than 3 months later, the Office of Chief Counsel wrote PTMA 2010-62, which specifically allows award based on “overpayment credit balances” and refund protection claims. The latter interpretation was validated by the Proposed Regulation<sup>150</sup> released six months later on January 18, 2011, signifying that the Service had come to a clear conclusion. The Proposed Regulation was subject to an open comment period. Not surprisingly, many whistleblower advocates were quick to point out the inconsistency in drafting as well as shortfalls of the definition of “collected proceeds” proposed.<sup>151</sup> The

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<sup>147</sup> I.R.M. 25.2.2.5, Grounds for Not Processing Claims for Award (06-18-2010).

<sup>148</sup> I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010) (stating “The requirement that claims be paid from collected proceeds generally means that payment will not be made until there is a final determination of tax liability (including taxes, penalties, interest, additions to tax and additional amounts) owed to the Service and such amounts have been collected by the Service. A final determination of tax does not occur until the statutory period for filing a claim for refund expires or there is an agreement between the taxpayer and the Service that there has been a final determination of tax for a specific period and a waiver of the right to file a claim for refund is effective.”).

<sup>149</sup> See Ferziger and Currell, *supra* note 5 at 1181 (“an informant’s perception of his likelihood of actually recovering a bounty seriously impacts his willingness to provide information by discounting, sometimes heavily, the potential value of the bounty or other reward.”).

<sup>150</sup> Prop. Treas. Reg. § 301.7623-1.

<sup>151</sup> See Letter from Scott Knott and Gregory Lyman, *Ferraro Law Firm.*, to Kristen

whistleblower advocates offered suggestions for improving the language of the Proposed Treasury Regulation. None of these suggestions were incorporated into the Final Regulation's language; however, some of the concerns were noted in the preamble. The whistleblower advocates' suggestions are analyzed in Part III below.<sup>152</sup>

### III. WHISTLEBLOWER ADVOCATES' INTERPRETATION OF COLLECTED PROCEEDS

On January 18, 2011, the IRS published Proposed Regulation § 301.7623-1, to clarify "the definition of proceeds of amounts collected and collected proceeds under section 7623"<sup>153</sup> and requested comments. In response, seventeen written comments were received from whistleblower advocates,<sup>154</sup> a student and an anonymous taxpayer.<sup>155</sup> A few months later, on May 11, 2011, five whistleblower attorneys testified at a hearing on the Proposed Regulation.<sup>156</sup> In their hearing testimony and written comments, whistleblower attorneys generally argued for a more expansive reading of collected proceeds. While a more expansive reading is certainly in the whistleblower attorneys' interest as well as their clients', an expansive reading may result in a loss of federal revenue protection. Whistleblower advocate comments have offered evidence that the current Service approach is overly narrow, provides conflicting guidance, and fails to account for the variety of forms and scenarios in whistleblower cases. The Service acknowledges it has provided insufficient guidance both explicitly in a Whistleblower Office report and implicitly in the preamble to the Final Regulation.<sup>157</sup> It is not clear, however, if the Service understands the

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Witter, *Internal Revenue Service* (Aug. 18, 2011), available at TAX NOTES TODAY Doc 2011-17953 (discussing the conflicts between I.R.M. 25.2.2.12 and PTMA 2010-62). *See also infra* text accompanying notes 153-270 (discussing alternative proposals regarding collected proceeds).

<sup>152</sup> *See infra* text accompanying notes 153-277.

<sup>153</sup> Prop. Treas. Reg. § 301.7623-1, 76 Fed. Reg. 2852 (Jan. 18, 2011).

<sup>154</sup> *See* Preamble to Treas. Reg. § 301.7623-1 (Feb. 21, 2012). *See also Collected Comments on Proposed Regulations: Payment of Whistleblower Rewards*, 2011 TAX NOTES TODAY 90-33 (May 9, 2011). (comments were submitted by individual whistleblower attorneys, their law firms, and a group representing the interests of whistleblower attorneys, Taxpayers Against Fraud Education Fund).

<sup>155</sup> *See* Collected Comments, *supra* note 154.

<sup>156</sup> *See generally* Hearing Transcript, *supra* note 22.

<sup>157</sup> *See* IRS WHISTLEBLOWER OFFICE FISCAL YEAR 2010 REPORT TO CONGRESS, *supra* note 1 at 7. *See also* Preamble to Treas. Reg. § 301.7623-1 (as amended Feb. 21, 2012) (noting that the Regulation does not address all of the concerns voiced in by commenters, including the ability of the Service to compensate a Whistleblower for a tip that prevents

severity of the insufficiency, or if the Service fully appreciates the need for drafting specific language to account for the wide variety of potential issues in whistleblower cases.

Whistleblower advocates' proposals regarding collected proceeds can generally be grouped into five proposal types warranting attention.<sup>158</sup> The following Part will evaluate the whistleblower advocates' proposals for (1) an expanded definition of collected proceeds,<sup>159</sup> the inclusion of (2) tax attributes,<sup>160</sup> (3) overpayments credit balances,<sup>161</sup> and (4) criminal fines<sup>162</sup> in the definition as well as the (5) finality<sup>163</sup> and (6) timing issues.<sup>164</sup>

#### A. What are Collected Proceeds?

Some whistleblower advocates have suggested broad standards for interpreting collected proceeds. One position that has been advocated is utilizing the standard "for the benefit of the Treasury" when considering what should be a collected proceed.<sup>165</sup> Other whistleblower advocates suggested equating collected proceeds to "net positive effect" for the U.S.

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future tax avoidance).

<sup>158</sup> See *infra* text accompanying notes 165-269. It should be noted that in the hearing and comment letters whistleblower attorneys made other suggestions, however, we have confined our comments to the most frequently mentioned and/or meritorious.

<sup>159</sup> See *infra* text accompanying notes 165-174 (discussing the potential for an expanded definition of collected proceeds).

<sup>160</sup> See *infra* text accompanying notes 175-207 (discussing exclusion of tax attributes from collected proceeds).

<sup>161</sup> See *infra* text accompanying notes 208-222 (discussing the partial inclusion of credit balances in collected proceeds).

<sup>162</sup> See *infra* text accompanying notes 223-238 (discussing the partial exclusion of criminal fines from collected proceeds).

<sup>163</sup> See *infra* text accompanying notes 239-269 (discussing issues of tax liability finality for the purposes of collected proceeds).

<sup>164</sup> See *infra* text accompanying notes 270-277 (discussing the timing of measuring collected proceeds and the timing of paying awards based on collected proceeds).

<sup>165</sup> See Letter from Michael Sullivan and Richard Rubin, *Finch McCranie LLP*, to Kristen Witter and Richard Hurst, *Internal Revenue Serv.*, at 4-5 (Apr. 18, 2011), available at 2011 TAX NOTES TODAY 77-20, (stating that "[f]undamental to an IRS whistleblower program is the concept of benefit to the Treasury. As the fundamental underlying the program, logically "benefit to the Treasury" should serve as the basis for determining and quantifying whistleblower rewards, and therefore as the basis for determining Collected Proceeds. Furthermore, we understand that the yardstick of benefit to the Treasury was applied in determining payments under the pre- 2006 IRS whistleblower program."). See also Hearing Transcript, *supra* note 22 at 14 (remarks of Richard Rubin stating, "Very much echoing the comments of my colleagues, I would suggest that collective proceeds, the fundamental there, is net benefit to the Treasury. It's as simple as that.").

Treasury.<sup>166</sup>

Unfortunately, neither proposal is feasible for a successful administration of the Whistleblower Program. The phrases “for the benefit of the Treasury” and “net positive effect” to the Treasury are even more amorphous and ambiguous than the current collected proceeds standard. Without adopting significant guidance defining “for the benefit of the Treasury” or “net positive effect,” neither of these terms are practical solutions. The proposed terms are not workable because neither term offers a certain calculation and would merely create confusion in award determinations. The Treasury has the benefit of funds deposited within it, and similarly funds deposited with the Treasury have a net positive effect. The Treasury derives no current benefit from funds not deposited. Uncollected tax liabilities are speculative future benefits for the Treasury. Paying a whistleblower award from not yet (if ever) collected funds does not create any certain positive or beneficial effect to the Treasury.

There is a *potential positive* effect to the Treasury if proceeds are in fact collected at a later date. However, such payments also risk a *potential negative* effect on the Treasury if no future proceeds are collected but funds have already been paid as an award to a whistleblower. Proposals for adoption of either phrase as equivalent to or instead of collected proceeds are thinly veiled attempts to read “collected” out of collected proceeds in order to expand the basis for paying whistleblowers. These proposals are attempts to have the Service pay whistleblowers without necessarily having the proceeds in hand. Further, these proposals leave open the very real possibility of paying whistleblowers from uncollected, and possibility never collected, funds. This payment system entirely conflicts with a primary objective of the Whistleblower Program: federal revenue protection.

Using a standard that attempts to read “collected” out of the statute is contrary to the legislative intent of the whistleblower statutes. The word

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<sup>166</sup> See Hearing Transcript, *supra* note 22, at 14 (remarks of Thomas Pliske, stating “I think net positive effect are three good words that should be used to define collected proceeds. If the government comes out ahead whether it's a reduction of the assessment because it's a tax calculation or it's the payment of the liability from a credit, either way the government is positively affected and the definition should be expanded to include not operating loss.”). See also *id.* (remarks of Linda Stengle, stating “The key issue here is: Was there a positive net effect on the Treasury? Positive net effect on the Treasury should be the basis for calculating the award to the whistleblower. When you broaden the definition and you focus on positive net effect to the Treasury, then its going to be a lot easier for the Whistleblower’s Office to make their calculations.”).

“collected” was intentionally included in the statute to modify proceeds.<sup>167</sup> Senator Grassley authored the 2006 IRS whistleblower amendments as well as the 1986 False Claims Act qui tam whistleblower provisions.<sup>168</sup> The False Claims Act served as a model for the 2006 IRS whistleblower amendments.<sup>169</sup> A qui tam plaintiff<sup>170</sup> recovery under the 1986 False Claims legislation is paid as a percentage of the “proceeds” of the action or settlement of the claim.<sup>171</sup> Twenty years later, Senator Grassley, drafted that tax whistleblower recoveries were to be made from “collected proceeds.”<sup>172</sup> He has expressly stated he based the IRS whistleblower provisions on the qui tam provisions.<sup>173</sup> When examining legislation by the same author for similar purposes (e.g., to reward efforts that assist in recovering amounts owed to the federal government), it follows that the use of different terminology must have meaning, particularly the addition of a modifying term. Despite definitional proposals to the contrary,<sup>174</sup> the term “collected” cannot simply be read out of the statute and its usage has a clear purpose in the statutory language.

### *B. Tax Attributes*

While the terminology proposals in Subpart IV.A. above have gained some support of whistleblower advocates,<sup>175</sup> the proposals ignore the need to define “proceed” and what it means for a “proceed” to be collected. This failure reappears in examining another, more common proposal of whistleblower attorneys: to treat tax attributes<sup>176</sup> as collected proceeds.

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<sup>167</sup> This modifying term is a result of the 1986 False Claims Act language requiring “recovery”. See [31 U.S.C. §§ 3729 et seq.](#)

<sup>168</sup> See Grassley letter, *supra* note 21, at 1.

<sup>169</sup> *Id.*

<sup>170</sup> For the purposes of this article, both a qui tam plaintiff under the False Claims Act and a whistleblower/informant under the IRS provisions will be referred to as whistleblowers.

<sup>171</sup> 31 U.S.C. § 3730(d)(1).

<sup>172</sup> § 7623(b)(1). Please note that a version of § 7623(a) was adopted in 1998 and uses the term “proceeds of amounts collected.” See *supra* text accompanying notes 99-106 (explaining that the Service treats “proceeds of collected amounts” and “collected proceeds” as having the same meaning).

<sup>173</sup> See Grassley letter, *supra* note 21, at 1.

<sup>174</sup> See *supra* text accompanying notes 165-174 (discussing proposed changes to the term “collected proceeds”).

<sup>175</sup> See *supra* text accompanying notes 165-174.

<sup>176</sup> Tax attribute is defined § 108(b)(2) to include the following: net operating losses, general business credits, minimum tax credits, capital loss carryovers, basis of property, passive activity loss and credit carryovers and foreign tax credit carryovers.

A proceed is “that which results, proceeds, or accrues from some possession or transaction.”<sup>177</sup> With respect to a tax whistleblower case, proceeds are that which results from the passing of information to the Service. Admittedly, by definition, proceeds do not necessarily have to be money.<sup>178</sup> This is certainly so in the tax context. Fundamental tax concepts, such as gross income<sup>179</sup> and amount realized,<sup>180</sup> contemplate far more than cash in hand.<sup>181</sup> Proceeds as more than money received have also been allowed in some qui tam cases.<sup>182</sup>

While the definition of proceed expands beyond cash on hand, allowing the reduction of tax attributes such as net operating losses (NOLs), capital loss carryovers, foreign tax credits, and other tax credits, to be quantified as proceeds fails to comply with the fundamental structure of the U.S. income tax system. Calculation of U.S. income tax for both individuals and businesses requires the addition, subtraction, and limitation of multiple tax items.<sup>183</sup> While the starting point of calculation is gross income,<sup>184</sup> and the

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<sup>177</sup> BLACKS LAW DICTIONARY, 6<sup>th</sup> ed. at 1204-5 (defining proceeds).

<sup>178</sup> *Id.* (defining proceeds and noting “[p]roceeds does not necessarily mean only cash or money.”).

<sup>179</sup> § 61(a) (Gross incomes “means all income from whatever sources derived.”).

<sup>180</sup> § 1001(b) (Amount realized is the “sum of any money received plus the fair market value of the property (other than money) received.”).

<sup>181</sup> *See generally Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955) (“Here we have undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.”), Rev. Rul. 79-24, 1979-1 Cum. Bull. 60 (concluding that the “fair market value of property or services taken into payment must be included into income.”).

<sup>182</sup> *See* Letter from Susan Strawn, Cleveland Lawrence III, Erika Kelton, and Paul D. Scott, *Taxpayers Against Fraud Education Fund*, to Kristen Witter, *Internal Revenue Service* at 5 note 7 (Apr. 18, 2011), available at TAX NOTES TODAY, Doc 2011-8440 (“For example, *United States, ex rel. Thornton v. Science Applications Int’l Corp.*, 207 F.3d 769 (5th Cir. 2000), held that the value of settled claims in a non-cash recovery should be included as part of a relator’s share award. *Thornton* further concluded that the government has a duty to advise the relator of the value of the settlement, including the non-cash proceeds. *United States, ex rel. Barajas v. United States*, 258 F. 3d 1004 (9th Cir. 2001), likewise ruled that settlement proceeds need not always consist of money or some tangible asset, and that a whistleblower was entitled to a share of the value of a non-cash settlement. In *Barajas*, the court concluded that the whistleblower should share in the value of repairs to faulty data transmitters -- non-cash services valued at as much as \$10 million dollars. *See also United States ex rel. Nudelman v. International Rehabilitation Associates*, 2005 US Dist. LEXIS 9605 (E.D. Penn. 2005), concluding that the relator should share in the value of three year monitoring agreement (valued at \$1.5 million).”).

<sup>183</sup> *See* BORIS I. BITTKER, MARTIN J. MCMAHON, AND LAWRENCE A. ZELENAK, *FEDERAL TAXATION OF INDIVIDUALS* 2-2 (3d 2002) (explaining and listing the calculation of federal income tax liability)

ending point is tax liability,<sup>185</sup> the calculation requires other items, specifically tax attributes like the ones mentioned above to be accounted for. The Service requires reporting of much information other than tax liability,<sup>186</sup> but the Service collects only two things from taxpayers: information and money. Anything other than money is information. While a tax attribute may serve to reduce tax liability, it is not collected and cannot be under the current U.S. tax structure.

That is not to say that tax attributes never have value. Tax attributes may have value under certain circumstances. The effort to consider tax attributes as proceeds recognizes their very real value, in many but not all cases, to taxpayers. In many merger and acquisition deals, NOLs and other tax attributes are given value.<sup>187</sup> They are certainly considered in negotiating the structure of a deal and factor into price.<sup>188</sup> Accounting rules for taxes, ASC 740, requires businesses to characterize NOLs as assets.<sup>189</sup> Indeed, an NOL is listed on a balance sheet as a deferred tax asset.<sup>190</sup>

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<sup>184</sup> *Id.* (listing gross income as the starting point).

<sup>185</sup> *Id.* at 2-7 (“The statutory concept of taxable income is the end product . . . determining what shall be included, excluded, or deducted in computing tax liability . . .”).

<sup>186</sup> See generally Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733 (2010) (discussing the policy and effect of information reporting and citing numerous examples).

<sup>187</sup> Thomas W. Bottomlee, Jason S. Bazar and Arthur C. Walker, *Don't Ignore a Target's NOLs: The Price and Structure of Your Deal Can Depend on Them*, 9 THE M&A JOURNAL 7 (“Generally, where the parties settle on a stock deal, the NOL carryforwards of a target “C” corporation will transfer with and be available to the target corporation. Accordingly, a target corporation’s NOL carryforwards that exist as of the closing date represent an economic asset of the target – the possible reduction of future income taxes. Thus, these NOLs may be of some value to some buyers, even in this dismal market. However, our experience has shown that when deal makers are negotiating the purchase price for a target’s stock they will often either fail to address the potential value of these NOLs or at least fail to address the value early enough in the process to make a meaningful difference. In addition, if the issue does arise in price negotiations, buyers often argue that the market price for NOLs is “pennies on the dollar.”). See also Larry Maples, *Pitfalls in Preserving Net Operating Losses*, CPA JOURNAL (March 2007) (“The “value” of a net operating loss (NOL) depends not only upon its size, but also on the amount of income the law allows the NOL to offset.”).

<sup>188</sup> See Bottomlee, *supra* note 187.

<sup>189</sup> FIN. STANDARDS ACCT. BOARD, *Acct. Standards Codification 740, Income Taxes*.

<sup>190</sup> See also Anthony Catanach and Shelley Wells-Catanach, *Net Operating Losses: How Much Are These “Assets” Really Worth?*, 21 COMMERCIAL LENDING REV. 4 (July 2006) (stating “FAS-109 allows these potential tax savings to be recorded on the company's balance sheet as a deferred tax asset, given that positive future cash flows are expected from the tax savings generated by the NOL's use.”).

For businesses that are going concerns with reasonable expectations of future profits, tax attributes no doubt have value. For businesses that can create tax structures that sell, exchange, or leverage them, they also have value.<sup>191</sup> There are, of course, limitations to NOL usage, including the NOL limitation rule related to certain changing ownership.<sup>192</sup> While NOLs and other tax attributes are assets, they are assets with no inherent payment value until they are utilized to offset tax liability. Section 172(b)(1)(A) allows NOLs to be carried back to offset tax liability for two years and carried forward to offset future tax liability for 20 years.<sup>193</sup> This long time horizon for potential benefit recognition is a key argument against allowing NOLs to constitute proceeds in the year the NOL reduction occurs. There are many extenuating circumstances that would preclude a business from recognizing the benefit of the NOL such as change in business form, subsequent years of NOLs, or winding up a business.

Even though tax attributes are valuable to businesses in many cases, they do not rise to the level of a proceed until they are utilized to offset tax owed. They do not represent any “end” in the tax process. They are not equivalent to tax owed. They are a part of the calculation that leads to tax liability.<sup>194</sup> It is the adjustment of tax liability that should be the starting definition for what is a proceed.

A tax liability can be compromised by the Service or not paid at all for innumerable reasons.<sup>195</sup> This reality forms the basis of the need for the proceeds to be collected. For tax purposes, collection is the fundamental purpose of the Service.<sup>196</sup> The agency exists to collect *revenue*. It does not

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<sup>191</sup> See Robert Rizzi, *New Respect for “Trafficking” in Losses, NOL Protections Take Hold.*, 37-3 CORPORATE TAXATION 30 (“The result was the development of a cottage industry of tax planning to maneuver taxpayers safely around the hair trigger, and to permit the use of NOLs under many conditions that might, in substance, actually involve trafficking in NOLs.”).

<sup>192</sup> See generally § 382.

<sup>193</sup> § 172(b)(1)(A). This time frame has been periodically modified. A temporary tax provision allowed carryback for five years for 2008 and 2009 NOLs see § 172(b)(1)(H).

<sup>194</sup> See Preamble to Treas. Reg. 301.7623-1 (as amended Feb. 21, 2012) (“tax attributes such as NOLs are component elements of a taxpayer’s liability.”).

<sup>195</sup> See e.g. Authority for Offers in Compromise (OIC) is found at § 7122, and an OIC is executed via Forms 656, 733-A and 733-B. Authority for Appeals Office settlement is found at Reg. § 601.106, and Appeals Settlements are executed on Forms 870, 870-AD or 890. Authority to Closing Agreements is found at § 7121, and closing agreements can be executed on Forms 866 and 906.

<sup>196</sup> See SALTZMAN, *supra* note 107 at 1-5 (“its distinct objective of revenue collection”).



collect tax attributes or more specifically, NOLs. The existence of a tax attribute does not have a direct revenue impact to the Treasury. The Service collects money or seizes assets that it liquidates into money, and it has broad powers of collection.<sup>197</sup> The Service has never seized an NOL, nor could it. The Service would never seize an NOL because an NOL has no independent value to the Service. To collect means to “claim as due and receive payment for.”<sup>198</sup> Payment is axiomatic to this inquiry.

While a whistleblower tip that serves to reduce a current NOL does not rise to the level of collected proceeds, that does not mean, however, the NOLs reduction cannot or will not be liquidated and collected at a future point. In the preamble to the Final Regulation, the Service explained that if a whistleblower tip resulted in a reduced NOL, which had previously been used in full to generate a refund, “then the amount of the erroneous refund recovered and collected would be collected proceeds.”<sup>199</sup> The timing of the collection of tax proceeds is at issue. Proceeds that are not currently collected are not entertained under the statute. The Service would have to deem it collected in guidance. Such guidance, however, is contrary to the legislative intent requiring the collection of revenues. The use of the term collected implies that funds must be in hand, and that the proceeds must have been liquidated and accepted by the Service. For the Service to deem a proceed collected without having it in hand also presents another problem for § 7623(a), which states that a whistleblower award “shall be paid from the proceeds of amounts collected.”<sup>200</sup> Without any collection, there are no proceeds from which to pay under subsection (a).

The original drafter of the whistleblower amendments, Senator Grassley, commented that he would like to see a more inclusive definition of collected proceeds.<sup>201</sup> While Senator Grassley might want to reward whistleblowers for information that leads to a reduction in an NOL, he has expressly recognized that the statutory language makes this impossible.<sup>202</sup> In a September 13, 2011 letter to IRS Commissioner Shulman, Senator

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<sup>197</sup> *Id.* at 15-3 (“the organization and operation of the collection function, as well as the substantive law of liens and levies, give the Service broad and formidable powers to collect delinquent taxes.”).

<sup>198</sup> MERRIAM WEBSTER DICTIONARY, available at <http://www.merriam-webster.com/dictionary/collect?show=1&t=1325105771> (defining collect).

<sup>199</sup> See Preamble to Treas. Reg. 301.7623-1 (as amended Feb, 21, 2012).

<sup>200</sup> § 7623(a). Section 7623(b) differs slightly in that it states that a whistleblower “shall . . . receive an award . . . of the collected proceeds . . . resulting from the action . . .”

<sup>201</sup> See Grassley letter, *supra* note 21, at 7.

<sup>202</sup> *Id.*

Grassley stated that

“[i]t is important for whistleblower confidence - and tax administration - that whistleblowers be rewarded for providing information about income being reduced by net operating losses (NOLs). I understand that this is a difficult issue as IRS does not collect payments of tax in such cases and so a whistleblower award likely could not be made until a taxpayer's NOLs are fully utilized and pays taxes.”<sup>203</sup>

At its heart, Senator Grassley’s statement recognizes that whistleblower payments based on the reduction of a tax attribute are not possible until proceeds are collected. Senator Grassley’s acknowledgement is important because he has long endorsed expanding and increasing the utilization of the Whistleblower Program.

A compromise offered by some whistleblower advocates is to calculate a present value for the tax attribute.<sup>204</sup> Whistleblower advocates have argued the appropriate treatment of a tax attribute reduction, specifically an NOL, is to pay a whistleblower a percentage of a present value calculation.<sup>205</sup> While administratively tidy and efficient, this calculation would remove the requirement of “collected” from the whistleblower statute. It presumes future collection, which may not occur, and it also does not solve the problem of fulfilling the § 7623 requirements that whistleblower awards be paid from proceeds. Based on the definition of proceed<sup>206</sup> and the value given to a tax attribute within the Code,<sup>207</sup> tax attributes fail to provide collection as required under statute to pay a whistleblower award.

### C. Overpayment Credit Balances

The 2012 Final Regulation states that collected proceeds include “a reduction of an overpayment credit balance used to satisfy a tax liability incurred because of the information provided.”<sup>208</sup> PMTA 2010-62 verified the Service’s position that the reduction of “an overpayment credit balance”

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<sup>203</sup> *Id.*

<sup>204</sup> See Sullivan and Rubin Letter, *supra* note 165 at 6-8 (suggesting use of present value calculations and discount factors in valuing whistleblower payments for proceeds not yet collected).

<sup>205</sup> *Id.*

<sup>206</sup> See *supra* text accompanying note 177.

<sup>207</sup> See Treas. Reg. § 301.7623-1(a)(2) (as amended Feb. 22, 2012).

<sup>208</sup> *Id.*

is included in collected proceeds,<sup>209</sup> despite conflicting guidance in the current I.R.M.<sup>210</sup>

Whistleblower attorneys have suggested that the term “credit balance” is a poor choice of terminology because it is not a term used with respect to corporate taxpayers.<sup>211</sup> This is correct. Credit balance is rarely found outside of the retirement account tax context<sup>212</sup> or I.R.M. references to procedures for dealing with taxpayer accounts.<sup>213</sup> This poor word choice has required the Service to further explain its interpretation of overpayment credit balance.

Although “credit balance” is an imprecise term, the inclusion of “overpayment” as the modifier offers significant clarity in interpreting the Service’s intentions. There are many reasons that a taxpayer, individual or business, might have a credit balance with the Service, including overpayments, outstanding refundable or nonrefundable credits, or even certain tax attributes.<sup>214</sup> The use of the term overpayment, however, presumes to exclude all positive tax account balances that are the result of

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<sup>209</sup> See PTMA 2010-62, *supra* note 128 (analyzing the payment of refund protection and credit reduction claims under § 7623).

<sup>210</sup> I.R.M. 25.2.2.12(1) (Jun. 18 2010 version) (“satisfaction of taxpayers’ liabilities by reducing a credit balance is not within the scope of collected proceeds.”).

<sup>211</sup> See Knott and Lyman Letter, *supra* note 53 at 4 (“ . . . the Proposed Regulations are simply too narrowly drafted to with respect to the impact of credits on complex corporate returns.”). See also Letter from Linda Stengle, *Kenney & McCafferty, PC*, to Richard Hurst, *Internal Revenue Service* at 1 (Feb. 23, 2011), available at TAX NOTES TODAY, Doc 2011-4349.

<sup>212</sup> See e.g. I.R.M. 4.72.14.3, Technical Requirements (05-04-2001).

<sup>213</sup> See e.g. I.R.M. 1.2.50.3 Delegation Order 13-2 (Rev. 1) (03-03-2008), I.R.M. 1.13.8.9 Browse Mode (See Exhibit 1.13.8-13 and Exhibit 1.13.8-15) (01-01-2006), I.R.M. 1.13.9.5 Specific instructions for Section 594 returns (04-04-1998), I.R.M. 1.15.29.1 Description and Authorities (07-01-2005), I.R.M. 2.3.29.5 Command Code ICOMP (06-23-2009), I.R.M. 2.3.51.12 Table of Screen Exhibits (01-01-2011), I.R.M. 2.4.26.4 Command Code FRM14 (03-30-2009), I.R.M. 2.4.26.3 Command Code FRM49 (03-30-2009), I.R.M. 2.4.34.3 Terminal Responses for Command Code DOALL (07-01-2011), I.R.M. 2.4.34.2 Terminal Input For Command Code DOALL (01-01-2011), I.R.M. 3.13.5.57 Glossary of Terms (01-01-2011), I.R.M. 3.13.12.1 Overview (01-01-2011), I.R.M. 3.13.12.22 EO Delinquency Notices (01-01-2011), I.R.M. 3.17.30.17 Special Non-Master File (NMF) Procedures (01-01-2010), I.R.M. 3.17.30.5 Control Record List (01-01-2010), I.R.M. 3.17.63.13 Account Series 4000 Liability Accounts (10-01-2004), I.R.M. 3.17.63.26 Federal Tax Deposits (FTD) (07-27-2010), I.R.M. 3.17.64.16 Electronic Transmissions (09-01-2011), I.R.M. 3.17.64.9 CADE - Customer Account Data Engine (09-01-2011).

<sup>214</sup> See Knott and Lyman Letter, *supra* note 53 at 4 (stating “An ‘overpayment’ credit balance is just one of the many types of credit balances that exist under the IRC.”).

tax credits or losses. Proper interpretation requires giving meaning to all terms.<sup>215</sup>

Overpayment credit balance only allows refund of taxpayer's balances that are a result of payments, as opposed to nonrefundable credits or tax attributes such as an NOL, capital loss carryforward, or a foreign tax credit. If a credit balance resulted from refundable credits and the taxpayer were refund eligible, then presumably the refund provisions of the Regulation would apply to allow a whistleblower tip that prevented a refund or enable the recapture of a refund would apply. As such, use of "overpayment credit balance" in combination with the refund protection provision disallows whistleblower payments only on nonrefundable credits or tax attributes, which are items that are not automatically collected upon occurrence.

The Service most recently clarified overpayment credit balance in the preamble to the Final Regulation.<sup>216</sup> Specifically, the Service stated that use of overpayment credit balance includes credits to an individual or corporate taxpayer that could be refunded under § 6402, but does not include amounts such as § 6603 cash deposits.<sup>217</sup> Because § 6402 authorizes the Service to refund overpayments to taxpayers,<sup>218</sup> it follows that the Service would consider reductions of refund-eligible § 6402 overpayments to be reductions of overpayment credit balances.

The Service's notation of § 6603 is more difficult to interpret. Section 6603 allows taxpayers to make monetary deposits with the Service for taxes not yet due.<sup>219</sup> Perhaps the Service's attempt to distinguish cash deposits from overpayment credit balances is driven by the Service's focus on "overpayment." By definition, a cash deposit "may be used . . . to pay any

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<sup>215</sup> See *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883) ("It is the duty of the Court to give effect, if possible, to every clause and word of a statute, avoiding, if it may be, any construction which implies that the legislature was ignorant of the meaning of the language it employed.").

<sup>216</sup> Preamble to Treas. Reg. § 301.7623-1 (as amended Feb. 22, 2012).

<sup>217</sup> *Id.*

<sup>218</sup> § 6402(a) ("In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), (e), and (f) [1] refund any balance to such person.").

<sup>219</sup> § 6603(a) ("A taxpayer may make a cash deposit with the Secretary which may be used by the Secretary to pay any tax imposed under subtitle A or B or chapter 41, 42, 43, or 44 which has not been assessed at the time of the deposit. . . .").

tax imposed . . . which has not been assessed at the time of deposit.”<sup>220</sup> A cash deposit cannot be an “overpayment” because there was not yet a tax to pay. The Service’s notation of § 6603 appears to be an attempt to insist on overpayment as a necessary requisite for funds to be an overpayment credit balance.

The danger from the preamble’s treatment of § 6603 cash deposits is that Whistleblowers may infer that cash deposits do not qualify as collected proceeds. If a cash deposit is used to “satisfy a tax liability incurred because of information provided,”<sup>221</sup> then the cash deposit should be collected proceeds. A reduction of a cash deposit due to a Whistleblower’s tip satisfies the elements of collected proceeds. Moreover, the treatment of the reduction of a cash deposit should be no different than the treatment of the denial of a refund claim that would have otherwise been paid.<sup>222</sup> Utilization of cash deposits to satisfy increased tax liability due to a Whistleblower’s tip should be collected proceeds. Accordingly, the Service’s use of § 6603 to delineate overpayment credit balances will likely create more confusion rather than providing clarity. While the Service attempted to provide additional guidance for overpayment credit balances in the Regulation’s preamble, significant uncertainty still surrounds the inclusion of overpayment credit balances in collected proceeds.

#### D. Criminal Fines

Other than the inclusion of tax attributes, the other proposals that received the most attention during the notice and comment period was the proposed inclusion of all criminal fines and restitution in collected proceeds.<sup>223</sup> The Service has confirmed restitution’s inclusion in collected proceeds;<sup>224</sup> however, the Service’s exclusion of certain criminal fines from

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<sup>220</sup> *Id.*

<sup>221</sup> Treas. Reg § 301.7623-1(a)(2).

<sup>222</sup> See PTMA 2010-62, *supra* note 128.

<sup>223</sup> See Knott and Lyman Letter, *supra* note 53 at 6-8 (Apr. 18, 2011); Letter from Thomas Dunne, to Kristen Witter, *Internal Revenue Service* at 1-2 (Feb. 22, 2011), available at TAX NOTES TODAY Doc 2011-3714; Letter from Thomas C. Pliske, *Tax Whistleblower Law Firm LLC*, to Kristen Witter, *Internal Revenue Service* at 15-17 (Mar. 24, 2011), available at TAX NOTES TODAY Doc 2011-6549; Letter from Patrick Carmody, *Carrig Counsel*, to Kristen Witter, *Internal Revenue Service* at 2 (Mar. 28, 2011), available at TAX NOTES TODAY Doc 2011-6550; Strawn, Lawrence, Kelton and Scott Letter, *supra* note 182 at 6-7.

<sup>224</sup> Preamble to Treas. Reg. 301.7623-1 (as amended Feb. 22, 2012).

collected proceeds is a change from prior Service policy.<sup>225</sup> The Service's current policy is that criminal fines that are required to be deposited in the Crime Victims Fund under 42 U.S.C. § 10601 are not proceeds.<sup>226</sup> The Service's position implies that it believes the term collected in § 7623 means collected by the Service.<sup>227</sup> Fines that are deposited in the Crime Victims Fund are in fact collected; they are just not collected by the Service.

A converse interpretation from the Service would create a statutory conflict in the availability of fund payouts. If criminal fines are proceeds under § 7623 and collected means collected by the federal government (not only the Service), then this conflict would result in competing statutory guidance as to the proper availability of the fines for payments. 42 U.S.C. § 10601 requires that the fines are deposited in the Crime Victims Fund and available to programs under that section, and § 7623 requires making the fines available for whistleblower payments. Some whistleblower advocates have suggested that, under statutory construction rules, the 2006 amendments to § 7623 would prevail because they are more recent.<sup>228</sup> This interpretation, however, assumes that criminal fines are proceeds under the statute, which may not be the case, and ignores a reading that does not create a conflict between the statutes. The 2006 amendments added subsection § 7623(b), which includes a parenthetical after collected proceeds.<sup>229</sup> The parenthetical states, "(including penalties, interest, additions to tax, and additional amounts)".<sup>230</sup> The term "fine" is not present in the parenthetical, despite the fact that this language had been included in previous IRS guidance.<sup>231</sup> This suggests that the omission of

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<sup>225</sup> See *supra* text accompanying notes 81-152 (discussing the Service's policy regarding criminal fines). See also *supra* text accompanying notes 127-135 (noting change in Service's policy on the inclusion of all criminal fines in collected proceeds).

<sup>226</sup> *Id.*

<sup>227</sup> See PTMA 2010-60, *supra* note 128 (discussing IRS position that criminal fines required to be deposited in the Crime Victims Fund are not collected proceeds).

<sup>228</sup> *Id.* ("Although it is true, as you point out, that the 1996 amendments to § 7623 providing award payments will be made from collected proceeds was enacted after the VOC Act, we do not think, as you suggest, that § 7623 can be interpreted to constitute an implied exception to the VOC Act.").

<sup>229</sup> § 7623(b)(1).

<sup>230</sup> *Id.*

<sup>231</sup> See I.R.M. 25.2.2.10(1), *Factors for Determining the Allowability of Claims* (Apr. 27, 1999) ("Rewards are paid only with respect to taxes, penalties and *fin*es collected, and on amounts of revenues protected (claims or refund denied).") (emphasis added). See also I.R.M. 25.2.2.13(1)(a), *Partial Allowances*, (Apr. 27, 1999) ("However, a partial reward may be paid if, for example, it can be ascertained in a *criminal prosecution* case that the

the term “fine” is intentional because prior versions of the I.R.M. included fine as a basis for whistleblower payments.<sup>232</sup>

In administering the tax system, the Service uses penalties and interest as common terms and for taxpayers who pay late or fail to pay at all.<sup>233</sup> Whistleblower advocates have suggested that penalties should include criminal penalties.<sup>234</sup> It could, but a rule of statutory construction is to first attempt to construe two potentially conflicting statutes so as to give them both meaning.<sup>235</sup> This is possible only if criminal fines are not included in collected proceeds. If collected proceeds do not include criminal fines, then there is no conflict between the statutes.

On the other hand, if criminal fines are part of collected proceeds, another administratively expedient reading, and one taken by the Service in PTMA 2010-60<sup>236</sup> and verbally in the May 2011 hearing,<sup>237</sup> would be to

conviction was directly or indirectly attributable to the informant’s information. A reward allowance based on the *fine* when paid may be made as a partial allowance prior to the civil settlement of the tax liability.”) (emphasis added).

<sup>232</sup> *Id.*

<sup>233</sup> See e.g. § 6601 *et seq.* (extensively using the term interest and detailing interest on tax liabilities and payments to the Service). See also e.g. § 6651 *et seq.* (using the term penalty as well as the phrase “addition to tax” to detail taxpayer penalties for failure to pay a tax, accuracy-related tax issues, and fraud).

<sup>234</sup> See Knott and Lyman Letter, *supra* note 53 at 1-3 (Apr. 18, 2011); Dunne Letter, *supra* note 216 at 1-2; Pliske Letter, *supra* note 223 at 15-17; Carmody Letter, *supra* note 223 at 2.

<sup>235</sup> See 73 AM JUR 2D STATUTES § 168 (2011) (“Ordinarily, related statutes should be construed, if possible, by reasonable interpretation, so as to give full force and effect to each of them, since, where it is possible to do so, it is the duty of the courts in the construction of statutes to harmonize and reconcile laws and to adopt that construction of a statutory provision which harmonizes and reconciles it with other statutory provisions.”).

<sup>236</sup> See PTMA 2010-60, *supra* note 128.

<sup>237</sup> See Hearing Transcript, *supra* note 22 at 14 (statements of Thomas Kane, *Office of Associate Chief Counsel, Internal Revenue Serv.*, stating “I think there is also a misconception out there about where we stand on criminal fines. I think the only thing that we have said so far with respect to criminal fines is with respect to a very narrow circumstance where criminal fines are deposited into and segregated into a fund specifically identified under Title XVIII or another title of the code. And because of the nature of that fund, we the Service can't get at it. I think that's the only thing that we talked about to date that's really specifically addressed that --.”). See also *id.* (statements of Stephen A. Whitlock, *Director, Whistleblower Office, Internal Revenue Serv.*, stating “Subsequent to the publication of the proposed rule, Chief Counsel released their opinion on the criminal fine issue and any fine that's required to be deposited into the Victims of Crime Fund would be outside the scope of our definition of proceeds from which we pay an award. My understanding is that's pretty much any criminal fine.”). See also *id.* (statements of Kristen Witter, *Office of Associate Chief Counsel, Internal Revenue Serv.*,

exclude only criminal fines that are deposited in the Crime Victim Fund under 42 U.S.C. § 10601. This is not as clean of a statutory construction as the alternative explained above but still defensible by the Service.

Of course, it would be ideal if Congress added § 7623 as another express exception to 42 U.S.C. § 10601, but that is not a currently available option. The Service is saddled with using statutory construction because it is tasked with administering and enforcing § 7623, which could conflict with 42 U.S.C. § 10601. The Service cannot amend either statute, only Congress may do so.<sup>238</sup> As such, the Service must offer guidance that attempts to harmonize both statutes. The Service does not have the choice to ignore either one. Its current attempt at harmonizing the statutes is not unreasonable and the result is that certain criminal fines are not be included in collected proceeds.

#### *E. Finality Issues*

Whistleblower advocates have also expressed concern regarding when award payments are made.<sup>239</sup> This concern is well founded, as the GAO's Whistleblower Office audit concluded that "whistleblower claims can take years to process."<sup>240</sup> Indeed, one whistleblower attorney quotes a time period of "at least 5-6 years"<sup>241</sup> from submission to payment. Such lengths of time create a disincentive for whistleblowers to step forward, by temporally separating the risk they undertake and expected reward.

The Service has lengthened the time period for whistleblower payment to achieve greater finality in the process.<sup>242</sup> The Service policy for

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stating "The Crime Victims Fund Act specifies that all criminal fines assessed by a district court are required to be deposited into this fund fines assessed for Title XXVI criminal violations are not excluded from that requirement, and we do not have access to those funds to be able to pay out awards.").

<sup>238</sup> U.S. CONST. art I, § 8 ("To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.").

<sup>239</sup> See Knott and Lyman Letter, *supra* note 53 at 8-10. See also Sullivan and Rubin Letter, *supra* note 165 at 6-8. See also Patrick Carmody, *Why do Whistleblower Cases Take so Long?*, blog post, available at [http://www.carrigcounsel.com/Carrig\\_Counsel\\_Tax\\_Whistleblower\\_IRS\\_Rewards/Alerts/Entries/2011/7/15\\_Why\\_Do\\_Tax\\_Whistleblower\\_Cases\\_Take\\_So\\_Long.html](http://www.carrigcounsel.com/Carrig_Counsel_Tax_Whistleblower_IRS_Rewards/Alerts/Entries/2011/7/15_Why_Do_Tax_Whistleblower_Cases_Take_So_Long.html) (Jul. 15, 2011).

<sup>240</sup> See GAO Report, *supra* note 76 at 8.

<sup>241</sup> See Carmody Blog Post, *supra* note 239.

<sup>242</sup> I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010).



whistleblower payment<sup>243</sup> now requires that “the statutory period for [the taxpayer] filing a claim for refund expires,”<sup>244</sup> which is generally two years from payment of the tax,<sup>245</sup> or that “there is an agreement between the taxpayer and the Service that there has been a final determination of tax for a specific period and a waiver of the right for filing a claim for refund is effective.”<sup>246</sup>

In a typical tax matter, the Service has a limited time to assert a taxpayer’s deficiency.<sup>247</sup> For taxpayers who file a return timely, the Service must assert a deficiency within three years.<sup>248</sup> Taxpayers who understate gross income by more than 25% are subject to a six-year statute of limitations,<sup>249</sup> and taxpayers who fail to file a return or file a fraudulent return have no statute of limitations for that tax year.<sup>250</sup>

Taxpayers are similarly limited in their abilities to apply for a refund. Section 6511 limits claims for refunds to the lesser of three years from the time that the return is filed or two years from payment.<sup>251</sup> Because whistleblower payments rely upon collected proceeds, the more relevant limit is usually two years from payment. Previously, the Service interpreted collected proceeds to be when payment was collected from the taxpayer. The Service now adopts the view that “payment will not be paid until there is a final determination of tax liability,”<sup>252</sup> and the Service defines final determination to include the two-year refund window.<sup>253</sup>

This additional two-year wait disappoints some whistleblower advocates, who view the additional time period as unnecessary.<sup>254</sup> The Service added this time period to achieve finality. Although the old adage

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<sup>243</sup> See GAO Report, *supra* note 76 at 8. The eight-step process documented by the GAO is: 1. Whistleblower files claim, 2. Whistleblower Office initial claim review, 3. Subject matter expert review, 4. Classification and examination, 5. Appeals and collections, 6. Period for taxpayer to exercise right to request refund. 7. Whistleblower Office final review and 8. Award payment.

<sup>244</sup> I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010).

<sup>245</sup> § 6511.

<sup>246</sup> *Id.*

<sup>247</sup> § 6501

<sup>248</sup> § 6501(a).

<sup>249</sup> § 6501(e)(1).

<sup>250</sup> § 6501(c)(1) and (3).

<sup>251</sup> § 6511(a).

<sup>252</sup> I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010).

<sup>253</sup> *Id.*

<sup>254</sup> See Knott and Lyman Letter, *supra* note 53 at 8-10; Sullivan and Rubin Letter, *supra* note 165 at 11.

may indicate “that nothing is certain by death and taxes,” finality is actually quite hard to achieve for the Service, even when it settles with taxpayers.<sup>255</sup> Last year, the Service’s Appeals Office closed more than 133,000 taxpayer matters,<sup>256</sup> 85-90% of which were likely settled.<sup>257</sup> While there are several ways in which to settle a dispute with the Service, only one way is statutorily recognized as final: closing agreements under § 7121.<sup>258</sup> This lack of settlement finality has created the need for the Service to wait until the two-year refund window closes.

The Service settles disputes with taxpayers using settlement agreement forms (e.g. Forms 870 and 870-AD), closing agreements (e.g. Forms 866 and 906), and compromise agreements (e.g. Offers in Compromise).<sup>259</sup> On its face, settlement agreement Form 870 does not achieve finality. It contemplates that, post-payment, the taxpayer could request a refund and the Service could make further assessment.<sup>260</sup> The Service prefers to use this form rather than other forms,<sup>261</sup> likely because it allows the Service to assert later uncovered deficiencies. Indeed, the I.R.M. expressly advises Service personnel that “[i]f the taxpayer requests greater finality [than Form 870 provides], explain Service policy with regard to reopenings and make an attempt to persuade the taxpayer a Form 870-type agreement is adequate.”<sup>262</sup>

Form 870-AD offers a somewhat more certain resolution in that the form expressly limits recourse for both the Service and the taxpayer by stating:

If this offer is accepted, *the case will not be reopened by the commissioner unless* there was: fraud, malfeasance, or a misrepresentation of material fact; a deficiency or overassessment resulting from adjustments made under Subchapters C and D of Chapter 63 concerning the tax

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<sup>255</sup> See *infra* text accompanying notes 259-269.

<sup>256</sup> INTERNAL REVENUE SERV., 2010 Data Book, table 21, available at <http://www.irs.gov/taxstats/article/0,,id=207731,00.html>.

<sup>257</sup> INTERNAL REVENUE SERV., 2009 Data Book, table 21, available at <http://www.irs.gov/taxstats/article/0,,id=207731,00.html> (comparing prior years information).

<sup>258</sup> § 7121.

<sup>259</sup> See SALTZMAN, *supra* note 107

<sup>260</sup> See Internal Revenue Serv., Form 870 (reverse side).

<sup>261</sup> See I.R.M. 8.6.4.3.3(1), Agreements Used When Taxpayer Requests Greater Finality (10-26-2007) (indicating the policy preference for 870 forms).

<sup>262</sup> *Id.*

treatment of partnership and subchapter S items determined at the partnership and corporate level; an excessive tentative allowance of a carryback provided by law. *No claim for refund or credit will be filed or prosecuted by the taxpayer for the years stated on this form, other than for amounts attributed to carrybacks provided by law.*<sup>263</sup>

Although Form 870-AD expresses finality, there are a number of listed exceptions that affect finality.<sup>264</sup> Moreover, the Supreme Court expressly found that this form, “though not binding in itself, may when executed become, under some circumstances, binding on the parties by estoppel.”<sup>265</sup> This Supreme Court quote indicates that an 870-AD only achieves finality in “some circumstances.” Consequently, despite Service efforts to persuade taxpayers to the contrary,<sup>266</sup> common Service settlement agreements (e.g. Forms 870 and 870-AD) do not achieve finality.

Closing agreements, on the other hand, are statutorily deemed final. Under § 7121(b) closing agreements “shall be made final and conclusive, except upon a showing of fraud or malfeasance or misrepresentation of material fact . . .”<sup>267</sup> As deemed final under the statute, “even the parties themselves may not rescind or cancel”<sup>268</sup> a closing agreement in absence of fraud, malfeasance or misinterpretation. However, even though closing agreements are statutorily deemed final, collected proceeds may not be fully realized under a closing agreement that concludes only certain tax matters and not an entire tax year. For example, Form 906 only contemplates the settlement of specific tax matters, not setting the tax liability for a tax year (as contemplated by Form 866). Accordingly, other tax items that are not settled under Form 906 could affect the ultimate tax liability, which determines collected proceeds. In other words, a whistleblower could provide a tip that results in a taxpayer’s increased income (or decreased deduction); then the taxpayer could resolve the income/deduction matter under a Form 906 closing agreement but later apply for a refund on the basis of other tax matters. While the closing agreement concluded the tax

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<sup>263</sup> See Internal Revenue Serv., Form 870-AD (reverse side) (emphasis added).

<sup>264</sup> *Id.*

<sup>265</sup> See SALTZMAN, *supra* note 107 at 9-79 (quoting *Botany Worsted Mills v. U.S.*, 278 U.S. 282, 289 (1929)).

<sup>266</sup> See I.R.M. 8.6.4.3.3(1), *Agreements Used When Taxpayer Requests Greater Finality* (10-26-2007) (stating the Service policy to persuade taxpayers of the adequacy of 870-type forms).

<sup>267</sup> § 7121(b).

<sup>268</sup> See SALTZMAN, *supra* note 107 at 9-98.

matters in question, it did not set the final tax liability for the tax year. Until a tax year's tax liability is set and proceeds are collected (based on that liability), there are no collected proceeds to calculate a whistleblower award payment.

The lack of certain finality with tax settlements creates significant uncertainty for the Service and whistleblowers when calculating collected proceeds. Consequently, finality must be balanced with administrability so that whistleblower cases can be processed and closed, and an appropriate incentive level is maintained. The Service's position with respect to the two-year refund statute of limitations is administrable and a reasonable time period to wait to achieve finality for typical matters, matters using settlement agreements (e.g. Forms 870 and 870-AD), and closing agreements for specific matters (e.g. Form 906). Closing agreements that settle a tax year's liability and waive refund rights (as Form 866 does) are sufficiently final therefore collected proceeds should not be subjected to the two-year refund statute when this type of closing agreement is used.

Even with a Form 866 closing agreement for the tax year, the possibility always exists that subsequent events could alter the collected proceeds at a later date. For example, subsequent year carrybacks could create this situation.<sup>269</sup> This, however, should not affect the proceeds that are collected under a Form 866 agreement. Waiting on such a contingency undermines the certainty, and consequently the incentive, for a whistleblower. Allowing this level of uncertainty would undermine the legislative intent of the 2006 amendments to create greater financial incentive for whistleblowers with tips providing significant revenue. Only Form 866 closing agreements should be considered sufficiently final to measure and pay collected proceeds once the proceeds are collected from the taxpayer because this Form settles the tax liability for the taxpayer. All other closing agreement forms should be subject to the two-year refund statute to calculate collected proceeds with certainty.

#### *F. Timing Issues*

The final issues raised in the comment letters involved timing, both the timing of income and deductions for the taxpayer and timing of payments to whistleblowers.

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<sup>269</sup> See e.g., § 172(b)(1)(A) (allowing for NOL carryback and carryforward).

## 1. Temporary Adjustments

Subsequent events are not only a concern with respect to closing agreements, they are a concern for many other types of whistleblower claims. The timing of income and deductions has always been a concern for the Service. Taxpayers have an incentive to defer income recognition into subsequent years to delay paying tax, and taxpayers have an incentive to accelerate deductions to minimize current taxable income.<sup>270</sup> These incentives are inherent in the structure of the Code and likely form the basis for many whistleblower tips. These issues typically do not turn on whether the income or deduction itself is improper, but instead on the proper timing. A whistleblower tip that involves a timing adjustment warrants special consideration.

The anonymous taxpayer's comment letter raised the issue of whether "temporary and timing adjustments items that, if adjusted during the exam, are expected to reverse in a future year" should be considered collected proceeds.<sup>271</sup> The taxpayer argues that proceeds on such amounts "should be limited to the amount of interest paid by the corporate violator."<sup>272</sup> This comment is particularly insightful and makes a valid point. For a taxpayer who inappropriately accelerates a tax benefit but is entitled to claim it at a later date, a whistleblower tip exposing the deficiency should not be compensated on the value of the tax year change because it will be claimed later. Rather, the whistleblower payment should be made on a basis that reflects the revenue protected. Here, it is the time value of revenue. Accordingly, as the anonymous taxpayer points out, the whistleblower should be compensated on the time value of money. This scenario raises many related questions of timing and finality with respect to collected proceeds.

## 2. Timing of Payment & Future Payments

As explained above, some whistleblower attorneys have proposed monetizing tips, which lead to uncollected proceeds, into current payment

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<sup>270</sup> See *Helvering v. Gregory*, 69 F.2d 809, 810-11 (2d Cir. 1934) ("Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.").

<sup>271</sup> Letter from Anonymous Taxpayer to Kristen Witter, *Internal Revenue Serv.*, at 3-4 (Mar. 23, 2011), available at TAX NOTES TODAY Doc 2011-6545.

<sup>272</sup> *Id.* at 3.

using a discount factor.<sup>273</sup> These proposals rely on advancing payment for not yet collected proceeds. Advancing payment is contrary to the statutory requirement of collection, which contemplates payment in hand.<sup>274</sup> Attempts to monetize uncollected proceeds with present value calculations or discount factors defy the statutory requirement of collection.<sup>275</sup> While this approach is not supported by the language and is unwise, it does suggest a broader view of temporal measurement that is discussed in Part IV.<sup>276</sup>

The outstanding question remaining is when a measurement for an award must occur. There is no statutory guidance or limit. The current Service guidance only indicates that it cannot occur before collection and finality have been met.<sup>277</sup> There are no limitations for extending the time for measurement until collection is made. This also opens up the issue of periodic payments on collected amounts. These, of course, run contrary to ease of administration due to the need for continued and perhaps prolonged monitoring, and timely payment. In certain circumstances, such a plan may be the only available option for whistleblower compensation.

#### IV. A BETTER APPROACH FOR COLLECTED PROCEEDS

As discussed in Parts II and III, the Service's interpretation of collected proceeds under § 301.7623-1 and the alternatives proposed by the whistleblower advocates fail to fully address the primary attributes of a successful Whistleblower Program.<sup>278</sup> A successful Whistleblower Program should offer sufficient incentives to attract whistleblowers, maintain procedures that are administrable, and promote federal revenue protection.<sup>279</sup> Part IV demonstrates that there is better approach for collected proceeds that relies on expanding the time frame to capture the additional tax revenues required for collected proceeds.<sup>280</sup>

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<sup>273</sup> See also Sullivan and Rubin Letter, *supra* note 165 at 7 (advocating use of the discount factor).

<sup>274</sup> See *supra* text accompanying notes 168-175.

<sup>275</sup> See *supra* text accompanying notes 168-175.

<sup>276</sup> See *infra* text accompanying notes 302-314.

<sup>277</sup> See PTMA 2010-62, *supra* note 128 at 1-2 (stating that the “language . . . has the legal effect of authorizing the IRS to disburse money that it collects . . .” and further discussing the interpretation of collected). See also I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010) (noting finality required).

<sup>278</sup> See *supra* text accompanying notes 82-277.

<sup>279</sup> See *supra* notes 5-7.

<sup>280</sup> See *infra* text accompanying notes 302-314.

The outstanding issues under the current whistleblower program are: (1) whether proceeds should be paid prior based on future collection,<sup>281</sup> (2) whether all criminal fines should be included in collected proceeds,<sup>282</sup> (3) the inclusion of credit balances and tax attributes in collected proceeds,<sup>283</sup> and (4) timing and finality issues related to measuring collected proceeds.<sup>284</sup> With respect to future collection, criminal proceeds, credit balances and tax attributes, the Service has taken a supportable and well-reasoned position.<sup>285</sup> However, if the Service would adopt a longer time horizon for the measurement of collected proceeds and award payment, then much of the concern over nonpayment for awards resulting in changes to credit balances and tax attributes could be ameliorated.

#### A. Whistleblower Awards Cannot be Paid Without Collection

There are numerous proposals that fall under this heading. Proposals could be as sweeping as rewarding any credible whistleblower claim with a finders' fee,<sup>286</sup> regardless of collection, or using economic modeling to predict future proceeds for calculation of award payment.<sup>287</sup> Proposals could also be as narrow as only expanding collected proceeds to include NOL reductions but no other tax attribute items.<sup>288</sup> These alternatives are appealing because they greatly incentivize whistleblowers to come forward. While these alternatives are likely to maximize the number of potential whistleblowers to come forward, the practical administration is lacking given the Service's resource constraints. Broadening the scope of collected proceeds could overly burden the Whistleblower Office, generating too many claims and diverting attention away from the larger § 7623(b) whistleblower claims.<sup>289</sup> The processing and payment delays under the current Whistleblower Program are already a significant problem,<sup>290</sup> and these alternatives could exacerbate the current process delays by flooding the system with claims. More importantly, these alternatives are not

<sup>281</sup> See *infra* text accompanying notes 286-293.

<sup>282</sup> See *infra* text accompanying notes 294-298.

<sup>283</sup> See *infra* text accompanying notes 299-301.

<sup>284</sup> See *infra* text accompanying notes 302-314.

<sup>285</sup> See *infra* text accompanying notes 286-301.

<sup>286</sup> See Sullivan and Rubin Letter, *supra* note 165 at 4 (suggesting reward of exposure of all tax fraud).

<sup>287</sup> *Id.* at 7-8 (suggesting the use of a discount factor to arrive at a present value for future evasion).

<sup>288</sup> See *supra* text accompanying notes 175-207.

<sup>289</sup> See Ferziger & Currell, *supra* note 5 at 1172.

<sup>290</sup> See *supra* text accompanying notes 56-80.

supported by the current statutory language mandating collection,<sup>291</sup> and they utterly fail to protect federal revenue.<sup>292</sup> These proposals could facilitate a tax whistleblower program that pays out more in awards than it increases tax revenues, which is certainly contrary to the legislative intent of the 2006 amendments.<sup>293</sup> A change in the interpretation of “collected” as required by statute could increase the incentive to whistleblowers but the cost of such a change would be too high from an administration and revenue protection standpoint.

*B. Under the Service’s Current Approach, District Court Criminal Fines are Appropriately Excluded from Collected Proceeds*

If Congress decided its objective was to maximize potential tax whistleblower awards by including fines, 42 U.S.C. § 10601 would provide an exception to criminal fines in tax whistleblower cases.<sup>294</sup> These fines could be included in collected proceeds and paid to tax whistleblowers, with the balance going to the criminal victims fund. Given the existence of the criminal victims fund statute and as discussed in Subpart III.D., the Service has appropriately interpreted § 7623 to give meaning to both statutes in a reasonable manner.<sup>295</sup> It is evident that the losers here are tax whistleblowers whose tips are the catalysts for tax criminal prosecutions resulting in criminal fines.

There is a possible exception to create an award for the Whistleblower. Prosecuting U.S. attorneys can be cognizant of this statutory landscape and request restitution in lieu of criminal fines so as to increase the pool of collected proceeds. It is not a perfect solution. It lacks any degree of certainty of payment because it relies on sentencing discretion. Worse still, if the whistleblower’s identity has successfully been kept secret, such a request could imply to a defendant the existence of a whistleblower.<sup>296</sup> Perhaps one saving grace is that tax criminal prosecutions require greater proof than other tax proceedings<sup>297</sup> and are typically reserved for the most

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<sup>291</sup> See *supra* text accompanying notes 165-174.

<sup>292</sup> See *supra* text accompanying notes 194-207.

<sup>293</sup> See *supra* text accompanying notes 165-174.

<sup>294</sup> See *supra* text accompanying notes 223-238.

<sup>295</sup> See *supra* text accompanying notes 228-238.

<sup>296</sup> The request itself could imply a whistleblower. In addition, a prosecutor’s request for a restitution in lieu of criminal fine is likely to engender a request for explanation from the judge, defense, or both.

<sup>297</sup> See Tax Court Rule 142(b) (noting the burden of proof for civil tax fraud as “clear and convincing”). See also *In re Winship*, 397 U.S. 358 (“ . . . we explicitly hold that the



egregious cases. In such cases, proceeds are often had in a variety of forms: tax revenue, penalties for fraud, and interest.<sup>298</sup> In many cases, the other sources of collection will contribute to a significant pool of proceeds to pay out the whistleblower.

While a statutory exception would be ideal, the Service cannot just ignore the existence of 42 U.S.C. § 10601. Given the available options under the language of statutory language, the Service's approach to omit fines from collected proceeds is appropriate.

### *C. Tax Attributes Cannot be Included in Collected Proceeds*

As explained in Subpart III.B., reductions in tax attributes alone cannot be included in a collected proceeds calculation.<sup>299</sup> They must be viewed in the broader context of tax liability. All award payments require collected revenues to the Treasury. Tax attributes may provide collected revenues, however there is no way to calculate with certainty the amount of the potential revenues that will result from the existence of a tax attribute item.<sup>300</sup> The whistleblower statute is designed to promote federal revenue protection, and this can only occur if award payments are made from proceeds that are collected. However, whistleblower information that results in significant tax attribute reduction may ultimately result in collected proceeds if the time period for measuring the proceeds is extended. In the next Subpart, we discuss an expanded time horizon.<sup>301</sup>

### *D. The Service should take a Broader View of the Time Period for Collecting Proceeds*

The Service should expand the time horizon for collecting proceeds. This alternative is a compromise between the Service's interpretation<sup>302</sup> and whistleblower advocates' proposals, discussed in Parts II and III.<sup>303</sup> This

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Due Process Clause protects the accused against conviction except upon proof beyond a reasonable doubt of every fact necessary to constitute the crime with which he is charged.”). *See also* I.R.M. 25.1.1.2.2, Requirements of Proof (05-29-1999) (noting the differing burdens for tax criminal matters and tax civil matters).

<sup>298</sup> *See* § 1 (imposing tax on taxable income); § 6601 *et seq.* (noting interest on tax liabilities); § 6651 *et seq.* (noting penalties on tax liabilities).

<sup>299</sup> *See supra* text accompanying notes 175-207.

<sup>300</sup> *See supra* text accompanying notes 175-207.

<sup>301</sup> *See supra* text accompanying notes 302-314.

<sup>302</sup> *See supra* text accompanying notes 81-152.

<sup>303</sup> *See supra* text accompanying notes 153-277.

alternative acknowledges that there must be a positive cash increase in tax revenues collected in order for a reward payment, but allows additional time for the positive cash increase to occur. There are two possible methods to create an additional time frame to calculate collected proceeds. The first is to allow a whistleblower case that results in an adjustment that produces uncollected proceeds to remain open until the expiration of any possible carryforwards. For many items this may be only a few years. For NOLs, carryforwards are allowed for twenty years.<sup>304</sup> In the case of NOLs, this carryforward period is quite lengthy and is administratively unwieldy. A variation of the proposal, similar to a proposal advanced by the anonymous taxpayer,<sup>305</sup> could offer any whistleblower claim with a potential for collected proceeds an additional ten-year window (instead of the full 20-year carryforward) for the collection of proceeds.

These alternatives will require additional administration costs because some cases will not be closed as quickly as under the current interpretation of collected proceeds, and additional monitoring will be required for all carryforward cases. To ease the administration of these proposals, the proposal should only apply to § 7623(b) claims. Payment for claims under § 7623(a) are statutorily within the discretion of the Service, and are not the claims that Congress or the Service are expecting to raise significant revenue.<sup>306</sup> Further, all carryforward claims should be evaluated annually. The notification to the whistleblower under this proposal is very limited in nature. The need to provide some communication to the whistleblower must be weighed against confidentiality concerns.<sup>307</sup>

Whistleblower claims with carryforwards should be directed into an annual review cycle for the remainder of the limitations period or the ten-year limit, and the whistleblowers should receive notification that their claim has been evaluated and directed into the annual review cycle. One negative of the current program is that, after submission of a tip, whistleblowers can wait years before receiving any information from the Service.<sup>308</sup> Much of this silence is undertaken to prevent whistleblower

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<sup>304</sup> § 172(b)(1)(A).

<sup>305</sup> See Anonymous Letter, *supra* note 271.

<sup>306</sup> Compare §7623(a) and (b) (no minimum case threshold for discretionary payment vs. mandatory payment for tips involving amounts in dispute of at least \$2 million or annual gross income of \$200,000.).

<sup>307</sup> See generally Kwon, *supra* note 35 (discussing confidentiality issues in the IRS Whistleblower Program).

<sup>308</sup> See Internal Revenue Serv., *What Happens to a Claim for an Informant Award (Whistleblower)*, available at <http://www.irs.gov/compliance/article/0,,id=181290,00.html>

collaboration from tainting the taxpayer case.<sup>309</sup> Once taxpayer liability has been determined and the only outstanding issue is whether proceeds will be collected in the future, taint is no longer a concern. Communication at this window is appropriate and will prevent a lack of communication between the Service and the whistleblower for what could in some cases be decades.

The concern of taint and for disclosure of taxpayer information may still be present with the proposed notification. If the notification contains any more information than a statement that the tip is being placed in the annual review cycle, then the notification may require that whistleblower execute a confidentiality statement that the information contained in this notice and the receipt of the notice itself will not be disclosed to any third party with the exception of the whistleblower's legal representative. The notification is not a promise of a future reward but an acknowledgement that the submitted claim may be eligible for payment based on the investigation and potential future use of the information reported to generate collected proceeds.

The time expansion proposal does not violate any statutory prohibition. In fact, there is not mention of time for measurement of proceeds. Only the I.R.M. discussed the need for finality with respect to the taxpayer's case.<sup>310</sup> There is no discussion of time allowed for collection of proceeds. Accordingly, no current guidance would have to be changed. This proposal will merely speak in an area on which the Service has been silent.

Admittedly, this proposal does add administrative cost and could prolong the process in some ways; however, some of the additional administration should be accomplished by computer algorithm to check for the collection of additional proceeds that could be eligible for distribution to a whistleblower. A review by Whistleblower Office personnel will be required if proceeds are flagged; however, appropriate computer-based screening, at which the Service has proven previously adept, should limit additional labor costs.

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("The process, from submission of complete information to the Service until the proceeds are collected, may take several years.")

<sup>309</sup> See I.R.M. Exhibit 25.2.2-6, Memorandum from Steven T. Miller (Feb. 17, 2010) ("In some cases, contacts between the IRS and an informant may taint information received from the informant.")

<sup>310</sup> See I.R.M. 25.2.2.1(6), Overview: Authority and Policy (06-18-2010) ("payment will not be paid until there is a final determination of tax liability").

Most importantly, the proposal functions to fulfill the legislative intent for a greater incentive.<sup>311</sup> Senator Grassley has expressed concern that whistleblowers who have come forward with good and valuable tips are not paid because the tips may result in tax attribute changes that are not readily converted into collected proceeds.<sup>312</sup> This proposal takes a broader view of the time for collection to allow for the payments when proceeds are collected. It does so, however, without resorting to the frequently advanced proposal of payout without collection.<sup>313</sup> Such proposals do not protect federal revenue and could facilitate a program that spends far more on whistleblowers than it takes in.

This proposal certainly contemplates that the Service would make partial or periodic payments as proceeds are collected. This should not be unusual. It was contemplated in the 1999 I.R.M., which provided that the whistleblower “Claims Examiner should periodically review the account to determine whether additional collections have been made which would justify an additional reward to the informant.”<sup>314</sup> The proposal to increase the length of the time to calculate the collected proceeds will continue to protect federal revenues, create a greater incentive to whistleblowers and create reasonable additional administration requirements. This proposal provides a workable solution to the collected proceeds that is currently lacking in the Service’s interpretation.

#### CONCLUSION

The Service’s whistleblower program has undergone significant revision in the last six years.<sup>315</sup> These revisions have drastically improved the incentives to attract whistleblowers and the Service’s administration of the program, while continuing to promote federal revenue protection. Despite these improvements, additional work is needed to address several deficiencies. The deficiency in greatest need of correction is what constitutes collected proceeds under the whistleblower statute.<sup>316</sup> Under current guidance, the term “collected proceeds” remains vague and

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<sup>311</sup> Compare §7623(a) and (b) (no minimum case threshold for discretionary payment vs. mandatory payment for tips involving amounts in dispute of at least \$2 million or annual gross income of \$200,000.).

<sup>312</sup> See Grassley letter, *supra* note 21, at 7.

<sup>313</sup> See *supra* text accompanying notes 165-174.

<sup>314</sup> I.R.M. 25.2.2.15(1)(b), Assessed Deficiencies Determined Uncollectible (04-27-1999).

<sup>315</sup> See *supra* text accompanying notes 45-55, 112-146.

<sup>316</sup> See *supra* text accompanying notes 81-277.

ambiguous despite the Service's attempts at clarification. Additional guidance is necessary to promote greater certainty for award payments. This certainty is critical to attracting potential whistleblowers to come forward, and, if appropriately structured and administered, should decrease award payout delays.

As discussed in Part IV, the collected proceeds term should be clarified.<sup>317</sup> The changes to the Regulation are a step in the right direction,<sup>318</sup> but stop far short of offering a comprehensive reading of collected proceeds. The alternatives proposed by the whistleblower advocates have the opposite problem of being overly inclusive.<sup>319</sup> Our proposed solution attempts to find a reasonable middle-ground that provides sufficient incentive to attract whistleblowers to come forward while maintaining administrability and federal revenue protection. This solution upholds the Service current (non-conflicting) guidance on collected proceeds but expands the timeframe for payout of tax attribute items including net operating losses.

For any valid whistleblower tip that results in a tax attribute adjustment but not collected proceeds, the proposed solution extends the time for collecting proceeds to either the full window for taxpayer usage of the tax attribute, or, in the alternative, a ten-year window for easier administrative purposes. Opening a ten-year window for claims that do not generate additional tax revenues in the return year solves an inherent problem to the current definition of collected proceeds that focuses exclusively on the tax return year or years reported by the whistleblower and ignores the potential value of tax attributes. This ten-year window further acknowledges that many whistleblower claims may involve tax revenue recoveries that extend beyond the tax year or years reported by the whistleblower.

In order for this proposal to succeed the Service must be willing to use partial payouts of awards and implement additional resources into monitoring and tracking claims throughout the entire ten-year payout window. While there are some additional costs to the Whistleblower Office under the proposal, the added certainty and potential for award payouts not present under the current system should maintain the level of tips already attracted and perhaps attract new whistleblower tips. This new system

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<sup>317</sup> See *supra* text accompanying notes 278-314.

<sup>318</sup> See Prop. Treas. Reg. § 301.7623-1. See also *supra* text accompanying notes 81-152.

<sup>319</sup> See *supra* text accompanying notes 153-277.

would appeal to whistleblowers who have a valid tip but are concerned that there is no current basis for a payout of an award. By submitting their claim now, the whistleblower is essentially setting a lien on future tax revenues that result from the information turned into the Whistleblower Program and no longer has to weigh the risk of having another whistleblower come forward with the same information or potentially have the taxpayer amend and correct the erroneous return independently from the IRS.

Implementing an interpretation of collected proceeds that enables whistleblowers to predict potential award payouts with greater certainty provides greater incentive to the whistleblower to come forward. An effective incentive for whistleblowers is the crux to an effective Whistleblower Program. The definition of collected proceeds must be reevaluated and expanded to ensure that a proper incentive is offered to attract whistleblowers to step forward and blow the whistle.