Beware the Whistleblower: Will the IRS Take a Page Out of DOJ's Playbook?

By Paul D. Scott

The U.S. Department of Justice has long relied on whistleblower actions to safeguard the integrity of public expenditures, with well-publicized and increasingly large recoveries the result. In contrast, the Internal Revenue Service has historically been hesitant to make use of whistleblowers, who have thus had commensurately limited effect on revenue collection. This historical contrast in approach to policing the public fisc, however, is rapidly changing.

The False Claims Act, which is enforced by the Department of Justice, permits whistleblowers to file suits (called *qui tams*) on behalf of the United States against those who defraud the government, then allows whistleblowers to share in the resultant recoveries.[1] In 1986, Congress amended the False Claims Act to enhance the incentives for whistleblowers to file *qui tams*. The amended Act provides for treble damages and penalties of up to $11,000 per false claim.[2] Qualifying whistleblowers can receive up to a maximum of 25 to 30 percent of the government's recovery, depending on whether the United States takes over prosecution of a case.[3] Notably excluded from the Act's coverage are claims predicated solely on violations of the Internal Revenue Code.[4]

Since 1954, the IRS has had its own statutory authorization to pay rewards to promote whistle-blowing.[5] The component of the program most familiar to practitioners today is the Form 211 procedure, which is outlined in Revenue Publication 733.[6] Pursuant to this procedure, whistleblowers who have reported underpayments of tax to the IRS may subsequently seek a reward (potentially amounting to 15 percent of the amount recovered) by submitting a completed Application for Reward for Original Information (Form 211), to the local IRS campus, referencing both the subject taxpayer and the information that was provided regarding the taxpayer.[7]

To date, the Form 211 procedure has had limited effect, owing in substantial measure to the historically low cap on rewards ($2 million),[8] the absence of any provisions allowing whistleblowers to enforce their claims to rewards, and limited promotion of the program.[9] Thus, while recoveries by the United States in whistleblower cases under the False Claims Act have been increasing exponentially since the Act was amended in 1986 (from $390,000 in 1987 to over $1.1 billion in 2005),[10] recoveries by the IRS under its whistleblower program in recent years have not even reached $100 million (including taxes, penalties, and interest).[11]

Partly because of this disparity in numbers, the IRS has been under increasing pressure to restructure its whistleblower incentive program. In 2004, Senator Charles Grassley, Chairman of the Senate Finance Committee, who was a key sponsor of the 1986 False Claims Act Amendments, proposed revisions to section 7623 of the Internal Revenue Code that would have created a whistleblower framework similar in key respects to the False Claims Act.[12] The legislation was not enacted in 2004, but the IRS had already taken notice.

Specifically, in the latter half of 2004, the IRS implemented Policy Statement 4-27 to increase the maximum reward generally available under its rewards program from $2 million to $10 million. This change did not correct all the limitations of the Form 211 procedure, but it did send a strong message that the IRS was serious about trying to enhance its whistleblower program. That message was reinforced in June 2006 when the Treasury Inspector General for Tax Administration pointedly reported to Congress that examinations based on whistleblower tips were almost twice as effective as examinations based simply on Discriminant Index Function scores (as measured by dollars recovered per hour of examination time).[14] The IRS's management concurred with the report and agreed to correct management inefficiencies in the program, such as inconsistent payment decisions and long delays in payment.[15] Before the TIGTA report was final, the IRS had announced plans to designate Informant's Rewards Program coordinators for each operating division and to establish a National Oversight

Committee for the Informant's Reward Program.[16] Completion of those and related efforts was scheduled for August 31, 2006.[17]

Having adopted these changes to its Form 211 program, the IRS will likely next focus on its Special Agreement Program, a lesser publicized program by which the IRS negotiates contracts with whistleblowers before the whistleblowers provide all their information about alleged underpayments of tax.[18] Unlike the Form 211 program, the Special Agreement program provides an enforcement mechanism for whistleblowers, making it a potential source of leads that might not otherwise come in through the Form 211 program. Historically, the IRS has not promoted the Special Agreement program,[19] tending to reserve such agreements only for information associated with high-dollar recoveries.

If the IRS continues to pursue its stated objective of making its processes "more accommodating" to whistleblowers,[20] these practices will likely change. For example, although Special Agreements will always be limited necessarily in number and size by the bureaucratic burden associated with their review and approval, the IRS could easily move to publicize the program and increase its volume of leads.

Even if the IRS makes no more internal changes, new whistleblower legislation is waiting in the wings. On September 15, 2006, the Senate Committee on Finance approved S. 1321, which would create a tax whistleblower program akin to the False Claims Act.[21] Under the current proposal, whistleblowers would be entitled to appeal award decisions to the Tax Court, with the amount of their potential rewards ranging as high as 30 percent.[22] The bill is pending on the Senate's legislative calendar.[23]

The practical reality is that the political landscape has changed. In 1998, with Linda Tripp's betrayal of Monica Lewinsky's confidence at the front of the public's mind, Senator Harry Reid (soon to be the Senate's Majority Leader) comfortably referred to the informant program as "rewards for rats."[24] After the unraveling of corporate scandals at Enron and other major companies, the tone changed. The Sarbanes-Oxley Act of 2002 made whistleblower protection a public policy priority.[25] Earlier this year, Senator Grassley publicly challenged the IRS to establish "a clear roadmap of reform so Treasury and the IRS no longer treat whistleblowers like skunks at the picnic."[26] In this environment, with the constant reminders provided by ever-increasing False Claims Act recoveries, it is likely that the top half of the federal government's income statement will soon be subjected to much the same whistleblower scrutiny reserved for the bottom half today.

Paul D. Scott *is the principal of the Law Offices of Paul D. Scott, based in San Francisco. A former trial attorney with the Civil Fraud Section of the U.S. Department of Justice in Washington, D.C. Mr. Scott is a graduate of the University of California at Berkeley and Yale Law School. His email address is pdscott@lopds.com.*

1. 31 U.S.C. §§ 3729, *et seq*. (2000).
2. 31 U.S.C. § 3729(a). Penalties were set at a maximum of $10,000 in 1986. They were increased to a maximum of $11,000 as of September 29, 1999. *See* 28 U.S.C. § 2461 (note); 28 C.F.R. § 85.3(a)(9) (2005).
3. 31 U.S.C. § 3730(d). Other significant changes included a reduction in the intent standard under the Act to "reckless disregard for the truth," 31 U.S.C. § 3729(b), and a clarification of the burden of proof as a "preponderance of the evidence." 31 U.S.C. § 3731(c).
4. 31 U.S.C. § 3729(e).
5. I.R.C. § 7623.
6. IRS Publication 733 (Rev. 10-2004).
7. IRS Form 211 (Rev. 6-2006). *See also* Publication 733.
8. Policy Statement P-4-86 IRM 1.2.1.4.26 (Approved August 26, 1997).
9. *Krug v. United States*, 168 F.3d 1307, 1309 (Fed. Cir. 1999); *Doe v. United States*, 38 Ct.Cl 377, 378 (1997).
10. U.S. Department of Justice (Civil Division), *Fraud Statistics Overview, October 1, 1986 – September 30, 2005* (2005).
11. Treasury Inspector General for Tax Administration, *The Informant's Rewards Program Needs More Centralized Management Oversight* (June 2006).
12. *See* S. 1637, 108th Cong., 2d Sess. § 488 (2004).
13. American Jobs Creation Act of 2004, Pub. L. No. 108-357 (October 22, 2004), 118 Stat. 1418.
14. Treasury Inspector General for Tax Administration, *supra* note 11. The primary method used by the IRS to select returns for audit is the Discriminant Index Function (DIF), a mathematical technique by which income tax returns are evaluated for potential examination through the assignment of weights to various characteristics of the return. *Id. at n.18*.
15. Treasury Inspector General for Tax Administration, *supra* note 12 (Synopsis and Response).
16. *Id. at App. VII*, Management's Response to Draft Report.
17. *Id*.
18. Special Agreements are entered into under I.R.C. § 7823, 26 C.F.R. § 301.6723-1, Policy Statement P-4-27 (formerly P-4-86), Delegation Order 25-7 (formerly D.O. 204), and TD Order 150-10.
19. Informant Rewards, Internal Revenue Manual 25.2.2.5 (04-27-1999).
20. Treasury Inspector General for Tax Administration, *supra* note 12 (Synopsis).
21. Sen. Rep. No. 109-336, 109th Cong., 2d Sess. (2006).
22. S. 2301, 109th Cong., 2d Sess. (2006).
23. Item 614, DOCID: SC007, Senate Calendar Online via GPO Access [wais.access.gpo.gov], October 17, 2006.
24. *See* 144 CONG. REC. S4379, S4398 (daily ed. May 5, 1998) (statement of Sen. Harry Reid).
25. 18 U.S.C. § 1514A (2002).
26. Tom Herman, *IRS Reworks its Whistleblower Program*, WALL STREET JOURNAL, Eastern Ed. (June 22, 2006), at D1.