

Tax Whistle-Blowers to Receive Increased Rewards

By Paul D. Scott

Paul D. Scott is a former trial attorney in the civil fraud section at the U.S. Department of Justice. His firm, the Law Offices of Paul D. Scott, sponsors <http://www.taxwhistleblowers.org>. He can be contacted at counsel@lopds.com.

Senate Finance Committee ranking minority member Chuck Grassley, R-Iowa, while serving as the panel's chair last year, publicly challenged the IRS to establish "a clear road map of reform so Treasury and the IRS no longer treat whistleblowers like skunks at the picnic."¹ With the passage of the Tax Relief and Health Care Act of 2006, Congress chose to impose the requested reforms itself. Whistle-blowers with information about large tax avoidance schemes have now been officially welcomed to the picnic.

Section 406 of the act substantially strengthens the IRS's whistle-blower program by increasing available rewards and creating a meaningful enforcement mechanism for whistle-blowers to collect them.² The new program provides for rewards between 15 percent and 30 percent in cases in which the IRS pursues an administrative or judicial action against a taxpayer based on information brought to its attention by a qualifying whistle-blower.³ Payments to qualified whistle-blowers are mandatory, and whistle-blowers have the right to appeal unsatisfactory IRS award determinations to the Tax Court.⁴ If they receive a reward, whistle-blowers will be permitted to take an above-the-line deduction for attorney fees and costs paid by them to recover their award.⁵

The new program is limited to claims against taxpayers whose gross annual income exceeds \$200,000 and whose potential indebtedness for taxes, penalties, and interest is greater than \$2 million.⁶ The statute places a 10 percent cap on awards to whistle-blowers in cases in which there have been prior public disclosures of their

allegations,⁷ and rewards can also be reduced if whistle-blowers planned and initiated the actions that led to the underpayments of tax.⁸

Since 1954 the IRS has had statutory authorization to pay rewards,⁹ but before enactment of the act the IRS's existing programs had been faulted for providing inadequate incentives and protections for whistle-blowers. The component of the previously existing program most familiar to practitioners today is the procedure outlined in Publication 733.¹⁰ Under that procedure, whistle-blowers who have reported underpayments of tax to the IRS may seek a reward amounting to up to 15 percent of the amount recovered by submitting a completed Form 211, "Application for Reward for Original Information," to the local IRS campus.¹¹

The Form 211 procedure has historically had limited effect, however, due in substantial measure to a low cap on rewards (\$2 million),¹² the absence of any provisions allowing whistle-blowers to enforce their claims to rewards, and limited promotion of the program.¹³

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. But while that was a material increase in the available reward, it did not resolve the other fundamental limitations of the Form 211 procedure.

The other lesser-known program operated by the IRS is its special agreement program, under which select whistle-blowers have been permitted to write contracts with the IRS that set forth, among other things, the parties' understanding of what percentage the whistle-blower will receive if the IRS obtains a recovery. The special agreement program has thus provided an enforcement mechanism for whistle-blowers, but the IRS has historically made it a formal point not to promote the special agreement program,¹⁴ and it has tended in practice to reserve those agreements only for information associated with high-dollar recoveries.

Section 406 of the act is more substantive and far-reaching than anything the IRS has ever attempted in this

⁷*Id.*

⁸*Id.*

⁹26 U.S.C. section 7623 (Aug. 16, 1954, ch. 736, 68A Stat. 904; Title XIX, section 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Title XII, section 1209(a), July 30, 1996, 110 Stat. 1473).

¹⁰IRS Publication 733 (rev. Oct. 2004).

¹¹IRS Form 211 (rev. June 2006). *See also* Publication 733.

¹²Policy Statement P-4-86 IRM 1.2.1.4.26 (approved Aug. 26, 1997).

¹³*Krug v. United States*, 168 F.3d 1307, 1309, *Doc* 1999-6633, 1999 TNT 33-9 (Fed. Cir. 1999); *Doe v. United States*, 38 Ct. Cl. 377, 378 (1997).

¹⁴Informant Rewards, Internal Revenue Manual 25.2.2.5 (Apr. 27, 1999).

¹Tom Herman, "IRS Reworks Its Whistle-Blower Program," *The Wall Street Journal*, Eastern Ed. (June 22, 2006), at D1.

²*Id.* at section 406.

³H.R. 6111, 109th Cong., 2d Sess., section 406(a)(1) (2006).

⁴*Id.*

⁵*Id.* at section 406(a)(3).

⁶H.R. 6111, 109th Cong., 2d Sess., section 406(b)(1) (2006).

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area. The act's most notable features increase the available rewards, make payments mandatory to qualified whistle-blowers, create a right to appeal to the Tax Court, and eliminate any cap on the amount of potential recoveries.

The striking feature about most of those important reforms is that they directly parallel the False Claims Act (FCA), a statute enforced by the Department of Justice, which has had tremendous success in attracting tips regarding fraud against federal government programs. The FCA permits whistle-blowers to file suits (called *qui tams*) on behalf of the United States against those who defraud the government, then allows whistle-blowers to share in the resultant recoveries.¹⁵ In 1986 Congress amended the FCA, at Grassley's prompting, to enhance the incentives for whistle-blowers to file *qui tams*. Under the amended FCA, qualifying whistle-blowers can receive up to 25 percent to 30 percent of recoveries, depending on whether the United States takes over prosecution of a case.¹⁶ There is no cap on the amount that can be recovered, and whistle-blowers have the right to enforce their claims to rewards in federal district court.

Since the FCA was amended in 1986, recoveries under it from whistle-blower cases have been increasing exponentially (from zero in 1987 to over \$1.4 billion in 2006).¹⁷ By comparison, recoveries by the IRS under its whistle-blower program in recent years have not exceeded \$100 million annually (including taxes, penalties, and interest).¹⁸ The new tax whistle-blower incentives, which directly parallel the FCA, are thus broadly expected to have a profound impact, as the top half of the federal government's income statement will soon be subjected to the same whistle-blower scrutiny that is reserved for the bottom half today.

¹⁵31 U.S.C. sections 3729 et seq. (2000). Notably excluded are claims predicated solely on violations of IRC 31 U.S.C. section 3729(e).

¹⁶31 U.S.C. section 3730(d). Other significant changes included a reduction in the intent standard 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. section 3731(c).

¹⁷Fraud Statistics Overview, Oct. 1, 1986 - Sept. 30, 2006, Civil Division, U.S. DOJ. See http://www.lopds.com/main/page.php?page_id=23.

¹⁸Treasury Inspector General for Tax Administration, "The Informant's Rewards Program Needs More Centralized Management Oversight," Ref. No. 2006-30-092 (June 2006).