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Tax Litigation

Expert Analysis

Defining 'Collected Proceeds' Under the IRS's Whistleblower Program

In September, this column addressed ethical constraints on lawyers who blow the whistle on former clients. While such limitations present a hurdle to one potentially productive source of information, over the past decade whistleblowing has become big business, generating substantial paydays for disgruntled spouses, former business partners and others who seek to profit by reporting tax fraud to the Internal Revenue Service. Perhaps more importantly, information from whistleblowers has generated billions of dollars in revenues for the IRS. If the IRS has its way, however, a case pending before the U.S. Court of Appeals for the D.C. Circuit stands to significantly limit the size of whistleblower awards—an outcome the Senator responsible for creating the IRS Whistleblower Office and a group of former federal prosecutors and Tax Court practitioners worry could hamper the IRS's enforcement of the Internal Revenue Code.

By **Jeremy H. Temkin**

IRS Whistleblower Program

For over 150 years, Congress has authorized the government to pay monetary awards to people who report tax crimes by others. Over time, the provision for whistleblower awards was extended to both civil and criminal violations of the tax code. The Tax Relief and Health Care Act of 2006, however, substantially altered the existing program, creating a new framework for evaluating whistleblower submissions, identifying criteria for measuring awards in larger cases and establishing the IRS Whistleblower Office tasked with administering the program.

Under the 2006 Act, the IRS has discretion to make awards to whistleblowers whose information leads to the detection of underpayments, or prosecutions for violations of the tax code. See 26 U.S.C. §7623(a). By contrast, in cases where "the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000," the IRS is *required* to award whistleblowers between 15 and 30 percent of "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." 26 U.S.C. §7623(b)(1). (Under the applicable regulations "collected proceeds" and "proceeds of amounts collected" (upon which discretionary awards under §7623(a) are predicated) include "[t]ax, penalties, interest, additions to tax, and additional amounts collected because of the information provided; amounts collected prior to receipt of the

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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. Collected proceeds are limited to amounts collected under the provisions of title 26, United States Code." 26 C.F.R. §301.7623-2(d)(1).)

Since 2007, information submitted by whistleblowers has assisted the IRS in collecting over $3.4 billion in "collected proceeds," leading to the approval of more than $465 million in monetary awards to whistleblowers. See IRS Whistleblower Office, Annual Report to Congress (2016). In 2016 alone, the IRS made 418 awards to whistleblowers, which totaled nearly $61 million of $386 million collected. Id. This reflects a substantial increase in the number of awards over fiscal years 2014 and 2015, when the IRS made 101 and 99 awards, respectively. (The total value of the 101 awards in 2014 was $52 million (or 16.9 percent of the $309 million collected by the IRS). By comparison, the 99 awards in 2015 amounted to $103 million (or 20.6 percent of the $501 million collected).) Moreover, viewed in light of the annual average of 160 awards totaling $46 million since the 2006 statute went into effect, the new Whistleblower Program appears to be successfully incentivizing people to come forward with information relating to tax non-compliance.

'Whistleblower 21276-13w'

Notwithstanding the promising statistics, recent litigation reveals concerns with the IRS's operation of the Whistleblower Program. In *Whistleblower 21276-13w v. Commissioner of Internal Revenue,* 147 T.C. 121 (2016), a couple provided information that eventually led a bank to plead guilty to conspiring to defraud the IRS, filing false returns and tax evasion. The bank paid the IRS over $74 million: $22 million in tax restitution, $22 million in criminal fines and $16 million in civil forfeiture. The whistleblowers and the IRS agreed that an award of 24 percent of the "collected proceeds" was warranted, but they disagreed on what constituted the "collected proceeds." The whistleblowers argued they should receive 24 percent of the full $74 million recovery, while the IRS argued the whistleblowers were only entitled to 24 percent of the $22 million restitution payment.

The Tax Court found in favor of the whistleblowers, holding that "Section 7623(b)(1) is straightforward and written in expansive terms," and that while the term "collected proceeds" is not statutorily defined, "words in a statute must be read in their context." Id. at 127. Noting that it had elsewhere defined "proceeds" as "total revenue: the total amount brought in," the Tax Court held that "collected proceeds" was not limited solely to tax restitution payments. Id. at 128. The court buttressed its opinion with both a review of other circumstances where Congress adopted such broad terms as "proceeds," or "property," and with several other examples of tax-related statutes that fell outside of Title 26, or interacted with laws from other titles of the United States Code, including "perhaps the most telling instance: [t]he very provisions establishing the Whistleblower Office." Id. at 130.

The IRS appealed to the D.C. Circuit. In its opening brief, the IRS first argued that "[w]hen Congress spoke of 'collected proceeds' in §7623(b), it was using shorthand to refer to what it had already outlined in §7623(a)—'proceeds of amounts collected by reason of the information provided.'" Brief of Petitioner-Appellant at 31, *Whistleblower 21276-13w v. Commissioner of Internal Revenue* (D.C. Cir. Aug. 24, 2017). Since §7623(a) only permits awards for information regarding the "violat[ion] of the internal revenue laws," the IRS sought to limit awards to those proceeds collected pursuant to Title 26 of the United States Code. Id. at 31-33.

The IRS further argued that since fines and forfeitures collected pursuant to Title 18 of the United States Code are generally required by statute to be deposited either in the United States Treasury or in a fund for distribution to victims, the Tax Court's holding created an irreconcilable conflict between the tax code and the criminal code. Id. at 47-49.

In an amicus brief, Senator Chuck Grassley—the primary drafter of the 2006 law that created the IRS Whistleblower Office—sided with the whistleblowers. (Senator Grassley has regularly criticized the IRS for working to undermine the potential success of the Whistleblower Program. See Jeremy H. Temkin, "IRS Whistleblower Program: Road Map for Dodd Frank?," New York Law Journal (Jan. 13, 2011).) Senator Grassley claimed that "[26 U.S.C. §7623(b)] was designed to be broad and to include awards for criminal fines, forfeitures and other amounts collected as a result of the information submitted by a whistleblower." Brief of U.S. Senator Charles E. Grassley as Amicus Curiae Supporting Petitioner-Appellee, *Whistleblower 21276-13w v. Commissioner of Internal Revenue*, 4 (Oct. 24, 2017). He explained that "Congress declined to specifically define or otherwise limit the term 'collected proceeds,'" and that absent such a limitation "the term should be interpreted consistent with [the] clear intent" of the Whistleblower Law—to incentivize the exposure of large-scale abuses of the tax code. Id. at 6-7. Senator Grassley also argued that, historically, the IRS had considered criminal fines to be eligible for whistleblower awards, and had only excluded such payments by regulation in 2014—providing further evidence for the notion that the Whistleblower Law intended criminal fines and forfeiture to fall within its ambit. Id. at 14.

In a separate amicus brief, a group of former federal prosecutors and Tax Court practitioners similarly argued that reversing the Tax Court's decision could have serious ramifications for the efficacy and reach of the entire IRS Whistleblower Program. Brief of Former Federal Prosecutors and Tax Court Practitioners as Amici Curiae Supporting Petitioners-Appellees, *Whistleblower 21276-13w v. Commissioner of Internal Revenue* (Oct. 24, 2017). The practitioners noted that excluding criminal fines and forfeiture and limiting awards to a percent of the tax restitution received substantially reduces the size of potential awards available to whistleblowers, and could potentially alter the calculus of individuals considering whether to risk their careers and reputations by alerting the IRS to potentially criminal tax violations. Id. at 6-8. Furthermore, a finding that "collected proceeds" is limited to the tax restitution portion of a sentence could provide perverse incentives to the IRS and targeted taxpayers to negotiate resolutions that emphasize fines at the expense of tax restitution payments, thereby shielding more of a payment from whistleblowers (and leaving more of the judgment in the hands of the government). Id. at 3-4.

It remains to be seen whether the D.C. Circuit will allow the IRS to persist in its narrow interpretation of "collected proceeds" that are subject to awards, or whether it will side with whistleblowers seeking to maximize their awards.

Conclusion

The IRS relies on whistleblowers to assist in their investigation of tax code violations—many of which would not be detected but for these insiders' efforts. While it is impossible to know the extent to which whistleblowers are motivated by the potential for financial remuneration as opposed to personal animus or other considerations, the 2006 Whistleblower Law reflects Congress's assessment that the prospect of large dollar awards will encourage individuals to come forward. It remains to be seen whether the D.C. Circuit will allow the IRS to persist in its narrow interpretation of "collected proceeds" that are subject to awards, or whether it will side with whistleblowers seeking to maximize their awards.