

TAX LITIGATION ISSUES

Expert Analysis

## Is the IRS Whistleblower Program Finally Reaching Its Potential?

In 2006, Congress substantially expanded the Internal Revenue Service's Whistleblower Program, giving additional financial incentives to people who provide information about others who cheat on their taxes. Since that time, whistleblowing has become big business, resulting in thousands of submissions each year and generating billions of dollars in recoveries by the IRS.

Over the years, however, whistleblowers and their lawyers have lodged several complaints regarding the IRS's management of the Whistleblower Program. Principal among these complaints has been the slow pace of processing claims and the relatively stingy awards attributable, in part, to the narrow definition of "collected proceeds" upon which awards are predicated. Last year, Congress provided relief

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on the latter issue and, not coincidentally, the IRS Whistleblower Office's most recent report to Congress announced a banner year for recoveries attributed to information provided by whistleblowers, as well as substantially larger awards to the informants.

### The Whistleblower Program

Under the framework established by the Tax Relief and Health Care Act of 2006, the IRS is required to award whistleblowers between 15 and 30 percent of "the proceeds collected as a result of the action (including any related actions) or from any settlement in response to such action" where either "the proceeds in dispute exceed \$2,000,000" or, in cases involving an individual,

the taxpayer's gross income exceeds \$200,000 for any taxable year at issue. 26 U.S.C. §7623(b). The IRS has the discretion (but not the obligation) to make awards in smaller cases. See 26 U.S.C. §7623(a).

As this column previously chronicled, the IRS was slow to implement

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the new Whistleblower Program and Senator Charles Grassley, the principal proponent of the underlying legislation, and the Treasury Inspector General for Tax Administration (TIGTA) were critical of the Service's apparent hostility to rewarding informants. See J. Temkin, "IRS Whistleblower Program: Road Map for Dodd-Frank," *New York Law Journal* (Jan. 13,

2011). Among the early concerns regarding the administration of the Whistleblower Program was the lag between the whistleblower's initial submission, the recovery of proceeds (following a civil audit or criminal investigation and any ensuing litigation), the expiration of the taxpayer's time to claim a refund, and the ultimate calculation and payment of the award.

As time passed, however, the IRS started collecting proceeds and issuing awards. All told, since the 2006 legislation went into effect, information submitted by whistleblowers has led to the collection of over \$5 billion in proceeds and the approval of more than \$810 million in awards to whistleblowers. See IRS Whistleblower Office, Fiscal Year 2018 Annual Report to Congress (Feb. 2019). The breakdown of these resources and payments is telling. In the first six years the program operated, the Service paid whistleblowers less than \$70 million out of the \$1.3 billion collected as a result of their information. Over the next six years (between Oct. 1, 2011 and Sept. 30, 2017), awards increased to over \$430 million out of approximately \$2.3 billion in collections. Significantly, these figures included the \$104 million award paid to Bradley C. Birkenfeld, the Swiss banker who provided information that led to

the recovery of over \$780 million from his former employer, UBS.

### Redefining 'Collected Proceeds'

Notwithstanding the payment of some substantial awards, whistleblowers and their lawyers still expressed concerns that the IRS's awards were unduly stingy. One specific complaint was the IRS's regulations that limited "collected proceeds" and "proceeds of amounts collected" (upon which whistleblower awards were predicated) to "amounts collected under the provisions of title 26, United States Code." 26 C.F.R. §301.7623-2(d)(1). In light of this definition, the IRS excluded criminal fines and forfeitures predicated on violations of Title 18 from awards, even where those payments were the direct result of information provided by whistleblowers.

In *Whistleblower 21276-13w v. Commissioner of Internal Revenue*, 147 T.C. 121 (2016), the Tax Court agreed with two whistleblowers who complained that the computation of their award based on \$20 million in restitution recovered under Title 26 improperly excluded an additional \$54 million in criminal fines and civil forfeiture paid under Title 18. In reaching this conclusion, the Tax Court noted 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" and elsewhere proceeds was defined as "total revenue: the total amount brought in."

The IRS appealed the Tax Court's decision to the U.S. Court of Appeals for the D.C. Circuit. See J. Temkin, "Defining 'Collected Proceeds' Under the IRS Whistleblower Program," *New York Law Journal* (Nov. 16, 2017). While that appeal was pending, Congress weighed in on the side of the whistleblowers. Thus, as part of the Bipartisan Budget Act of 2018, Congress clarified that whistleblower awards should be predicated on all funds collected as a result of a whistleblower's efforts, including non-Title 26 amounts. Specifically, §7623(c) provides that "[f]or purposes of this section, the term 'proceeds' includes—(1) penalties, interest, additions to tax, and additional amounts provided under the internal revenue laws, and (2) any proceeds arising from laws for which the Internal Revenue Service is authorized to administer, enforce, or investigate, including—(A) criminal fines and civil forfeitures, and (B) violations of reporting requirements."

### Increased Awards, But Continuing Issues

In light of the statutory change, the IRS dropped its appeal of the Tax Court's decision and the D.C. Circuit dismissed the case. See *Whistleblower 21276-13w v. Commissioner*

of *Internal Revenue*, No. 17-1119, 2018 WL 1896503 (March 29, 2018). As a result, the whistleblowers in that case received an additional \$12.9 million, on top of the \$4.5 million they had previously received under the IRS's narrower interpretation of proceeds.

One year after Congress broadened the definition of "collected proceeds," whistleblower awards are larger than ever. Indeed, the Whistleblower Office's most recent report to Congress notes that, for the fiscal year ending Sept. 30, 2018, the IRS made 217 awards to whistleblowers, including 31 awards under §7623(b). These awards totaled \$312.2 million out of over \$1.4 billion collected (including approximately \$810 million in amounts recovered pursuant to non-Title 26 violations, as compared to \$631.3 million in Title 26 recoveries). Moreover, while the total number of awards declined from the preceding two years, 2018 signified substantial increases in the size of awards and the amount of proceeds collected: In fiscal 2016, the IRS made 418 awards (including 18 awards under §7623(b)) totaling \$61.4 million out of \$368.9 million of proceeds collected, and in fiscal 2017, there were 242 awards (including 27 under §7623(b)) totaling \$34 million out of \$190.6 million of proceeds collected. Significantly, the larger awards reflect a greater percentage of the proceeds collected: In

fiscal 2018, whistleblowers received 21.7 percent of the proceeds collected as a result of their information, up from 16.6 percent in fiscal 2016 and 17.8 percent in fiscal 2017.

In light of these numbers, the Whistleblower Program appears to be serving its purpose of incentivizing people to come forward with information relating to tax non-compliance. However, it is worth noting that the 12,286 claims submitted during fiscal 2018, were comparable to the 13,396 submitted in fiscal 2016 and the 11,946 claims submitted in

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fiscal 2017. Moreover, the average number of days to process mandatory awards increased from 2,693 days in fiscal 2016 and 2,672 days in fiscal 2017, to 3,401 days in fiscal 2018, an increase from approximately 7.3 years to 9.3 years. Additionally, although the Whistleblower Office is still comprised of 36 full-time employees (compared to 38 and 37 in fiscal 2017 and fiscal 2016, respectively), the report acknowledged that the office was impacted by retirements

and losses due to promotions. In particular, its Case Development and Oversight and Award Recommendation and Coordination Units experienced employee turnover of nearly 20 percent.

## Conclusion

Whistleblowers such as ex-spouses, disgruntled business partners and former employees are frequently motivated by a multitude of factors, including personal vindictiveness. However, the prospect of financial gain has long driven whistleblowers and their lawyers to marshal evidence in order to make the IRS's pursuit of tax fraud. Consistent with the purpose of the Whistleblower Program as a whole, the enactment of §7623(c) reflects Congress's judgment that tax enforcement will benefit from offering large dollar awards to individuals who come forward with information. While whistleblowers and their lawyers will continue to do so in the hopes of receiving a substantial payday, in light of the continuing delays in resolving whistleblower claims, Congress should consider giving the IRS additional resources to enable it to investigate all worthwhile leads on a more timely basis, thereby enabling the Whistleblower Program to reach its full potential.