POINTER TO REMEMBER

Not Just Whistling in the Dark: Recent Guidance on Whistleblower Awards

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Background

Toward the end of 2006 Congress revised section 7623, which authorizes rewards for informants who provide information to the Service that leads to the detection and punishment of noncompliant taxpayers. Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406 (enacting section 7623(b)). Encouraging individuals to share knowledge of tax noncompliance on the part of others through monetary rewards is not a new concept in the United States. The practice dates back to shortly after the Civil War. Congress codified the program in 1934, and in 1996 the program began allowing for informant rewards distributed out of proceeds collected by reason of the information provided, rather than a separate fund.

According to a Treasury Inspector General for Tax Administration (TIGTA) Report, the informant program that existed prior to the 2006 amendments was effective in helping the Service detect tax noncompliance, but it was plagued with administrative problems. TIGTA, The Informants’ Rewards Program Needs More Centralized Management Oversight, 2006-30-092 (June 6, 2006), available at http://www.treasury.gov/tigta/auditreports/2006reports/200630092fr.pdf. Procedures for processing and evaluating tax informant claims were inconsistent, delays were common, and the vast majority of informant claims were rejected by Service reviewers without adequate explanation. In light of these problems, the TIGTA report suggested centralizing the program’s management and standardizing procedures for processing claims.

In addition to administrative problems, the prior program suffered from other deficiencies that were thought to limit an informant’s willingness to participate. The decision over whether to pay an award and the award amount were usually denied their day in court because of sovereign immunity principles.

2006 Changes

The 2006 legislation addresses many of the problems identified in the TIGTA report. Most importantly, the legislation authorizes, and the Service has created, a centralized Whistleblower Office to examine all informant award claims and make award determinations. Although the discretionary award procedure that existed prior to the 2006 legislation remains in place, section 7623(b) now mandates that the Service pay a reward based on amounts collected if it institutes an administrative or judicial action based on information provided by the informant and the informant satisfies the other conditions listed in section 7623(b). Recoveries under the revised program also have increased. They range from 15% to 30% of the amounts collected if the informant’s information substantially contributed to the amounts recovered.

At the same time that Congress expanded the existing informant reward program, it also included several limitations and restrictions in order to deter abuse and frivolous claims. For example, if the informant bases his or her allegations on information derived from a public source, the maximum reward drops to 10% of the recovered funds. I.R.C. § 7623(b)(2)(A). In an effort to prevent an informant from benefitting from his or her own unlawful conduct, the statute gives the Service the authority to reduce the award if the informant planned or initiated the transaction that led to the tax underpayment. If the informant is convicted of criminal conduct arising from his or her role in the transaction, no award is permitted. I.R.C. § 7623(b)(3).

In order to deter frivolous allegations, section 7623(b) only applies if the amount in dispute exceeds $2 million. Interest and penalties are included in determining whether the amount in dispute reaches this threshold. If the allegations pertain to an individual taxpayer, the expanded rewards program applies only if the individual taxpayer’s gross income during any year at issue exceeds $200,000. I.R.C. § 7623(b)(5).

The statute also confirms that the informant must submit information to the Service under penalty of perjury. If not, the informant is not eligible for an award. I.R.C. § 7623(b)(6)(C).

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Recent Guidance

The Service has released several forms of guidance under section 7623(b) during the past year. Notice 2008-4, 2008-2 I.R.B. 253, for example, sets out basic procedures for filing award claims. The claim should include specific information about the noncompliant taxpayer who is the subject of the claim, along with facts supporting the claimant’s belief that the taxpayer owes additional taxes. The claimant is instructed to include documentation substantiating the claim and, if the documents are not within the claimant’s possession, a description of the documents and their location. The claimant is asked to estimate the amount of tax owed, and to explain the claimant’s relationship to the taxpayer and how the claimant became aware of the alleged noncompliance. Notice 2008-4 confirms that Treasury Department and other government employees acting within the scope of their employment duties are generally not entitled to an award.

Later in 2008 the Service released Chief Counsel Notice CC-2008-011 (Feb. 27, 2008), which addresses issues that arise when the informant is also the taxpayer’s employee or representative. In cases in which the informant is an employee of the taxpayer, the notice counsels Service personnel to adhere strictly to the “one bite” rule. This long-standing rule allows the government legally to use information obtained from an informant even if the informant obtained the information in an illicit or illegal manner as long as the government was a passive recipient of the information and did not encourage the informant’s conduct. As a result of the one bite rule, the notice instructs Service employees, as a general rule, to meet with the informant only once. The notice also warns that it is never appropriate for a Service employee to accept information from an informant who is also acting as the taxpayer’s representative. If the representative makes a direct or indirect overture about becoming an informant, Service employees are instructed to no longer treat the informant as the taxpayer’s representative and to notify the taxpayer. It then becomes the representative’s responsibility to explain to the taxpayer why he or she can no longer act on the taxpayer’s behalf before the Service.

Guidance released in 2008 also responds to various privacy and confidentiality issues surrounding informant awards. With respect to the claimant’s confidentiality, Notice 2008-4, supra, acknowledges that the Service may not be able to investigate the informant’s claim without revealing the informant’s identity to the taxpayer. Nevertheless, Notice 2008-4 assures informants that the Service will seek to protect the informant’s identity to the fullest extent permitted by law. With respect to the taxpayer’s confidentiality, a Joint Committee Explanation of section 7623(b) recognizes that the Service may need to disclose the taxpayer’s return information to the informant in order to carry out an effective investigation of the taxpayer. Staff of the Joint Comm. on Taxation, Technical Explanation of H.R. 6408, the “Tax Relief and Health Care Act of 2006,” as Introduced in House on December 7, 2006, at 89, JCX-50-06 (Dec. 7, 2006). Newly released temporary regulations under section 6103 permit the Service to make such a disclosure as long as the informant acts within the authority of a written contract with the Service. See Temp. Treas. Reg. § 301.6103(n)-2T. The regulations are narrowly drawn and include safeguards to ensure that the informant does not re-disclose the information to other parties. These safeguards include the threat of civil or criminal liability for unauthorized disclosure. Temp. Treas. Reg. § 301.6103(n)-2T(c), (d).

Section 7623(b) now grants the informant a right to appeal an award claim to the Tax Court. I.R.C. § 7623(b)(4). A recent decision, DaCosta v. United States, 82 Fed. Cl. 549 (2008), confirms that the Tax Court has exclusive jurisdiction in this context. In October 2008, the Tax Court adopted amendments to its Rules of Practice and Procedure that discuss procedural issues surrounding an informant award appeal. These issues include filing instructions, designating a place of trial, and other pleadings requirements. Tax Ct. Rules 340-344. As a general matter, the Tax Court will treat an informant award appeal as it would any action filed in Tax Court. Thus, for example, an informant initiates an appeal by filing a Tax Court petition. Tax Ct. Rules 340(a), 341(a). The rules also recognize the authority of special trial judges to hear an informant award appeal. Tax Ct. Rule 182(c).

Conclusion

Although the expanded informant reward program under section 7623(b) remains relatively new, press accounts report that award claims are already substantial. Stephen Whitlock, the first director of the Whistleblower Office, made the following comments shortly after the Office’s creation:

The idea behind the statute is that there are certain kinds of tax noncompliance cases that the Service may have difficulty identifying without the help of a knowledgeable insider. Some of the things we’ve received over the past few months are consistent with the statutory purpose, and people who were in a position to know what was going on inside a corporation have come forward and told us about it....

116 Tax Notes 98, 99 (2007). If layoffs in the financial services sector increase, the number of informant claims from former employees may increase as well. Practitioners representing whistleblowers should continue to monitor developments relating to section 7623(b) in order to ensure that they provide effective representation.