Secretary Mnuchin — A Chance To Drain The Swamp

by Dean A. Zerbe

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In this article, Zerbe, lead counsel for the petitioners in *Whistleblower 21276-13W*, explains why the Trump administration should not appeal the Tax Court's pro-whistleblower decision on collected proceeds.

The new administration has pledged to "drain the swamp" in Washington. Swamp draining is a long, laborious, step-by-step process. In tax policy, that translates into the development of a pro-growth tax code that's simpler and fairer — and fairness requires diligence about tax evasion. Everyone, whether rich or poor, must comply with the tax rules.

It's often the seemingly small decisions that can have a big impact and send far-reaching signals to government employees and the public that the marsh will indeed be made dry.

Such a seemingly small decision now before the new administration is the proper definition of collected proceeds for the purpose of calculating awards under the IRS whistleblower program. That program is one of the IRS's most effective tools for targeting illegal offshore accounts and tax evaders. Sen. Chuck Grassley, R-Iowa (the author of the IRS whistleblower law), and other advocates of the program have recognized that having the correct definition of collected proceeds is critical to the program's long-term success.

That definition determines which payments are included in the award calculation. The modern version of the whistleblower law, section 7623(b), provides that the whistleblower receive an award of 15 to 30 percent of "the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any related actions or from any settlement)."[1]

The definition first became an issue several years ago, when memoranda from the IRS Office of Chief Counsel to the IRS Whistleblower Office reflected a change of position on the scope of collected proceeds.[2] Subsequent Treasury regulations (T.D. 9687) embraced the chief counsel's new, narrow definition: collected proceeds encompass only payments made by the taxpayer under title 26.

However, the Tax Court in *Whistleblower 21276-13W*[3] rejected that narrow reading as contrary to the plain language of the statute. It held that "collected proceeds" in section 7623(b) is a term of broad scope and includes non-title 26 penalties, fines, forfeitures, and restitution paid by a taxpayer. This is consistent with how the law has historically been interpreted and administered.

The collected proceeds question is timely for the new administration for two reasons. First, the government has until April 28 to decide whether to appeal the Tax Court's holding. Second, Congress and the new administration have taken an interest in this matter: Treasury Secretary Steven Mnuchin, in response to a question during

[1] Section 7623(b)(1).

[2] *See* PMTA 2012-10 and PMTA 2010-60.

[3] *Whistleblower 21276-13W v. Commissioner*, 147 T.C. No. 4 (2016) (slip op.), *supplementing* 144 T.C. 290 (2015). The regulations, which went into effect after the relevant actions in this case took place, were not at issue.

his confirmation hearing from Grassley, assured the senator of his support for the IRS whistleblower program and committed to working to address the narrow definition of collected proceeds.[4]

Mnuchin has an opportunity to make the right decision for honest taxpayers, tax enforcement, and tax fairness — and in the process, sound the bell that the swamp is being drained.

The future success of the whistleblower program — and the success of IRS and Justice Department efforts to go after tax evaders, especially those with illegal offshore accounts — largely hinges on whether Mnuchin decides to embrace the win for whistleblowers on collected proceeds, or instead appeals the Tax Court's decision.

I. *Whistleblower 21276-13W*

The administration should accept the Tax Court's decision because it is grounded in a clear reading of the statute, historical practice, and public policy. However, it is useful to have an understanding of the facts of the case and the court's reasoning, given that they provide a real-world coloring of the whistleblower program in practice and illuminate and illustrate the issues.

A. The Facts

The whistleblowers (husband and wife) gave the government information from A to Z about the taxpayer. They informed the IRS and Justice Department about a tax conspiracy and shared key information about the taxpayer's structure that made the investigation and indictment possible. Working with government agents, the whistleblowers developed a plan that ultimately brought the taxpayer down. That plan included using the whistleblowers' relationship with high-level individuals working for the taxpayer to catch them red-handed engaging in tax evasion.

Further, the wife (with two small children), at personal risk to herself, twice wore a wire to record incriminating evidence. She also lured the taxpayer's executive to the United States, where he could be arrested. As the judge noted during the trial, it's like James Bond.

For hard-eyed readers who suspect dramatic license by the whistleblowers' attorney, I need only cite the government's stipulation of the facts: "In short, but for the work, information and effort of the [whistleblowers] in assisting the federal government, the government's successful action against [the taxpayer], as it was carried out, would not have been possible." The government also stated that "but for the information and assistance provided by the [whistleblowers], the U.S. government, as a practical matter, would not have been able to indict and prosecute [the taxpayer]."[5]

The excellent work of the Justice Department attorneys and investigators at the FBI and the IRS was vital to the success in this matter, but, as intended when the whistleblower award law was written, a partnership with the whistleblowers made that success possible.

B. The Dollars

The taxpayer paid approximately $74 million to the U.S. government as part of its guilty plea. As is common in cases of this type and size brought by the Justice Department, the $74 million was a mix of different fines, penalties, and restitution under title 18.

The taxpayer was subject to only one charge: criminal conspiracy under 18 U.S.C. section 371 — in this case, criminal conspiracy to violate the tax laws. The amounts paid by the taxpayer were collected under three statutes: 18 U.S.C. section 3556 (restitution), 18 U.S.C. section 3571 (criminal fines), and 18 U.S.C. section 981(a)(1)(A) (civil forfeiture).

[4] The relevant portion of the Senate confirmation hearing reads:
Senator Grassley: The IRS has chosen to interpret the whistleblower law narrowly, to the detriment of whistleblowers, and in several instances the IRS has interpreted the term "collected proceeds," which is the basis for determining the amount of award, to exclude criminal penalties and certain other proceeds, such as penalties assessed for undisclosed foreign bank accounts. Two questions, and I'll state them both: Should you be confirmed, can I count on you to be supportive of the whistleblower program and work to ensure its success? And would you be willing to review the IRS's administration of the program, including its very narrow interpretation of the words "collected proceeds"?
Treasury Secretary Nominee Mr. Mnuchin: Absolutely, you have my assurance — and I will further say that the majority of Americans voluntarily file their tax returns honestly. We are aware there is tax fraud. There is tax evasion, as you said, and we need to be diligent, and I believe that the whistleblower laws are a very important part of that. I will work very hard with you on that.

[5] *See Whistleblower 21276-13W*, 144 T.C. at 298.

The IRS conceded that the $20 million restitution payment counted as collected proceeds because the funds were assessed as a tax under a 2010 amendment to section 6201(a)(4). However, the IRS continued to assert that the payments under the other two title 18 provisions were not collected proceeds for purposes of an award under section 7623(b)(1).

C. The Arguments

1. The IRS's Arguments

The IRS maintained that section 7623(a) limits the scope of actions eligible for whistleblower awards to violations of "the internal revenue laws," and because the internal revenue laws are codified as title 26, only amounts collected directly under a title 26 provision can qualify for a whistleblower award. So, even though the taxpayer's underlying conduct and violations solely concerned conspiring to evade income taxes in this case, the IRS argued that "the scope of Title 26's whistleblower statute is limited to tax violations," and that "collected proceeds from which an award may be paid are limited to amounts collected by the Secretary under Title 26."

The IRS also asserted that even if forfeiture amounts and criminal fines can be considered collected proceeds under section 7623(b), they are still unavailable to pay out a whistleblower award because of statutory restrictions on how forfeitures and criminal fines can be used. That argument was based on a 1996 amendment to the predecessor of section 7623(a), which provided that whistleblower awards under that section would be paid directly from the proceeds collected, rather than from funds appropriated by Congress.

2. The Whistleblowers' Arguments

In the interest of time, I will spare the reader the arguments made by counsel for the whistleblowers[6] since many of them were adopted by the Tax Court and are discussed below.

D. The Tax Court's Decision

The Tax Court conclusively rejected the IRS's arguments. It observed that the language of section 7623(b)(1) is unambiguously "plain" and "straightforward."[7] Finding that the term "collected proceeds" is not statutorily defined, the court looked to the plain meaning of the words "proceeds" — which it noted was a broad word — and "collected." The court concluded that "collected proceeds" is "an expansive and general term," encompassing all the money the government collected from the action, and that although Congress could easily have limited collected proceeds to title 26, it did not.

The court was not persuaded by the IRS's statutory argument. It noted that none of the authority cited by the IRS supported the agency's contention that internal revenue laws are limited to title 26, and that the IRS's position is contradicted by the agency's own guidance.[8] The opinion also quoted from section 6531, which establishes the statute of limitations for prosecutions of "any of the various offenses arising under the internal revenue laws." The court found "especially illuminating" section 6531(8)'s reference to 18 U.S.C. section 371, given that the provision applied directly to the government's action against the taxpayer in this case.

In sum, the Tax Court found that all the proceeds collected from the taxpayer were collected proceeds under section 7623(b)(1) because "the Secretary, through the IRS' criminal enforcement unit, took administrative action in response to information provided by petitioners," which ultimately resulted in the collection of $74 million from the taxpayer. Further, the opinion strongly suggests that the Treasury regulations on collected proceeds would not withstand challenge, given that the court found the statutory language plain and straightforward.

On the IRS's contention that the restitution and criminal fine were unavailable for payment as a whistleblower award, the court held that

[6] *See* Petitioners' Response to Respondent's Memorandum on Collected Proceeds, *Whistleblower 21276-13W*, nos. 21216-13W and 21217-13W (T.C. filed Jan. 28, 2016).

[7] Slip. op. at 10–11.

[8] *Id.* at 16 n.13 (citing a statement from PTMA 2012-10 as an acknowledgement by the IRS that tax laws may be found outside title 26).

although availability might apply to discretionary whistleblower awards under section 7623(a), which must "be paid from the proceeds," availability does not apply to awards under section 7623(b), which requires that whistleblowers "receive as an award [a percentage] of the collected proceeds." The court emphasized the distinction between discretionary and mandatory whistleblower awards in this respect and held that because section 7623(b)(1) clearly provides that the whistleblower award is calculated by using a percentage of the collected proceeds, it is not paid *directly from* those proceeds. In other words, the collected proceeds do not need to be "available" for payment to the whistleblower since they are "used only for purposes of calculating the amount of the award to be given to the whistleblower."[9]

The IRS filed a motion for reconsideration that essentially asserted variants of its earlier arguments, with a focus on the funding issue. The motion also invited the Tax Court to substitute the word "taxes" for the term "collected proceeds" in the statute.[10]

The whistleblowers' response noted that the Tax Court had addressed the issue of funding, and that because 7623(b)(1) establishes a mandatory entitlement to a percentage of the collected proceeds, no further appropriation or authorization language is needed. The reply cited from the decision: "Section 7623(b)(1) does not refer to, or require, the availability of funds to be used in making an award . . . . The statute explicitly instructs the Secretary to pay the whistleblower who qualifies for the mandatory award program."[11]

The Tax Court summarily rejected the IRS's motion for reconsideration. As noted earlier, the deadline for appeal is April 28.

II. To Drain or Not to Drain the Swamp

The government must consider both law and policy in deciding whether to appeal or embrace the Tax Court's holding and change Treasury and IRS guidance on the definition of collected proceeds. Both law and policy speak to accepting the Tax Court's broad definition of collected proceeds.

A. The Law Says Drain

It is important to note that the Tax Court addressed all the arguments made by the IRS — the same arguments the agency has used in its chief counsel memoranda and in the Treasury regulations to justify its new, narrow position on collected proceeds.

IRS chief counsel and Treasury officials have consistently told Congress and the whistleblower community that the government is not opposed to a return to the traditional definition of collected proceeds (that is, encompassing titles 18, 26, 31, etc.), but that in good faith they did not believe that their reading of the law allowed them to take that position. In fact, it is my understanding that the IRS Whistleblower Office originally argued for keeping in place the broad definition of collected proceeds, but was overruled by chief counsel because of its reading of the law.

Now comes the Tax Court opinion, which gives the IRS and Treasury a four-lane highway to provide a broad definition of collected proceeds. All the legal concerns raised by chief counsel have been put to bed by the Tax Court. The court's decision provides a fresh start and gives the IRS and Treasury all the legal authority necessary to return to a broad definition of collected proceeds.

B. Policy Says Drain

There can be no doubt about the correct policy answer in this instance. For the reasons set forth above, collected proceeds must be more broadly construed. To begin with, the success of encouraging knowledgeable and informed whistleblowers to come forward depends heavily on their having confidence that they will be fairly compensated if (1) the government receives the whistleblower's information, (2) the government takes action on the information provided, and (3) that action results in collected proceeds.

If whistleblowers see that all three tests are met, but the government underpays by way of an overly narrow view of collected proceeds, many of the most valuable whistleblowers may not consider it worth the risk to come forward. This

[9] *Id.* at 26.

[10] Motion for Reconsideration at 10, *Whistleblower 21276-13W*, nos. 21216-13W and 21217-13W (T.C. Sept. 2, 2016).

[11] Slip op. at 28.

would continue the underuse of the whistleblower program and contribute to a downward spiral: As fewer whistleblowers are adequately paid or paid at all, fewer will come forward. The strength of the program is that whistleblower payments encourage more and better whistleblowers to come forward. Success breeds success. Further, a vital and active whistleblower program has a positive impact on overall taxpayer compliance. The bottom line is that undermining certainty and inappropriately reducing award payments threatens the very core of the whistleblower program.

As a matter of both public and tax policy, it is also clearly in the IRS's interest to encourage whistleblowers to come forward with complete information on violations of law, regardless of whether those violations will be subject to criminal or civil penalties, forfeitures, etc. The current IRS policy of issuing awards only for title 26 violations limits the material provided to the agency and creates an atmosphere in which whistleblowers either do not submit information, or parse their submissions — to the detriment of the IRS and the government at large.

The government's interest in encouraging whistleblowers to come forward is particularly strong in the case of deterring criminal tax conduct and bringing tax evaders to justice. Criminal tax evasion often involves a party deliberately misleading or concealing information from the IRS. As a result, whistleblowers are an especially important tool in helping the government find, understand, and rein in tax criminals. In that context, the stakes for whistleblowers are higher. Generous awards are appropriate and necessary to provide an incentive for whistleblowers in light of the reputational, safety, and financial risks involved.

Given the difficult budget environment for the IRS, it is all the more important to encourage whistleblowers to come forward. They can greatly assist the work of the IRS and limit the agency's time and effort in asserting a case against a taxpayer. As an IRS study showed, cases brought against taxpayers based on information provided by whistleblowers have a high success rate and are cost-efficient.[12] A successful whistleblower program means that IRS examinations are better focused on tax evaders and less so on honest taxpayers (a double win for honest taxpayers).

Finally, it is a cornerstone of public and tax policy that similarly situated individuals be treated similarly. With its current policy on collected proceeds, the government has created a situation in which similarly situated whistleblowers are subject to vastly different treatment based purely on the vagaries of the government's own actions. For example, a whistleblower who provides information on an illegal offshore account will get an award if the taxpayer ultimately pays a title 26 penalty, but will receive nothing if the taxpayer pays a foreign bank account report penalty (under title 31). This disparity is exacerbated by the fact that the decision on how to pursue a taxpayer is solely within the discretion of the government.

As a policy matter, the path the government takes regarding a taxpayer's behavior in violating the tax laws should not determine whether a whistleblower receives an award. It is the underlying conduct that matters. The disparate treatment of whistleblowers under the current policy will only discourage whistleblowers from coming forward — with the sole winners being taxpayers engaged in illegal activity. The correct policy position recognizes that it is the conduct of the errant taxpayer that should trigger the amount of the reward, and not whether an agent or prosecutor determines that non-title 26 sanctions should be pursued or imposed for tax misconduct.

The new administration has a chance to bring a common-sense view on collected proceeds by jettisoning the blindered focus on clawing back as much money as possible from whistleblowers (with no regard to the detrimental impact for the future). Instead, the new administration has the opportunity to think long-term and embrace a policy that will expand one of the IRS's most successful programs for going after big-dollar tax cheats.

[12] IRS, "The Informants' Project: A Study of the Present Law Reward Program" (Sept. 1999).

The new administration will hear from naysayers in the bureaucracy. Be wary: These are the same short-term thinkers who advocate for killing geese that lay golden eggs. If the new administration listens to the goose killers, it will certainly hear hosannas from private bankers in Switzerland and law firms in Panama, among others.

But if, instead, the new administration casts aside ossified thinking and embraces this win for whistleblowers on collected proceeds in *Whistleblower 21276-13W*, it will be tangible proof that the administration believes in a fair tax code. And the trickling you hear will be the sound of water draining from the swamp. ■