

**Fiscal Year 2012 Report to the Congress  
on the Use of Section 7623**

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## **FY 2012 Report to Congress on the Use of Section 7623**

### **I. Executive Summary**

The Tax Relief and Health Care Act of 2006 (the Act) enacted significant changes in the IRS award program for whistleblowers. For information provided to the IRS after December 19, 2006, new section 7623(b) of the Internal Revenue Code (the Code) generally requires the IRS to pay awards if information an individual provides substantially contributes to the collection of tax, penalties, interest, and other amounts when the amounts in dispute are more than \$2,000,000. The law set award ranges based on percentages of the collected proceeds and established a Whistleblower Office within the IRS to administer those awards.

The Secretary of the Treasury must conduct an annual study and report to the Congress on the use of section 7623 and the results obtained and include any legislative or administrative recommendations for section 7623 and its application (section 406(c) of the Act). This report discusses program activities for fiscal year (FY) 2012. It includes a review of the law and regulations applicable to whistleblower awards, changes made in program administration since the Act, a description of internal and external program guidance, administrative priorities, and data on awards paid.

The primary purpose of the Act was to encourage people with knowledge of significant tax noncompliance to provide that information to the IRS. In FY 2012, the IRS received 332 submissions identifying 671 taxpayers that, based on the face of the submissions, appear to meet the section 7623(b) criteria. Many of the individuals submitting this information claim to have inside knowledge of the transactions they are reporting, often including extensive documentation in support of their claims. Because there are a number of steps in the process, the IRS cannot yet tell how many of the submissions will result in collected proceeds and whether the whistleblowers' estimates of the amounts in dispute are accurate.

The IRS pays awards from collected proceeds that result from an audit or investigation. Because payments are not made until the taxpayer has exhausted all appeal rights and the statutory period for the filing of a claim for refund has expired or been waived by the taxpayer, the IRS may not make payments for several years after the whistleblower has filed the claim. The IRS paid the first awards under the 2006 amendments in FY 2011 and continued to do so in FY 2012; however, most of the awards paid during FY 2012 resulted from claims filed under the prior law.

## II. Program History

### A. Prior Law and Policy

The IRS has had the authority to pay awards to whistleblowers for many years. What is now section 7623(a)<sup>1</sup> of the Code has its origins in legislation the Congress enacted in 1867. The original law provided the Secretary of the Treasury with the authority “to pay such sums as he deems necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same.” Before 1996, the IRS made payments from appropriated funds. In 1996, section 1209 of the Taxpayer Bill of Rights 2 (PL 104-168) expanded the purposes for which the IRS may pay awards, added “detecting underpayments of tax” as a basis for making an award, and changed the source of funds from IRS operating funds to proceeds of amounts collected from the taxpayer (other than interest).<sup>2</sup>

Before the 2006 amendments to section 7623, awards to whistleblowers were discretionary, and IRS policy determined the amount.<sup>3</sup> The policy provided a framework for assessing the contribution of the information to the collection of proceeds from a taxpayer and allowed for awards of 1 percent, 10 percent, or 15 percent of proceeds. The published policy set a cap on awards at \$10,000,000, but the IRS waived this cap from time to time under “special agreements” with a whistleblower.

The Internal Revenue Manual (IRM) provided several grounds for rejecting a claim for award, including participation in the evasion scheme that was the subject of the report the whistleblower provided. Other common reasons for rejecting claims included:

- The information provided was of no value.<sup>4</sup>
- The IRS already had the information or the information was available in public records.
- No collection of taxes and penalties existed from which the IRS could pay an award.

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<sup>1</sup> The 2006 amendments re-designated the prior section 7623 as section 7623(a), added new provisions as section 7623(b), and included program administration requirements that were not incorporated into the Internal Revenue Code. The appendix to this report reprints section 7623, as amended, as well as additional provisions in the Act that Congress did not incorporate into the Code.

<sup>2</sup> The IRS has separate authority to pay informant expenses from appropriated funds available for confidential criminal investigation expenditures. The IRS makes those payments under authorities delegated to Criminal Investigation and they are not within the scope of the Whistleblower Office or this report to Congress.

<sup>3</sup> Regulations implementing what is now section 7623(a) appear at Code of Federal Regulations Title 26, section 301.7623-1. The last version of the policy issued prior to the 2006 amendments was published in 2004, as Policy Statement P-4-27. The policy was revised in FY 2010, through revisions of the Internal Revenue Manual that were described in the FY 2010 Annual Report. The FY 2010 Annual Report can be found on the IRS web site at [http://www.irs.gov/pub/whistleblower/annual\\_report\\_to\\_congress\\_fy\\_2010.pdf](http://www.irs.gov/pub/whistleblower/annual_report_to_congress_fy_2010.pdf).

<sup>4</sup> The information might be of no value because it did not provide a sufficient basis for initiating an examination or investigation of the issue presented, or because the examination resulted in a “no change” finding.

## **B. 2006 Amendments**

The Tax Relief and Health Care Act of 2006 (section 406) (PL 109-432) created section 7623(b) of the Code. This section set a new framework for the consideration of whistleblower submissions and established the Whistleblower Office within the IRS to administer that framework. Operating at the direction of the Commissioner of the IRS, the Whistleblower Office coordinates with other divisions of the IRS, analyzes information submitted, and makes award determinations. The statute provides that the Whistleblower Office may investigate the claim itself or assign it to the appropriate IRS office for investigation. The Whistleblower Office does not currently investigate claims itself. Individuals may appeal the Whistleblower Office's award determinations under section 7623(b) to the U.S. Tax Court.

A whistleblower must meet several conditions to qualify for the section 7623(b) award program.<sup>5</sup> To qualify for a whistleblower award, the information must:

- Relate to a tax noncompliance matter in which the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000; and
- For individual taxpayers only, relate to a taxpayer whose gross income exceeds \$200,000 for at least one of the tax years in question.

If the information meets the above conditions and substantially contributes to a decision to take administrative or judicial action that results in the collection of tax, penalties, interest, additions to tax, or additional amounts, the IRS will pay an award of at least 15 percent, but not more than 30 percent, of the collected proceeds resulting from administrative or judicial actions (including related actions) or from any settlement in response to an administrative or judicial action. The maximum award percentage decreases to 10 percent for cases based principally on specific allegations disclosed in certain public information sources (such as government audit reports). The Whistleblower Office also can reduce the percentage if the whistleblower planned and initiated the actions that led to the underpayment of tax.

## **III. Program Developments**

### **A. Staffing**

At the beginning of FY 2012, the Whistleblower Office staff of 18 included ten analysts with decades of experience in a broad array of IRS compliance programs. In addition, the IRS Office of Chief Counsel has appointed a senior attorney to serve as Special Counsel to the Director of the Whistleblower Office. The Special Counsel provides legal advice to the Director and coordinates support that other Chief Counsel offices provide.

In January 2012, the Small Business/Self-Employed (SB/SE) Division transferred the Informant Claims Examination (ICE) Unit to the Whistleblower Office. This group of 13 employees is responsible for case management and administration of the discretionary award program under what is now section 7623(a). When the Whistleblower Office was established in 2007, its primary focus was on implementing the 2006 amendments to

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<sup>5</sup> If the submission does not meet the criteria for section 7623(b) consideration, the IRS may consider it for an award under the pre-Act discretionary authority (what is now section 7623(a) of the Code).

Section 7623, and it had no formal role in case management or award determinations for claims filed under the prior law. In 2008, the IRS delegated authority to approve 7623(a) awards to the Director of the Whistleblower Office, and increasing coordination of activities between the ICE Unit and the Whistleblower Office made the transfer of staff and functions a logical step in the evolution of the program. As is noted below, the transfer provides opportunities for process efficiencies and realignment of duties that will improve service to whistleblowers and the Operating Divisions. At the end of FY 2012, the total staff of the Whistleblower Office was 36.

## **B. Case Management Information System**

In January 2009, the IRS began using a new case management system to record all new section 7623 claims. By the end of FY 2009, the IRS converted all section 7623(b) claims recorded on the old systems to the new system and began planning to convert legacy data to the new system. The legacy data on pre-amendment claims and section 7623(a) claims submitted prior to January 2009 was loaded into the new system in July 2010, and records on all open legacy cases were updated to incorporate the enhanced features of the new system.<sup>6</sup>

In July and August 2012, the IRS modified the case management information system to incorporate additional data fields, and modify existing data fields, to capture information that will enhance our ability to manage claims and will allow data to be collected that can help assess Whistleblower Office and Operating Division performance. For example, the system adds additional options to classify case closing reasons and more accurately tracks time-in-status information. These modifications will also allow the IRS to provide additional data in future Annual Reports.

## **C. Program Guidance**

The IRS issued Notice 2008-4 to provide initial guidance on how to submit information to the IRS. A revision to Form 211, Application for Award for Original Information,<sup>7</sup> accompanied this notice. The notice addressed the most pressing guidance requirements—how to submit information and the criteria that the IRS will apply to determine whether the information qualifies under section 7623(b). The notice included the requirement that an individual submit the information under penalty of perjury and defined ineligible submissions. A submission may be ineligible because the person submitting it is disqualified (e.g., a federal employee who learned of the tax noncompliance in the course of performing his or her duties) or because the information does not provide a basis for IRS action. The latter category includes information that is speculative or that the IRS already knows. The notice also described the types of information that the whistleblower should include for the IRS to be able to fully evaluate the submission.

The IRS published revisions to the IRM on June 16, 2010. Those revisions updated procedures for receipt and processing of whistleblower submissions and provided the

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<sup>6</sup> Legacy data on closed cases is available for research and reference in the new system, but was not updated.

<sup>7</sup> <http://www.irs.gov/pub/irs-pdf/f211.pdf>

framework for making award determinations. An important policy change reflected in the IRM was that awards paid in section 7623(a) cases submitted on or after July 1, 2010 (those in which the statutory thresholds for 7623(b) claims are not met) will be determined using the same criteria and percentages that apply to 7623(b) claims. Section 7623(a) claims submitted prior to July 1, 2010, will be evaluated under the rules and policy in effect at the time the claim was filed.

The IRS issued final regulations on February 22, 2012, which clarified the definitions of “proceeds of amounts collected” and “collected proceeds” for purposes of section 7623 and state that the provisions of Treasury Regulations section 301.7623-1(a) concerning refund prevention claims are applicable to claims under section 7623(a) and (b). In clarifying the definition of proceeds of amounts collected and collected proceeds, the regulation also provides that the reduction of an overpayment credit balance is also considered proceeds of amounts collected and collected proceeds under section 7623.

The IRS published final regulations governing the use of contracts for services related to the detection of violations of the internal revenue laws or related statutes, and they became effective on March 15, 2011. These regulations describe the circumstances under which the disclosure of taxpayer information to a whistleblower (and, if applicable, the whistleblower’s representative) may be made, limitations on the use of any disclosed information, and safeguards to ensure those limitations are followed.

On June 7, 2012, the Director of the Whistleblower Office issued interim guidance with an effective date of August 1, 2012. The interim guidance incorporated the Treasury Regulation definition of collected proceeds, added additional provisions for timing of award determinations and for award computation, established procedures for tax withholding on award payments, and revised and updated procedures for administrative proceedings.<sup>8</sup> The interim guidance will be incorporated in a revision of the IRM expected in FY 2013.

On June 20, 2012, the Deputy Commissioner for Services and Enforcement issued a memorandum to the Operating Division Commissioners, the Chief of Criminal Investigation, and the Director of the Whistleblower Office.<sup>9</sup> In that memorandum, the Deputy Commissioner highlighted the importance of whistleblower information in identifying suspected noncompliance, the need to evaluate whistleblower information in a timely manner, and the value of whistleblower debriefings to fully understand the issues presented. The memorandum also set performance objectives for evaluation of whistleblower submissions and for award determinations when audits or investigations are completed.

On December 18, 2012, a Notice of Proposed Rulemaking was published in the Federal Register.<sup>10</sup> The proposed regulations provide a comprehensive framework for receipt of whistleblower submissions, evaluation of the contribution of whistleblower information to IRS actions, and determination of awards under section 7623. Among other topics, the

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<sup>8</sup> [http://www.irs.gov/pub/foia/ig/spder/ig\\_wo-25-0612-01.pdf](http://www.irs.gov/pub/foia/ig/spder/ig_wo-25-0612-01.pdf)  
[http://www.irs.gov/pub/foia/ig/wi/ig\\_wo\\_memo\\_03.pdf](http://www.irs.gov/pub/foia/ig/wi/ig_wo_memo_03.pdf)  
[http://www.irs.gov/pub/foia/ig/spder/ig\\_wo\\_02\\_combined.pdf](http://www.irs.gov/pub/foia/ig/spder/ig_wo_02_combined.pdf)

<sup>9</sup> [http://www.irs.gov/pub/irs-utl/field\\_directive\\_dated\\_june\\_20\\_2012.pdf](http://www.irs.gov/pub/irs-utl/field_directive_dated_june_20_2012.pdf)

<sup>10</sup> <https://www.federalregister.gov/articles/2012/12/18/2012-30512/awards-for-information-relating-to-detecting-underpayments-of-tax-or-violations-of-the-internal>



proposed regulations provide definitions of key terms, eligibility criteria, evaluation criteria, and payment procedures. Public comments are due by February 19, 2013.

#### **D. Program Operations**

The Whistleblower Office evaluates the submissions it receives to determine whether the information offered may materially contribute to the assessment or collection of unpaid taxes, penalties, interest, or other amounts. If an audit or investigation is conducted based on the information a whistleblower provides, the Whistleblower Office will determine whether an award is payable under either 7623(a) or 7623(b) and the amount of any award.

In FY 2011, the Whistleblower Office paid the first claims under section 7623(b). Five claims have been paid under the revised law. Taxpayer privacy laws do not permit the publication of data on specific claims unless there has been a waiver of privacy rights and allow reporting on consolidated data only when the number of claims paid is large enough to produce a statistical report.<sup>11</sup>

The number of payments made under the section 7623(b) program is not projected to grow dramatically in FY 2013. As discussed, it typically takes a number of years to analyze, investigate and/or audit, and collect proceeds. At each stage in the tax administration process, taxpayers have rights to challenge IRS findings, including administrative and judicial appeals. The incentive for taxpayers to exercise those rights increases as the amounts in dispute get larger, which can mean a longer timeline for whistleblower submissions alleging larger dollar noncompliance.

During FY 2012, the IRS received 332 whistleblower submissions relating to 671 taxpayers<sup>12</sup> that, based on the face of the submissions, appear to meet the threshold of \$2,000,000 in tax, penalties, interest, and additions to tax in section 7623(b). Many of the individuals submitting information to the IRS claimed to have inside knowledge of the reported transactions, often including extensive documentation in support of their claims. The IRS does not yet know how many of these cases will result in collected proceeds after examination or investigation, as the amounts alleged reflect only the whistleblower's estimate of the potential recovery. Twelve of 128 claims paid in FY 2012 involved collections of more than \$2,000,000.<sup>13</sup>

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<sup>11</sup> One claim paid in FY 2012 was accompanied by a limited privacy waiver that permits the IRS to confirm that, on August 27, 2012, the IRS paid an award of \$104 million to a whistleblower.

<sup>12</sup> The Whistleblower Office often receives submissions that allege underpayment of tax by more than one taxpayer. In most cases, the IRS must evaluate the liability of each taxpayer individually—a single audit or investigation cannot resolve the issues for all taxpayers identified in the submission.

<sup>13</sup> Most of the claims involving \$2,000,000 or more were submitted prior to the 2006 amendments to section 7623, under what is now section 7623(a).

**(Table 1)**  
**7623(b) SUBMISSIONS BY FISCAL YEAR<sup>14</sup>**

	<b>Submissions</b>	<b>Taxpayers Identified<sup>15</sup></b>
<b>2007</b>	<b>50</b>	<b>875</b>
<b>2008</b>	<b>377</b>	<b>1369</b>
<b>2009</b>	<b>472</b>	<b>2178</b>
<b>2010</b>	<b>422</b>	<b>5545</b>
<b>2011</b>	<b>314</b>	<b>734</b>
<b>2012</b>	<b>332</b>	<b>671</b>

The charts below provide information on the status of open claims identified as potentially exceeding the \$2,000,000 threshold for section 7623(b). These claims are identified during initial review of submissions by the Whistleblower Office and then forwarded to subject matter experts (SMEs) in the IRS Operating Divisions. The SMEs determine whether the whistleblower information will be provided to field offices for audit or investigation, considering the quality of the information provided, IRS enforcement priorities and, in some cases, legal limitations on the use of the information submitted. Once information is provided to a field office, it may be incorporated into an ongoing audit or investigation, a new audit or investigation may be started, or it may be deferred or declined in favor of higher priority cases or issues. Upon completion of an audit or investigation or after a decision by a SME or a field office not to act on the information the whistleblower provided, the file is returned to the Whistleblower Office. The Whistleblower Office determines whether a whistleblower is eligible for an award and, if so, the amount of the award.

The tables below include a category called “Whistleblower Office-Case Suspended.” Action on claims may be suspended for several reasons. These include waiting for collection action after tax has been assessed, waiting for the taxpayer to exhaust or waive appeal rights, and waiting for action on related cases. A related case suspension would be appropriate when a whistleblower submission identifies multiple taxpayers, and the IRS decides to take action on some but not others. The declined cases would be suspended until the actions on other taxpayers are resolved. Another reason to suspend for related cases would be that actions have been completed on some taxpayers, but the amount in dispute is below the \$2,000,000 threshold for section

<sup>14</sup> The classification of a particular submission as a potential 7623(b) case, and the number of taxpayers identified can change as additional information is developed. As a result, the numbers for a particular fiscal year included in previous annual reports do not match the numbers reported here. The data in this table is current as of December 12, 2012, for submissions received in the fiscal years indicated.

<sup>15</sup> A relatively small number of submissions account for a large number of taxpayers identified, as they contain long lists of taxpayers involved in the reported activity, or they lead to the identification of a large number of taxpayers. While the numbers of taxpayers identified for FY 2011 and FY 2012 are substantially lower than prior years, experience has shown that these numbers are likely to rise as the information submitted is further analyzed.

7623(b). Suspending action to determine whether additional actions could push the aggregate amount in dispute over the threshold preserves the whistleblower's potential Tax Court appeal right. Until information system changes were made on August 8, 2012, the Whistleblower Office could not record the reason for suspension in the information system in a way that would permit statistical reporting, but a change in data collection will permit this information to be reported in future reports. The table below reflects application of the additional reasons for suspension in approximately 23 percent of the total number of suspended claims. The records on the remaining claims will be updated to reflect the reason for suspension in FY 2013.

**(Table 2)**  
**Current Status of Open 7623(b) Claims**  
**(as of 12/10/2012)**

<b>Current Status</b>	<b>Submissions</b>	<b>Taxpayers</b>	<b>Whistleblowers</b>	<b>Claim #s</b>
Not recorded	3	23	3	23
Appeals <sup>16</sup>	40	102	38	87
CI Review	4	4	3	4
Operating Division Field Examination	695	2846	542	2714
Operating Division Subject Matter Expert Review	116	327	83	318
Whistleblower Office - Award Evaluation <sup>17</sup>	4	7	4	3
Whistleblower Office - Case Suspended <sup>18</sup>	171	4913	123	4810
Whistleblower Office - Case Suspended Collection Action <sup>19</sup>	4	17	4	17
Whistleblower Office - Case Suspended Refund Statute <sup>20</sup>	3	6	3	5
Whistleblower Office - Case Suspended Related Claims Still In Process <sup>21</sup>	44	605	32	550
Whistleblower Office - Case Suspended TEFRA Related <sup>22</sup>	1	54	1	51
Whistleblower Office - Form 11369 Review <sup>23</sup>	313	1069	252	987
Whistleblower Office - Initial Review	51	70	38	67
<b>Total</b>	<b>1449</b>	<b>10043</b>	<b>1126</b>	<b>9636</b>

<sup>16</sup> "Appeals" refers to claims related to matters in which the taxpayer has sought review by IRS Appeals

<sup>17</sup> "Whistleblower Award Evaluation" is now used when all pre-conditions for determining an award have been satisfied. In these cases, the Whistleblower Office is either preparing to issue a letter to the whistleblower regarding a proposed award, or has done so and is working through the process for a final determination and payment of an award.

<sup>18</sup> "Whistleblower Office-Case Suspended" includes suspended cases that have not yet been assigned to one of the other "suspended" statuses listed below.

<sup>19</sup> "Suspended-Collection Action" is used when an assessment has been made but the amount assessed has not been collected.

<sup>20</sup> "Suspended-Refund Statute" is used when there has been an assessment and collection, but the taxpayer has not exhausted or waived rights to challenge. In general, a taxpayer that has made payment on an assessment may challenge the assessment by filing a claim for refund in US District Court within two years of the last payment.

<sup>21</sup> "Suspended-Related Claims Still In Process" is used when a submission involves multiple taxpayers and action is not complete with respect to all of the taxpayers. When the Whistleblower Office can make a payment on completed actions without prejudice to the whistleblower's rights it does so.

<sup>22</sup> "Suspended-TEFRA Related" is used in cases involving entities subject to the partnership taxation rules of the Tax Equity and Fiscal Responsibility Act of 1982, when actions must be taken to assess and collect the amount due from the TEFRA partners.

<sup>23</sup> "Whistleblower Office 11369 Review" refers to the form used by the Operating Divisions and CI to report tax administration actions that are relevant to a whistleblower submission. The Whistleblower Office reviews the form and supporting documents to determine whether it has sufficient information to evaluate the whistleblower's eligibility for an award, and to determine whether a decision can be made. If the information is sufficient but a decision cannot be made, the claim is typically assigned to one of the "suspended" categories and monitored until a decision can be made.

The table below reflects the number of days in current status from the date that the claim cleared the previous status. For example, the time that a claim is in Operating Division Field Examination is measured from the date Operating Division Subject Matter Review was completed. The data collection used to generate this data did not consider the possibility that a claim may not move through the process linearly. For example, the claim reported as “longest” in Operating Division Subject Matter Expert status was returned for subject matter expert review after a field examination was conducted, because it was not clear that supplemental information submitted after the claim was originally reviewed had been considered.

As previously discussed, the Whistleblower Office has significantly revised the information system to begin collecting data that will account for circumstances such as the return of a claim for further review. Changes were also made in the definition of the “Whistleblower Office-Award Evaluation” status, and four new “Whistleblower Office-Suspended” statuses were added, as described in the text preceding Table 2. The information system revisions to reflect these changes require manual updates to thousands of records, and are expected to be complete in FY 2013. Table 3 does not yet reflect these changes. After these updates are completed, future reports will more accurately capture the current time in status.

**(Table 3)**  
**Open claims, Days in Current Status**  
**(as of 12/10/2012)**

<b>Current Status</b>	<b>Average</b>	<b>Longest</b>	<b>Shortest</b>
Appeals	233	988	1
CI Review	61	94	0
Operating Division Field Examination	424	1506	1
Operating Division Subject Matter Expert Review	260	1429	0
Whistleblower Office - Award Evaluation	1141	1302	780
Whistleblower Office - Case Suspended	368	1175	0
Whistleblower Office - Form 11369 Review	334	1498	0
Whistleblower Office - Initial Review	117	646	1

**E. Outreach and Communications**

The IRS has developed a communications plan to address outreach to both the public and IRS personnel on changes in the whistleblower program. The plan includes efforts to identify opportunities for improvement and potential barriers to change.

The Whistleblower Office has a page on the IRS Intranet to make information available to IRS personnel, and it provides articles for internal newsletters and speakers for professional education events to reach employees who are most likely to deal with a

whistleblower case. In November 2010, the Whistleblower Office hosted a meeting of managers and employees from the Whistleblower Office and the ICE Unit to discuss issues related to claim intake and evaluation, and award determinations and payment. One result of this meeting was to begin planning for the transfer of the ICE Unit from the Small Business/Self Employed Operating Division to the Whistleblower Office. This realignment was accomplished in January 2012, when the ICE Unit migrated from SB/SE to the Whistleblower Office. This realignment consolidated staffs working on section 7623 claims, offering opportunities to improve efficiency and productivity.

A dedicated page on the public website, [www.irs.gov](http://www.irs.gov),<sup>24</sup> contains information for the public about the purpose of the Whistleblower Program, how to make a submission, and what to expect after making a submission, as well as links to Notice 2008-4 and Form 211. The Whistleblower Office also makes presentations to professional groups involved in the representation of taxpayers and whistleblowers, including Taxpayers Against Fraud and the American Bar Association Tax Section, both to describe program developments and to obtain outside perspectives on the program.

In October 2011 and June 2012, the Deputy Commissioner for Services and Enforcement hosted meetings with attorneys who represent whistleblowers and taxpayers. These meetings provided an opportunity for IRS and Chief Counsel senior staff to hear concerns and suggestions about the IRS whistleblower program. The Deputy Commissioner's June 20, 2012 memorandum emphasizing the benefits that can be derived from whistleblower information, and setting performance objectives for timely evaluation of whistleblower submissions, was an indirect result of these meetings. In addition, the Whistleblower Office published interim guidance in June, with an August effective date, to permit public comments on its efforts to implement suggestions received in the stakeholder meetings.<sup>25</sup> For example, the interim guidance included a procedure for withholding agreements in cases where whistleblowers have deductible attorney fees and costs. This procedure, which has been used in subsequent award payment administrative proceedings, was a direct result of a suggestion made in one of the meetings.

#### **IV. Administrative Priorities and Issues**

The Whistleblower Office continues to work with the IRS Office of Chief Counsel and Treasury Department to develop appropriate administrative program guidance. Based on the Whistleblower Office's experiences in administering the whistleblower program since its formation in 2007, the IRS has identified several areas it believes should be addressed through administrative guidance and as well as other issues.

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<sup>24</sup> <http://www.irs.gov/compliance/article/0,,id=180171,00.html>

<sup>25</sup> [http://www.irs.gov/pub/foia/ig/spder/ig\\_wo-25-0612-01.pdf](http://www.irs.gov/pub/foia/ig/spder/ig_wo-25-0612-01.pdf)  
[http://www.irs.gov/pub/foia/ig/wi/ig\\_wo\\_memo\\_03.pdf](http://www.irs.gov/pub/foia/ig/wi/ig_wo_memo_03.pdf)  
[http://www.irs.gov/pub/foia/ig/spder/ig\\_wo\\_02\\_combined.pdf](http://www.irs.gov/pub/foia/ig/spder/ig_wo_02_combined.pdf)

## **A. Administrative Priorities**

### **1. Guidance**

A top priority is to update formal published guidance for section 7623. As is noted in the previous section, the IRS issued final regulations to define “collected proceeds,” and has proposed comprehensive regulations that will revise the current regulations implementing section 7623 to reflect the remaining 2006 amendments to the statute.

### **2. Review and update internal operating procedures to improve program performance.**

The distinction made during initial processing of whistleblower submissions between 7623(b) claims and 7623(a) claims is based on Whistleblower Office review of the information submitted, and a projection about the potential that an audit or investigation based on the claim may result in an “amount in dispute” of more than \$2,000,000. This assessment of claim potential was administratively convenient for division of work between the former ICE Unit and the Whistleblower Office, but it never had significance for the final resolution of the claim. The legally significant distinction is made when the “amount in dispute” is determined—at the end of the audit or investigation. The IRS has found many times that a claim initially thought to be a potential 7623(b) claim did not result in a dispute between the IRS and one or more taxpayers in excess of \$2,000,000, and a smaller number of cases where the initial assessment of potential return was too low.

With the integration of the ICE Unit into the Whistleblower Office, the workload allocation justification for projecting the potential return from whistleblower claims at the time a claim is submitted no longer exists. In addition, experience administering the program has shown that it would be more efficient to classify claims based on the Operating Division responsible for making the tax administration decisions with respect to the issues raised by the whistleblowers.

- Approximately two thirds of claims submitted involving Large Business and International Division (LB&I) taxpayers were classified as potential 7623(b) claims. These cases were assigned to an analyst in the Whistleblower Office, then forwarded to SMEs in the Industry Groups within LB&I for further evaluation. Other claims were evaluated by LB&I case classification staff, and those with potential merit were sent to the same SMEs for further evaluation. Classification of these claims by the Whistleblower Office adds little or no value because LB&I uses the same process to evaluate all claims it receives.
- The Small Business/Self Employed Division (SB/SE) receives a much higher number of whistleblower submissions, but only about 5 percent were identified as potential 7623(b) claims. The IRS has concluded that the general examination program case assignment process can effectively identify claims that may warrant more attention during the evaluation process, and that the Whistleblower Office distinction between potential 7623(b) claims and other claims is adding little value.

With LB&I and SB/SE general examination programs receiving the vast majority of whistleblower claims and each processing their inventory differently because of differences in the characteristics of the typical claims referred to those organizations,

the Whistleblower Office will change its intake process in FY2013. It will stop projecting potential results, and it will classify claims based on Operating Division assignment. Assignment of claims to a Whistleblower Office analyst for monitoring and coordination will be based on factors such as the need for coordination within or among operating divisions to address multiple issues or taxpayers identified in a whistleblower submission. There will be no substantive impact on whistleblowers as a result of this change, as the award percentages for 7623(b) claims and other claims are the same for submissions received after July 2010. In future reports, we will report separate statistics for each Operating Division.

## **B. Other Issues of Interest**

A number of additional issues exist in the administration of the Whistleblower Program.

- 1. Rules on access to and disclosure of taxpayer information could provide stronger protection for taxpayers.** A whistleblower can appeal any determination on an award under section 7623(b)(1), (2), or (3) of the Code to the Tax Court (section 7623(b)(4) of the Code). A meaningful right to appeal to Tax Court requires disclosure to the whistleblower of the basis for the award determination, which often will include taxpayer information that is protected from disclosure under section 6103. Consistent with section 6103(h), the IRM and the proposed regulations provide for disclosure of taxpayer information by the IRS to the whistleblower if the whistleblower enters into a confidentiality agreement and agrees not to disclose the information other than as permitted in that agreement.

The FY 2010 Annual Report noted two concerns regarding the disclosure of taxpayer information to the whistleblower as part of an award determination. First, current law does not provide an effective sanction if the whistleblower discloses taxpayer information in violation of the confidentiality agreement and section 6103(h). Second, the whistleblower may, against the wishes of the taxpayer, disclose the identity of the taxpayer in a Tax Court or other judicial proceeding. The taxpayer is not a party to any dispute between the IRS and a whistleblower over eligibility for or the amount of an award under section 7623, but both pleadings and court decisions in these cases routinely included details about the taxpayer. This second concern was addressed in a revision to Tax Court rules, which now require that taxpayer information be masked in documents filed with the Court. However, release of information during discovery in Tax Court proceedings is not addressed in the new rules and has brought a new set of concerns.

In cases brought before the Tax Court, whistleblowers who challenge IRS decisions on their award claims continue to raise questions about the separate decisions made regarding the taxpayer's liability and seek information through pre-trial discovery on those decisions. While the Tax Court has ruled in a few cases that its jurisdiction to consider whistleblower award claim appeals does not include the authority to order IRS action with respect to taxpayer liability, it has not yet ruled on the scope of permitted discovery. The ability of the IRS to successfully resist overbroad or otherwise improper whistleblower discovery requests related to taxpayer liability issues is unclear and an area of concern. There appears to be no effective sanction, and no effective restraint, when a whistleblower obtains confidential taxpayer information in discovery and chooses



to release that information to the public.<sup>26</sup> It is fundamentally unfair to the taxpayer, whose issues with the IRS have been fully resolved, to have confidential information revealed in a case where the taxpayer is not a party and has no interest—other than in the protection of its private taxpayer information.

- 2. The law does not provide for whistleblower protection.**<sup>27</sup> Unlike other laws that encourage whistleblowers to report information to the government, section 7623 does not prohibit retaliation against the whistleblower. When the whistleblower is an employee of the taxpayer, retaliation can take the form of a job-related action. In other cases, whistleblowers may face threats of physical harm or damage to economic interests. In such cases, whistleblowers reporting information under section 7623 may have recourse under state law, but federal law does not appear to provide a remedy.

The IRS has, as a matter of policy and as an application of section 6103, committed to protect a whistleblower's identity and even the fact that the agency received whistleblower information in a particular case. This commitment is qualified, however, as the IRS tells whistleblowers it may identify them if they are an essential witness in a judicial proceeding or if ordered to do so by a court of competent jurisdiction. Despite the IRS's commitment to protect whistleblower identities, litigation has highlighted a tension between the IRS's commitment to whistleblowers and its obligations in civil discovery. Certain litigants have sought information on informant involvement in tax matters even in cases where the government did not identify the whistleblower as a potential witness at trial. The appropriate response to such a request should be to neither confirm nor deny informant involvement, because a truthful denial in some cases will allow individuals to draw a conclusion in other cases. The authority to take this approach is premised in case law, however, and an adverse ruling on a discovery request could open the door to fishing expeditions to identify whistleblower involvement and targeted requests to determine whether particular individuals made whistleblower submissions.

- 3. There are statutory and computational limitations to determining what constitutes "collected proceeds."** The FY 2010 Annual Report highlighted issues related to the definition of collected proceeds. Potential taxpayer liabilities are sometimes resolved in a manner that does not result in collected proceeds from which an award may be paid. For example, if a taxpayer is prosecuted for a criminal violation of the internal revenue laws, a sentence after conviction may include fines. Criminal fines are not available to pay awards under section 7623 because the Victims of Crime Act (42 U.S.C. section 10601, et seq.) requires that all criminal fines be deposited in the Victims of Crime Fund.

The Whistleblower Office has identified another area where it cannot use recoveries from taxpayers to pay awards under section 7623. The IRS is responsible for administering internal revenue laws under Title 26 of the United

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<sup>26</sup> The IRS has sought protective orders from the Tax Court in some cases, but the court has not ruled on those requests. Even if such an order is issued by the court, the potential sanctions for violating the order may provide little meaningful deterrent for a whistleblower who is litigating a claim denial.

<sup>27</sup> This issue was included in the FY 2010 and 2011 reports.

States Code. The IRS has also been delegated responsibility to administer other laws, such as those related to the Bank Secrecy Act and Foreign Bank Account Reports (FBARs). The IRS has used FBAR penalties as an important component in its efforts to combat use of offshore bank accounts to evade U.S. tax obligations. However, those laws appear in Title 31 of the United States Code, which also provides for a separate award program for information that leads to the identification of violations. The authority to pay awards under section 7623 extends only to recoveries under title 26, and does not permit awards to be paid based on collection of FBAR penalties.

4. **The dollar amount thresholds for “gross income” and “amounts in dispute” should be clarified.**<sup>28</sup> Section 7623(b)(5) sets two thresholds for application of section 7623(b), which also serve to define the jurisdiction of the U.S. Tax Court to review whistleblower award determinations. The general rule applicable to all claims requires that “the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000.” The law also provides that subsection (b) shall apply “in the case of any individual [taxpayer], only if such individual’s gross income exceeds \$200,000 for any tax year....” Because neither term is defined in the statute, there is uncertainty in both the administration of the whistleblower program and in determining whether the U.S. Tax Court has jurisdiction to consider an appeal.

The “individual’s gross income” limitation was apparently included in the law to ensure that the focus of the award program under section 7623(b) is on relatively high income taxpayers. In the absence of a definition, the IRS must look to other provisions of the Internal Revenue Code to determine how to calculate “gross income.” This may require complex calculations in cases where allocation of partnership income or other similar issues apply. The IRS questions whether this effort is intended or justified, given that failure to satisfy the gross income threshold generally shifts the claim from a mandatory section 7623(b) claim to a discretionary section 7623(a) claim. To the extent that the individual income threshold was intended to provide a limit on U.S. Tax Court jurisdiction, the practical impact appears to be limited. Few cases involving individual taxpayers will exceed the \$2,000,000 threshold but not have at least one taxpayer whose income exceeds \$200,000 or at least one taxpayer that is not an individual.

Similar concerns pertain to the \$2,000,000 “amount in dispute” threshold. Section 7623(b)(5)(B) requires that “the tax, penalties, interest, additions to tax, and additional amounts in dispute” must exceed \$2,000,000. The term “in dispute” is not defined in the law, the legislative history, or elsewhere in the Internal Revenue Code, nor does the law or legislative history indicate the point at which the amount in dispute is determined. An allegation by a whistleblower does not create a dispute between the IRS and a taxpayer, nor does the amount asserted by the whistleblower to be owed by a taxpayer satisfy the statutory threshold. The IRS requires that the dispute in question be between the IRS and one or more taxpayers (or persons who may be required to pay penalties or “other amounts”). In cases where action is taken on multiple taxpayers as a result of

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<sup>28</sup> This issue was included in the FY 2010 and 2011 reports.

information provided by a whistleblower, the IRS aggregates the disputed amounts of multiple taxpayers to determine whether the \$2,000,000 threshold has been exceeded.

The IRS and whistleblowers would have greater certainty about the application of section 7623(b) if the “gross income” and “amount in dispute” thresholds were replaced by a reference to a threshold that can be reasonably ascertained, such as the amount of collected proceeds.

5. **The Whistleblower Office has limited information about the extent of the whistleblower’s contribution in some criminal cases.**<sup>29</sup> In some criminal cases, information available to the Whistleblower Office on the extent of the whistleblower’s contribution may be limited by grand jury secrecy rules. The Whistleblower Office may not review and consider grand jury information protected from disclosure under the Federal Rules of Criminal Procedure unless an exception to the secrecy rules is granted on a case-by-case basis. Without that information, it may not be possible for the Whistleblower Office to independently assess the extent of the whistleblower’s contribution when making a determination regarding an award under section 7623.

## V. Whistleblower Awards Paid

The table below provides information on informant claims paid. The IRS cannot make an award determination until the underlying taxpayer matter is completed, including any administrative or judicial appeals the taxpayer may choose to pursue. Whistleblowers are advised that this process may take five to seven years and longer when there are protracted appeals or collection actions. In FY 2011, the first awards were paid based on information submitted under the 2006 amendments to section 7623. However, most awards have been based on claims covered by the pre-2006 law. Taxpayer privacy laws do not permit the publication of data on specific claims, and allow reporting on consolidated data only when the number of claims paid is large enough to produce a statistical report. The number of claims paid under 7623(b) is too small to qualify for separate reporting, so that data has not been segregated from other award payments made in FY 2012. For most of the cases included in the table below, the applicable award percentages were those established in prior IRS policy, not the higher percentages set by the 2006 law.

The number and amount of awards paid each year can vary significantly, especially when a small number of high-dollar claims are resolved in one year (as was the case in FY 2008). One factor contributing to the lower award payments in FY 2009 was a change in the IRS definition of the point at which proceeds in a tax case are available to make an award payment. In the past, the IRS monitored the tax case to ensure that it collected proceeds before processing the award claim. Where the taxpayer filed an administrative or judicial appeal, the IRS did not pay claims until the court finally resolved the appeal. The IRS determined that it should not pay claims even when the taxpayer has not filed an appeal until the period for filing an appeal has lapsed. The general rule is that a taxpayer may file a claim for refund within two years of the last

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<sup>29</sup> This issue was included in the FY 2010 and 2011 reports.

payment, unless he or she has waived that right. Thus, beginning in July 2009, the IRS monitors cases for both collection and the lapse of the period for filing a claim for refund.

**(Table 4)**  
**Amounts Collected and Awards Paid under 7623 FY 2008-2012<sup>30</sup>**  
**(as of 9/30/2012)**

	2008	2009	2010	2011	2012
<b>Cases Received</b>	3,704	5,678 <sup>31</sup>	7,577	7,471	8,634
<b>Awards Paid</b>	198	110	97	97	128
<b>Collections over \$2,000,000</b>	8	5	9	4	12
<b>Total Amount of Awards Paid<sup>32</sup></b>	\$22,370,756	\$5,851,608	\$18,746,327	\$8,008,430	\$125,355,799
<b>Amounts Collected<sup>33</sup></b>	\$155,985,834	\$206,032,872	\$464,695,459	\$48,047,500	\$592,498,294
<b>Awards paid as a percentage of amounts collected</b>	14.3%	2.8%	4.0%	16.7%	21.2%

<sup>30</sup> All awards paid from FY 2007 through FY 2010 were paid under section 7623(a), the pre-amendment law governing award claims. FY 2011 and FY 2012 include a limited number of awards paid under 7623(b).

<sup>31</sup> The implementation of a new case management information system included changes in the way the IRS recorded submissions under 7623(a). The IRS cannot determine the extent to which this change was a factor in the higher number of cases received after the new system was implemented in FY 2009.

<sup>32</sup> The amount of awards paid includes both fully-paid awards and partially-paid awards. In FY 2012, there were four partial payments.

<sup>33</sup> The "amounts collected" reflects proceeds attributed to the whistleblowers used to compute awards under section 7623 for the relevant year. The actual payments by taxpayers generally occurred in prior years.

## **VI. Appendix: Revised Section 7623 and other provisions of law**

### **A. Revised 26 USC Section 7323**

TITLE 26 - INTERNAL REVENUE CODE

Subtitle F - Procedure and Administration

CHAPTER 78 - DISCOVERY OF LIABILITY AND ENFORCEMENT OF TITLE

Subchapter B - General Powers and Duties

Sec. 7623. Expenses of detection of underpayments and fraud, etc.

(a) In General- The Secretary, under regulations prescribed by the Secretary, is authorized to pay such sums as he deems necessary for -

(1) detecting underpayments of tax, or

(2) detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same,

in cases where such expenses are not otherwise provided for by law. Any amount payable under the preceding sentence shall be paid from the proceeds of amounts collected by reason of the information provided, and any amount so collected shall be available for such payments.

(b) Awards to Whistleblowers-

(1) IN GENERAL- If the Secretary proceeds with any administrative or judicial action described in subsection (a) based on information brought to the Secretary's attention by an individual, such individual shall, subject to paragraph (2), receive as an award at least 15 percent but not more than 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 in response to such action. The determination of the amount of such award by the Whistleblower Office shall depend upon the extent to which the individual substantially contributed to such action.

(2) AWARD IN CASE OF LESS SUBSTANTIAL CONTRIBUTION-

(A) IN GENERAL- In the event the action described in paragraph (1) is one which the Whistleblower Office determines to be based principally on disclosures of specific allegations (other than information provided by the individual described in paragraph (1)) resulting from a judicial or administrative hearing, from a governmental report, hearing, audit, or investigation, or from the news media, the Whistleblower Office may award such sums as it considers appropriate, but in no case more than 10 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 in response to such action, taking into account the significance of the individual's information and the role of such individual and any legal representative of such individual in contributing to such action.

(B) NONAPPLICATION OF PARAGRAPH WHERE INDIVIDUAL IS ORIGINAL SOURCE OF INFORMATION- Subparagraph (A) shall not apply if the information resulting in the initiation of the action described in paragraph (1) was originally provided by the individual described in paragraph (1).

(3) REDUCTION IN OR DENIAL OF AWARD- If the Whistleblower Office determines that the claim for an award under paragraph (1) or (2) is brought by an individual who planned and initiated the actions that led to the underpayment of tax or actions described in subsection (a)(2), then the Whistleblower Office may appropriately reduce such award. If such individual is convicted of criminal conduct arising from the role described in the preceding sentence, the Whistleblower Office shall deny any award.

(4) APPEAL OF AWARD DETERMINATION- Any determination regarding an award under paragraph (1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).

(5) APPLICATION OF THIS SUBSECTION- This subsection shall apply with respect to any action--

(A) against any taxpayer, but in the case of any individual, only if such individual's gross income exceeds \$200,000 for any taxable year subject to such action, and

(B) if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000.

(6) ADDITIONAL RULES-

(A) NO CONTRACT NECESSARY- No contract with the Internal Revenue Service is necessary for any individual to receive an award under this subsection.

(B) REPRESENTATION- Any individual described in paragraph (1) or (2) may be represented by counsel.

(C) SUBMISSION OF INFORMATION- No award may be made under this subsection based on information submitted to the Secretary unless such information is submitted under penalty of perjury.'

## **B. Other provisions of Section 406 of the Tax Relief and Health Care Act of 2006**

(a)(2) ASSIGNMENT TO SPECIAL TRIAL JUDGES-

(A) IN GENERAL- Section 7443A(b) (relating to proceedings which may be assigned to special trial judges) is amended by striking 'and' at the end of paragraph (5), by redesignating paragraph (6) as paragraph (7), and by inserting after paragraph (5) the following new paragraph:

(6) any proceeding under section 7623(b)(4), and'.

(B) CONFORMING AMENDMENT- Section 7443A(c) is amended by striking '(5) or (6)' and inserting '(5), or (6)'.

(3) DEDUCTION ALLOWED WHETHER OR NOT TAXPAYER ITEMIZES- Subsection (a) of section 62 (relating to general rule defining adjusted gross income) are amended by inserting after paragraph (20) the following new paragraph:

(21) ATTORNEYS FEES RELATING TO AWARDS TO WHISTLEBLOWERS- Any deduction allowable under this chapter for attorney fees and court costs paid by, or on behalf of, the taxpayer in connection with any award under section 7623(b) (relating to awards to whistleblowers). The preceding sentence shall not apply to any deduction in excess of the amount includible in the taxpayer's gross income for the taxable year on account of such award.'

(b) Whistleblower Office-

(1) IN GENERAL- Not later than the date which is 12 months after the date of the enactment of this Act, the Secretary of the Treasury shall issue guidance for the operation of a whistleblower program to be administered in the Internal Revenue Service by an office to be known as the 'Whistleblower Office' which--

(A) shall at all times operate at the direction of the Commissioner of Internal Revenue and coordinate and consult with other divisions in the Internal Revenue Service as directed by the Commissioner of Internal Revenue,

(B) shall analyze information received from any individual described in section 7623(b) of the Internal Revenue Code of 1986 and either investigate the matter itself or assign it to the appropriate Internal Revenue Service office, and

(C) in its sole discretion, may ask for additional assistance from such individual or any legal representative of such individual.

(2) REQUEST FOR ASSISTANCE- The guidance issued under paragraph (1) shall specify that any assistance requested under paragraph (1)(C) shall be under the direction and control of the Whistleblower Office or the office assigned to investigate the matter under paragraph (1)(A). No individual or legal representative whose assistance is so requested may by reason of such request represent himself or herself as an employee of the Federal Government.

(c) Report by Secretary- The Secretary of the Treasury shall each year conduct a study and report to Congress on the use of section 7623 of the Internal Revenue Code of 1986, including--

(1) an analysis of the use of such section during the preceding year and the results of such use, and

(2) any legislative or administrative recommendations regarding the provisions of such section and its application.

(d) Effective Date- The amendments made by subsection (a) shall apply to information provided on or after the date of the enactment of this Act.