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The IRS's Proposed Amendments to Its Informant Award Program

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For the third consecutive year, the Internal Revenue Service has failed to pay any informants under its newly minted whistleblower program. The old program, which was first codified in 1867, was generally considered a disappointment. In 2006, Congress passed the Tax Relief and Health Care Act, which created the IRS Whistleblower office and made rewards to whistleblowers less discretionary.

Iowa Republican Sen. Charles Grassley, a staunch supporter of whistleblowers, was the strongest congressional voice in support of the whistleblower provisions. This new program received an impressive 460 informant submissions in fiscal year 2009 alone. These submissions identified 1,941 taxpayers who were accused of avoiding more than \$2 million each in taxes, penalties and interest.

And what did those whistleblowers receive from the IRS? Absolutely nothing. On Jan. 18, the IRS published notice of proposed rulemaking that will redefine how whistleblowers may be compensated by the government. Perhaps the proposed rules indicate renewed interest and investment in the whistleblower program and the days of bountiful tips and no rewards could soon be coming to an end.

The Procedure

Under Internal Revenue Code 7623(a), the IRS shall pay awards to people who provide "specific and credible information" to the IRS if the information results in the collection of taxes, penalties, interest or other amounts from a noncompliant taxpayer. The IRS wants specific information about significant tax issues.

"Significant" is defined by the IRS as taxes, penalties, and interest owed in excess of \$2 million. This is not the venue to report speculative concerns, air personal disputes, drop a dime on a former spouse, or to report isolated events such as a waiter failing to declare his tips as income.

There are two basic tracks currently in place for whistleblower complaints that are filed with the IRS. On the first track, whistleblowers submit information concerning amounts in dispute — back taxes, interest and penalties — in excess of \$2 million. In these cases, the IRS is looking for non-compliant taxpayers with annual gross income of more than \$200,000. If the IRS successfully obtains a recovery from a non-compliant taxpayer, the IRS is required to pay the whistleblower between 15 and 30 percent of the recovery. Whistleblowers on this track who are not satisfied with the reward may appeal to the U.S. Tax Court located in Washington, D.C.

The second track applies to cases involving less than \$2 million in dispute. If the IRS obtains a recovery in these cases, payment of a reward to the whistleblower is discretionary, with a maximum of 15 percent of the recovery up to a maximum of \$10 million. Whistleblowers on this track cannot appeal to the U.S. Tax Court.

A Waiting Game

When one thinks of a "whistleblower case," the successful Federal False Claims Act (FCA), 31 U.S.C. 3729, et seq., comes to mind. In the 25 years since that statute was amended, the government has recovered \$28 billion from individuals and corporations who have submitted false claims for payment.

Practitioners, however, should be aware that the procedures under the IRS Informant Award Program are very different from those of the FCA. In FCA cases, the whistleblower and legal counsel are often actively engaged with the government in investigating and even prosecuting the case. The percentage awarded to the whistleblowers in those cases is statutorily prescribed and largely dependent upon the assistance rendered by the whistleblower and his or her counsel throughout the process. The FCA allows the whistleblower to become a plaintiff in litigation against the fraudster and also provides for the recovery of reasonable attorneys fees and costs incurred in prosecuting the case.

The IRS program is significantly different. Under the IRS program, a whistleblower and counsel file a single form (IRS Form 211). All information the whistleblower wishes to share as the basis of a potential investigation and possible recovery must accompany that form.

It behooves whistleblowers to provide as much detail and supporting evidence with their submissions at the inception of the case to maximize the potential reward. The government decides whether to investigate the case based upon the whistleblower's credibility, so providing verifiable details in responses to the questions on IRS Form 211 is essential.

Attorneys provide valuable assistance to whistleblowers in presenting compelling submissions to the government. Practitioners should be aware that, unlike the FCA, IRS whistleblowers are not named plaintiffs and the United States Code does not provide for the recovery of attorney fees in these cases. Thus, fee arrangements in IRS whistleblower cases are typically contingent.

An attractive component of the IRS program is its confidentiality. According to the IRS's website, the service protects the identity of whistleblowers "to the fullest extent permitted by law." Under some circumstances, a whistleblower might become a necessary witness in a judicial proceeding. The IRS will inform the whistleblower if such a situation arises and will assess whether to proceed with the case.

The drawback of confidentiality is that the whistleblower does not have open access to the status of the government's case. The government will confirm receipt of the whistleblower's claim, but thereafter it is largely a game of "hurry up and wait" for a check in the mail. There is no way to know if the IRS follows up on the proffered allegations. Given the current state of affairs in the IRS, that wait could be many years. The IRS must wait until all appeal rights of the offending taxpayer have either expired or been exhausted before a reward to the whistleblower is even contemplated.

The IRS Whistleblower Executive Board was created in July 2008 and meets periodically to address the administration of the whistleblower program. Unfortunately, the board has not yet reviewed a single award claim recommendation or determination under the new program.

Proposed Changes

With the apparent proliferation of fraud, waste, and abuse in all programs and agencies of the United States, the IRS proposed changes on Jan. 18 to increase the utility and efficiency of its whistleblower program. For instance, the proposed amendments allow for rewards to be paid to whistleblowers if the information they provide results in the denial of a claim for a refund that the IRS would have otherwise paid or reduces an overpayment credit balance.

In other words, if the whistleblower's tip prevents the IRS from paying an improper refund to the putative defendant, the amount of that refund will be included in the calculation of the recovery by the government. This represents a significant change from the law as it currently stands. It seeks to monetize prospective violations as opposed to recovering amounts that previously were paid. Similarly, if the whistleblower provides the IRS with information that a putative defendant tried to claim a fraudulent loss as an offset to tax liability, the resulting amount of taxes owed will be included when calculating the whistleblower's reward.

These proposed changes, if adopted, will open the whistleblower program up to a whole new population of citizens with credible information. Claims for rewards that would have previously been denied may now be granted.

Moving Forward

If the proposed rules are implemented, whistleblowers will likely become a larger part of the government's fight against fraud, waste and abuse. It is incumbent upon the IRS to act swiftly and decisively upon information provided if it hopes to prove the credibility of the new amendments. The current statutory incentive to whistleblowers is no incentive at all — awards have not been paid in three years. If utilized correctly, the proposed rules will assist the IRS in preventing fraud before it occurs — which is the goal, after all.

When a tip comes in that substantial refunds in the queue for payment should be stopped, the IRS must investigate quickly and thoroughly. The spotlight on fraud and the IRS's efforts to stop rampant abuses are positive developments. Time will

tell how effective these changes will be.

Whistleblowers Create Revenue

It is commendable that the federal government has recognized the flaws in this program to date. Even the architect of the 2006 amendments, Sen. Grassley, said he hopes "the IRS will work faster to process the whistleblower submissions, try not to accumulate a backlog, and stop as many big-dollar fraud operations as possible." Until the IRS starts paying out claims, however, no one will take the program seriously. The IRS must understand that whistleblowers create revenue: The government keeps between 70 and 85 percent of every recovery initiated by a whistleblower.

The financial future of the IRS is uncertain. In his fiscal 2012 budget proposal, President Obama seeks to add approximately \$1.1 billion to the overall IRS budget, envisioning thousands of additional employees working to collect unpaid taxes and target offshore tax evaders. On Feb. 9, however, Republicans in the U.S. House of Representative placed the IRS squarely on the chopping block. The House Appropriations Committee has recommended cutting the IRS's budget by \$593 million. The IRS can use all possible assistance from private citizens right now, and whistleblowers provide not just labor in uncovering fraud but open invitations for the IRS to increase its collections. •

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