TAF EDUCATION FUND
TAXPAYERS AGAINST FRAUD

April 18, 2011

Via Federal e-Rulemaking Portal

Ms. Kristen N. Witter
Internal Revenue Service
Box 7604
Ben Franklin Station
Washington DC 20044

Re: Comments On Proposed Treasury Regulation Section 301.7623-1
CC:PA:LPD:PR (Reg-131151-10)

Dear Ms. Witter

Taxpayers Against Fraud Education Fund ("TAFEF") submits these comments in response to the IRS' proposed rulemaking governing the Service's whistleblower program, codified at 26 U.S.C. §7623. TAFEF is a national non-profit, public interest organization dedicated to combating fraud through the promotion and use of federal and state whistleblower laws. TAFEF's membership includes nearly 400 attorneys who represent whistleblowers and assist federal and state governments to recover funds lost through fraudulent and corrupt business practices. TAFEF is uniquely situated to comment on the factors necessary to a successful whistleblower program. Since 1986, TAFEF's members have represented whistleblowers in federal False Claims Act ("FCA") matters that have generated tens of billions of dollars in civil and criminal recoveries, and set records for Department of Justice success. The FCA's whistleblower provisions are recognized to be the Justice Department's chief civil fraud enforcement tool,[1] and are a

---

1 See H.R. Rep. No. 99-660, p. 18 (1986) ("[T]he False Claims Act is used as ... the primary vehicle by the Government for recouping losses suffered through fraud").

1220 19th Street, NW Suite 501 Washington, DC 20036 phone (202) 296-4826 fax (202) 296-4838
www.taf.org or taf-info@taf.org

model for the states[2] and the Internal Revenue Service[3] which have adopted similar whistleblower statutes.

The Service has requested public comment regarding proposed guidance that seeks to clarify the meaning of "collected proceeds" as it relates to the payment of awards under Section 7623, which provides that a whistleblower receive a percentage share 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." Section 7623(b)(1) and (2).

Proposed Section 301.7623-1 reads, in pertinent part, as follows:

> (2) Proceeds of amounts collected and collected proceeds. For purposes of section 7623 and this section, both proceeds of amounts collected and collected proceeds include: tax, penalties, interest, additions to tax, and additional amounts collected by reason of the information provided; amounts collected prior to receipt of the information if the information provided results in the denial of a claim for refund that otherwise would have been paid; and a reduction of an overpayment credit balance used to satisfy a tax liability incurred because of the information provided.

Proposed Section 301.7623-1 revisits the earlier proposed definition of the term "collected proceeds," (proposed I.R.M. 25.2.2.1, June 18, 2010), which excluded amounts by which a credit balance is reduced or a claim for refund is denied as a result of whistleblower's information.[4]

---

2 At least twenty eight states have enacted false claims statutes that include whistleblower provisions modeled on the federal False Claims Act.

3 See Internal Revenue Code Sections 7623(a) and (b).

4 Proposed I.R.M. 25.2.2.1 (06-18-2010) provided, in relevant part, as follows:

> "Collected proceeds" are the monies the Service obtains directly from a taxpayer(s) which are based upon the information the whistleblower has provided. Award claims may not be paid under 7623(a) or (b) which are based on information which leads to the denial of a claim for refund which otherwise would have been paid. Criminal fines, which must be deposited into the Victims of Crime Fund, cannot be used for payment of whistleblower awards. Awards

TAFEF agrees that amounts collected through offsets of credit balances or denials of claims for refund are appropriately included in the definition of "collected proceeds." Such amounts have historically been deemed part of "collected proceeds" by the IRS even prior to the 2006 amendments to the IRS whistleblower program.[5] However, as detailed below, the proposed guidance does not go far enough in clarifying additional common situations where "collected proceeds" will be obtained as a result of whistleblower information, and thus creates unnecessary uncertainty for whistleblowers.

Specifically, proposed Section 301.7623-1 should be clarified to provide explicitly that collected proceeds (1) include offsets against net operating losses as well as offsets against taxpayer-favorable adjustments, where such offsets inure to the financial benefit of the United States; and (2) to clarify that criminal (as well as civil) penalties are "collected proceeds."

---

may not be paid on the taxpayer(s) liabilities satisfied by the reduction of a credit balance as monies are not obtained based on the information the Whistleblower provided.

5 Section 26 C.F.R. 301.7623-1 historically stated the following:

> "(a) . . . .The rewards provided for by section 7623 and this section will be paid from the proceeds of amounts (other than interest) collected by reason of the information provided. For purposes of section 7623 and this section, proceeds of amounts (other than interest) collected by reason of the information provided include both additional amounts collected because of the information provided and amounts collected prior to receipt of the information if the information leads to the denial of a claim for refund that otherwise would have been paid."
>
> ***
>
> (g) *Effective date.* This section is applicable with respect to rewards paid after January 29, 1997. [T.D. 8780, 63 FR 44778, Aug. 21, 1998].

1. "Collected Proceeds" Should Include Quantifiable Non-Contingent Values Received by the Federal Treasury as a Result of Whistleblower Information

Section 7623(b) states broadly that "additional amounts" beyond tax, penalties and interest are included in the "collected proceeds" that are the basis of an award. Accordingly, to be consistent with Congressional intent, "collected proceeds" that form the bases of whistleblower rewards must include all quantifiable, non-contingent values received by the federal Treasury - be they direct monetary payments or "additional amounts" resulting from offsets.

Proposed Section 301.7623-1 only specifically references two categories of offsets, *viz*, denials of claims for refund and offsets of credit balances. But equivalent values may be collected by the federal Treasury in other ways as well. Two common examples are offsets against carried net operating losses ("NOLs") or offsets against unrelated, taxpayer-favorable adjustments.

There is no meaningful analytical distinction between an offset against a credit balance and an offset against NOLs or an unrelated, taxpayer-favorable adjustment. For example, with regard to NOLs, if a whistleblower claim identifies improper NOLs generated by a taxpayer in year one, and that information results in the taxpayer paying taxes, rather than using the improper NOLs in year two, then the federal Treasury has plainly gained a measurable, quantifiable financial benefit. Likewise, in cases where an assessment based on whistleblower information financially benefits the government by offsetting an otherwise unrelated, taxpayer-favorable adjustment, the value of the offset against the adjustment is a measurable benefit to the Treasury.[6] In these instances the

---

6 An example of an unrelated, taxpayer-favorable adjustment is found at I.R.M. Exhibit 25.2.211, Section 3, "Sample Preliminary Award Report". That example describes a situation where the whistleblower information led to a $5.25 million taxpayer assessment. However, in this example there was also a favorable taxpayer adjustment of $1.25 million. The total amount actually paid (excluding interest) by the taxpayer was $4 million (whistleblower assessment – taxpayer adjustment). Even though the whistleblower information led to the $5.25 million assessment, in this example he was only awarded based on the net $4 million. Awards should not be based on the net amount

whistleblower's award must be based on the entire value received by the Treasury – whatever the form such value takes.

TAFEF recognizes that in rare cases NOLs carried forward may be so large that they will never be fully extinguished, but by making clear that "collected proceeds" includes offsets that result in measurable and non-contingent financial value to the Treasury, the IRS would only be required to pay awards where the NOLs have been extinguished. That is, only if and when the taxpayer's NOLs are fully utilized, and tax paid on income that would have otherwise been offset by improper NOLS, would a whistleblower award be ripe for payment.

Case precedent under the analogous whistleblower award provisions of the False Claims Act, 31 U.S.C. §3729 et seq., strongly supports this approach. The FCA provides the successful whistleblower with a 15 to 30 percent share of "the proceeds of the action or settlement of the claim." The majority of courts that have considered a whistleblower's entitlement to a share of non-cash recoveries agrees that to the extent that the Government receives a benefit (cash or otherwise), the whistleblower is entitled to receive a share.[7] Similarly, whistleblowers share when the Government's obligation to

---

paid where there are unrelated adjustments, but on the total tax liability resulting from the whistleblower's information.

7 For example, United States, ex rel. Thornton v. Science Applications Int'l Corp., 207 F.3d 769 (5th Cir. 2000), held that the value of settled claims in a non-cash recovery should be included as part of a relator's share award. Thornton further concluded that the government has a duty to advise the relator of the value of the settlement, including the non-cash proceeds. United States, ex rel. Barajas v. United States, 258 F. 3d 1004 (9th Cir. 2001), likewise ruled that settlement proceeds need not always consist of money or some tangible asset, and that a whistleblower was entitled to a share of the value of a non-cash settlement. In Barajas, the court concluded that the whistleblower should share in the value of repairs to faulty data transmitters - non-cash services valued at as much as $10 million dollars. See also United States ex rel. Nudelman v. International Rehabilitation Associates, 2005 US Dist. LEXIS 9605 (E.D. Penn. 2005), concluding that the relator should share in the value of three year monitoring agreement (valued at $1.5 million).

pay is reduced or eliminated. For example, defendants in health care matters may have federal reimbursements unrelated to the fraud owing to them. To the extent the value of those reimbursements is used as non-cash satisfaction of all or a portion of the defendant's settlement payment, they are included in the basis for the whistleblower award. The reason is evident – the Government receives the value of not having to pay reimbursements to a defendant in the same way that it receives value from having the defendant's settlement payment wired directly to the Treasury.

The same approach should be adopted by the IRS in defining "collected proceeds." Whenever the Treasury recovers measurable, current value, it should be included in the basis of a whistleblower award. If the value is contingent then an award is not made unless and until it is current.

Following this approach would not only be consistent with Congress' intent and basic notions of fairness; it would also be good public policy. The manifest purpose of the whistleblower program is to attract quality whistleblowers. The current definition of collected proceeds is incomplete and thus creates a level of uncertainty for whistleblowers considering stepping forward that will erode the IRS whistleblower program's future prospects. In many instances, whistleblowers will not know when they make a submission whether the taxpayer will be carrying net operating losses or whether there may be an unrelated taxpayer-favorable adjustment at the point their allegations are resolved. Without some assurance that they will still be rewarded in such circumstances, if the government obtains a non-contingent, quantifiable financial benefit as a result of their information, whistleblowers will understandably be chilled from coming forward.

2. The Definition of "Collected Proceeds" Should Be Clarified To Include Criminal Penalties And Sanctions

The Tax Relief and Health Care Act of 2006 ("TRHCA") specifically provides that "collected proceeds" include "penalties." Significantly, TRHCA does not distinguish civil from criminal penalties, nor does it distinguish criminal "fines" from criminal "penalties." Congress' use of inclusive term "penalties" indicates that all types of penalty – be they criminal or civil; fine or other sanction – penalties are intended to be included in the definition of "collected proceeds."

Notwithstanding TRHCA's broad statutory language, Proposed IRM 25.2.2.1(7) specifically excludes criminal "fines" from the definition of "collected proceeds," and reverses the Service's longstanding practice of including such fines in proceeds that form the basis of the whistleblower's award. In doing so, Proposed IRM 25.2.2.1 is contrary to TRHCA and makes a distinction between criminal penalty and fine that does not exist in the Code. A "fine" is simply a subset of the broader category of "penalties" that can also include imprisonment or other consequences like disbarment. See, e.g., 26 USC § 7201 ("Any person who willfully attempts to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be imprisoned not more than 5 years, or fined not more than $250,000 for individuals . . . .") (Emphasis added.); see also 26 U.S.C. 162(f) (disallowing deductions for "any fine or similar penalty paid to a government for the violation of any law"); 26 CFR 1.162-21(b)(1)(iii) ("For purposes of this section a fine or similar penalty includes an amount paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal)").

The Proposed IRM should be clarified to include criminal penalties of all sorts in the definition of "collected proceeds."

3. Rewards For Whistleblower Submissions Made Before The Tax Relief and Health Care Act of 2006 Was Enacted Should Be Capped At $10 Million

Prior to TRHCA, rewards under the IRS' predecessor whistleblower program were discretionary and subject to varying caps. Before August 1997, whistleblower awards were capped at $100,000. In August 1997, the award cap was raised to $2 million. And in August 2004, the cap was again raised – to $10 million.

It had long been the policy and practice of the IRS to make awards according to increased caps in place at the time of award, rather than the time of submission. This approach is consistent with the policies underlying a decision to increase the amount of whistleblower awards, and promotes the program's overall goals. Among other things, higher awards on earlier cases serve to encourage future high-quality whistleblowers to take the substantial risk of stepping forward with information about tax abuses.

The legislative history for TRHCA indicates that Congress also intended that IRS whistleblowers be rewarded up to the increased cap in place at the time of award, rather than the time the whistleblower makes his submission. "The reward ceiling is $10 million (for payments made after November 7, 2002), and the reward floor is $100." (Emphasis added.) See Joint Comm. On Taxation Staff Report, JXC 50-06, Dec. 7, 2006 at 88; Joint Comm. On Taxation Staff Report, JCS-1-07, Jan. 17, 2007 at 745. Earlier Internal Revenue Manuals are consistent with this approach as well. The IRM published December 30, 2008 states that "For award claims filed prior to December 20, 2006. . . " the Service will pay awards at varying percentage levels with the "award not exceeding $10 million." I.R.M. 25.2.2.9.1 (Dec. 30, 2008). And as recently as early 2010, the IRS' "FAQ" page regarding whistleblower awards published that "The discretionary maximum percentage of award for an (a) [Section 7623(a) case is 15 percent, up to $10 million." (Emphasis added.)

Without explanation, the IRS reversed its longstanding practice and existing Internal Revenue Manual policy and imposed a new rule that caps awards according to the limits in place at the time of submission rather than award. See e.g., Proposed Exhibit 25.2.2-13, "Award Calculation Computation Guidelines." Thus, rather than capping the awards of all pre-December 20, 2006 claims at $10 million, the Service proposes to impose caps of $100,000 and $2 million on some awards.

This reversal is both arbitrary and inconsistent with Congressional intent. The IRM should be revised to reflect the Service's longstanding and published policy of awarding whistleblowers who submitted claims prior to December 20, 2006 up to a cap of $10 million.

If you have any questions or would like to clarify any of the foregoing comments, please do not hesitate to contact us.

Susan Strawn, Esq.
President
Taxpayers Against Fraud
Education Fund
(202) 296-4826, ext. 22

Cleveland Lawrence III, Esq.
Director of Legal Education
Taxpayers Against Fraud
Education Fund
(202) 296-4826, ext. 27

Erika Kelton, Esq.
Phillips & Cohen, LLP
(202) 833-4567
Co-Chair
IRS Whistleblower Committee
Taxpayers Against Fraud
Education Fund

Paul D. Scott, Esq.
Law Offices of Paul D. Scott, P.C.
(415) 981-1212
Co-Chair
IRS Whistleblower Committee
Taxpayers Against Fraud
Education Fund