

## **Executive Summary**

Section 7623(b), providing for whistleblower awards, was enacted as part of the Tax Relief and Health Care Act of 2006 (the Act). For information provided to the Internal Revenue Service (IRS) after December 19, 2006, new section 7623(b) generally requires the IRS to pay awards on amounts in dispute over \$2 million if information provided by an individual results in the collection of tax, penalties, interest, and other amounts. The law sets award ranges based on percentages of the collected proceeds, with the award in particular cases to be determined by a Whistleblower Office that operates at the direction of the IRS Commissioner. On February 2, 2007, the IRS announced the appointment of Stephen Whitlock as the first Director of the IRS Whistleblower Office.

Section 406(c) of the Act requires the Secretary of the Treasury to conduct a study and report to Congress each year on the use of section 7623, including an analysis of the use of that section and the results obtained, as well as any legislative or administrative recommendations regarding section 7623 and its application. This is the first report submitted in accordance with that requirement and it discusses the progress made by the IRS Whistleblower Office in the first 12 months of its existence. The report includes a review of the law and regulations applicable to whistleblower awards, changes made in program administration since the Act, the status of new program guidance required by the Act, and data on awards paid

The overarching purpose behind the Act was to provide incentives for persons with knowledge of significant tax noncompliance to come forward and assist the IRS. With a few notable exceptions, pre-amendment submissions under section 7623 were dominated by claims well below the \$2,000,000 threshold set in the new law. Only 12 of 227 pre-amendment full paid claims in 2007 involved collections of more than \$2 million, and only 3 involved collections of more than \$10 million. In contrast, in the twelve months since the Whistleblower Office was established, the IRS received 116 submissions that each alleged more than \$2 million in tax noncompliance, 24 of which alleged more than \$10 million. The individuals submitting this information claim to have inside knowledge of the transactions they are reporting, often with extensive documentation to support their claims.

# Program History

## *Prior Law and Policy*

The IRS has had the authority to pay awards to whistleblowers<sup>1</sup> for many years. What is now section 7623(a)<sup>2</sup> of the Internal Revenue Code (IRC) has its origins in legislation enacted in 1867. The original law provided the Secretary 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.” Prior to 1996, payments were made from appropriated funds. Amendments in that year expanded the purposes for which awards may be paid, adding “detecting underpayments of tax” as a basis for making an award. The 1996 amendments also changed the source of funds from IRS operating funds to proceeds of amounts collected from the taxpayer (other than interest).<sup>3</sup>

Prior to the 2006 amendments to section 7623, awards to whistleblowers were discretionary, and the amount was determined based on IRS policy.<sup>4</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%, 10% or 15% of proceeds, generally not to exceed \$10 million.

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 provided by the whistleblower<sup>5</sup>. Common reasons for rejecting claims were

- the information provided was of no value,
- the information was already known to the IRS or available in public records, or
- there was no collection of taxes and penalties from which an award could be paid.

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.

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<sup>1</sup> The IRS has generally referred to persons who submit information under Section 7623 as “informants,” and referred to the program as the “Informant Claims Program.” Since the law now refers to “whistleblowers,” that term will be used in this report except where the term “informant” appears in an office title or published document.

<sup>2</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 were not incorporated into the Internal Revenue Code.

<sup>3</sup> The IRS has separate authority to pay informant expenses from appropriated funds available for confidential Criminal Investigation expenditures. Those payments are made under authorities delegated to IRS CI, and are not within the scope of the Whistleblower Office or this report to Congress.

<sup>4</sup> Regulations implementing what is now section 7623(a) appear at 26 CFR 301.7623-1. The most recent version of the policy was issued in 2004, as Policy Statement P-4-27, and reprinted as Publication 733.

<sup>5</sup> IRM 25.2.2.17

## ***New Law***

Section 7623(b) was created by section 406 of the Tax Relief and Health Care Act of 2006 (the Act) (PL 109-432). Section 7623(b) established a mandatory whistleblower award program that included a new Whistleblower Office. The Whistleblower Office operates at the direction of the Commissioner of Internal Revenue. It coordinates and consults with other divisions of the IRS as directed by the Commissioner, analyzes information submitted, and makes award determinations. The Whistleblower Office may investigate the matter itself, or assign it to the appropriate IRS office for investigation. Determinations by the Whistleblower Office may be appealed to the US Tax Court.

A whistleblower must meet several conditions to qualify for the mandatory award program<sup>6</sup>. In order 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;
- relate to a taxpayer, and in the case of an individual taxpayer, one whose gross income exceeds \$200,000 for at least one of the tax years in question; and
- substantially contribute to a decision to take administrative or judicial action that results in the collection of tax, penalties, interest, additions to tax and additional amounts.

If the above conditions are met, the whistleblower must receive 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 is reduced to 10 percent for cases based principally on specific allegations disclosed in listed information sources (such as government audit reports), and may also be reduced if the whistleblower planned and initiated the actions that led to the underpayment of tax.

## ***Implementing the New Law***

On February 2, 2007, the IRS announced the appointment of Stephen Whitlock as the first Director of the Whistleblower Office. One of his first actions was to participate in a forum sponsored by the Senate Finance Committee, which brought together Government and private sector stakeholders to share their perspectives and expectations regarding the whistleblower program. Almost immediately, the IRS began to receive submissions from whistleblowers with allegations of tax noncompliance well in excess of the \$2 million threshold in section 7623(b). Thus, the IRS began processing cases under the new law even as it was working on the most basic questions of program design.

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<sup>6</sup> If the submission does not meet the criteria for 7623(b) consideration, it may be considered for an award under the pre-Act discretionary authority (what is now section 7623(a)).

## **Actions Taken in the First Twelve Months**

Staffing: The Whistleblower Office has a staff of eight, that includes six analysts with decades of experience in a broad array of IRS compliance programs.

Program Analysis: The IRS reviewed the pre-amendment Informant Awards Program to understand its strengths and weaknesses, the existing program controls, and the status of improvement initiatives. This included a comprehensive study of regulations, policies and guidelines, prior internal and external oversight reports, and case files on recent award decisions. The Director of the Whistleblower Office and staff met with IRS employees familiar with the Informant Awards Program, including those involved in receipt and analysis of whistleblower submissions, those who conduct or supervise examinations and investigations based on those submissions, and those involved in award decisions and payment. They also met with attorneys who represent whistleblowers to discuss individual cases as well as broader program perspectives. This analysis, which is continuing, has influenced decisions on initial case processing protocols as well as longer term program design priorities.

Program Design: A top priority for the whistleblower program was the intake and analysis of whistleblower submissions. This aspect of the program required immediate attention because whistleblower submissions began arriving almost immediately after section 7623(b) was enacted.

Working with the IRS Operating Divisions, the Criminal Investigation Division, and the Office of Chief Counsel, the Whistleblower Office has designed an intake process that includes initial review by Whistleblower Office staff and an evaluation by Operating Division subject matter experts. The Operating Division subject matter experts determine whether the information submitted by the whistleblower warrants initiation of an examination of the issues reported. Each IRS Operating Division also has a Division Counsel. Division Counsel attorneys provide advice on technical tax issues as well as any legal issues that could limit the IRS's ability to use some or all of the information provided by the whistleblower. For example, documents submitted by a whistleblower are sometimes marked "attorney-client privileged." A Division Counsel attorney would need to determine whether the asserted privilege may legitimately be claimed for the document and whether an exception to that privilege may apply. In addition, as part of the subject matter expert's analysis, the whistleblower may be asked to meet to discuss the submission, to ensure that the IRS fully understands the issues raised and to ensure that all relevant information has been submitted.

Program guidance: Notice 2008-4<sup>7</sup> provided initial guidance on how to submit information to the IRS, and was accompanied by a revision to Form 211 "Application for Award for Original Information."<sup>8</sup> The Notice addressed the most pressing guidance requirements—how to submit information, and the criteria that will be applied to determine whether the information qualifies under the Act. It includes the requirement that the information be submitted by an individual, under penalty of perjury, and it defines ineligible submissions. A submission may be ineligible because the person

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<sup>7</sup> <http://www.irs.gov/newsroom/article/0,,id=176632,00.html>

<sup>8</sup> <http://www.irs.gov/pub/irs-pdf/f211.pdf>

submitting it is disqualified (e.g., a Federal employee who learned of the tax noncompliance in the course of performing his/her duties), or because the information does not provide a basis for IRS action. The latter category includes information that is speculative or is already known to the IRS. The Notice also described information that should be included by the whistleblower that will be needed to evaluate the submission.

The Form 211 revision incorporates the provisions of the law and the Notice, and is intended to help whistleblowers present information that is essential to evaluate whether a submission meets the requirements of section 7623(b). One change to the form, a new address for submissions, reflects an important change in processing whistleblower information. The Form 211 is now sent to the Whistleblower Office, where all submissions are reviewed to determine whether they appear to qualify under section 7623(b). Those that do not appear to qualify are sent to the Informant Claims Examination Unit in Ogden, UT, for processing as potential 7623(a) claims.

The IRS completed a Privacy Impact Assessment and a Privacy Act System of Records Notice for the whistleblower program. Both were essential steps in establishing program controls required by law and regulation.

The IRS adapted an existing correspondence control system as an interim case management system for the Whistleblower Office. Actions to acquire a commercial-off-the-shelf case management system have been taken, with pilot testing scheduled for the third quarter of FY 2008.

The IRS established a working group led by the Whistleblower Office, with representatives from the Operating Divisions, Criminal Investigation Division, and the Office of Chief Counsel. The working group is addressing the detailed steps needed to implement the changes in the law, including updates, revisions or replacements for the regulations, policies, operating procedures, and forms related to whistleblower awards.

Program Operations: Fiscal Year 2007 was a year of significant transition for the whistleblower program. In addition to the substantial changes in the law and the creation of a new Whistleblower Office, the Service continued to implement program changes that started in Fiscal Year 2006. Informant claims operations formerly assigned to five IRS Campuses were consolidated at the Ogden Informant Claims Examination (ICE) unit in FY 2006. Actions to complete the consolidation continued into FY 2007.

By January 31, 2008, the IRS had received 116 whistleblower submissions that each appeared to meet the \$2 million of tax, penalties, interest, and additions to tax threshold in section 7623(b), 24 of which alleged more than \$10 million. An additional 29 did not include a specific amount<sup>9</sup>. The individuals submitting information to the IRS claimed to have inside knowledge of the transactions they were reporting, often with extensive documentation to support their claims. It is too early to tell how many of these 116 cases will be sustained after examination or investigation by the IRS. However, to put this in context, under the old Informant Award Program only 12 of 227 full paid claims in

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<sup>9</sup> These numbers reflect submissions received by the Whistleblower Office. Additional submissions were made to other IRS offices prior to the revision of Form 211, which directs that the forms be sent to the Whistleblower Office. The IRS is consolidating information about these other cases in the Whistleblower Office.

2007 involved collections of more than \$2 million, and only 3 involved collections of more than \$10 million.

The Whistleblower Office also received a number of requests for status reports on pre-amendment submissions, as well as some requests for reconsideration of decisions on pre-amendment submissions. While the Whistleblower Office had no authority to make decisions on pre-amendment submissions, it made inquiries to determine the status of open cases and to ensure that informant claims policies had been followed in a number of closed cases.

Outreach and Communications: The IRS developed a communications plan to address outreach to both the public and IRS personnel regarding changes in the whistleblower program. The plan includes efforts to identify opportunities for improvement, potential barriers to change, and manage expectations regarding the scope and pace of change. The Whistleblower Office has a page on the IRS intranet to make information available to IRS personnel, and will continue to provide articles for internal newsletters and speakers for professional education events to reach employees who are most likely to deal with a whistleblower case. A dedicated page on the public IRS.GOV website provides a description of the law, links to Notice 2008-4 and Form 211, and other information about what a whistleblower should expect when making a submission. The Whistleblower Office will continue to make presentations to professional groups involved in representation of taxpayers and whistleblowers, both to describe program developments and to obtain outside perspectives on the program.

### **Priorities for Fiscal Year 2008**

The IRS has four priority initiatives for the whistleblower program in Fiscal Year 2008. The first initiative is to complete a comprehensive revision of IRM provisions relevant to whistleblower awards. The existing IRM guidance was developed to address the discretionary awards program under what is now section 7623(a). The revision will incorporate the changes required as a result of the new law, as well as a re-examination of policies and procedures that were not directly affected but have not been critically examined for some time.

The second initiative is to develop criteria for making determinations on award eligibility and award percentages. Section 7623(b) provides for an award range of 15 percent to 30 percent of collected proceeds, and it provides for two exceptions. While each case must be considered on the specific facts, the criteria will be used to guide the analysis and provide some transparency in the Whistleblower Office decision process.

The third initiative is to continue to reach out to external stakeholders for feedback and recommendations on program development and implementation issues, such as the development of the criteria noted above. This outreach will inform our efforts to develop new regulations for the program, which will be included on the next Department of Treasury priority guidance plan.

The fourth initiative is to conduct pilot testing and then deploy a new case management system. The IRS has identified a commercial-off-the-shelf system that is well suited to the needs of the whistleblower program, and expects delivery and pilot testing in the fourth quarter of FY 2008.

## Whistleblower Awards Paid

The chart below reflects information on informant claims that the Service has reported to Congress each year. As the successor to the five Campus organizations from prior years, the ICE unit is responsible for processing the payment of all claims under what is now section 7623(a), based on evaluations of the contributions made by informants and a determination of the applicable award percentage.<sup>10</sup> There is no correlation between the year of claim submission and the year when an award is paid, because the IRS must complete an investigation or examination of the underlying tax matter (including any appeal by the taxpayer) and must collect proceeds before it can pay an award. It would be very rare to complete this process in the same year that a claim is submitted. Year-to-year fluctuations in the amount of awards paid and the amount collected are attributable to a small number of large cases closed in 2006 and 2007.

### Receipts and payments, FY 2003-2007

	2003	2004	2005	2006	2007
<b>Cases Received</b>	4,765	5,380	2,740	4295	2751
<b>Awards Paid</b>	190	259	169	220	227
<b>Collections over \$2 million</b>	NA	NA	NA	NA	12
<b>Amount of Awards Paid</b> <sup>11</sup>	\$4,057,476	\$4,585,143	\$7,602,685	\$24,184,458	\$13,600,205
<b>Amounts Collected</b>	\$61,556,175	\$74,130,794	\$93,677,606	\$258,590,435	\$181,784,287

<sup>10</sup> All of the claims paid in FY 2007 were based on information received prior to December 20, 2006, the date of enactment of Section 406 of the Tax Relief and Health Care Act of 2006. Thus, the applicable award percentages were those established in IRS policy, not the higher percentages set in the new law.

<sup>11</sup> The amount of awards paid includes fully paid awards and partially paid awards. In FY 2007, 35 informants received partial payments totaling \$3.2 million.

## ***Appendix: Revised 7623 and other provisions of law***

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.'

#### **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)' 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) is 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.