

# The Resurgence of Whistleblowers in IRS Bond Enforcement

By: *W. Mark Scott*

## I. THERE AND BACK AGAIN

The IRS Office of Tax Exempt Bonds received a significant number of whistleblower tips during my tenure as director (from its inception in 2000 to November of 2005); enough so that I established a formal review process and review committee to screen tips to determine whether an examination was merited.<sup>1</sup> Generally these tips were received by phone or mail, and were directed to the office or to a particular person working in my former office.

## Law Office of W. Mark Scott, PLLC



**Mark Scott**  
**Ph: 202/249-1090**  
**mark@scottpllc.com**  
**www.scottpllc.com**

*The author's practice includes the representation of taxpayers before the IRS and courts of law. The author has more than 28 years of tax law experience, including over 18 years of IRS experience.*

Tips came in from a variety of sources. Several were from attorneys who simply wanted to show that other law firms were providing similar opinions! The examinations opened through these tips resulted in a high percentage of adverse audit results.<sup>2</sup>

During this period of time, the only way for a tipster to seek an award was either by filing a formal claim through the longstanding IRS whistleblower award statute or by bringing an action pursuant to the False Claims Act.<sup>3</sup> Both of these routes had severe disadvantages. Under the old whistleblower statute, the IRS held sole and complete discretion as to whether to award a payment to an informant.<sup>4</sup> And the False Claims Act excluded federal tax claims.<sup>5</sup> As a result, tips were most often received informally, generally through phone conversations with the whistleblower.

Sometime after my departure, the number of informal tips received from whistleblowers fell off precipitously.<sup>6</sup>

## II. THE NEW LAW

In 2006, Congress greatly expanded the existing IRS whistleblower statute to make it easier for tipsters to receive an award directly from the IRS and to increase the potential amount of the award.<sup>7</sup> Under the newly enacted statute, if certain requirements are met, the IRS is required to pay an award.<sup>8</sup> The law also requires the IRS to create a separate

whistleblower office to administer the award program.<sup>9</sup> Since the enactment of this new law and the creation of the Whistleblower Office, the IRS has received over 1,300 whistleblower submissions.<sup>10</sup> Of these, the IRS Office of Tax Exempt Bonds had received 32 separate tips by May of 2011.<sup>11</sup>

### III. THE WHISTLEBLOWER, CLAIM PROCESS, AND AWARD

#### *a. Who Can Be Paid an Award?*

Only certain persons are authorized to receive an award under the new whistleblower statute.<sup>12</sup> Persons not eligible to receive an award include IRS employees when they learn of the tax noncompliance in the course of their work activities, persons who have access to federal tax information as part of their official duties with a state or local government, persons who have access to federal tax information as part of their official capacity as a member of a state body or commission, and persons who are not natural persons (i.e., corporations or partnerships).<sup>13</sup>

The whistleblower may be someone who participated in the tax scheme. This may not prevent the whistleblower from receiving an award; however, this will generally be a negative factor in determining the amount of the award.<sup>14</sup>

Whistleblowers may be represented by counsel, but claims cannot be anonymous and must identify the whistleblower.<sup>15</sup> Nevertheless it is not unusual for a whistleblower to engage counsel to ensure the claim is properly prepared and submitted, to provide assistance to the IRS during the examination process, to negotiate the highest possible award and, if

necessary, to seek review of the award amount in the U.S. Tax Court.<sup>16</sup>

#### *b. How is a Claim Filed?*

To submit a formal claim for award, an informant files an IRS Form 211, *Application for Award for Original Information*.<sup>17</sup> The completed application is submitted directly to the Whistleblower Office and not to the IRS Office of Tax Exempt Bonds.<sup>18</sup> The tipster will attach documentary support with the form. The tipster, or his counsel, may also prepare an analysis of the data in an attempt to accelerate the IRS examination.

In the claim, the informant is required to reveal *how* the information came to his attention, *when* he acquired the information, and a description of his relationship with the taxpayer.<sup>19</sup>

#### *c. How is a Claim Worked by the IRS?*

The Whistleblower Office will review the claim to ensure it is complete, for a determination of whether it meets certain threshold requirements, and for a possible referral to the Criminal Investigation division.<sup>20</sup> The threshold analysis will determine whether the claim meets the dollar limits of the new law (discussed below) and whether the claim was filed by a person entitled to an award.<sup>21</sup>

If the claim is complete, meets this threshold analysis, and is not forwarded to the IRS criminal investigators, the Whistleblower Office will contact the subject matter expert in the IRS operating division.<sup>22</sup>

These subject matter experts review the submitted information to determine if it may be tainted, meaning it may be subject to attorney-client privilege or any other legal protections

that would preclude the IRS from using it in an examination.<sup>23</sup> If it is determined that the information may be tainted, the Office of Chief Counsel reviews the claim and determines which documents should and should not be forwarded to the examination division.<sup>24</sup>

The subject matter expert may also debrief the tipster.<sup>25</sup> Based on the written claim and debriefing, the subject matter expert makes a recommendation as to whether the lead should be followed up by an examination.<sup>26</sup> During the examination, the IRS may request further information from the whistleblower.<sup>27</sup> Generally this relationship will involve seeking additional information only, but a formal agreement may be entered into between the government and the whistleblower if a closer working relationship is necessary.<sup>28</sup> The tipster's identity will rarely be disclosed to the taxpayer.<sup>29</sup>

*d. How does the IRS Determine the Award Amount?*

To be eligible for a payment under the new law, the tax, penalties, interest, additions to tax, and additional amounts in dispute must exceed \$2,000,000.<sup>30</sup> If the allegedly noncompliant individual is a person, the individual's gross income must exceed \$200,000 for any of the taxable years at issue in the claim.<sup>31</sup> If the claim does not meet this threshold analysis, it is worked as a claim submitted under prior law, where the determination of an award is entirely within the discretion of the IRS.

How the "amount in dispute" determination applies to claims submitted for tax-exempt bond violations has not been publicly announced. The use of tax exposure computed for closing agreement purposes would generally ease the burden of meeting the \$2,000,000

threshold. But it is unclear whether the same tax exposure computation used to determine settlement amounts in bond examinations and voluntary closing agreements should be the basis for the determination of the amount in dispute.<sup>32</sup> Or, assuming something akin to tax exposure is used, whether the computation should be adjusted to, for instance, eliminate the application of future value principles to past due amounts or the present value principles to those tax amounts due in future years. Other adjustments might also be considered. Should the determination of tax exposure, which is simply a guess as to the amount of potential forgone taxes owed by bondholders, be reduced to take into account that some portion of this estimated amount may be attributed to individual bondholders that do not meet the \$200,000 threshold? What if the amount in dispute relates to overdue rebate? Should the amount in dispute be reduced to take into account an agreement by the issuer to retire the bonds early? These are some of the many unanswered questions.

Once the threshold amounts are met, the new law kicks in. If the IRS follows up on the tip and conducts an examination that results in a closing agreement with the issuer, the amount of the award depends, foremost, on whether the information received is based principally on "specific allegations" contained in public documents, such as judicial or administrative proceedings, government reports, or media accounts. If so, the award is capped at 10% of the collected proceeds and may be any amount under 10% (including zero).<sup>33</sup>

Presumably, although it is not entirely clear, the term "specific allegations" refers specifically to allegations of tax violations and not to general allegations. For instance, in the context of tax-

exempt debt, if a media report includes a discussion of how bond proceeds have not been spent as planned, but invested at a higher yield, but the story does not raise any potential tax law violations as a result of these actions, is the claim award limited to the 10% cap?

If the 10% cap does not apply, then the award must be at least 15%, but no more than 30%, of the collected amount.<sup>34</sup>

The IRS Whistleblower Office will apply a number of factors to determine how much to award within the ranges noted above (zero to 10%, or 15% to 30%). Positive factors include prompt action by the informant, identifying an issue that was unknown to the IRS, identifying taxpayer behavior that would be difficult to detect, producing details in a clear and organized manner, and a positive impact between the claim and the behavior of the taxpayer.<sup>35</sup> Negative factors include delayed reporting by the tipster and the tipster being actively involved in the noncompliance.<sup>36</sup> In fact, the statute permits the Whistleblower Office to reward less than the 15% minimum amount when an informant was actively involved in the noncompliance.<sup>37</sup> The Whistleblower Office has determined that awards paid to “significant planners and initiators” will be reduced by at least 66%, awards paid to “moderate planners and initiators” will be reduced between 33% and 66%, and awards paid to “minimal planners and initiators” will be reduced between 0% to 33%.<sup>38</sup>

To date, not a single claim submitted to the IRS Office of Tax Exempt Bonds has resulted in the payment of an award.<sup>39</sup>

Finally, section 7623(b)(4) of the Internal Revenue Code provides the Tax Court

jurisdiction to hear appeals of award determinations, including the amount or denial of an award, under the expanded program.<sup>40</sup>

Generally informants will wait many years before receiving an award.<sup>41</sup> In addition to the time involved in performing the initial review in the Whistleblower Office and conducting the tax examination, the taxpayer may seek an administrative review in the IRS Office of Appeals or proceed to U.S. Tax Court. In addition, the taxpayer may seek a refund of any amounts paid and, potentially, sue for such a refund in District Court or the Court of Federal Claims.<sup>42</sup> For these reasons, the IRS has determined that it cannot issue an award until the statute of limitations for filing a claim for refund has expired.<sup>43</sup>

In this context, therefore, informants who refer bond violations may be at an advantage to other whistleblowers because adverse bond examinations are almost always closed by closing agreement. By their nature, closing agreements are final and cannot be appealed.<sup>44</sup> Accordingly, payment of the award should be made shortly after the date the closing agreement is executed.

Finally, the Whistleblower Office has determined that all awards will be subject to withholding.<sup>45</sup>

#### IV. A WHISTLEBLOWER BASED EXAMINATION

##### *a. How do I know if a Bond Examination Resulted from a Tip?*

The IRS will preserve the identity of a tipster, and will presumably not indicate that the source of the examination is a tip received through the filing of a formal claim with the Whistleblower Office.<sup>46</sup> The IRS, however, may

provide vital clues that would indicate that the examination was the result of a whistleblower tip. IRS personnel have indicated, for instance, that the examination opening letter for a tax-exempt bond examination resulting from a tip will indicate that the specific bonds are not being audited as part of the general examination selection or as part of a specific audit program.<sup>47</sup> Instead, the letter will indicate that the bonds were selected for examination because of the receipt of specific information about the particular bond issue.<sup>48</sup> In addition, it should be apparent to controversy counsel based simply on the types of questions being asked by the agent that the examination was a result of specific information received by the IRS.

IRS examiners should build their cases independent of the whistleblower's assertions and corroborate all of the information provided by the whistleblower. Therefore issuers should be granted a fair and defensible examination process. It is the responsibility of controversy counsel to ensure this actually happens.

*b. A Possible Early Response*

If an issuer or borrower knows that a whistleblower tip has been or will be made, and that the tip has validity, the issuer or borrower could quickly proceed to the IRS on a voluntary basis if an examination has not been opened.<sup>49</sup> Per the IRS, the settlement terms should be more favorable to the issuer than a settlement if the same violation had been discovered during an examination.<sup>50</sup>

## V. CONCLUSION

After several years of receiving very few tips, the IRS Office of Tax Exempt Bonds has recently received 32 tips relating to outstanding tax-exempt bonds. With the recent announcement of more layoffs in the banking industry, I expect to see a continued resurgence of examinations initiated from whistleblower tips.

---

<sup>1</sup> See former Internal Revenue Manual (IRM) §4.81.1.6, which established processes specific to tips received by the Office of Tax Exempt Bonds.

<sup>2</sup> The Treasury Inspector General for Tax Administration issued a report in 2005, which includes a number of obvious errors, but does accurately show 36 separate whistleblower tips received by the Office of Tax Exempt Bonds in 2004. (The number of tips shown in the report for 2002 and 2003 is in error.) Treasury Inspector General for Tax Administration, *Statistical Portrayal of the Tax Exempt Bonds Office's Enforcement Activities From Fiscal Year 2002 Through Fiscal Year 2004*, Report 2005-10-186, p. 12 (Sept. 2005).

<sup>3</sup> Prior to 2006, Internal Revenue Code (IRC) §7623 provided simply that the IRS was authorized to pay an award in certain situations. Regulations issued under section 7623 authorized an award up to 15% of the amount (other than interest) collected by reason of the information and required a formal claim on Form 211, *Application for Reward of Original Information*. Treas. Reg. §301.7623-1. Allegations of fraud against the U.S. Government are filed with the Department of Justice under the False Claims Act False Claims Act, 31 U.S.C. §3729 et seq.

<sup>4</sup> The decision of the IRS to pay an award, or to pay a certain amount, was not reviewable by any court. See, e.g., *Wolf v. Commissioner*, TC Memo 2007-133 (May 30, 2007).

<sup>5</sup> The False Claims Act includes a "qui tam" provision. This provision allows whistleblowers to pursue an action in the name of the government. 31 U.S.C. §3730(a). Tax cases are specifically excluded under this provision. 31 U.S.C. §3729(e). The largest whistleblower proceeding in TEB history related to yield burning in advance refunding escrows. This proceeding was pursued as a qui tam action by Mr. Michael Lissack and, ultimately, resulted in a

---

settlement approaching \$200 million, with 15% paid to Mr. Lissack. Notwithstanding the payment of this award, courts of law subsequently declined to follow the government's treatment of Mr. Lissack's action as a qui tam suit and have, instead, found that Mr. Lissack's action to be barred under the tax restriction applicable to such suits. *United States ex rel. Lissack v. Sakura Global Capital Markets Inc.*, 377 f.3d 145 (2<sup>nd</sup> Cir. 2004).

<sup>6</sup> A portion of this drop in tips could, in part, be attributed to the required processing of tips by the newly created Whistleblower Office.

<sup>7</sup> The Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, div. A, title IV, §406, 120 Stat. 2922 (Dec. 20, 2006).

<sup>8</sup> IRC §7623(b).

<sup>9</sup> The Whistleblower Office was established in December of 2006. IR-2007-201 (Dec. 19, 2007) ("Procedure Unveiled for Reporting Violations of the Tax Law, Making Reward Claims"); *see also* IR-2005-25 (Feb. 2, 2007) ("IRS Begins Work on Whistleblower Office; Whitlock Named First Director").

<sup>10</sup> Internal Revenue Service, *Fiscal Year 2010 Report to the Congress on the Use of Section 7623*.

<sup>11</sup> Per Cliff Gannett, director, at American Bar Association May 2011 meeting.

<sup>12</sup> Nothing prevents whistleblowers from submitting a claim for which they are not eligible. Whistleblowers not eligible for an award may simply choose to submit their tip directly to the IRS Office of Tax Exempt Bonds.

<sup>13</sup> The extent of the existing restriction on state and local government employees is somewhat unclear as the IRM and Notice provisions are inconsistent, with the Notice providing a more limited description of the exclusion. Presumably the IRS only intends to preclude claims filed by state and local government employees who have received federal tax information pursuant to the exception to the IRC §6103 disclosure statute. IRM §25.2.2.5 (June 18, 2010); Par. 3.04 of Notice 2008-4, 2008-1 C.B. 253; IRC §6103(d).

<sup>14</sup> IRM §25.2.2.9.2, ¶ 11.B. (June 18, 2010).

<sup>15</sup> IRC §7623(b)(6)(B); Par. 3.04(6) of Notice 2008-4.

<sup>16</sup> IRC §7623(b)(4).

<sup>17</sup> Par. 3.02 of Notice 2008-4.

<sup>18</sup> *Id.*

<sup>19</sup> Par. 3.03(8) of Notice 2008-4.

<sup>20</sup> IRM §25.2.2.4 (Jun. 18, 2010); IRM §25.2.2.7 (Jun. 18, 2010).

<sup>21</sup> IRM §25.2.2.7 (Jun. 18, 2010).

<sup>22</sup> In the case of tax-exempt bonds, the current subject matter expert is Derek Knight, a field manager in the Office of Tax Exempt Bonds.

<sup>23</sup> IRM §25.2.2.7 (Jun. 18, 2010).

<sup>24</sup> *Id.*

<sup>25</sup> IRM §25.2.2.6 (Jun. 18, 2010).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> IRC §6103(k)(6) and (n); Treas. Reg. §301.6103(n)-2.

<sup>29</sup> Par. 3.06 of Notice 2008-4. One circumstance mentioned in the Notice where the whistleblower's identity would be disclosed by the U.S. government is when the claimant is called as a witness in a judicial proceeding.

<sup>30</sup> IRC §7623(b)(5)(B); Prop. Treas. Reg. §301.7623-1 proposes to broaden the amounts included in this threshold by including amounts denied on refund claims and reductions in overpayment balances.

<sup>31</sup> IRC §7623(b)(5)(A).

<sup>32</sup> *See* IRM §4.81.6.5.3.1 (Aug. 5, 2011), for IRS instructions on how to compute taxpayer exposure.

<sup>33</sup> This lower percentage is not applicable if the informant was the original source for the public disclosure. Par. 3.09 of Notice 2008-4.

<sup>34</sup> IRC §7623(b).

<sup>35</sup> IRM §25.2.2.9.2 (Jun. 18, 2010).

<sup>36</sup> *Id.*

<sup>37</sup> IRC §7623(b)(3).

<sup>38</sup> IRM §25.2.2.9.2 (June 18, 2010).

<sup>39</sup> Per discussions with IRS personnel.

<sup>40</sup> *But see Cooper v. Commissioner*, 135 T.C. 70 (July 8, 2010) (wherein the tipster was denied the right to challenge the IRS's refusal to pursue his claim).

<sup>41</sup> GAO report

<sup>42</sup> IRC §7422.

<sup>43</sup> IRM §25.2.2.12 (Jun.18,2010).

<sup>44</sup> IRC §7121(b).

<sup>45</sup> Par. 3.10 of Notice 2008-4.

<sup>46</sup> Par. 3.06 of Notice 2008-4.

<sup>47</sup> Per Cliff Gannett, director, at American Bar Association May 2011 meeting.

<sup>48</sup> Letter 4559, referred to at IRM 4.81.5.6.1 (Oct. 1, 2009).

<sup>49</sup> IRM §7.2.3.1.2 (Aug. 5, 2011).

<sup>50</sup> IRM §7.2.3.1.1 (Aug. 5, 2011).