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## More Cheese for the Rats: Tax Court and Congress Give Big Win to Whistleblowers with Broad Definition of “Proceeds”

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## NOTE

# More Cheese for the Rats: Tax Court and Congress Give Big Win to Whistleblowers with Broad Definition of “Proceeds”

*Whistleblower 21276-13W v. Commissioner of Internal Revenue*, 147 T.C. 121 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017)

*Stephen W. Carman\**

### I. INTRODUCTION

The United States has a voluntary tax compliance system, whereby the burden to report income and take appropriate deductions is on the taxpayer.<sup>1</sup> This self-reporting system encourages some taxpayers to underreport their taxes owed, as a result of fraud or simply a misunderstanding of the Tax Code.<sup>2</sup> This underreporting has created a tax gap, the difference between what the Internal Revenue Service (“IRS” or “the Service”) receives and what is actually owed.<sup>3</sup> One avenue for the IRS to combat this tax gap is through a program that rewards those who provide leads to the Service that result in recovering significant revenue for the federal government.<sup>4</sup> The Service has this option through section 7623 of the Internal Revenue Code (“IRC” or “the Code”), which created a whistleblower program to reward informants for information leading to “detecting underpayments of tax” or “detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conspiring at the same.”<sup>5</sup>

To be successful, the whistleblower program should provide an adequate incentive for whistleblowers to risk their reputations and careers and come forward with information, while also maintaining its ability to collect sufficient

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1. J. T. Manhire, *What Does Voluntary Tax Compliance Mean?: A Government Perspective*, 164 U. PA. L. REV. ONLINE 11, 12, 17 (2015).

2. See Jeanne Sahadi, *\$458 Billion in Taxes Go Unpaid Every Year*, CNN MONEY (Apr. 29, 2016, 12:36 PM), <http://money.cnn.com/2016/04/29/pf/taxes/taxes-owed-tax-gap/>.

3. *Id.*

4. See Marsha J. Ferziger & Daniel G. Currell, *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, 99 U. ILL. L. REV. 1141, 1142–43 (1999).

5. I.R.C. § 7623(a) (West 2018) (amended 2018).

revenue to close the tax gap.<sup>6</sup> This balancing was at issue in *Whistleblower 21276-13W v. Commissioner*, where the Tax Court evaluated whether proceeds collected under provisions not located in the IRC, including the criminal fines and civil forfeitures at issue in the case, should be considered in the payment of a whistleblower award.<sup>7</sup> The Tax Court ruled in favor of a broad interpretation of the statute, giving a win to whistleblowers by increasing their potential rewards.<sup>8</sup> After the Tax Court's decision, Congress cemented this whistleblower victory by amending section 7623 to explicitly include criminal fines, civil forfeitures, and other reporting penalties.<sup>9</sup> While the broad holding and statutory amendment certainly increase the incentive for whistleblowers to come forward with information,<sup>10</sup> the new law partially hinders the ability of the whistleblower program to make a dent in the tax gap. This note examines the impact of this decision and the subsequent statutory amendment on the whistleblower program and suggests changes to make the program most capable of rewarding whistleblowers while also closing the tax gap.

## II. FACTS AND HOLDING

Section 7623(b) of the Code mandates the Commissioner of the IRS to provide whistleblowers with awards for information that results in the Service's detection of underpayment of taxes or its ability to bring to justice individuals guilty of violating the internal revenue laws of the United States, provided that the qualifications of section 7623(b)(5) are met, which require the taxpayer have a gross income greater than \$200,000 and "the proceeds in dispute exceed \$2,000,000."<sup>11</sup> In hopes of an award under these provisions, the petitioners in *Whistleblower 21276-13W v. Commissioner of Internal Revenue*, a husband and wife, filed an Application for Award for Original Information with the IRS Whistleblower Office.<sup>12</sup>

The involvement of the petitioners in the tax recovery consisted of them working with the federal government to tackle a large, targeted business for tax evasion.<sup>13</sup> The husband worked with clients engaged in illegal activity, and his involvement in the case began when he entered into a plea agreement with the

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6. See Karie Davis-Nozemack & Sarah Webber, *Paying the IRS Whistleblower: A Critical Analysis of Collected Proceeds*, 32 VA. TAX REV. 77, 79–81 (2012).

7. See *Whistleblower 21276-13W v. Comm'r*, 147 T.C. 121, 138–40 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017). According to the docket, a joint stipulation was filed to dismiss the case voluntarily, but as of April 2018, the appeal has not yet been dismissed.

8. See *id.* at 138–39.

9. See I.R.C. § 7623(c) (West 2018) (amended 2018).

10. Dean Zerbe, *IRS Rewards For Tax Whistleblowers – Good News!*, FORBES (Aug. 4, 2016, 6:50 PM), <https://www.forbes.com/sites/deanzerbe/2016/08/04/irs-rewards-for-tax-whistleblowers-good-news/#646afe9b697d>.

11. I.R.C. § 7623(5)(A)–(B) (West 2018) (amended 2018).

12. *Whistleblower 21276-13W*, 147 T.C. at 121.

13. *Whistleblower 21276-13W v. Comm'r*, 144 T.C. 290, 293–98 (2015).

Department of Justice to testify to the entity structure used by his clients for illegal activity, which consisted of a large foreign business.<sup>14</sup> In his testimony, he informed the government that a foreign business assisted U.S. taxpayers with tax evasion.<sup>15</sup> While he did not have the necessary documentation to incriminate the targeted business, he knew a senior officer who did, and the petitioner husband developed a plan with the government to bring this officer to the United States, where the government could arrest him, question him, and ask him to incriminate the targeted business.<sup>16</sup>

To carry out this plan, the wife flew to England and met with the senior officer and explained to him that she and her husband had been paid \$1.2 million in embezzled money that they had not paid taxes on and to seek his aid with the problem.<sup>17</sup> After no one had heard from the senior officer for weeks, the government sent the petitioner husband to the Cayman Islands to meet with the same senior officer.<sup>18</sup> Following this meeting, the petitioner wife was again sent to England to meet with the senior officer.<sup>19</sup> After further discussing the plan to move the \$1.2 million to a safe account, the senior officer came to the United States.<sup>20</sup> A promise of \$15,000 incentivized him to violate an instruction by the targeted business to not come to the United States, where he was arrested and later assisted the government in its investigation of the targeted business.<sup>21</sup> The investigation led to the government finding that the targeted business managed \$1.2 billion in secret accounts in order to prevent the Service from finding the money and the income that arose from the accounts.<sup>22</sup>

Following a guilty plea, the targeted business paid \$74,131,694 in tax restitution, a criminal fine, and civil forfeitures to the government for “conspiring to defraud the IRS, file false Federal income tax returns, and evade Federal income tax in violation of 18 U.S.C. sec. 371.”<sup>23</sup> The IRS initially denied the petitioners an award on the grounds that they had not submitted the award request forms prior to providing their information.<sup>24</sup> But the Service ultimately granted the award as a result of the Tax Court’s holding that failure to submit a timely award claim does not preclude whistleblowers from receiving an award.<sup>25</sup> After the appropriateness of the award was decided by the Tax Court, the parties disagreed as to the amount of the award, with the whistleblowers arguing that they were entitled to a portion of the tax restitution, criminal fines,

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14. *Id.* at 292.

15. *Id.* at 293.

16. *Id.* at 293–94.

17. *Id.* at 294–95.

18. *Id.* at 295–96.

19. *Id.*

20. *Id.* at 296–97.

21. *Id.*

22. *Id.* at 297–98.

23. *Whistleblower 21276-13W v. Comm’r*, 147 T.C. 121, 122–23 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017).

24. *Whistleblower 21276-13W*, 144 T.C. at 291.

25. *Id.* at 305–06.

and civil forfeitures, and the Service arguing that they were entitled only to a portion of the tax restitution.<sup>26</sup>

The parties' dispute centered around differing interpretations of the term "collected proceeds" as was found in section 7623(b)(1) of the Code at the time of the case.<sup>27</sup> Section 7623(b)(1) stated that, assuming the other qualifications are met, the whistleblower will "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."<sup>28</sup> The whistleblowers argued that "collected proceeds" included the entire \$74 million collected from the taxpayer, entitling them to a portion of the criminal fines and civil forfeitures imposed upon the taxpayers.<sup>29</sup> The Service argued that, under section 7623, only "collected proceeds" recovered under provisions of the Code could be used to pay the award because section 7623 relates only to violations of Federal tax laws, and, therefore, the whistleblowers were entitled only to a portion of the tax restitution.<sup>30</sup>

After considering the parties' respective arguments, the Tax Court first held the phrase "collected proceeds," as found in section 7623, was "not limited to amounts assessed and collected under [the Code]."<sup>31</sup> Second, the Tax Court held that collected proceeds should be used only when determining the amount awarded to whistleblowers.<sup>32</sup> Finally, the court held that both criminal fines and civil forfeitures were "collected proceeds" when determining a section 7623 award,<sup>33</sup> and therefore, the whistleblowers were awarded twenty-four percent of the total collected proceeds, which included portions of the tax restitution, the criminal fine, and civil forfeitures.<sup>34</sup>

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26. *Whistleblower 21276-13W*, 147 T.C. at 122, 126.

27. *Id.* at 123.

28. I.R.C. § 7623(b)(1) (West 2017), amended by I.R.C. § 7623(b)(1) (West 2018).

29. *Whistleblower 21276-13W*, 147 T.C. at 126.

30. *Id.*

31. *Id.* at 135.

32. *Id.* at 136.

33. *Id.* at 138–39.

34. *Id.* at 140.

### III. LEGAL BACKGROUND

#### A. Section 7623

In 1867, Congress passed what is now IRC section 7623(a), giving the Secretary of the Treasury the discretion to award amounts to promote the “detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same.”<sup>35</sup> This law basically remained unchanged during its first 140 years, with courts finding that the Service’s decision of whether to award a whistleblower was unreviewable.<sup>36</sup> In 2006, Congress requested review of the whistleblower program, and an audit found the program was underutilized due to administrative problems and inadequate incentives for whistleblowers.<sup>37</sup> The audit concluded that the whistleblower program was generating significant revenue but was capable of more success if issues regarding the Service’s discretion to award and the structure of the awards could be remedied.<sup>38</sup>

Shortly after the audit, Congress passed the Tax Relief and Health Care Act of 2006, which made several significant changes to the Service’s whistleblower program.<sup>39</sup> These changes included (1) creating section 7623(b), which made awards to whistleblowers no longer discretionary provided “the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000”; (2) giving whistleblowers the right to appeal the Service’s award; and (3) creating the Whistleblower Office of the Internal Revenue Service to report to the IRS Commissioner.<sup>40</sup> With these changes in place, the whistleblower program has led to the Service recovering large amounts of tax dollars.<sup>41</sup> According to Whistleblower Office Director, Lee D. Martin, “whistleblowers [have] assisted the IRS in collecting \$3.4 billion in revenue, and, in turn, the IRS has approved more than \$465 million in monetary awards to whistleblowers [since 2007].”<sup>42</sup>

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35. *History of the Whistleblower/Informant Program*, INTERNAL REVENUE SERV., <https://www.irs.gov/uac/history-of-the-whistleblower-informant-program> (last updated Jan. 25, 2018).

36. *Id.*

37. See Davis-Nozemack & Webber, *supra* note 6, at 84–85.

38. *Id.*

39. Tax Relief and Health Care Act of 2006, Pub. L. 109–432, § 406(a)(1)(D), 120 Stat. 2922, 2958–59 (codified at I.R.C. § 7623(b)); *History of the Whistleblower/Informant Program*, *supra* note 35.

40. *History of the Whistleblower/Informant Program*, *supra* note 35; see I.R.C. § 7623 (West 2018) (amended 2018).

41. See Davis-Nozemack & Webber, *supra* note 6, at 85–86.

42. Robert M. Wood, *Tax Cheats Beware: IRS Whistleblower Awards Soar 322%*, FORBES (Jan. 17, 2017, 8:48 AM), <http://www.forbes.com/sites/robertwood/2017/01/17/tax-cheats-beware-irs-whistleblower-awards-soar-322/#65d9d3b9568f>.

Whistleblowers may not always be model taxpaying citizens themselves, but they can be valuable in closing the tax gap.<sup>43</sup> A comment letter to the Commissioner once stated, “[P]romoters of tax shelters and tax fraud are not surrounded by boy scouts and angels.”<sup>44</sup> The quote apparently stemmed from the fact that many whistleblowers had begun tipping the Service when one of their business or personal relationships went bad.<sup>45</sup> This led to former Senator Harry Reid (D-Nev.) advocating for the elimination of the whistleblower program because he felt it was wrong to encourage people to snitch on those close to them for personal benefit.<sup>46</sup> But this is not always the case. Some whistleblowers may tip the Service after being reluctantly involved in the scheme and wanting to have a clean conscience.<sup>47</sup> Regardless of their motives, whistleblowing can lead to significant monetary recovery for the Service.

### *B. Proceeds for Purposes of a Whistleblower Award Calculation*

IRC section 7623(b) contains the relevant statutory language for how whistleblowers’ awards should be calculated under the new mandatory whistleblower award program.<sup>48</sup> At the time the Tax Court heard the instant case, the statute provided that a whistleblower should recover “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.”<sup>49</sup>

Other than the parenthetical following “collected proceeds” in section 7623(b), collected proceeds was not statutorily defined.<sup>50</sup> However, the Service issued guidance on the whistleblower program in 2010, stating “‘Collected proceeds’ are the monies the IRS obtains directly from a taxpayer which are based upon the information the whistleblower has provided.”<sup>51</sup> Similarly, the Tax Court addressed collected proceeds in *Whistleblower 22716-13W v. Commissioner* when it declined to “read the phrase ‘collected proceeds’ into section 7623(b)(5)(B),” which lists what should be included in calculating whether the \$2 million threshold has been met.<sup>52</sup> Further, the Department of the Treasury

43. See Davis-Nozemack & Webber, *supra* note 6, at 81–82.

44. *Id.* (quoting Letter from Jesselyn Radack, Dr. Marsha Coleman-Adebayo & Gina Green to Douglas Shulman, Comm’r, Internal Revenue Serv. 3 (Aug. 10, 2011)).

45. *Id.*

46. *Id.* at 81 (citing 144 CONG. REC. S4379-05, S4397-98 (May 6, 1998) (statement of Senator Reid)).

47. *Id.* at 81–82.

48. See I.R.C. § 7623(b)(1) (West 2017), *amended by* I.R.C. § 7623(b)(1) (West 2018).

49. *Id.* (emphasis added).

50. *Whistleblower 21276-13W v. Comm’r*, 147 T.C. 121, 127–28 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017).

51. *Id.* at 125.

52. *Id.* (citing *Whistleblower 22716-13W v. Comm’r*, 146 T.C. 84, 97 (2016)).

issued regulations in 2014 to limit the definition of collected proceeds to amounts collected under the Code,<sup>53</sup> consistent with the Service's position in this case. But these regulations were inapplicable to this decision because the date of their enactment was after the closing of the Service's award determination.<sup>54</sup> Thus, both the Service's narrow interpretation of collected proceeds and the Tax Court's previous refusal to read the term into section 7623(b)(5)(B) demonstrated the intent to interpret collected proceeds narrowly. With this backdrop, the Tax Court settled the meaning of collected proceeds in *Whistleblower 21276-13W v. Commissioner of Internal Revenue*.<sup>55</sup>

The Tax Court ruled in favor of a broad interpretation of collected proceeds and held that the criminal fines and civil forfeitures should be included for purposes of the award calculation, as the proceeds are not limited to those collected under the Code.<sup>56</sup> In response to this holding from the Tax Court<sup>57</sup> and while the appeal of this decision was docketed at the D.C. Circuit, Congress amended section 7623 and explicitly codified the holding.<sup>58</sup> In the new version of the statute, the phrase at issue in the Tax Court's decision, collected proceeds, was replaced with "proceeds collected," and the statute now defines what constitutes "proceeds" under the statute.<sup>59</sup> Resolving all ambiguity in the statute, which created the issues in *Whistleblower 21276-13W*, the statute now states proceeds include "criminal fines and civil forfeitures, and . . . violations of reporting requirements."<sup>60</sup>

The statute codifies the intent of the amendment's proponent and the principal drafter of the original section 7623(b), Senator Charles Grassley (R-Iowa),<sup>61</sup> which was expressed in his amicus brief filed while *Whistleblower 21276-13W* was on appeal. Senator Grassley argued that the inclusion of criminal fines and civil forfeitures in the award calculation is in line with the intent to "incentivize whistleblowers to come forward with information regarding

53. 26 C.F.R. § 301.7623-2(d) (West 2018).

54. Stephen Olsen, *Tax Court Holds Whistleblower "Collected Proceeds" Includes Criminal Fines and Civil Forfeitures*, PROCEDURALLY TAXING (Aug. 4, 2016), <http://procedurallytaxing.com/tax-court-holds-whistleblower-collected-proceeds-includes-criminal-fines-and-civil-forfeitures/>.

55. *Whistleblower 21276-13W*, 147 T.C. at 139–40.

56. *Id.*

57. See H.R. REP. NO. 115-466, at 336–40 (2017) (discussing issues and holding of *Whistleblower 21276-13W* before stating the proposed amendments).

58. I.R.C. § 7623 (West 2018) (amended 2018).

59. *Id.* § (b)(1), (c).

60. *Id.* § (c)(2)(A)–(B).

61. Julia Malleck, Big Win for Whistleblowers in Bipartisan Budget Act, WHISTLEBLOWERS PROTECTION BLOG (Feb. 9, 2018), <https://www.whistleblowersblog.org/2018/02/articles/legislation/big-win-for-whistleblowers-in-bipartisan-budget-act/>.



major tax frauds.”<sup>62</sup> He also argued that failing to include these in the award calculation would undermine the whistleblower program and thwart the Congressional intent in enacting section 7623(b), by creating award uncertainty for whistleblowers when reporting cases that may become criminal.<sup>63</sup> While Senator Grassley ultimately cemented his wishes through amending the statute, the Tax Court gave him an early win through their broad interpretation of collected proceeds in *Whistleblower 21276-13W v. Commissioner of Internal Revenue*.

#### IV. INSTANT DECISION

In determining whether amounts paid as criminal fines and civil forfeitures are collected proceeds for purposes of determining a whistleblower award, the Tax Court began its analysis in *Whistleblower 21276-13W v. Commissioner of Internal Revenue* by interpreting the statutory language of section 7623(b).<sup>64</sup> The court determined that the language of section 7623(b)(1) – stating an award of a portion of “the *collected proceeds* (including penalties, interest, additions to tax, and additional amounts)” – is plain, and, therefore, “the sole function of the courts is to enforce it according to its terms.”<sup>65</sup> The court went on to say that because the term collected proceeds is not statutorily defined, the canons of statutory construction must be used to determine the term’s meaning.<sup>66</sup> The canons listed by the court included “(1) when words used in a statute are not specifically defined, courts generally give the words their plain or ordinary meaning” and “(2) words in a statute must be read in their context, with a view to their place in the overall statutory scheme.”<sup>67</sup>

Relying on these canons, the court reviewed the previous instances in which the federal courts had interpreted the word “proceeds.”<sup>68</sup> In *Phelps v. Harris*, the Supreme Court stated that “proceeds” is a “word of great generality,” and that “[p]roceeds are not necessarily money.”<sup>69</sup> The Tax Court has also previously interpreted “proceeds” and stated that “[t]he general dictionary definition of ‘proceeds’ encompasses ‘what is produced by or derived from something (as a sale, investment, levy, business) by way of total revenue: the

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62. Brief of U.S. Senator Charles E. Grassley as Amicus Curiae Supporting Petitioner-Appellee and Affirmance at 5, *Whistleblower 21276-13W v. Comm’r of Internal Revenue* (D.C. Cir. 2017) (No. 17-1119).

63. *Id.*

64. *Whistleblower 21276-13W v. Comm’r*, 147 T.C. 121, 127 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017).

65. *Id.* at 124, 127 (second quote quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989)).

66. *Id.* at 127.

67. *Id.* (first citing *FCC v. AT&T, Inc.*, 562 U.S. 397, 403 (2011), then citing *Davis v. Mich. Dep’t of Treasury*, 489 U.S. 803, 809 (1989)).

68. *Id.* at 127–28.

69. *Id.* (alteration in original) (quoting *Phelps v. Harris*, 101 U.S. 370, 380 (1879)).

total amount brought in.”<sup>70</sup> The court also noted that “collect” generally has an expansive definition, with the *Oxford English Dictionary* defining collect as “[t]o gather together into one place or group; to gather, get together.”<sup>71</sup>

Considering the expansive definitions of both “collect” and “proceeds,” the Tax Court expressed hesitation to construe a term narrowly when its plain and ordinary meaning was so expansive.<sup>72</sup> This hesitation was reinforced by Congress failing to limit whistleblower awards to amounts collected under the Code, including unpaid taxes, when it could have easily expressed this limitation.<sup>73</sup> Congress’s failure to limit awards was additionally shown by the legislative intent of section 7623(b)(1), to create “an expansive rewards program.”<sup>74</sup> This intent was evidenced by other expansive terms throughout the statute, including “any administrative or judicial action,” “any related actions,” and “any settlement in response to such action.”<sup>75</sup> Further, the Tax Court found nothing that indicated internal revenue laws are limited to those found in the Code, as argued by the Service, and that there are numerous internal revenue laws found outside of the Code.<sup>76</sup>

After determining that collected proceeds should be given a broad interpretation, the Tax Court rejected the Service’s position that the parenthetical language of the statute, “including penalties, interest, additions to tax, and additional amounts,” limits collected proceeds to taxes and related payments.<sup>77</sup> The Service’s argument was based on section 6665(a) of the Code, which states that “tax” in the Code also refers to “the additions to the tax, additional amounts, and penalties.”<sup>78</sup> According to the Service, there was nothing to indicate that Congress wanted to give these terms broader meaning in the whistleblower statute than they did in section 6665(a).<sup>79</sup> But the Tax Court noted that “including” was the first word in the parenthetical and reasoned that the Code states “[t]he terms ‘includes’ and ‘including’ when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.”<sup>80</sup> Given this language in the Code, and the common understanding of “including,” the Tax Court concluded that Congress’s intent was for the parenthetical list to be non-exhaustive.<sup>81</sup>

After rejecting the argument that collected proceeds should be limited by the list in the parenthetical, the Tax Court concluded that section 7623(b)(1)

70. *Id.* at 128 (alteration in original) (quoting *Anderson v. Comm’r*, 123 T.C. 219, 232 (2004)).

71. *Id.* (alteration in original).

72. *Id.* at 129.

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.* at 130.

77. *Id.* at 134.

78. *See id.* at 132; I.R.C. § 6665(a) (2012).

79. *Whistleblower 21276-13W*, 147 T.C. at 132.

80. *Id.* (quoting I.R.C. § 7701(c) (West 2018)).

81. *Id.*

made clear that the whistleblower's award should be calculated based on the "collected proceeds."<sup>82</sup> This clarity is provided by the distinction between section 7623(a), the traditional discretionary award statute, and section 7623(b), the new mandatory award statute, where section 7623(b) explicitly states how to calculate the whistleblower's award and this calculation is based on a percentage of the collected proceeds.<sup>83</sup>

After relying on canons of statutory construction to guide its decision making, the Tax Court finally addressed whether criminal fines and civil forfeitures were collected proceeds.<sup>84</sup> First addressing criminal fines, the court reasoned that the parenthetical list for "collected proceeds" included "penalties," and fines are often considered penalties under the Code.<sup>85</sup> Further, the court rejected the Service's argument that criminal fines cannot be included in calculating the whistleblower award because the fines are paid into the Crime Victims Fund and are, therefore, unavailable to the Service to pay out in the whistleblower award.<sup>86</sup> In rejecting this argument, the court reasoned that the plain language of the statute mentions nothing of the collected proceeds having to be available to the Service to pay the award.<sup>87</sup> Thus, the Tax Court held that criminal fines are "collected proceeds" when determining a whistleblower award.<sup>88</sup>

The Tax Court considered similar arguments when determining whether civil forfeitures are collected proceeds.<sup>89</sup> The court rejected the Service's argument that the civil forfeitures could not be included because they were not collected under the Code, as the court held that internal revenue laws can be found outside of the Code.<sup>90</sup> Further, the court rejected the Service's argument that because the civil forfeitures are paid into the Treasury Forfeiture Fund and are therefore unavailable to be paid out in an award by the Service, they cannot be "collected proceeds" when determining a whistleblower award.<sup>91</sup> Thus, the Tax Court concluded that the petitioners should be awarded twenty-four percent of the total collected proceeds (the percentage agreed upon by the parties), including the criminal fine, civil forfeitures, and the restitution payment.<sup>92</sup>

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82. *See id.* at 133.

83. *Id.* at 134.

84. *Id.* at 136–39.

85. *Id.* at 136–37.

86. *Id.* at 137–38.

87. *Id.* at 138.

88. *Id.*

89. *Id.*

90. *Id.* at 139.

91. *Id.*

92. *Id.* at 140.

## V. COMMENT

According to the Service, the United States has an approximately \$458 billion “tax gap” every year.<sup>93</sup> This tax gap consists entirely of revenue that is owed to the government but is unpaid by taxpayers.<sup>94</sup> While a large portion of the amount contains no malice from taxpayers, \$387 billion arises from underreporting, and \$44 billion is the result of unpaid corporate income taxes.<sup>95</sup> With approximately 150 million tax returns filed in 2016,<sup>96</sup> it is logistically impossible for the Service to examine in detail every tax return. Generally, the Service will examine roughly one percent of them.<sup>97</sup> As a result, there are countless unexamined returns that may contain underpayments that widen the tax gap.<sup>98</sup>

One way for the Service to minimize the gap without fortuitously examining the correct returns is through the use of an effective whistleblower program that rewards informants for information leading to the collection of unpaid taxes. Although the Service has had a whistleblower program in place for over a century,<sup>99</sup> this program proved largely unsuccessful in encouraging whistleblowers to come forward primarily due to uncertainty and discretion in the award calculation.<sup>100</sup> In 2006, Congress amended the whistleblower program with the goal of making it more successful by providing more certainty that whistleblowers would be rewarded for the risk that they take in tipping the Service and, therefore, increasing participation in the program.<sup>101</sup> The primary amendments included (1) the creation of section 7623(b), which differed from the existing 7623(a) in that it made awards for high dollar returns no longer discretionary; (2) the addition of whistleblower appeal rights; and (3) the creation of the Whistleblower Office, with hope that these amendments would encourage more whistleblowers to come forward.<sup>102</sup>

Yet despite its lofty goals, the new whistleblower program has failed to fully deliver as promised. For example, at the end of fiscal year 2016, there

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93. Sahadi, *supra* note 2.

94. *Id.*

95. *Id.*

96. *U.S. Taxpayers Efiled More Than 128 Million Returns in 2016*, EFILE, <https://www.efile.com/efile-tax-return-direct-deposit-statistics/> (last visited Apr. 10, 2018).

97. Edward A. Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the “Tax Gap”*, 24 AKRON TAX J. 1, 5 (2009).

98. *See id.*

99. *History of the Whistleblower/Informant Program*, *supra* note 35.

100. Davis-Nozemack & Webber, *supra* note 6, 82–83.

101. *Id.* at 84–85.

102. *See History of the Whistleblower/Informant Program*, *supra* note 35.

were 2627 open section 7623(b) claims and only eighteen awards paid out under section 7623(b) during the fiscal year.<sup>103</sup> While closing the tax gap, the whistleblower program has proven inefficient compared to other federal whistleblower programs, such as the False Claims Act, which recovered \$5.69 billion, resulting in \$435 million in whistleblower awards in 2014 for tips “primarily for mortgage, health care and defense fraud cases.”<sup>104</sup> This recovery under the False Claims Act is significantly greater than the \$368,907,298 recovered by the Service in 2016 through the whistleblower program.<sup>105</sup> The whistleblower program’s inefficiency can possibly be attributed to both the lengthy time period it takes to process awards – an average of over seven years in 2016 for claims under section 7623(b)<sup>106</sup> – and that one of the most common factors of claim closure in 2016 was that there were no “Title 26 Collected Proceeds.”<sup>107</sup> The most recent amendment to section 7623, which occurred as a result of this case, fully eliminated the issue of there being no Title 26 collected proceeds. And the new and more explicit statutory language regarding what must be included in the award calculation should expedite the process of claims through lowering decision costs.

While these benefits from the amendment are likely a step in the right direction toward the whistleblower program reaching its full potential, several changes must occur. First, the Service should begin paying out more claims. Second, it should make these payments public to encourage other whistleblowers to come forward in the future. Finally, the statute must be properly tailored to adequately incentivize whistleblowers to come forward without hindering the effectiveness of the program. The Tax Court and now Congress through codifying the holding have certainly provided the adequate incentive to whistleblowers, but changes should be made to the statute to prevent the Service from paying out portions of money that are never in its hands, as this is an unreasonable result.

The remainder of this Part discusses the legislative intent of section 7623(b) to create an expansive award program, as analyzed by the Tax Court and demonstrated by the subsequent amendment. Then, the appropriateness of including both criminal fines and civil forfeitures in collected proceeds will be evaluated, respectively. Finally, this Part suggests changes to the definition of proceeds that will strike an appropriate balance between rewarding whistleblowers and closing the tax gap.

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103. INTERNAL REVENUE SERV., IRS WHISTLEBLOWER PROGRAM: FISCAL YEAR 2016 ANNUAL REPORT TO CONGRESS 3, 15 (2016), [https://www.irs.gov/pub/whistleblower/fy16\\_wo\\_annual\\_report\\_final.pdf](https://www.irs.gov/pub/whistleblower/fy16_wo_annual_report_final.pdf).

104. Saskia de Melker, *Top Payouts to Federal False Claims Whistleblowers in Fiscal Year 2014*, PBS NEWS HOUR (Dec. 21, 2014, 1:24 PM), <http://www.pbs.org/news-hour/updates/fortune-fraud-top-5-biggest-payouts-federal-whistleblowers-2014/>.

105. See INTERNAL REVENUE SERV., *supra* note 103, at 10.

106. *Id.* at 11.

107. *Id.* at 17.

*A. Legislative Intent of Section 7623(b)*

In its statutory interpretation of collected proceeds as found in section 7623(b), the Tax Court gave weight to Congress's legislative intent in drafting the statute.<sup>108</sup> As collected proceeds is a broad term and the statute contained other broad terms, the Tax Court stated that it was clear that Congress intended section 7623(b) to create an "expansive rewards program" with the mandatory whistleblower program.<sup>109</sup> The Tax Court's reasoning was consistent with others on the interpretation of legislative intent, with commentators stating, "Congress hope[d] the lure of much bigger rewards w[ould] prompt more informants to offer better tips and help the [Service] reduce the nation's \$290 billion tax gap."<sup>110</sup> This can be accomplished by creating mandatory awards for informants who provide information on high-dollar tax returns and by creating a more whistleblower-friendly reward calculation structure.<sup>111</sup>

But in the first five years following the amendments in 2007, whistleblower payments had not increased, despite large increases in whistleblower tips and revenue collected by the Service.<sup>112</sup> Commentators hypothesized that this was due to the Service narrowly interpreting the meaning of collected proceeds<sup>113</sup> to only consist of recovered taxes under the Code.<sup>114</sup> Whistleblower advocates hypothesized that this interpretation did not provide the award certainty needed for informants to take the risk and come forward with information.<sup>115</sup> Senator Grassley, the proponent of the mandatory whistleblower award and the amendment to codify the broad interpretation of proceeds, joined the arguments of whistleblower advocates in his amicus brief.<sup>116</sup> The broad interpretation of "collected proceeds" from the Tax Court in the instant decision and the codification of the holding are significant victories for whistleblower advocates and illustrate Congress's intent to create an expansive and incentivizing reward program for whistleblowers.

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108. Whistleblower 21276-13W v. Comm'r, 147 T.C. 121, 129 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017).

109. *Id.*

110. See Davis-Nozemack & Webber, *supra* note 6, 85–86 (alterations in original) (quoting Tom Herman, *Tipster Rewards Require Patience*, WALL STREET J. (Dec. 26, 2007, 12:01 AM), <https://www.wsj.com/articles/SB119862937462949815>).

111. *Id.* at 86.

112. *Id.* at 78–79.

113. *Id.* (noting that in the first five years of 7623(b), tips increased 76%, revenue collected increased 79%, but whistleblower award payments decreased 44%).

114. Zerbe, *supra* note 10.

115. Davis-Nozemack & Webber, *supra* note 6, 91–92.

116. Brief of U.S. Senator Charles E. Grassley as Amicus Curiae Supporting Petitioner-Appellee and Affirmance, *supra* note 62, at 5.

*B. Inclusion of Criminal Fines in the Award Calculation Is Overly Broad*

Recall that the Service argued that the criminal fine in the instant case could not factor into the award calculation, as the fine was deposited into the Crime Victims Fund and never available to the Service to pay in the award.<sup>117</sup> But despite this argument, the Tax Court adopted a broad interpretation of the statute, which included the fine in the award calculation.<sup>118</sup> This interpretation was explicitly written into the statute with the amendment, as the statute now includes criminal fines and states that proceeds collected should be “determined without regard to whether such proceeds are available to the Secretary.”<sup>119</sup>

While the Tax Court’s interpretation and the amended statute certainly aid in expanding the scope of the whistleblower program and incentivizing whistleblowers to come forward with information, an interpretation that causes the Service to pay money it never receives is overly broad and hinders the Service’s ability to use the whistleblower program as an effective means of closing the tax gap.

The Service’s inability to effectively use the whistleblower program is illustrated in the instant case. In *Whistleblower 21276-13W v. Commissioner*, of the \$74,131,694 collected as a result of the whistleblowers’ tip, \$22,050,000 was from the criminal fine, with this amount being \$2,049,999 greater than the amount recovered in tax restitution.<sup>120</sup> With the decision to include civil forfeitures and criminal fines in the definition of “collected proceeds” for purposes of the award calculation, the Service was required to pay out an award of \$17,791,607.<sup>121</sup> This amount was nearly eighty-nine percent of the amount recovered in tax restitution,<sup>122</sup> with \$5,292,000 coming from the criminal fine of which the Service had no access<sup>123</sup> and \$7,699,606.32 coming from the civil forfeitures in control of the Treasury Forfeiture Fund.<sup>124</sup> The whistleblower program’s primary goal of closing the tax gap<sup>125</sup> is difficult to attain when the award calculation structure nearly erodes the entirety of the gap closure. For this reason, a statute that mandates the Service and the Treasury to pay out awards with money they never have in hand is unreasonable and will have an adverse effect on the whistleblower program’s success. Section 7623(c) should

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117. See *Whistleblower 21276-13W v. Comm’r*, 147 T.C. 121, 137–38 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017).

118. *Id.* at 138.

119. I.R.C. § 7623(b)(1), (c)(2)(A) (West 2018) (amended 2018).

120. See *Whistleblower 21276-13W*, 147 T.C. at 123.

121. *Id.* at 140.

122. See *id.* (\$17,791,607 / \$20,000,001 = 0.88958 or 88.96%).

123. See *id.* (0.24 x \$22,050,000 = \$5,292,000).

124. See *id.* (0.24 x \$32,081,693 = \$7,699,606.32).

125. Davis-Nozemack & Webber, *supra* note 6, 85–86.

be further refined to explicitly preclude the inclusion of criminal fines in the whistleblower award calculation.

*C. Inclusion of Civil Forfeitures in the Award Calculation Appropriately Balances Interests of the Service and Whistleblowers*

In administering the whistleblower program, a primary goal should be to provide adequate incentive for whistleblowers to come forward with information, while also ensuring that the program remains a strong avenue for the Service to combat the tax gap.<sup>126</sup> As with criminal fines, the Service argued that because the civil forfeitures were deposited into the Treasury Forfeiture Fund, the funds were not available to the Service to pay a whistleblower award and should not be included in “collected proceeds.”<sup>127</sup> The amendment to section 7623 defeats this argument by stating that proceeds should be “determined without regard to whether such proceeds are available to the Secretary.”<sup>128</sup> But the Service’s concerns do not appear to be nearly as strong in the civil forfeiture context as in the criminal fine context, as the Treasury manages the Forfeiture Fund and Congress has the power to earmark funds collected to pay whistleblower awards.<sup>129</sup> If Congress passes legislation to allow for civil forfeitures to pay whistleblower awards in this context, this approach will satisfy the primary goal of the whistleblower program by ensuring that whistleblowers will be rewarded for coming forward with their information even if there is not significant recovery under the Tax Code, while also not requiring the Treasury to pay money that it has no control over and, consequently, damaging the ability of the whistleblower program to be successful in collecting revenue for the federal government. The amendment to section 7623 to explicitly include civil forfeitures when determining whistleblower awards should improve the success of the whistleblower program.

## VI. CONCLUSION

The Whistleblower Program has been an effective tool for the Service to work toward closing the tax gap since it was amended in 2006<sup>130</sup> to create the mandatory award payment provision in section 7623(b).<sup>131</sup> Since that time, the

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126. *See id.* at 79–80.

127. *See Whistleblower 21276-13W*, 147 T.C. at 139.

128. I.R.C. § 7623(b)(1) (West 2018) (amended 2018).

129. *See Terrorism and Financial Intelligence: Treasury Executive Office for Asset Forfeiture*, U.S. DEP’T TREASURY, <https://www.treasury.gov/about/organizational-structure/offices/Pages/The-Executive-Office-for-Asset-Forfeiture.aspx> (last updated Jan. 21, 2015).

130. Wood, *supra* note 42.

131. *See* I.R.C. § 7623(b) (West 2018) (amended 2018).



Service has collected an average of \$393,405,326 per year in the last three fiscal years on record, as a result of the Whistleblower Program.<sup>132</sup> This amount is up from \$258 million in revenue collected in 2006, the final year before section 7623(b) was created.<sup>133</sup> This increase logically resulted from the increased incentive for whistleblowers to come forward with information through the mandatory and more favorable award calculation procedure.<sup>134</sup> This incentive was further increased by the decision in the instant case and the codification of its holding to create a very broad definition of proceeds, which should especially incentivize whistleblowers with information pertaining to offshore accounts, as they no longer have to worry about whether they will receive a substantial award or any award at all due to limited or no collection by the Service under the Code.<sup>135</sup>

However, the broad definition of what can be considered in paying the whistleblower award may hurt the whistleblower program's ability to pay out awards while also collecting significant amounts for the government. This is especially illustrated in the instant case with the whistleblower award nearly eroding all of the collected unpaid taxes.<sup>136</sup> To correct this problem, Congress should amend the statute to preclude criminal fines from being included in the award calculation and to ensure that the Treasury has available to it the portions of civil forfeitures collected to pay whistleblowers' awards. This will maintain the necessary incentive for tips while also protecting the Service's ability to administer an efficient and successful program to fight the \$458 billion annual tax gap.<sup>137</sup>

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132. See INTERNAL REVENUE SERV., *supra* note 103, at 10.

133. See Davis-Nozemack & Webber, *supra* note 6, at 78 n.2.

134. See I.R.C. § 7623(a)–(b) (West 2018) (amended 2018) (Notice the discretionary nature of 7623(a) awards compared to the mandatory nature of 7623(b) awards.).

135. See Zerbe, *supra* note 10.

136. See *supra* note 122; Whistleblower 21276-13W v. Comm'r, 147 T.C. 121, 140 (2016), *appeal docketed*, No. 17-1119 (D.C. Cir. 2017).

137. See Sahadi, *supra* note 2.