

# WHISTLEBLOWERS AND TAX ENFORCEMENT: USING INSIDE INFORMATION TO CLOSE THE “TAX GAP”

*Edward A. Morse\**

I. Introduction .....	1
II. Overview of the IRS Examination Function .....	4
A. Prophylactic Benefits.....	5
B. Direct Benefits .....	7
III. Rewards for Informants .....	13
A. Discretionary Informant Rewards Under I.R.C. § 7623(a).....	13
B. Whistleblower Awards Under I.R.C. § 7623(b) .....	18
IV. Ethical Considerations: Additional Limits for Whistleblower Awards? .....	29
V. Conclusions .....	35

## I. INTRODUCTION

Voluntary self-assessment is a longstanding and indispensable aspect of our federal income tax system.<sup>1</sup> The Internal Revenue Code requires taxpayers to file timely and accurate returns of their taxable income and to pay the taxes due.<sup>2</sup> Taxpayers generally comply with

---

\* Professor of Law, McGrath North Mullin & Kratz Endowed Chair in Business Law, Creighton University School of Law, [morse@creighton.edu](mailto:morse@creighton.edu).

1. See *Millsap v. Comm’r*, 91 T.C. 926, 931 n.10 (1988). The court stated:

This concept [that a return is required for an assessment of federal income tax] is deeply rooted in our history. In part, our country was founded as the result of tax revolt wherein citizens protested being taxed without their consent. Our tax system is rooted in the concept of voluntary compliance which does not permit the government to arbitrarily assess tax without a proper list or report.

*Id.*

2. See, e.g., I.R.C. § 6001 (West 2008) (imposing general obligation to keep records and make returns); § 6012 (requiring income tax returns); § 6072 (noting the time for filing income tax returns); § 6151 (noting the time and place for paying taxes).

these obligations without direct intervention by the government.<sup>3</sup> The “tax gap” is born in this private zone of voluntary compliance whenever a taxpayer, whether intentionally or unintentionally, reports and pays less tax than if the law were correctly applied.<sup>4</sup>

Taxpayers have sometimes misunderstood what voluntary compliance means.<sup>5</sup> Unfortunately, that misunderstanding works to their detriment. Legal penalties, including civil and criminal sanctions for taxpayers<sup>6</sup> and their professional advisors,<sup>7</sup> are designed to reinforce the Code’s requirements to file and pay one’s taxes.<sup>8</sup> However, the efficacy of penalties to deter noncompliance is ultimately linked to prospects for enforcement, which in turn requires discovery of noncompliance.

The Federal government has various means at its disposal to discover noncompliance by taxpayers and to enforce the tax laws. Examination powers are at the core of these efforts, as they allow the government to penetrate a taxpayer’s otherwise private realm to evaluate whether reporting positions comply with the law and the facts.<sup>9</sup> Laws requiring disclosure of tax information by third parties also facilitate government scrutiny of taxpayer reporting and enhance compliance.<sup>10</sup>

---

3. See INTERNAL REVENUE SERV., REDUCING THE FEDERAL TAX GAP 6 (2007), available at [http://www.irs.gov/pub/irs-news/tax\\_gap\\_report\\_final\\_080207\\_linked.pdf](http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf).

4. See *id.*

5. For example, in 1999, the Commissioner included this statement in the instructions for Form 1040: “Thank you for making this nation’s tax system the most effective system of voluntary compliance in the world.” In response, a taxpayer (or non-taxpayer, to be more accurate) asked: “(1) Why does the Commissioner say that? (2) What does that mean? (3) How does it affect the [Petitioner]?” *Takaba v. Comm’r*, 119 T.C. 285, 288 (2002).

6. See, e.g., § 6651 (discussing failure to file penalty); § 6662 (discussing accuracy-related penalties); § 6662(a) (discussing special accuracy-related penalties regarding reportable transactions); § 6663 (discussing the fraud penalty). For criminal provisions applicable to taxpayers, see, e.g., §§ 7201-07 (identifying various tax crimes).

7. See, e.g., § 6694 (discussing understatement of taxpayer’s liability by tax return preparer); § 6695 (discussing other assessable penalties regarding preparation of tax returns for others); § 6700 (discussing promoting abusive tax shelters); § 6701 (discussing aiding and abetting understatement of tax liability). For an overview and critique of rules and penalties imposed on preparers, see generally Richard M. Lipton, *What Hath Congress Wrought? Amended Section 6694 Will Cause Problems for Everyone*, 107 J. TAX’N 68 (2007).

8. See, e.g., Richard J. Wood, *Accuracy-Related Penalties: A Question of Values*, 76 IOWA L. REV. 309, 318 (1991). They may also help to offset some of the government’s compliance costs, although Professor Wood contests the validity of this purpose from a policy perspective. See *id.* at 319-20.

9. See § 7602 (discussing the examination of books and witnesses).

10. See generally Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695 (2007) (noting that “[t]he Article argues that substantive federal income tax law can—and in many cases does—foster compliance by harnessing the structural incentives of third parties.”); William L. Burke, *Tax Information Reporting and Compliance in the Cross-Border Context*, 27 VA. TAX REV. 399 (2007).

Enforcement efforts have a direct and measurable impact on closing the tax gap with regard to examined returns.<sup>11</sup> Other benefits also resonate throughout the tax system, which are more difficult to quantify.<sup>12</sup> The threat of enforcement presumably reinforces voluntary compliance; information developed from examination of taxpayer returns may enhance prospects for accurately targeting those likely to be noncompliant or particular noncompliant practices.<sup>13</sup>

Enforcement efforts involve significant costs for the government and for affected taxpayers.<sup>14</sup> Some taxpayers selected for examination have no changes to their returns, resulting in costs incurred by both parties without any recovery of additional tax collections.<sup>15</sup> Although information technology may increase the accuracy of targeting enforcement efforts toward those likely to be noncompliant,<sup>16</sup> a low-tech solution is also available. Informants or “whistleblowers”<sup>17</sup> potentially enhance the effectiveness of examinations based on access to inside information. The informant effectively becomes a tool for peeking inside the otherwise private zone of voluntary compliance.

Whistleblower laws have been widely used by state and federal governments to enhance enforcement and to prevent future harms from violators.<sup>18</sup> Although some statutes only protect the whistleblower against retaliation, others also incentivize disclosure by providing

---

11. *See infra* Part II.

12. *See id.*

13. *See* DEP'T OF THE TREASURY BUDGET IN BRIEF 6 (2008), available at <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf>. The budget includes funding for studies to capture data needed to “keep the IRS’ targeting systems and compliance estimates up to date” and to “develop strategies to combat specific areas of non-compliance, improve voluntary compliance, and allocate resources more effectively.” *Id.* One significant taxpayer benefit was the potential to “reduce the burden of unnecessary taxpayer contacts.” *Id.*

14. *See id.*

15. *See infra* Part II.

16. *See* INTERNAL REVENUE SERV., REDUCING THE FEDERAL TAX GAP 3, 28-32 (2007), available at [http://www.irs.gov/pub/irs-news/tax\\_gap\\_report\\_final\\_080207\\_linked.pdf](http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf).

17. These terms will be used interchangeably throughout the article, although the term “informant” is arguably broader than the term “whistleblower,” which might be interpreted as an employee who informs on his or her employer. *See* BLACK’S LAW DICTIONARY 1627 (8th ed. 2004) (defining “whistleblower” as “an employee who reports employer wrongdoing to a governmental or law-enforcement agency”).

18. *See generally* Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 MICH. L. REV. 1757, 1768-72 (2007) (discussing various models for whistleblowing legislation); Mary K. Ramirez, *Blowing the Whistle on Whistleblower Protection: A Tale of Reform*, 76 U. CIN. L. REV. 183, 191 (2007) (noting that “[t]he sheer number of anti-retaliation laws illustrate[s] that whistleblowers are a critical component to effective law enforcement in a complex society as insiders often furnish invaluable assistance in the investigation and prosecution of public corruption and corporate fraud.”).

monetary rewards.<sup>19</sup> Such incentives may indeed enhance enforcement effectiveness, but collateral impacts on other social values, including privacy and fidelity in professional relationships, also deserve consideration.

This article provides a critical look at the current scheme for rewarding tax informants, and in particular on the relatively new program for so-called “whistleblower awards.” Despite enhanced incentives for informants to come forward, tax award programs continue to operate in an environment based on discretion and uncertainty. Additional legislation is needed to clarify uncertainties and to limit eligibility for rewards, including protection of private tax return information from disclosure and preventing the government from incentivizing the breach of confidential obligations through offering rewards.

Part II provides an overview of the IRS examination function and examines data involving the utility of informants in selecting returns for examination. Part III explores the statutory scheme for rewarding informants under I.R.C. § 7623, which was recently amended to include a separate whistleblower awards program affecting relatively large tax deficiencies.<sup>20</sup> Part IV discusses some ethical and legal issues presented by the current whistleblower scheme. In particular, it identifies the need to protect professional obligations concerning confidentiality in the context of enhanced compliance goals. It argues for further clarification of reward parameters in order to provide appropriate incentives to help reduce the tax gap, while providing a clear message of deterrence for those who would violate professional or legal standards in making disclosures.

## II. OVERVIEW OF THE IRS EXAMINATION FUNCTION

I.R.C. § 7602 provides broad authority for the Treasury Department to “examine any books, papers, records, or other data which may be relevant or material”<sup>21</sup> for the purpose of “ascertaining the correctness of any return, making a return where none has been made, determining the liability . . . for any internal revenue tax . . . or collecting any such

---

19. See Dworkin, *supra* note 18, at 1768-72. Professor Dworkin strongly favors legislation that provides incentives in addition to mere protections against retaliation, criticizing the protective model as based on the “faulty premise” that “most observers of wrongdoing are people of conscience who would report the wrongdoing absent the fear of retaliation.” *Id.* at 1768.

20. See I.R.C. § 7623(b) (West 2008).

21. See *id.* at § 7602(a)(1).

liability.”<sup>22</sup> The examination function entails significant coercive powers including summons authority,<sup>23</sup> which operates primarily against the taxpayer whose return is under examination. As discussed below, examinations raise revenues from taxpayers under examination, and they are also likely to enhance tax administration in other important ways that are more difficult to quantify. However, they also impose significant costs on taxpayers, including those who are otherwise compliant.

#### A. Prophylactic Benefits

Approximately 179 million tax returns were filed in 2007.<sup>24</sup> The sheer volume of returns suggests certain practical limits upon the government’s ability to examine all returns that may contain tax underpayments.<sup>25</sup> Based on current audit practices, only about one percent of these returns is likely to be examined.<sup>26</sup> Moreover, a majority of these examinations will involve a “correspondence” examination focusing on select narrow issues, rather than a comparatively more comprehensive “field” examination.<sup>27</sup>

Examinations contribute important intangible benefits that enable the tax system to continue depending on voluntary compliance. The Internal Revenue Manual states: “The primary objective in selecting

---

22. *See id.* at § 7602(a).

23. *See id.* at § 7602(a)(2).

24. *See* ELECTRONIC TAX ADMIN. ADVISORY COMMITTEE ANN. REP. TO CONGRESS 18 (2007), available at <http://www.njsea.org/ETAAC2007REPORT.pdf>. Of these, approximately 136.3 million are individual returns; 6.51 million are corporate returns; 3.05 million are partnership returns; with the balance consisting of fiduciary, payroll, unemployment, and exempt organization returns. *Id.* MICHAEL J. GRAETZ, 100 MILLION UNNECESSARY RETURNS 88 (2008) (pointing out that, in addition to millions of tax returns, the IRS must also process nearly 1.5 billion information documents each year).

25. Computer technology may provide a partial solution to the volume of information that must be processed. The Electronic Tax Administration Advisory Committee estimates that approximately 58 percent of all individual tax returns are expected to be filed electronically for the 2007 tax year. *See* ELECTRONIC TAX ADMIN. ADVISORY COMMITTEE ANN. REP. TO CONGRESS 1 (2007), available at <http://www.njsea.org/ETAAC2007REPORT.pdf>. Benefits from electronic filing include avoiding transcription of paper returns and validation of mathematical functions and certain input data, which ultimately may benefit both taxpayers and the government. *See id.* at 9. However, taxpayer concerns about enhanced audit rates (which may or may not be true) may be limiting participation. *See id.* at 16 (noting “[t]here is a strong perception among many paper filers that e-filing increases the chances of an audit. While we know that e-filed returns are twenty times more accurate than paper ones, the IRS needs to address the audit concerns for this taxpayer segment.”).

26. *See* INTERNAL REVENUE SERV. ENFORCEMENT AND SERVICE STAT. 3-9 (2007), [http://www.irs.gov/pub/newsroom/irs\\_enforcement\\_and\\_service\\_tables\\_fy\\_2007.pdf](http://www.irs.gov/pub/newsroom/irs_enforcement_and_service_tables_fy_2007.pdf). This estimate is based on the total examinations for individual returns (1,384,563) and business returns (59,516) in fiscal 2007. *Id.*

27. There were 311,339 “field” audits and 1,073,224 “correspondence” audits reported for individuals in fiscal 2007. *See id.* at 3.

returns for examination is to promote the highest degree of voluntary compliance on the part of taxpayers.”<sup>28</sup> Despite limited examination coverage, the knowledge that one could be selected for an examination potentially reinforces the obligation to report fairly and honestly.<sup>29</sup> Taxpayers who are tempted to cheat may be deterred from deliberately violating the law<sup>30</sup> and honest taxpayers may be assured that they are not alone in following the law.<sup>31</sup> These are important values that are likely to enhance taxpayer commitment to compliance throughout the system.

In addition to promoting voluntary compliance, other benefits may accrue within the tax system itself. Examinations may uncover facts about taxpayer behavior that prove useful in designing better rules or in designing better audit techniques. For example, they may identify areas where complex rules are commonly misunderstood and misapplied, indicating a need for simplification or additional clarification. As the IRS has recognized, “[t]he complexity of the nation’s current tax system is a significant reason for the tax gap, and even sophisticated taxpayers make honest mistakes on their tax returns. Accordingly, helping taxpayers understand obligations under the tax law is a critical part of improving voluntary compliance.”<sup>32</sup>

Examinations may also expose common means that taxpayers use to cheat, and these experiences may be transmitted to revenue agents. For example, industry specialization programs provide guidance and training concerning specialized issues that may deserve audit attention.<sup>33</sup> Such information can assist in improving the efficiency and effectiveness of examination efforts by providing training and guidance for examiners. To the extent that this information is also communicated to taxpayers, additional voluntary compliance may also be achieved.<sup>34</sup>

---

28. See INTERNAL REVENUE MANUAL § 4.1.1.1 (2006) (quoting Policy Statement P-4-21).

29. See *Florsheim Bros. Drygoods Co. v. United States*, 280 U.S. 453, 461 (1930) (noting, “the purpose of these [IRS] audits is not to eliminate the necessity of filing the return, but to safeguard against error or dishonesty.”).

30. See DEP’T OF THE TREASURY BUDGET IN BRIEF 2 (2008) (noting that estimates of enforcement revenues “exclude[] the likely larger revenue impact from the deterrence value of these and other IRS enforcement programs (e.g., criminal investigations)”), <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf>.

31. *Id.* at 1 (noting that “[enhanced enforcement] ensure[s] taxpayers meet their tax obligations, so that when Americans pay their taxes, they can be confident their neighbors and competitors are also doing the same . . .”).

32. See DEP’T OF THE TREASURY BUDGET IN BRIEF 2 (2008), <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf>.

33. See, e.g., INTERNAL REVENUE SERV., CASH INTENSIVE BUSINESS: MARKET SEGMENT SPECIALIZATION PROGRAM GUIDELINE (2003), available at 2003 WL 24183009.

34. Cf. Rev. Proc. 89-14, 1989-1 C.B. 814, § 5. The Revenue Procedure states:

The purpose of publication of revenue rulings and revenue procedures in the Bulletin is to promote uniform application of the tax laws by Service employees and to assist

### B. Direct Benefits

Examinations help to close the tax gap in more quantifiable ways. The IRS enforcement budget for fiscal 2007 was less than \$7 billion.<sup>35</sup> It leveraged these resources to collect \$59.2 billion in unpaid taxes through its enforcement efforts in fiscal 2007, up more than twenty-one percent from the \$48.7 billion in fiscal 2006.<sup>36</sup> Of this \$59.2 billion, about \$23.5 billion was attributable to examinations, and \$3.9 billion came from document matching programs, which correlate information reporting to amounts reported on taxpayer returns; the balance of \$31.8 billion was attributable to collection efforts for previously determined tax liabilities.<sup>37</sup>

As noted above, only about one percent of all returns is audited. The IRS uses mathematical and statistical techniques, including a so-called “Discriminate Index Function” (DIF) to weight various return characteristics for purposes of selecting returns for examination.<sup>38</sup> Particular algorithms or details regarding this function or methods for return selection are closely guarded secrets, but considerable information is provided concerning the examination rates for particular segments of the population. Selected audit rates and information are displayed in Table 1, below.

Table 1: Selected Examination Rates by Segment, FY 2007<sup>39</sup>

<i>Individuals</i>	<i>Total Examinations</i>	<i>Returns filed in Prior calendar year</i>	<i>Examination Coverage</i>
All Individuals	1,384,563	134,421,400	1.03%
Income >= \$1 million	31,382	339,138	9.25%
Income >= \$200,000	113,105	3,942,702	2.87%

taxpayers in attaining maximum voluntary compliance by informing Service personnel and the public of National Office interpretations of the internal revenue laws, related statutes, treaties, and regulations, and statements of Service procedures affecting the rights and duties of taxpayers.

*Id.*

35. See 2008 DEP'T OF THE TREASURY BUDGET IN BRIEF 3 (2008), <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf>.

36. See INTERNAL REVENUE SERV. ENFORCEMENT AND SERVICE STATISTICS (2007), [http://www.irs.gov/pub/newsroom/irs\\_enforcement\\_and\\_service\\_tables\\_fy\\_2007.pdf](http://www.irs.gov/pub/newsroom/irs_enforcement_and_service_tables_fy_2007.pdf).

37. See *id.*

38. See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, REFERENCE NO. 2006-30-092, THE INFORMANTS' REWARDS PROGRAM NEEDS MORE CENTRALIZED MANAGEMENT OVERSIGHT n.18 (2006), available at <http://www.ustreas.gov/tigta/auditreports/2006reports/200630092fr.html>. For further discussion of the “discriminate index function,” see *infra* note 49 and accompanying text.

39. See INTERNAL REVENUE SERV. ENFORCEMENT AND SERVICE STATISTICS (2007), [http://www.irs.gov/pub/newsroom/irs\\_enforcement\\_and\\_service\\_tables\\_fy\\_2007.pdf](http://www.irs.gov/pub/newsroom/irs_enforcement_and_service_tables_fy_2007.pdf).

Income >= \$100,000	293,188	16,599,800	1.77%
Income < \$200,000	1,277,065	130,478,698	0.98%
Income < \$100,000	1,091,375	117,821,600	0.93%
<i>Businesses</i>			
All Businesses	59,516	9,072,828	0.66%
Small Corp. (Assets < \$10 million)	20,020	2,171,144	0.92%
Large Corp. (Assets >=\$10 million)	9,644	57,357	16.80%
Large Corp. (Assets >=\$250 million)	3,424	12,588	27.20%
S Corporation	17,657	3,909,730	0.45%
Partnership	12,195	2,934,597	0.42%

This data shows that examination rates vary depending on income demographics. Individuals earning under \$100,000 are audited at only about one ninth the rate for those earning \$1 million or more, and only about one third of the rate for those with incomes of \$200,000 or more. Business categories reflect a similar bias favoring large corporations over their smaller counterparts.

The total for examinations shown in Table 1 does not reflect differences in the extent of the examination. Correspondence examinations, which are more limited in scope than a field examination, make up a significant portion of examination coverage for individuals. Table 2 breaks down correspondence and field examinations by income strata:

Table 2: Examination Types for Individuals, FY 2007<sup>40</sup>

	<i>Total</i>	<i>Field</i>	<i>% of</i>	<i>Correspondence</i>	<i>% of</i>
	<i>Examinations</i>	<i>Examinations</i>	<i>Total</i>	<i>Examinations</i>	<i>Total</i>
All Individuals	1,384,563	311,339	22.49%	1,073,224	77.51%
Income >=\$1 million	31,382	12,259	39.06%	19,123	60.94%
Income >=\$200,000	113,285	43,640	38.52%	69,645	61.48%
Income >=\$100,000	293,188	127,544	43.50%	165,644	56.50%
Income < \$200,000	1,277,065	267,699	20.96%	1,009,366	79.04%

40. *See id.* The final category in this table is derived by subtraction of the figures from the income >= \$100,000 category from the income >= \$200,000 category. The results from subtracting the income < \$100,000 category from the income < \$200,000 category are comparable in magnitude, although not identical.



Income < \$100,000 Income	1,091,375	183,795	16.84%	907,580	83.16%
>=\$100K,<200K	179,903	83,904	46.64%	95,999	53.36%

Taxpayers with higher income levels are generally receiving a greater percentage of field examinations (and a likely greater share of examination resources) than lower income taxpayers. However, somewhat surprisingly, those with incomes in the \$100,000 to \$200,000 range experience more field examinations (46.64%) than the millionaire group (39.06%).

Although higher income strata generally have higher examination rates, relatively few individual taxpayers will face field examinations. As shown in Table 3 below, the risk of a field examination remains low for every category, suggesting that the so-called audit lottery is still open for those who wish to play.

Table 3: Field Examinations as Percentage of Prior Year Returns Filed, FY 2007<sup>41</sup>

	<i>Field Examinations</i>	<i>Total Returns from prior year</i>	<i>Field Exam Percentage</i>
All Individuals	311,339	134,421,400	0.23%
Income >=\$1 million	12,259	339,138	3.61%
Income >=\$200,000	43,640	3,942,702	1.11%
Income >=\$100,000	127,544	16,599,800	0.77%
Income < \$200,000	267,699	130,478,698	0.21%
Income < \$100,000	183,795	117,821,600	0.16%

### C. Costs to Government and Affected Taxpayers

Examinations are potentially costly for taxpayers and the government. Generalizations about cost are fraught with difficulty, due in part to variations in the nature and extent of the examination. However, a general measure may be derived from budget figures for enforcement activities. Assuming an annual budget of \$7.2 billion for enforcement,<sup>42</sup> and assuming further that about forty percent of this

41. *See id.*

42. *See* DEP'T OF THE TREASURY BUDGET IN BRIEF 3 (2008), <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf>.

budget is spent on examination activities<sup>43</sup> and that about 1.5 million returns are examined,<sup>44</sup> this translates into an average government cost of \$1,920 for each examined return.

Data disclosed by the Treasury Inspector General for Tax Administration (TIGTA) provides another basis for an estimate based on hours spent per return, which would seem to confirm that this \$1,920 figure is a plausible estimate. A government study involving 997,550 returns from 1996 to 1998 that were selected for examination required 13,418,772 hours, or about 13.45 hours per return.<sup>45</sup> This measure of labor would translate to an adjusted hourly rate of approximately \$143 per hour (including direct employee costs and associated overhead costs), which does not seem unreasonable.<sup>46</sup>

Of course, examinations also impose costs on taxpayers. Examinations can be intrusive and disruptive, imposing intangible costs that are difficult to quantify. IRS training materials caution that “[i]n-depth examinations of income may involve a thorough examination of the taxpayer's books and records or contacting third parties. Examiners should be sensitive to the burden this places on the taxpayer and the impact an in-depth examination may have upon the taxpayer's personal and professional life.”<sup>47</sup> Moreover, if professional advice is required, significant additional direct costs may also be incurred. Only in rare cases will taxpayer costs be reimbursed, as in matters where the IRS proceeded to litigation without substantial justification for its position.<sup>48</sup>

The primary method used by the IRS in selecting returns is known as the “Discriminate Index Function” or “DIF” – which is a mathematical weighting approach that assigns weights to different return

---

43. This is based on FY 2007 total of \$59.2 billion, of which \$23.5 billion (about 40%) was attributable to collection. See *supra* note 37 and accompanying text. This metric assumes a *pro rata* relationship between revenues and costs.

44. See *supra* Table 1.

45. See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, *supra* note 38.

46.  $\$1,920/13.45 \text{ hours} = \$142.75$ . The TIGTA Report also includes data from smaller return samples, which generate a higher figure for hours per return. See *id.* Without more data as to the method for selection, the larger sample would seem to provide a more reliable estimate.

47. INTERNAL REVENUE SERV., CASH INTENSIVE BUSINESS: MARKET SEGMENT SPECIALIZATION PROGRAM GUIDELINE (2003), available at 2003 WL 24183009.

48. See, e.g., I.R.C. § 7430 (West 2008) (permitting recovery of fees and administrative costs by prevailing party in litigation unless position of the United States was “substantially justified”). For critical discussion of prevailing party awards, see generally Wm. Brian Henning, Comment, *Reforming the IRS: The Effectiveness of the Internal Revenue Service Restructuring and Reform Act of 1998*, 82 MARQ. L. REV. 405, 419-25 (1999). Costs incurred in connection with an audit would not be within the scope of an award under I.R.C. § 7430. See *Columbus Fruit and Vegetable Co-op Ass’n v. United States*, 8 Cl. Ct. 525, 530-31 (1985) (quoting legislative history indicating that preparing the petition or complaint that commences a tax case is the first of recoverable attorney’s fees, but any fees for services before that point may not be recovered as litigation costs).

characteristics.<sup>49</sup> The DIF approach is reasonably effective in selecting returns that produce positive audit adjustments, but a significant number of examined returns nevertheless result in no changes. A sample of examined returns for the years 2003 to 2005 showed that out of 15,832 returns selected pursuant to the DIF approach, 4,435 (twenty-eight percent) resulted in no change.<sup>50</sup> A larger sample of 997,550 returns for fiscal years 1996 to 1998 showed 169,148 (seventeen percent) with no changes.<sup>51</sup>

Examinations that produce no changes may nevertheless provide useful information to the government concerning the particulars of taxpayer compliance. Significant costs are nevertheless involved, and as noted above, compliant taxpayers are unlikely to be reimbursed for incurring them.

Comparative information concerning examinations conducted pursuant to the informants' program and the DIF method confirm that the informants' program not only produced fewer no-change returns, thereby minimizing costs imposed on compliant taxpayers, but they also returned a higher amount of adjustment dollars per hour. Salient results are summarized in Table 4 below.

---

49. See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, *supra* note 38, at n.18.

50. See *id.* at fig.3.

51. See *id.* at fig.2.

Table 4: TIGTA Study Results for DIF and Informant Examinations<sup>52</sup>

	<i>Total Adjustments</i>	<i>Total Hours</i>	<i>Adjustment \$/hour</i>	<i>No-Change Return %</i>
<i>FY 2003-2005</i>				
Informants	\$26,233,554	38,139	\$688	21%
DIF	\$422,356,790	1,105,890	\$382	28%
<i>FY 1996-1998</i>				
Informants	\$160,091,580	169,259	\$946	12%
DIF	\$7,358,908,430	13,418,772	\$548	17%

These results indicate that using informants to gather information about noncompliant taxpayers increases the likelihood of additional tax collections from examinations. Informants have increased the dollars returned per hour invested by the IRS, nearly doubling the proposed adjustment per hour over the DIF sample. Moreover, informants have apparently reduced the number of no-change audits, thereby saving scarce government resources and benefiting compliant taxpayers.

The above figures do not show the effects of additional costs incurred due to awards on the net recovery obtained. However, the TIGTA report indicates that expenditures for rewards through fiscal 2005 have been highly productive. As shown in Table 5 below, rewards for fiscal years 2001 through 2005 have generated significant benefits over and above the taxes, fines, penalties, and interest recovered in those cases.

Table 5: Excess of Recoveries over Rewards to Informants  
FY 2001-2005<sup>53</sup>

Fiscal Year	2001	2002	2003	2004	2005
Recoveries	\$44,024,333	\$66,940,519	\$61,556,175	\$74,130,794	\$93,677,606
Rewards	\$3,337,035	\$7,707,402	\$4,057,476	\$4,585,143	\$7,602,685
Benefit	\$40,687,298	\$59,233,117	\$57,498,699	\$69,545,651	\$86,074,921

The figures in Table 5 show positive contributions from rewards to informants. However, the direct impact on the tax gap during these years seems modest – less than \$100 million annually – although these

---

52. See *id.* at figs.2 & 3.

53. See *id.* at fig.1.

figures do not measure any indirect effects on compliance that may come from effective enforcement. Moreover, informants appear to be getting a small part of the total recovery – rewards are averaging about eight percent of the total recovered amount (which includes interest).

As discussed below, structural amendments to the whistleblower/informant reward programs in 2006 are likely to increase the total award payout. However, even if award percentages increase substantially, the extra payout is unlikely to offset the gains to the treasury that informants have historically generated. For example, even if the adjustment per hour is reduced by a full thirty percent (i.e., the top rate for prospective awards under I.R.C. § 7623(b)), the adjustment rate per hour for informants would continue to be higher than that obtained through the DIF approach.<sup>54</sup> However, the extent to which the additional awards will be effective in closing the tax gap remains untested. This will depend, in part, on the administration of award programs, as discussed below.

### III. REWARDS FOR INFORMANTS

The Federal government has a long history of providing rewards or incentives for information that assists in the enforcement of tax laws. Federal legislation has provided for rewards for information with regard to the enforcement of the tax laws since 1867.<sup>55</sup> Two separate programs currently provide a basis for seeking rewards for tax-related information, and each program is explored separately below.

#### *A. Discretionary Informant Rewards Under I.R.C. § 7623(a)*

I.R.C. § 7623(a) continues a longstanding discretionary system for authorizing the payment of rewards to informants. This provision generally authorizes the Secretary of the Treasury “to pay such sums as he/[she] 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

---

54. To illustrate, using the FY2003-2005 adjustment for examinations initiated by informants of \$26.2 million (see Table 4, above), and assuming a full thirty percent of the adjustment is diverted to a whistleblower under I.R.C. § 7623(b), that would still leave \$18.3 million for the government and a net adjustment per hour of \$481, which would continue to exceed adjustment rates from the DIF approach.

55. See *Dacosta v. United States*, 82 Fed. Cl. 549, 552 & n.5 (2008); History of the Whistleblower/Informant Program, <http://www.irs.gov/compliance/article/0,,id=181294,00.html> (last visited Oct. 20, 2008).

where such expenses are not otherwise provided for by law.”<sup>56</sup> Legislation in 2006 substituted “or” for “and” between clauses (1) and (2).<sup>57</sup> This amendment presumably clarifies and confirms that rewards may be given for detecting both civil and criminal violations of tax laws. However, regulations first promulgated in 1997 also state these two criteria in the disjunctive.<sup>58</sup>

Rewards are generally sourced from the “proceeds of amounts collected by reason of the information provided.”<sup>59</sup> Prior to the amendment in 2006, rewards could not be based on interest, but instead were restricted to the recovery of taxes and penalties.<sup>60</sup> Thus, the 2006 amendment potentially expands the base from which these discretionary rewards may be paid. This change effectively compensates the informant for waiting until the IRS collects these amounts from the taxpayer before obtaining payment of an award.<sup>61</sup>

Treasury regulations<sup>62</sup> and other administrative pronouncements<sup>63</sup> provide additional guidance to prospective informants, but they provide no basis to determine either eligibility or the amount of the payment.<sup>64</sup> The discretionary nature of rewards in this context has been confirmed in case law involving the adjudication of claims by informants seeking to recover their rewards.

---

56. I.R.C. § 7623(a) (West 2008).

57. Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(a)(1)(B), 120 Stat. 2922, 2958 (2006).

58. See Treas. Reg. § 301.7623-1(a) (as amended by T.D. 8737, 1997-2 C.B. 273) (providing that “[i]n cases where rewards are not otherwise provided for by law, a district or service center director may approve a reward, in a suitable amount, for information that leads to the detection of underpayments of tax, or the detection and bringing to trial and punishment of persons guilty of violating the internal revenue laws or conniving at the same.” (emphasis added)). This regulatory change was promulgated in T.D. 8737, 1997-2 C.B. 273, which included temporary regulations issued in response to section 1209 of the Taxpayer Bill of Rights 2, Pub. L. 104-168, 110 Stat. 1452 (1996).

59. I.R.C. § 7623(a).

60. See Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(a)(1)(C), 120 Stat. 2922, 2958 (2006) (striking the parenthetical restriction “other than interest” from current § 7623(a)).

61. However, to the extent that interest assessed precedes the date the informant provides information, the informant receives a direct benefit that does not correlate to the time value of his award.

62. See Treas. Reg. § 301.7623-1.

63. For current guidance from the IRS regarding awards for whistleblowers, see, for example, Whistleblower—Informant Award, <http://www.irs.gov/compliance/article/0,,id=180171,00.html> (last visited Jan. 17, 2009); see also INTERNAL REVENUE SERV., PUB. NO. 733, REWARDS FOR INFORMATION PROVIDED BY INDIVIDUALS TO THE INTERNAL REVENUE SERVICE (2004), available at <http://lib.store.yahoo.net/lib/realityzone/UFNIRSrewards.pdf>.

64. See, e.g., Treas. Reg. § 301.7623-1; INTERNAL REVENUE MANUAL § 25.2.2 (1999).

For example, in *Confidential Informant v. United States*,<sup>65</sup> an informant brought a claim against the government in the United States Court of Federal Claims based on what he had characterized as a “substantive right pursuant to I.R.C. § 7623.”<sup>66</sup> At the core of this claim was whether I.R.C. § 7623 was “money-mandating,” which was necessary to invoke jurisdiction of the claims court.<sup>67</sup> However, the court rejected the informant’s claim of a putative right to an award on the grounds that “neither the statute nor the regulation contains specific requirements that an informant must meet in order to be eligible for compensation. Furthermore, neither the statute nor the regulation states a sum certain.”<sup>68</sup>

Regulations state that a “district or service center director” determines whether a reward will be paid and the amount of the reward based on “[a]ll relevant factors, including the value of the information furnished in relation to the facts developed by the investigation of the violation.”<sup>69</sup> Regulations also provide that “[t]he amount of a reward will represent what the district or service center director deems to be adequate compensation in the particular case, generally not to exceed fifteen percent of the amounts (other than interest) collected by reason of the information.”<sup>70</sup> Thus, the regulations only provide an outer percentage limit for an award, but they do not entitle a claimant to a particular amount.

Claims based on a putative contract with the IRS to pay a reward for information, which would be money-mandating, are difficult to prove. One significant barrier is found in the regulations, which state in part: “No person is authorized under this section to make any offer, or promise, or otherwise to bind a district or service center director with respect to the payment of any reward or the amount of the reward.”<sup>71</sup> Persons other than the district or service center director are not expressly authorized to contract on the government’s behalf.<sup>72</sup>

---

65. 46 Fed. Cl. 1 (2000).

66. *Id.* at 4.

67. *See id.* at 5-6.

68. *Id.* at 6.

69. Treas. Reg. § 301.7623-1(c).

70. *See id.* The restriction “other than interest” in the current regulations does not yet reflect changes from the Tax Relief and Health Care Act of 2006. *See* discussion *supra* notes 59-61.

71. *See* Treas. Reg. § 301.7623-1(c).

72. *See, e.g., Confidential Informant v. United States*, 46 Fed. Cl. 1, 7 (2006) (noting that “[b]ecause neither the statute nor the implementing regulation granted the government officials in this case the authority to bind the government in contract, plaintiff’s contractual theory of relief cannot rely on the express authority of the government agents.”).

A recent case illustrates the difficulties encountered in seeking a discretionary reward. In *Abraham v. United States*,<sup>73</sup> the claimant became suspicious about the estate tax return that was being prepared for his mother's estate. He contacted the IRS with these concerns and was allegedly advised by the agent on duty that he would receive a reward of fifteen to twenty-five percent of the taxes collected if he would submit a letter documenting his concerns along with a check for his share of estate taxes due.<sup>74</sup> Abraham duly complied by sending such a letter along with a check for \$109,292.<sup>75</sup>

The Service audited the returns and after years of litigation, it collected a deficiency of some \$1.125 million from the estate.<sup>76</sup> Abraham thereafter filed an "Application for Reward for Original Information," and his claim was rebuffed by the IRS.<sup>77</sup> He filed suit in the Court of Federal Claims alleging breach of contract and demanding ten to fifteen percent of the deficiency under I.R.C. § 7623(a).<sup>78</sup>

Despite precedents adverse to the creation of a contract claim until the amount of the award is fixed and promised by the IRS,<sup>79</sup> the court permitted this taxpayer to go forward with proof that an "implied in fact" contract may exist between the taxpayer and the government.<sup>80</sup> Here, instead of an indefinite offer that would otherwise preclude the formation of a contract because there was no acceptance by the government, the claimant had asserted a specific offer, to which he responded with a letter and a check.<sup>81</sup> As for the authority of an agent to bind the government, the court would allow proof on the issue of whether implied actual authority existed in this case – despite the fact that the regulations limit express authority.<sup>82</sup>

Cases like *Abraham* show the perils faced by potential claimants in collecting their rewards. If Abraham is successful in his claim, he will

---

73. 81 Fed. Cl. 178 (2008).

74. *Id.* at 179, 186.

75. *Id.* at 179.

76. *Id.* at 180.

77. *Id.*

78. Abraham had filed an earlier claim in the Tax Court under the whistleblower provisions, but it was dismissed for lack of jurisdiction. *See id.* Presumably, the lower percentage that Abraham requested reflects the general limitation found in the regulations applicable to informant rewards, rather than the higher amount allegedly promised by the agent that may have contemplated an award under the whistleblower program of I.R.C. § 7623(b).

79. *See, e.g.,* *Krug v. United States*, 168 F.3d 1307, 1309-10 (Fed. Cir. 1999); *Merrick v. United States*, 846 F.2d 725, 726 (Fed. Cir. 1988) (noting that "[a]n enforceable contract will arise . . . only after the informant and the government negotiate and fix a specific amount as the reward.").

80. *See Abraham v. United States*, 81 Fed. Cl. 178, 183-87 (2008).

81. *See id.* at 186.

82. *See id.* at 186-87.



potentially offset his share of estate taxes and impose an additional burden on his fellow beneficiaries. Whether he will be paid at all, however, is highly uncertain. The message to the informant community in these circumstances does not appear encouraging. Short of contracting in advance with the district or service center director (or someone with express authority to negotiate on his or her behalf) for a specific award, contract theory provides a doubtful remedy for this uncertainty. Sound policy reasons may exist for limiting those who can contract on behalf of the government, but raising this defense also raises doubts concerning the reliability of IRS personnel and their representations. As the Federal Circuit has commented in a case involving another disaffected claimant for an award, IRS conduct in these matters may sometimes “leave[] much to be desired in terms of how the Government should treat its citizens.”<sup>83</sup>

Even if the government follows through and pays a reward, collection may take many years until litigation has run its course and the amounts at stake are collected.<sup>84</sup> Regulations permit an informant to waive a claim to a future reward in exchange for a current payment.<sup>85</sup> However, the Internal Revenue Manual requires that all rewards are subject to repayment if the collections on which it is based are subsequently reduced, presenting some additional risk to the claimant in this context.<sup>86</sup> Moreover, one would suspect that an early payment is significantly discounted, reflecting a conservative measure of the litigation or collection hazards in the particular case.<sup>87</sup>

---

83. See *Krug*, 168 F.3d. at 1310. See also Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357, 363 (2008) (highlighting findings of the Treasury Inspector General, including that “in 76 percent of the cases reviewers failed to offer any explanation for rejecting the claim”).

84. See *id.* (noting average delay of 7.5 years before obtaining awards).

85. See Treas. Reg. § 301.7623-1(c) (as amended in 1998).

86. See INTERNAL REVENUE MANUAL § 25.2.2.9 (1999). A special agreement might alter this requirement, though such agreements are discouraged. See *id.* § 25.2.2.5, ¶ 2. The Internal Revenue Manual also cautions: “[I]n the interest of maintaining a viable informants’ reward program, the merit of requiring repayment should always be weighed against the veracity of the informant and the information provided.” *Id.* § 25.2.2.9.

87. See *id.* § 25.2.2 illus.6, containing a “sample letter which may be used to offer the informant an early reward” which states “by signing the Request for Early Award, you will be waiving any possibility of a larger reward.”

### B. Whistleblower Awards Under I.R.C. § 7623(b)

The Tax Relief and Health Care Act of 2006 also added I.R.C. § 7623(b) to the Code.<sup>88</sup> This provision creates an alternative reward system for high-value cases, which is intended to provide greater certainty and predictability for potential claimants. However, as discussed below, considerable discretion remains, and the scheme adopted raises other significant and unanticipated problems for tax administration.

#### 1. Threshold Amounts

The award program under I.R.C. § 7623(b), entitled “Awards to Whistleblowers,” applies to enforcement actions where the “tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000.”<sup>89</sup> Additionally, if an individual taxpayer is involved, that individual must have gross income in excess of “\$200,000 for any taxable year subject to such action.”<sup>90</sup>

The rationale for imposing a relatively high threshold – \$2 million – for the disputed amount is not clearly stated. Legislation has been introduced to amend this provision by reducing this amount to \$20,000, but this change was not enacted.<sup>91</sup> The high threshold will likely relegate most potential claims to the discretionary informant program in I.R.C. § 7623(a), rather than to the whistleblower award program.

There are plausible policy reasons for limiting whistleblower claims to high-value targets in the initial phases of this program. The Whistleblower Office is a new division within the IRS that is charged with administering the whistleblower award program.<sup>92</sup> It may be prudent to limit the extent of its obligations in order to ensure that it is able to handle the workload effectively. Focusing on the highest value targets will also be most likely to generate favorable adjustments in

---

88. See Relief and Health Care Act of 2006, Pub. L. 109-432, § 406(a)(1)(D), 120 Stat. 2922 (2006). For one commentator’s assessment of the impetus behind these changes, see Ventry, *supra* note 83, at 362-68.

89. I.R.C. § 7623(b)(5)(B) (West 2008).

90. *Id.* at § 7623(b)(5)(A).

91. See H.R. 1591, 110th Cong. § 543(a) (1st Sess. 2007).

92. See Relief and Health Care Act of 2006, Pub. L. 109-432, § 406(b)(1), 120 Stat. 2922, 2959-60 (2006) (defining functions of the Whistleblower Office); *IRS Begins Work on Whistleblower Office; Whitlock Named First Director*, INTERNAL REVENUE SERV. NEWSROOM (Internal Revenue Serv., Washington, D.C.), Feb. 2, 2007, available at <http://www.irs.gov/newsroom/article/0,,id=167542,00.html>.

relation to the costs incurred.<sup>93</sup> Establishing a favorable track record may be an important foundation for seeking additional funding for future efforts of this nature.

The rationale for imposing an additional income limit for individual taxpayers is less clear. Satisfaction of the \$2 million threshold would seem to provide a sufficient basis for IRS attention regardless of whether an individual has a modest annual gross income. Nevertheless, this restriction is unlikely to impose a significant practical constraint on eligibility. Few taxpayers with income tax liabilities exceeding the \$2 million threshold would not also satisfy the \$200,000 income limitation. However, claims involving taxes that are not based on income, such as those involving federal wealth transfer taxes, as well as aggregate claims based on multiple open tax years for a taxpayer who failed to file returns, could conceivably be affected by this income limit.

## 2. Award Parameters

If the above thresholds are met, the whistleblower award program generally provides that the claimant “shall . . . receive as an award at least 15 percent but not more than 30 percent of the collected proceeds . . . resulting from the action . . . or from any settlement in response to such action.”<sup>94</sup> On its face, the statute defines this program in a manner that is quite different from the discretionary informant program under I.R.C. § 7623(a). First, it generally entitles the whistleblower to an award, rather than leaving this to the discretion of the district or service center director.<sup>95</sup> Second, it potentially increases the amount of such awards by defining the minimum award at fifteen percent, which was the maximum generally allowed under the discretionary informant award program.<sup>96</sup> Moreover, there are no caps on whistleblower awards, whereas the

---

93. Corporate tax abuses in prominent public cases may have also influenced Congress’ interest in focusing whistleblower incentives on large corporate targets. For example, Enron Corporation reported positive income for financial reporting purposes, but paid taxes in only one year during the period 1996-2001. See JOINT COMMITTEE ON TAXATION, PUB. NO. JCS-3-03, REPORT OF INVESTIGATION OF ENRON CORPORATION AND RELATED ENTITIES REGARDING FEDERAL TAX AND COMPENSATION ISSUES, AND POLICY RECOMMENDATIONS (2003). Even though Enron was under audit, the full scope of tax misconduct was not known until after its collapse. See *id.*

94. I.R.C. § 7623(b)(1).

95. See Treas. Reg. § 301.7623-1(c) (as amended in 1998) (stating that “[t]he amount of a reward will represent what the district or service center director deems to be adequate compensation in the particular case, generally not to exceed fifteen percent of the amounts (other than interest) collected by reason of the information.”).

96. See *id.*

discretionary awards under I.R.C. § 7623(a) are capped at a maximum of \$10 million.<sup>97</sup>

The whistleblower award program may circumscribe the role of IRS discretion, but it does not eliminate discretion entirely. The Whistleblower Office of the IRS, which is authorized to process tips received by taxpayers and to determine eligibility for whistleblower awards,<sup>98</sup> must still determine whether to proceed with an enforcement action. In particular, the statute requires that the IRS must proceed with an enforcement action “based on information brought to the Secretary’s attention” in order to secure an award.<sup>99</sup> Further, determining the amount of the award within the range of fifteen to thirty percent of the recovery depends primarily on “the extent to which the individual substantially contributed to such action.”<sup>100</sup>

First, whether the IRS proceeds “based on” information provided by the whistleblower is potentially complex, leaving room for uncertainty. For example, if multiple sources provide the same information, then which of them has brought the matter to the IRS’s attention for purposes of being entitled to the award? If the IRS had previously been building a case, must additional whistleblower information be outcome-determinative in the decision to proceed? Stated differently, is one entitled to an award when the IRS proceeds based “in part” on that information? Or is it “primarily” on that information? Or is the standard somewhere in between?

Second, the parameters for determining whether an individual “substantially contributed” also present uncertainty. The determination appears to involve an inquiry into the connection between information the whistleblower provides and the ultimate success of the IRS claim asserted against the taxpayer.<sup>101</sup> Moreover, whether the individual “substantially contributed” is arguably limited to determining the level,

---

97. See Ventry, *supra* note 83, at 364 (discussing the history of IRS practices in raising caps on awards).

98. See generally Whistleblower Office At-a-Glance, <http://www.irs.gov/irs/article/0,,id=179207,00.html> (last visited May 27, 2008).

99. I.R.C. § 7623(b)(1).

100. *Id.*

101. Compare INTERNAL REVENUE MANUAL § 25.2.2.17 (1999), which provides with regard to informant cases that

[n]o reward is allowable if the information originally furnished was unworthy of investigation even if the return is examined at some later date (but without reference to the information furnished) and a deficiency is assessed. Such claims should be rejected on the basis that the information did not cause the investigation nor did it, in itself, result in the recovery of taxes, fines, and penalties.

within the fifteen to thirty percent range, at which a payment should be made.

Although some discretion may be unavoidable, additional guidance as to the meaning of whether the information “substantially contributed” and its relationship to the “based on” determination would be helpful to enhance certainty and predictability of this process. For example, suppose the IRS already has information in its possession showing a likely deficiency, but it needs further proof to establish penalties for fraud. If a whistleblower provides this information and further actions are taken to assert fraud penalties, has the “based on” test been met? If so, has the individual substantially contributed? Is the award to be constrained to the amount collected from that issue, if the examination was already underway?<sup>102</sup> Additional administrative guidance here would be appropriate to limit potential litigation on these kinds of questions.

The statute indicates that the source of the information provided by the whistleblower may also be important in determining eligibility for an award. If the Whistleblower Office determines an action is:

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 . . . resulting from the 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.<sup>103</sup>

Thus, the whistleblower award program arguably permits, but does not require, an award of no more than ten percent if the whistleblower merely transmits information that comes from a public source, such as a judicial hearing, government report, or news story. Such information

---

102. The Code provides that the award is a percentage of “collected proceeds . . . resulting from the action (including any related actions) . . .” I.R.C. § 7623(b)(1). This indicates that information leading to an audit for one issue, but which expands to address other issues (i.e., with such expansions constituting “related actions”), may generate a whistleblower award that is a percentage of the entire recovery. Internal guidance regarding the assessment of whistleblower claims indicates that analysis of audit plans is one part of the evaluation of whether to proceed. See Memorandum from the Commissioner of Large and Mid-Size Business Division to all LMSB Industry Directors (July 21, 2008), available at <http://www.irs.gov/pub/foia/ig/lmsb/lmsb-4-0508-033.pdf>.

103. § 7623(b)(2)(A).

would have doubtful utility to the IRS, which would already have access to the information and could act independently to initiate an examination. Discretionary powers to provide a lesser award (or none at all) in this context resemble those in I.R.C. § 7623(a).

The statute also states that discretion to deny an award based on public information “shall not apply if the information resulting in the initiation of the action described in paragraph (1) was originally provided by the individual provided in paragraph (1).”<sup>104</sup> This enigmatic statement contemplates that, for example, a whistleblower may provide information before it becomes available from a public source, such as the news media or a judicial hearing. The subsequent availability of that information would not necessarily deprive the whistleblower of an award at the minimum fifteen percent level under I.R.C. § 7623(b)(1), assuming the IRS acted based on the information and it otherwise substantially contributed to the success of the enforcement effort.<sup>105</sup>

In addition to evaluating the source of the information and its contribution to the success of the IRS claim, the statute also requires the Whistleblower Office to evaluate whether the claim for an award “is brought by an individual who planned and initiated the actions that lead to the underpayment of tax [or other violation of Internal Revenue laws].”<sup>106</sup> If so, the Whistleblower Office “may appropriately reduce [the] award.”<sup>107</sup> If that individual is convicted of criminal conduct arising from his or her role in planning and initiating these actions, discretion is eliminated and the award must be denied.<sup>108</sup>

A recent IRS memorandum provides additional guidance on the administrative processing of whistleblower cases, including the handling of so-called “tainted” information coming from the whistleblower.<sup>109</sup> Tainted information “includes, but is not limited to information that is privileged, illegally obtained by the whistleblower, or information obtained by the government in a non-passive manner.”<sup>110</sup> The memo advises that tainted information may provide a basis for rejecting a

---

104. § 7623(b)(2)(B).

105. See § 7623(b)(1). As discussed below, the IRS may also seek additional cooperation or assistance from an informant. In this context, the substantial contribution analysis might also include effort as well as information.

106. See § 7623(b)(3).

107. See *id.*

108. See *id.*

109. See Memorandum from the Commissioner of Large and Mid-Size Business Division to all LMSB Industry Directors (July 21, 2008), available at <http://www.irs.gov/pub/foia/ig/lmsb/lmsb-4-0508-033.pdf>.

110. *Id.* at 3.

whistleblower claim.<sup>111</sup> The memo also suggests, however, that in some cases, tainted information will be passed along to the audit team.<sup>112</sup> Tainted information constrains the Whistleblower Office's ability to engage in additional contacts with the whistleblower for purposes of developing the information necessary to continue with an enforcement action, and it requires additional analysis to determine whether, and in what circumstances, it could be used as evidence.<sup>113</sup> This constraint may contribute to the use of third-party representatives, who may assist a prospective whistleblower in developing the necessary information prior to contacting the Whistleblower Office.<sup>114</sup>

### 3. Judicial Review in the Tax Court

The Code provides that whistleblower award determinations are eligible for judicial review by the Tax Court.<sup>115</sup> As discussed above, decisions involving discretionary awards under I.R.C. § 7623(a) are not eligible for judicial review unless the informant can establish a contract for payment.<sup>116</sup> In contrast, a whistleblower seeking an award under I.R.C. § 7623(b) has standing to enforce his or her claim to an award regardless of whether a contract exists. The statute expressly provides that “[n]o contract with the Internal Revenue Service is necessary for any individual to receive [a whistleblower award].”<sup>117</sup> A whistleblower under I.R.C. § 7623(b) also receives another benefit that informants under I.R.C. § 7623(a) generally do not receive: the ability to deduct attorney fees and court costs in enforcing that claim as an above-the-line deduction.<sup>118</sup>

---

111. *Id.* at 4 (listing among four examples of reasons to reject a claim, “the claim results from information that is subject to privilege that was not waived by the taxpayer”).

112. *Id.* at 2 (stating that “[i]f informant information is tainted, the [subject matter expert] and anyone who reviews the tainted information will not be able to participate in the civil examination after the information is passed on to the audit team.”).

113. See *id.* at 3. This analysis may involve a determination of whether the whistleblower is subject to the so-called “one-bite” rule applicable to employees or representatives of the taxpayer. See I.R.S. Chief Counsel Notice CC-2008-011 (Feb. 27, 2008), available at 2008 WL 623141.

114. See *infra* note 139 and accompanying text.

115. See I.R.C. § 7623(b)(4) (West 2008).

116. See *supra* notes 73-83 and accompanying text. See also *Destefano v. United States*, 52 Fed. Cl. 291, 293 (2002) (stating that “[t]he applicable statute and regulation [i.e., I.R.C. § 7623(a) and Treas. Reg. § 301.7623-1] neither create contractual obligations upon the Government nor do they empower judicial review.”).

117. § 7623(b)(6)(A).

118. See § 62(a)(21). However, this benefit may prove illusory if the whistleblower is required to pay costs or fees in a taxable year that differs from the year the award is paid. This deduction is not available for “any deduction in excess of the amount includible in the taxpayer’s gross income for the taxable year on account of such award.” *Id.*

The statutory scheme outlined above does not define the scope of review to be applied by the Tax Court. The review process also presents the possibility that otherwise secret policies and practices within the IRS will need to be disclosed and analyzed in order to evaluate the whistleblower's claim. The privacy of the targeted taxpayer is also potentially at risk through the need to disclose return information to allow judicial review of a whistleblower award claim. Finally, the identity of the whistleblower may also be disclosed in this process. These unresolved issues concerning the judicial review process are discussed below.

#### a. Scope of Review

On October 3, 2008, the Tax Court promulgated amendments to its rules governing whistleblower cases.<sup>119</sup> Title XXXIII of these amended rules includes new rules 340 to 344 containing procedures for whistleblower claims. Rule 341(b) provides the basic content of the "Petition for Whistleblower Action Under Code Section 7623(b)(4)," which requires, in addition to a copy of the IRS determination under review, "lettered statements explaining why the petitioner disagrees with the determination by the Internal Revenue Service Whistleblower Office" and "lettered statements setting forth the facts upon which the petitioner relies to support the petitioner's position."<sup>120</sup>

Significantly, these rules are silent as to the scope of review before the Tax Court. The explanation to new Rule 340 states in part: "Without specific statutory direction establishing whether whistleblower actions are to be decided on the administrative record, the Court contemplates that the appropriate scope of review will be developed in case law."<sup>121</sup> Congress' failure to provide guidance is problematic. If the purpose behind judicial review is to ensure that a whistleblower who is entitled to an award receives one (thereby preventing government misconduct from denying the right to recover), a *de novo* evaluation of the relevant evidence concerning eligibility for an award would most fully achieve that purpose.

A more deferential and limited scope of review, such as applying an abuse of discretion standard to the determinations in the record made by the Whistleblower Office, would admittedly be an improvement over

---

119. See *U.S. Tax Court Adopted Amendments to Rules of Practice and Procedure on Whistleblower Actions*, 8 TaxCore (BNA) No. 194 (Oct. 7, 2008).

120. TAX CT. R. 341(b)(3)-(4).

121. TAX CT. R. 340 cmts.



the purely discretionary system. However, it would provide significantly less comfort to whistleblowers that the system is not rigged against them. Unfortunately, that may be the only practical approach available to the Tax Court in these circumstances, to the extent that a thorough, adversarial review process injects the need to provide whistleblowers with access to information that is otherwise protected by law.

#### b. Disclosure of IRS Information

Treasury regulations restrict testimony and/or disclosure of IRS records or information in various circumstances, such as where that information might “disclose investigative techniques and procedures, the effectiveness of which could thereby be impaired.”<sup>122</sup> The discretionary informant award scheme did not require the IRS to disclose the basis for rejecting an award. For example, in *Conner v. United States*,<sup>123</sup> the Court of Federal Claims dismissed a *pro se* case brought by an informant who claimed a monetary reward for reporting several individuals who allegedly underpaid their taxes.<sup>124</sup> The claimant had received a rejection letter from the IRS which effectively stated that “Federal disclosure and privacy laws” prohibited disclosure of the specific reason for rejecting a claim for an award.<sup>125</sup>

In contrast, a whistleblower award claim involving the matter of whether the IRS acted “based on” the taxpayer’s information and whether that information “substantially contributed”<sup>126</sup> to the result arguably requires evaluation of the scope and effect of various investigative techniques, which otherwise would remain secret.<sup>127</sup> Neither Congress nor the Treasury has provided any basis for this kind

---

122. Treas. Reg. § 301.9000-2(a)(5) (2005).

123. 76 Fed. Cl. 86 (2007).

124. *Id.* at 87.

125. *Id.* A similar form letter is also found in the Internal Revenue Manual. See INTERNAL REVENUE MANUAL § 25.2.2 illus. 7 (“Letter 1010(SC), which can be used to reject a claim for reward”).

126. I.R.C. § 7623(b)(1) (West 2008).

127. For example, a subject matter expert (SME) within the whistleblower office is charged with “[d]etermining if the audit team has already identified the issue or if the information could help make the development of an existing issue more efficient or more complete. If the issue has been identified, determine when and how the team identified it.” Memorandum from the Commissioner of Large and Mid-Size Business Division to all LMSB Industry Directors 2 (July 21, 2008), available at <http://www.irs.gov/pub/foia/ig/lmsb/lmsb-4-0508-033.pdf>. Such determinations would be important in order to evaluate whether the IRS proceeded based on the whistleblower’s information, but they would also potentially require access to audit work papers and plans.

of disclosure, thus leaving the whistleblower in a difficult position with regard to proving entitlement to an award.

### c. Privacy Concerns for Targeted Taxpayers and Whistleblowers

The privacy rights of taxpayers under investigation also present potential concerns in whistleblower award litigation. Regulations provide that neither testimony nor information may be disclosed if doing so would violate the confidentiality of taxpayer information provided by I.R.C. § 6103, or would violate regulations governing information obtained under Bank Secrecy Act investigations.<sup>128</sup> In a whistleblower award case, the amount of the award may depend on whether the IRS collected a particular amount in a settlement (as opposed to litigation where the results can be known to the public). Thus, resolution of such a claim might require the disclosure of particular information from the taxpayer under examination in order to satisfy the whistleblower that he or she is receiving the appropriate amount. Such disclosures were unnecessary in a discretionary system, but are likely in a system based on rights.

Finally, litigation also presents concerns with regard to the disclosure of the identity of the whistleblower and other information to the public. Proposed legislation in 2007 sought to address general privacy issues through an amendment of I.R.C. § 7623(b)(4), which would state in part:

Notwithstanding sections 7458 and 7461, the Tax Court may, in order to preserve the anonymity, privacy, or confidentiality of any person under this subsection, provide by rules adopted under section 7453 that portions of filings, hearings, testimony, evidence, and reports in connection with proceedings under this subsection may be closed to the public or to inspection by the public.<sup>129</sup>

This amendment was not enacted, but ample administrative authority nevertheless exists for the Tax Court to provide for confidentiality and anonymity when necessary.<sup>130</sup> The October 3, 2008

---

128. See Treas. Reg. § 301.9000-2(a)(1) to (2) (2005).

129. H.R. 1591, 110th Cong. § 543(c)(4)(B) (1st Sess. 2007).

130. Despite a general practice favoring disclosure in judicial proceedings, I.R.C. § 7461(b)(1) provides that “[t]he Tax Court may make any provision which is necessary to prevent the disclosure of trade secrets or other confidential information, including a provision that any document or information be placed under seal to be opened only as directed by the court.” See also *Anonymous v. Commissioner*, 127 T.C. 89, 91-93 (2006) (discussing considerations for sealing records and proceeding anonymously in the Tax Court).

amendments to the Tax Court's rules include the following explanation, which relates to the need to protect confidential information, including the identity of the whistleblower:

Pursuant to section 7458, hearings before the Tax Court shall be open to the public. Pursuant to section 7461(a), all reports of the Tax Court and all evidence received by the Tax Court are generally public records open to the inspection of the public. Pursuant to section 7461(b)(1), the Court may issue protective orders, upon motion by a party or any other person and for good cause shown, to prevent or restrict the disclosure of trade secrets and other information. See Tax Court Rule 103(a). As result of this authority, in appropriate cases, the Court may permit a petitioner to proceed anonymously and seal the record in that case. See, e.g., *Anonymous v. Commissioner*, 127 T.C. 89 (2006). The Court contemplates that these generally applicable statutory provisions, Rule 103, and related case law, while they do not require the Court's records in all whistleblower actions to be sealed or require the Court to permit all petitioners in those cases to proceed anonymously, do provide authority for the Court to allow a petitioner to proceed anonymously and to seal the record when appropriate in whistleblower actions.<sup>131</sup>

This authority to protect the anonymity of the whistleblower and to protect information from public disclosure does not resolve the problem concerning the preservation of the privacy of the taxpayer under investigation, where disclosure to the informant and his/her counsel may be necessary to review an adverse determination concerning an award.

Temporary regulations have been promulgated to address this disclosure of return information if the IRS contracts with the whistleblower or his legal representative for additional services – a so-called “tax administration contract.”<sup>132</sup> The preamble to these regulations explains that I.R.C. § 6103(n) permits disclosure of return

---

131. TAX CT. R. 340 cmts.

132. See T.D. 9389, 2008-18 I.R.B. 863. The preamble states in part:

In analyzing information provided by a whistleblower, or investigating a matter, the Whistleblower Office may determine that it requires the assistance of the whistleblower, or the legal representative of the whistleblower. The legislative history of section 406 of the Act states that “[t]o the extent the disclosure of returns or return information is required [for the whistleblower or his or her legal representative] to render such assistance, the disclosure must be pursuant to an IRS tax administration contract.” Joint Committee on Taxation, Technical Explanation of H.R. 6408, The “Tax Relief and Health Care Act of 2006,” as Introduced in the House on December 7, 2006, at 89 (JCX-50-06), December 7, 2006.

*Id.*

information pursuant to a tax administration contract.<sup>133</sup> The preamble also notes, however, that “it is expected that such disclosures will be infrequent and will be made only when the assigned task cannot be properly or timely completed without the return information to be disclosed.”<sup>134</sup> Conditions for disclosure include restrictions that limit the content to that which is relevant to the services being procured, and appropriate safeguards must also be in place to ensure the continued confidentiality of this information.<sup>135</sup>

These regulations may assist whistleblowers with a tax administration contract in obtaining information on which to evaluate an award claim. However, other whistleblowers without such contracts may still face problems in enforcing their claims, assuming that taxpayer protections are otherwise taken seriously in this area.

Taxpayers targeted by whistleblower tips also deserve assurance that their return information is not disclosed inappropriately to whistleblowers seeking to enforce putative reward rights. Important policy choices thus remain unresolved here within this tension between taxpayer privacy and whistleblower rights. Reducing government discretion in awards may have a salutary effect on the incentive to come forward with information, but additional attention is required to provide the rules that will fill the discretionary void. A form of *in camera* review, in which the Tax Court accesses and reviews relevant documents without disclosing them to the whistleblower, might provide one means to resolve these tensions. *In camera* review processes have been used regarding other sensitive materials, such as FOIA requests for sensitive information affecting government investigations.<sup>136</sup> However, these processes are discretionary, and they involve potentially burdensome tasks for judges without the assistance of adversary challenges to evidence. It should also be noted that this approach to judicial review will more closely resemble features of a discretionary award system, which was part of the original need for reform. Clarification by appropriate policymakers, rather than *ad hoc* development, would be a preferable approach to developing the protocols for judicial review in this context.

---

133. *See id.*

134. *See id.* (internal quotation omitted).

135. *See id.*

136. *See, e.g., Lewis v. Internal Revenue Serv.*, 823 F.2d 375, 378 (9th Cir. 1987) (exempting IRS documents from FOIA request based on government affidavits, but allowing *in camera* review as a discretionary matter to determine exempt status).

#### IV. ETHICAL CONSIDERATIONS: ADDITIONAL LIMITS FOR WHISTLEBLOWER AWARDS?

Informant programs depend on the willingness to share information for the purpose of assisting law enforcement efforts. Some persons with information may be motivated to come forward in part by altruism or moral duty, but the financial rewards available here inject intense personal financial interests into this decision. The amount of the reward could be substantial – perhaps even life-changing – especially under the whistleblower award provisions, which are not subject to the cap of \$10 million imposed on other discretionary informants.<sup>137</sup> Submissions of up to \$2 billion have been reported in the first year of the whistleblower program,<sup>138</sup> and one firm specializing in assisting whistleblowers with their claims has publicly reported over \$5 billion in submissions.<sup>139</sup>

Informants seeking whistleblower awards under I.R.C. § 7623(b) must submit information under penalty of perjury.<sup>140</sup> The criminal penalty for perjury – which may include fines and/or imprisonment for up to five years – presumably deters intentionally false statements designed to harass or harm prospective taxpayer investigation targets.<sup>141</sup> However, even information provided in good faith is not necessarily foolproof. As noted above, informant-based examinations occasionally produce no changes on audit, even though that result appears less likely than under other examination selection techniques.<sup>142</sup> Thus, the discretion and judgment of the IRS continues to be important in determining whether to proceed on an informant's tip.<sup>143</sup>

The source of an informant's information is one aspect of that discretion. Informants under I.R.C. § 7623(a) submit Form 211, "Application for Award for Original Information," which asks the informant, among other things, to "[d]escribe how you learned about and/or obtained the information that supports this claim and describe your present or former relationship to the alleged noncompliant

---

137. See Whistleblower - Informant Award, <http://www.irs.gov/compliance/article/0,,id=180171,00.html> (last visited May 19, 2008).

138. See Ventry, *supra* note 83, at 367.

139. See Advertisement by The Ferraro Law Firm, *JOURNAL OF ACCOUNTANCY*, June 2008, at 101.

140. See I.R.C. § 7623(b)(6)(C) (West 2008).

141. See 18 U.S.C.A. § 1621 (West 2008) (defining perjury and its penalties).

142. See *supra* notes 50-51.

143. One of the examples of reasons for denying a whistleblower claim is that "information is not credible." See Memorandum from the Commissioner of Large and Mid-Size Business Division to all LMSB Industry Directors 4 (July 21, 2008), available at <http://www.irs.gov/pub/foia/ig/lmsb/lmsb-4-0508-033.pdf>.

taxpayers.”<sup>144</sup> This inquiry is arguably relevant for the purpose of determining whether there is any reason to doubt the veracity of the information provided. However, it is also relevant for the purposes of evaluating whether there may be other reasons to avoid dealing with this whistleblower.<sup>145</sup> It may also affect whether the whistleblower is eligible for an award at all, as in the case of one who planned or initiated a transaction.<sup>146</sup>

Whistleblowers who also planned or initiated an unlawful tax-avoidance scheme are well-qualified to provide reliable information for the purpose of identifying returns likely to generate positive tax adjustments. Significantly, the Code does not prevent the IRS from using the information gained from such persons as a basis for examining taxpayers. However, it prevents the Whistleblower Office from granting an award for such information if the informant’s conduct in planning/initiating on behalf of another results in a criminal conviction.<sup>147</sup> Short of a conviction, however, planner/initiators are only subjected to the uncertainty of a discretionary award.

Enhanced tax compliance is a worthy policy goal, but other values are also at stake in defining the scope of appropriate enforcement measures. The constraint on awards to planner/initiators reflects a normative judgment by Congress that those who receive criminal sanctions are not eligible for an award, despite the value of their information. Other whistleblowers, however, may be subject to other penalties short of criminal sanctions on account of their disclosure, but they are still eligible for full whistleblower awards under this statute.

Does the Code go far enough in restricting the scope of award-eligible behavior? For example, should the government induce an informant to violate a longstanding professional obligation for trust and confidentiality through offering a reward? Consider a prospective informant who is a member of the bar with a professional obligation to maintain confidentiality of client information.<sup>148</sup> Breaching client

---

144. Internal Revenue Serv., I.R.S. Form 211 (2007), available at <http://www.irs.gov/pub/irs-pdf/f211.pdf>.

145. This includes the so-called “one-bite rule.” See I.R.S. Chief Counsel Notice CC-2008-011 (Feb. 27, 2008), available at 2008 WL 623141.

146. See I.R.C. § 7623(b)(3) (West 2008). See also discussion *supra* notes 106-108.

147. See § 7623(b)(3).

148. See, for example, MODEL RULES OF PROF. CONDUCT R. 1.6(a) (2002), which provides in part: “A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is . . . authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).” Paragraph (b) allows disclosure, among other things, “to prevent the client from committing a crime or fraud” or to “prevent, mitigate, or rectify substantial injury to the financial interests or property of another . . . [due to]

confidentiality may result in civil sanctions, including disbarment, if the breach is disclosed.<sup>149</sup> However, the Code does not preclude an award based on this behavior; nor does it suggest that this behavior may provide the basis for reducing or denying an award.

The value of confidentiality in the lawyer-client relationship has persisted despite longstanding recognition that it may prevent us from knowing the truth in some cases.<sup>150</sup> As Professors Geoffrey Hazard and William Hodes have observed in their seminal work, *The Law of Lawyering*, “the confidentiality principle can stand on a moral base of its own. It creates a zone of privacy that cannot be breached by a too-inquisitive government, and thus enhances the autonomy and individual liberty of citizens.”<sup>151</sup> Admittedly, the primary mechanisms for deterring disclosure of confidential information are likely to be found in social and professional sanctions, rather than in criminal penalties. However, the deterrent effect of the sanction of disbarment depends in significant part on the economic penalty of being deprived of future earnings from practicing a profession, along with reputational sanctions that add to the harm in this economic calculus.<sup>152</sup> The efficacy of this calculus, which ordinarily favors keeping a confidence, is threatened when government alters it through potentially large rewards, particularly when rewards may be granted without disclosing the identity of the whistleblower.

An award program that offers discretionary payments that are uncertain and modest in amount would be unlikely to tip the scales in favor of disclosure, particularly if there were a risk of discovery that could lead to professional or reputational sanctions. However, a whistleblower award that is financially significant and provides relatively greater certainty for payment presents heightened risks,

---

crime or fraud,” which involves the use of the lawyer’s services. *See id.* at R. 1.6(b)(2)-(3). Attorneys who are not giving advice that is used in planning or initiating transactions involving crimes, but who merely become aware of information, would not be within the scope of these permitted exceptions. Comments clarify that paragraph (b)(3), affecting disclosures for a crime or fraud that has already occurred, “does not apply when a person who has committed a crime or fraud thereafter employs a lawyer for representation concerning that offense.” *Id.* at R. 1.6 cmt. 8.

149. *See* Ventry, *supra* note 83, at 392.

150. *See* 1 GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, *THE LAW OF LAWYERING* 132 (2d ed. Supp. 1998) (stating that “[i]t is the confidentiality principle that most often creates tension between the law of lawyering and ‘other’ law, for it exacts significant sacrifice of the truth-finding and justice-seeking aims of the law generally, and often requires that the victims of a client’s misdeeds be forsaken.”).

151. *Id.* at 131.

152. *See id.* at 132 (stating that “lawyers demonstrate the moral values of trust and loyalty when they say they will keep quiet and then do so, even when there are compelling reasons to speak out.”).

particularly when a whistleblower may be insulated from reputational harm and the prospect of professional sanction because his or her identity remains secret. Even if the identity were disclosed, as in the case where whistleblower testimony may be required, if the expected value of the award exceeds the expected present value of future earnings lost through disbarment by an amount sufficient to also offset any reputational harms to the informant, this could tip the scales in favor of disclosure. Such an award program may prove highly tempting to the professional whose personal values of trust and loyalty to the client are outweighed by his or her own personal financial self-interest.<sup>153</sup>

Government should be cautious in creating incentives for citizens to violate important ethical norms. The IRS has apparently recognized this value in other limited contexts involving taxpayer representatives. As a general matter, the Chief Counsel has advised IRS employees working with informants that “under no circumstances is it appropriate to accept any information from an informant . . . when the informant is also the taxpayer’s representative in any administrative matter pending before the Service.”<sup>154</sup> Although this language does not extend to all lawyer-client relationships, it nevertheless reflects a propensity for restraint and respect in this area. However, government restraint in this area is far from settled, as other commentators have raised concerns about the sanctity of the attorney-client relationship in other legal matters where attorneys may be required to disclose information to the government.<sup>155</sup>

---

153. Professor Ventry suggests that the incentives to disclose professional confidences “could be outweighed by the disincentives to share such information.” Ventry, *supra* note 83, at 392-93. However, this position does not seem to address the possibility that the whistleblower’s act may not ever be disclosed.

154. See I.R.S. Chief Counsel Notice CC-2008-011 (February 27, 2008), *available at* 2008 WL 623141. This Notice also cautions IRS employees to seek approval before engaging in additional contacts with an informant that might violate the so-called “one bite” rule, which allows the government to use information, even though it may have been obtained in an illicit or illegal manner, as long as the government did not encourage or acquiesce in the informant’s conduct.

155. See, e.g., Elizabeth A. Cheney, Note, *Leaving No Loopholes for Terrorist Financing: The Implementation of the USA Patriot Act in the Real Estate Field*, 58 VAND. L. REV. 1705, 1729-35 (2005) (discussing exemptions for attorneys to disclosure requirements under anti-money-laundering rules, as well as under section 307 of Sarbanes-Oxley); Robert J. Jossen, *Dealing with the Lawyer’s Responsibilities under the Sarbanes-Oxley Act of 2002: Ethical Dilemmas and Practical Considerations* (Oct. 6-7, 2005) (discussing disclosure and “noisy withdrawal” effects on confidentiality obligations), *available at* SL 027 ALI-ABA 417 (West). Tax shelter transactions have sometimes generated advocacy for relaxed protections of confidentiality and privilege for those involved in planning and facilitating them. See, e.g., Richard Lavoie, *Making a List and Checking It Twice: Must Tax Attorneys Divulge Who’s Naughty and Nice?*, 38 U.C. DAVIS L. REV. 141 (2004) (arguing that limited privilege protection is appropriate in tax shelter matters); Brian R. Ford, Note, *Current Development, Helter Shelter: Protecting Taxpayers’ Identities in Tax-Shelter Cases*, 18 GEO. J. LEGAL ETHICS 723 (2005).



Discretion to deny an award to a planner/initiator under the whistleblower program is useful in diminishing the possibility that a professional in this category will be induced to betray a client.<sup>156</sup> However, the planner/initiator constraint is not sufficient for the purpose of ensuring protection of other lawyer-client relationships. Not all lawyers who have information about client noncompliance with tax laws are considered planner/initiators. For example, a lawyer providing advice to a taxpayer in an unrelated matter (such as criminal law) may have access to information showing noncompliance. A blanket rule prohibiting awards if the disclosure breaches an obligation of professional ethics should be considered here in lieu of the more limited planner/initiator restriction. An absolute bar for rewards to those with a lawyer-client relationship - and possibly for other professional relationships involving trust or confidence, such as physicians, financial counselors, and certified public accountants - would send an appropriate message to the professional community that the government does not intend to induce professionals to breach their obligations to clients or patients.<sup>157</sup>

Of course, not all obligations of confidentiality are alike. For example, a foreign bank employee who disclosed depositor account information in violation of foreign bank secrecy laws has generated international attention in the area of tax enforcement.<sup>158</sup> Another bank employee disclosed transactional details concerning the bank's involvement in facilitating tax shelter transactions for others, though not for the bank itself, which potentially involved more than \$1.5 billion in tax liability.<sup>159</sup> Each of these cases may involve contractual obligations,

---

156. However, penalty provisions affecting return preparers also provide some deterrent effects here, which would presumably impact a decision to disclose. See *supra* note 7 and accompanying text.

157. See, e.g., AICPA MODEL CODE OF PROF. CONDUCT R. 301 (1992) (requiring accountants not to disclose confidential client information without specific consent from the client), available at [http://www.aicpa.org/about/code/et\\_300.html](http://www.aicpa.org/about/code/et_300.html); AMA PRINCIPLES OF MEDICAL ETHICS princ. IV (2001) (providing that "[a] physician shall respect the rights of patients, colleagues, and other health professionals, and shall safeguard patient confidences and privacy within the constraints of the law."), available at <http://www.ama-assn.org/ama/pub/category/2512.html>.

158. See Randall Jackson, *The Mouse that Roared: Liechtenstein's Tax Mess*, TAX NOTES INTERNATIONAL, Mar. 3, 2008 (discussing actions of the IRS and other countries to pursue taxpayers with Liechtenstein bank accounts disclosed by bank employee in violation of Liechtenstein bank secrecy laws), available at <http://www.taxanalysts.com/www/features.nsf/Articles/9F2D96E5846A5FD985257404000F69AE?OpenDocument>.

159. See David Armstrong & Jesse Drucker, *Dutch Bank Funded U.S. Tax Shelters*, WALL ST. J., May 2, 2008 (discussing whistleblower claim for federal recoveries of taxes involving more than 100 tax shelters involving U.S. companies, which may have saved these companies at least \$1.46 billion in taxes), available at <http://online.wsj.com/article/SB120968938981461421.html?mod=>

or obligations imposed by foreign law, which should not necessarily bind our government in its enforcement efforts.

Further discussion and exploration of the ethical concerns presented in this context is beyond the limited scope of this article. It is, however, quite clear that important issues remain essentially unresolved in Congress' attempt to design the whistleblower award scheme.

IRS administrative rules impose a number of other limitations on eligibility for the informant discretionary award program, which are rooted in prudential and ethical concerns. For example, employees of the Treasury Department, whether or not they are also employees of the IRS, are ineligible for informants' awards.<sup>160</sup> Other Federal employees are also ineligible if they obtained the information as part of their official duties.<sup>161</sup> However, a Federal employee who obtained information apart from his/her official duties is deemed eligible to the same extent as other informants.<sup>162</sup> Police officers are also eligible for rewards, unless a statute or ordinance specifically excludes them from accepting a reward.<sup>163</sup> Moreover, an award payment that would be "contrary to State or local law" may be denied.<sup>164</sup>

In Notice 2008-4,<sup>165</sup> the IRS issued interim guidance indicating that it will follow some of these restrictions from the discretionary informant award program in the whistleblower award program. The notice lists several examples of claims that would not be processed, including those submitted by Treasury Department employees or other government employees acting within the scope of their duties.<sup>166</sup> Significantly, the Notice also includes "claims submitted . . . by an individual who is precluded by Federal law or regulation from making the disclosure."<sup>167</sup> Although this example indicates that IRS administrative practices may

---

googlenews\_wsj. At an award level of fifteen percent, this translates to more than \$200 million, excluding penalties and interest that may increase the award.

160. See INTERNAL REVENUE MANUAL § 25.2.2.16(1)(a) (1999).

161. See *id.* § 25.2.2.17.

162. *Id.* § 25.2.2.16(1)(d). To illustrate, the Internal Revenue Manual states that a postal worker who overheard a taxpayer boasting about his nonpayment of taxes to customers in his store was allowed a reward. *Id.* Here, the IRM does not state whether the postal worker was on his rounds delivering mail, and if so whether that would affect eligibility based on performance of official duties.

163. See *id.* § 25.2.2.16(2).

164. See *id.* § 25.2.2.17(3)(g).

165. I.R.C. Notice 2008-4, 2008-2 I.R.B. 253 (Dec. 19 2007), available at 2007 WL 4427860.

166. *Id.* § 3.04 ex. 1.

167. *Id.* § 3.04 ex. 2. State laws are not taken into account in this example, although the Internal Revenue Manual would consider a violation of state laws as a basis for denial. See INTERNAL REVENUE MANUAL § 25.2.2.17(3)(g).

respect U.S. legal obligations to maintain privacy, the statutory basis for such a restriction is unclear, and this may be tested in litigation.<sup>168</sup>

When the parameters for obtaining an award are set forth in the whistleblower award statute, introducing additional restrictions or constraints by administrative pronouncement or regulation is problematic. As the politically accountable branch, Congress should direct attention to the important value questions lurking here and further restrict the categories of informants eligible for whistleblower awards. These issues are too significant and value-laded to be left to the discretion of the IRS, or to *ad hoc* development through the courts.

## V. CONCLUSIONS

The available data suggests that using informants can improve the effectiveness of the examination function and reduce the tax gap in a manner that increases the likelihood that noncompliant taxpayers are selected for examination. Provisions in the Tax Relief and Health Care Act of 2006 have improved upon the prior system for informant awards by enhancing incentives for informant participation. Claimants under the discretionary informant program under I.R.C. § 7623(a) may now obtain larger rewards based on collections that include interest, as well as taxes and penalty collections. More significantly, the whistleblower award program under I.R.C. § 7623(b) of the Code increases not only the amount of awards, but also the certainty and predictability of obtaining them without requiring an advance contract.

Despite a worthy effort, significant shortcomings persist in the whistleblower award program. By empowering claimants to seek judicial review of award determinations and removing the requirement for an advance contract, the whistleblower award program bolsters incentives for coming forward, but judicial review presents additional practical and legal questions that deserve further attention. These include the scope of review, the means of protecting taxpayer privacy with regard to tax and financial information, and the means of protecting the internal investigative processes of the IRS. Preserving the secrecy of a whistleblower's identity can be achieved through implementing Tax Court procedures for anonymity, but proceedings to examine

---

168. Moreover, not all legal obligations to maintain privacy may bear the same weight in relation to competing values of improving tax compliance. For example, legislative protections aimed at protecting an individual's personal information from disclosure to other firms or to the public (including those who might steal his/her identity) may not provide a sufficient basis to prevent disclosure to the IRS for the limited purpose of enhancing tax compliance, particularly when sufficient safeguards exist to protect that information from further public disclosure.

determinations of the whistleblower office will potentially involve other confidential information, thereby setting up an inherent conflict between the interests of the whistleblower in enforcing his/her award and the privacy and/or confidentiality interests of the targeted taxpayer and the government.

Perhaps the greatest concern about the whistleblower award system, however, involves the ability to reward those who breach professional relationships of trust or confidence. The only categorical constraint in the Code affects those who planned or initiated transactions on behalf of others, when those planner/initiators were also convicted of a crime. The public expects ethical behavior from the government, just as it is expected from taxpayers and their representatives. Enhancing tax collections is important, but other values also deserve consideration in framing an effective award system. “[T]he goal of IRS attorneys cannot be to collect the most revenue for the Government or to win cases at all costs. Rather, the goal is to ensure that the tax system is administered fairly and impartially.”<sup>169</sup>

Whistleblowers can become important tools to efficiently and effectively uncover noncompliance, thus increasing the perceived fairness of the tax system. However, an award system that induces professionals invited into a taxpayer’s private sphere for other purposes to breach confidential relationships arguably detracts from that basic fairness. Congress needs to revisit the whistleblower program and provide needed clarification on this important value question by precluding awards to those who violate professional obligations of confidentiality.

---

169. *Hartman v. Comm’r*, T.C.M. (RIA) 2008-124, at 66-68 (2008) (summarizing statements of then-IRS Chief Counsel B. John Williams in connection with IRS misconduct in litigation).