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The IRS Whistleblower Regulations

A Hindrance to Tax Enforcement

By Jay Nanavati

In modernizing the tax whistleblower statute over the last 12 years, Congress has finally created a simple and enforceable entitlement to substantial compensation for tax whistleblowers. Unfortunately, in practice, the IRS's whistleblower program still falls short of achieving its potential for improving tax enforcement. One culprit in the whistleblower program's failure to live up to its potential is the IRS's own whistleblower regulations.

History of U.S. Whistleblower Laws

The original version of the tax whistleblower statute dates to 1867. The statute, with minor changes, was eventually codified as Internal Revenue Code (IRC) section 7623(a). Under that regime, the IRS had virtually unreviewable discretion to pay—or refuse to pay—awards to whistleblowers.

In 2006, Congress passed Public Law 109–432, the first substantial revision to the whistleblower statute since its creation 139 years before. This legislation strengthened and modernized the IRS's whistleblower program in two ways:

- First, it relegated the existing, purely discretionary whistleblower law to IRC section 7623(a) and created a mandatory whistleblower law at section 7623(b) that was applicable to cases in which the "proceeds in dispute exceed $2,000,000" and that set whistleblower awards at 15%–30% of proceeds.
- Second, it created a mechanism for whistleblowers to enforce the requirement that the IRS pay awards. Whistleblowers can appeal the IRS's award determinations to the U.S. Tax Court.

In 2018, Congress added IRC section 7623(c) to clarify that qualified "proceeds" include not only tax, penalties, and interest, but also criminal fines, civil forfeitures, and nontax penalties arising from violations of reporting requirements.

While the 2006 and 2018 legislation stopped short of enabling whistleblowers to bring qui tam lawsuits, it did seemingly provide a simple and enforceable entitlement to substantial compensation for whistleblowers. The reality, however, has turned out to be more complicated.

A Regulatory Paradox

Although there are many reasons why the IRS's whistleblower program has fallen short of its potential, the IRS's own whistleblower regulations bear some blame. The primary difficulty with the regulations is that they disincentivize whistleblowing by requiring the whistleblower's information to have "substantially" contributed to an IRS action. The addition of this requirement allows the IRS to deny awards to whistleblowers, even when their information directly leads to actions that result in collected proceeds.

Unlike the regulations, the whistleblower statute has no substantiality requirement for entitlement to a mandatory award. The statute provides that "if the Secretary proceeds with any administrative or judicial action … based on information brought to the Secretary's attention by an individual, such individual shall … receive as an award at least 15 percent but not more than 30 percent of the proceeds collected as a result of the action" [IRC section 7623(b)(1)]. The statute treats substantiality solely as a criterion for determining the amount of the mandatory award: "The determination of the amount of such award by the Whistleblower Office shall depend upon the extent to which the individual substantially contributed to such action."

In contrast to the statute, the regulations require that a whistleblower's information "substantially contribute" to an administrative or judicial action for the whistleblower to be entitled to a mandatory award at all. This requirement is in the definition of "proceeds based on:" "The IRS proceeds based on information provided by a whistleblower when the information provided substantially contributes to an action against a person identified by the whistleblower" [Treasury Regulations section 301.7623-2(b)(1)]. The regulations contain no guidance on what is "substantial," leaving the matter at the discretion of the IRS. Of course, the statute under whose authority the regulations are promulgated requires only that an IRS action be "based on" the whistleblower's information, without further qualification.

Treasury Regulations section 301.7623-4(c)(1), however, hews to the language of the statute. This section requires only that an IRS action be "based on" the whistleblower's information; it does not, at least explicitly, contain the subjective substantiality requirement. Instead, it provides that "if the IRS proceeds with any administrative or judicial action based on information brought to the IRS's attention by a whistleblower, such whistleblower shall … receive as an award at least 15 percent but not more than 30 percent of the collected proceeds resulting from the action."

The first mention of substantiality in this section, other than in the heading, is in the context of determining the amount of the award: "The amount of any award under this paragraph depends on the extent of the whistleblower's substantial contribution to the action(s)." This appears to mean that substantiality only comes into play in setting the amount of the award. This is consistent with the language of the statute, but inconsistent with section 301.7623-2(b)(1).

Outcome Yet to Be Determined

How the Tax Court will address the dissonance between the statute and the IRS's own regulations remains to be seen. In the meantime, whistleblowers risk denial of meritorious claims on substantiality grounds, and the whistleblower program suffers. ❑

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