



TAXATION LAW

IRS authorizes paying whistleblowers

BY KEVIN DIAMOND

HISTORY

The Tax Relief and Health Care Act of 2006 (the act) enacted significant changes in the Internal Revenue Service award program for whistleblowers. The IRS shall pay awards for information that substantially contributes to the collection of taxes, penalties and interest.

The IRS has long held the authority to pay awards to whistleblowers. In fact, the origins of the whistleblower legislation relates back to the Civil War and the False Claims Act. The big difference was the old law, as now seen in 26 USC 7632(a), allowed the secretary of the Treasury to pay such amount as he deemed necessary “for detecting and bringing to trial and punishment person guilty of violating the internal revenue law or conniving at the same.” This meant whistleblowers were paid at the discretion of the secretary of the Treasury.

The implementation of 26 USC 7632(b) made a fundamental change to the IRS informant awards program. The key change in the law was the addition of this section under which awards are no longer discretionary! The new law says that whistleblowers “shall receive 15 percent to 30 percent of the collected proceeds.” In addition, the amendment gave the whistleblower certain rights of appeal. That appeal is limited to the U.S. Tax Court. Finally, the legislation required the IRS to establish a Whistleblower Office reporting to the commissioner of the IRS to implement the law.

The primary purpose of the act is to encourage people with knowledge of sig-

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nificant tax non-compliance to provide that information to the IRS. Many individuals who apply for this reward often claim to have insider knowledge of the transactions upon which they are reporting.

TECHNICAL REQUIREMENTS

A whistleblower must meet several conditions to qualify for the award program. Generally speaking, the information must:

- Relate to a tax noncompliance matter in which the tax, penalties, interest, additions to tax and additional amounts in dispute must exceed \$2 million; and
- Relate to a taxpayer whose gross income exceeds \$200,000 for at least one of the tax years in question.

If the information meets the above conditions and substantially contributes to a decision to take administrative or judicial action that results in the collection

of tax, penalties and interest, then the IRS will pay an award of at least 15 percent, but not more than 30 percent, of the collected proceeds resulting from administrative or judicial actions, or from any settlement in response to an administrative or judicial action.

LIMITATIONS

The maximum award can decrease to 10 percent for cases where it is determined that the information was disclosed in certain public information sources. Or, the reward may also be reduced if the IRS determines that the whistleblower planned and initiated the actions that led to the underpayment of tax.

TYPES OF TAX FRAUD

The types of fraud can vary greatly from each of the three types of groups: the individual taxpayer; the corporate taxpayers; and abusive or fraudulent tax professionals.

Below are some examples of each type of fraud:

INDIVIDUAL TAXPAYERS:

- Claims false deductions or expenses;
- Keeps two sets of books of accounting records;
- Intentionally declares the false income or knowingly changes the income;
- Makes overstatement of the deduction amount;
- Conducts the business deals by using false names;
- Declares false amounts income and expenditure in the books of accounting records;
- Transfers or conceals his/her assets or income; ➤ 2

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- Hides income in offshore accounts;
- Records personal expenditure as business expenditures; or
- Intentionally does not file the tax returns.

CORPORATE TAXPAYERS:

- Keeps two sets of books to track income and expenses for the purpose of hiding income;
- Fails to keep required business records;
- Destroys evidence, such as records and receipts;
- Lies during an IRS audit;
- Uses fake Social Security number and/or tax identification numbers;
- Hides income in offshore accounts;
- Pyramiding — collects taxes from employees and fails to pay them to the IRS;
- Unreliable third party payers — using a shady payroll service, which may fail to pay collected taxes to the IRS;
- Offshore employee leasing — attempts to redirect employee status and wages to avoid employment tax;
- Misclassifying worker status — giving employees the title of independent contractor in order to avoid paying the related taxes;
- Paying employees in cash — attempting to evade taxes by paying employees in cash without reporting the wages to the IRS;
- Filing false returns or failing to file required returns — intentionally misreporting income or failing to re-

port wages; or

- Misreporting officer compensation — misreporting officer compensation as S corporation corporate distributions or other such fraudulent reporting.

ABUSIVE TAX PROFESSIONALS ARE THOSE WHO:

- Claim they can obtain larger refunds than other preparers;
- Base their fee on a percentage of the amount of the refund;
- Advocate the use of abusive “off-shore accounts” as a means for not having to report income; or
- Advocate the use of abusive “tax shelters” to avoid taxes and create what will be represented as “legitimate losses to offset against taxable income.”

WHAT TO DO IF I HAVE TAX FRAUD TO REPORT

If you know of or suspect significant tax fraud, your best option is to find the services of a competent attorney. The tax attorney will be of great assistance in helping you understand the issues and procedure for filing a claim for a Whistleblower’s Informant Award. The claim must be filed with the IRS and there are many technical requirements that need to be met in order to qualify as a whistleblower who is entitled to the informant’s award. And ultimately, if there is a dispute over the award amount, it will be heard in the U.S. Tax Court!

The attorney will:

- Assist you in understanding the tax issues in your case;
- Determine if the issues are, in fact,

fraudulent actions that would lead to the collection of taxes, penalties and interest;

- Assist in the determination of whether the case has the possibility to qualify under the rules requiring a \$2 million-minimum for recovery and the taxpayer having earned at least \$200,000 in one of the years at issue;
- Assist in the filing of the required forms and documentary evidence to substantiate the whistleblower’s claim with the IRS;
- Frame the tax issues in a manner that the IRS will understand the legal and tax issues related to the noncompliant taxpayer;
- Communicate and cooperate with the IRS in pursuit of the collection action and work with the IRS until a determination is made; and
- Represent the whistleblower in U.S. Tax Court in the event an appeal of determination is required.

TAX TREATMENTS OF INFORMANT AWARDS

IRS awards can lead the whistleblower to very significant returns. At the minimum requirement of \$2 million, recovery at 15 percent to 30 percent could result in an informant award from \$300,000 to \$600,000. The range of an award under IRC Section 7623(b) for a recovery of \$10 million would be from \$1.5 million to \$3 million.

All awards issued by the IRS will be subject to current federal tax reporting and withholding requirements and the whistleblower will receive a Form 1099 or other form as prescribed by law. ■