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United States Senate

CHARLES E. GRASSLEY

WASHINGTON, DC 20510–1501

January 28, 2013

The Honorable Neal S. Wolin
Acting Secretary
U.S. Department of Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Steven T. Miller
Acting Commissioner
Internal Revenue Service
111 Constitution Avenue NW
Washington, DC 20224

The Honorable Mark Mazur
Assistant Secretary for Tax Policy
U.S. Department of Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Acting Secretary Wolin, Acting Commissioner Miller, and Assistant Secretary Mazur:

As the author of the 2006 updates to the Internal Revenue Service (IRS) whistleblower program, I have a keen interest in seeing that the program is successful and competently administered. Since its inception, I have been in regular contact with officials from the Department of Treasury (Treasury) and IRS about concerns I have with the implementation of the IRS whistleblower program. Last year, after then-Deputy Commissioner Miller's whistleblower memorandum, the announcement of a handful of whistleblower awards, and finally securing responses to my previous letters, I had hoped those responsible for the program in IRS and Treasury were finally starting to take my concerns seriously. More importantly, I hoped that there had started to be an understanding of the importance of whistleblowers and a strong whistleblower program.

However, the recent handling of the proposed IRS whistleblower regulations has reignited my concerns. In June, the then-Acting Assistant Secretary for Tax Policy informed me by letter that the IRS expected the regulations to be issued in early fall of 2012. I waited patiently for the release of the IRS whistleblower proposed regulations. September came, then October, and November, with no regulations and no update on how their completion was proceeding. Finally, on December 14, 2012, the proposed regulations were released, just in time for the Administration's push to confirm its nominee for Treasury General Counsel. Just as with responses to my earlier letters, it seems no progress is made within the whistleblower program until and unless there is something the Administration wants in return.

I was cautiously optimistic that the proposed regulations would make real strides in advancing the whistleblower program. I hoped they would provide some assurance to whistleblowers that they are seen as a valuable asset for addressing tax fraud. Unfortunately,

these proposed regulations are likely to further concerns in the whistleblower community that the IRS and Treasury view whistleblowers with hostility.

My comments are based in large part on my experience over the last 30 years reviewing and overseeing the implementation and enforcement of the Federal False Claims Act (FCA) – the federal government's most successful anti-fraud program — and the basis for the IRS whistleblower program. Despite early problems with the Department of Justice's either refusing to or selectively enforcing the FCA, eventually the department came around. As a result, the FCA has returned more than $30 billion to the treasury. I am deeply troubled that the IRS and Treasury continually ignore the lessons of success of the False Claims Act, largely to the detriment of whistleblowers, but also to the American taxpayers. Chief among my concerns is that the regulations, as proposed, will hamstring the program by limiting whistleblower awards and discouraging knowledgeable insiders from coming forward. The regulations mostly ignore issues and concerns raised in letters and statements by me, as well as concerns raised by my staff in meetings with officials from Treasury and IRS.

For example, comments I've made on what should count as "collected proceeds" were ignored. In my April 30, 2012, letter to Secretary Geithner and then-Commissioner Shulman, I requested information on how whistleblower claims would be protected in the future when the disallowance of net operating losses (NOLs) reduces a future refund claim.[1] However, the draft regulations don't give any credit for a whistleblower who provides information that leads to a reduction in NOLs if the reduction in NOLs doesn't immediately result in taxes collected. Thus, a whistleblower could blow the whistle, reduce a big bank's NOLs by $100 million and if the bank doesn't pay any tax that year, the whistleblower is out of luck, even if the next year the bank pays $100 million, thanks to the whistleblower's wiping out those NOLs the previous year.

The proposed regulations conclude it is too complicated and costly to administer an NOL provision that would track whether the whistleblower's work ultimately led to the payment of tax down the road. It is hard to find words that express my concerns that the IRS – an agency that has imposed some of the most complicated regulations possible on taxpayers – is now claiming that it would be too complicated to track whether a company has paid taxes. This complaint does not even pass the smell test, given the few number of awards being made to whistleblowers overall, let alone the even fewer potential awards that would need to be tracked to determine whether a company that has NOLs is now paying taxes. We need to reward whistleblowers for blowing the whistle when it reduces NOLs.

What is it about tracking NOLs that would impose such hardship and costs on the IRS? What prevents there from being procedures that require the whistleblower office to check on an annual basis to determine if a taxpayer has paid taxes? I ask that you provide me with any analysis and cost estimates that were relied on in determining that such procedures would impose "significant costs" and be a "heavy administrative burden."

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[1] April 30, 2012, Letter to Secretary Geithner and Commissioner Shulman, expressing concern that "regulations do not address how a whistleblower's claims are protected and advanced in the future when the disallowance of a net operating loss…reduces a future refund claim." http://www.grassley.senate.gov/about/upload/Document_.pdf. *See also*, September 13, 2011, Letter to Commissioner Shulman, "It is important for whistleblower confidence – and tax administration – that whistleblowers be rewarded for providing information about income being reduced by net operation losses (NOLs)." http://www.grassley.senate.gov/about/upload/Shulman-re-IRS-9-13-11.pdf.

Another area of concern is that the definition of "collected proceeds" in the proposed regulations is also specifically limited to proceeds raised under Title 26. My concern is that restricting the definition in this way may unduly limit the scope of the program. Information, such as that relating to undisclosed foreign bank accounts, may be indispensable in detecting underpayments of tax, without directly relating to the underpayments themselves. Yet, by excluding penalties under Title 31, which includes penalties under the Bank Secrecy Act, the proposed regulations are limiting the likelihood a whistleblower will come forward with such information. It appears that the decision to limit the definition to proceeds under Title 26 is based on the IRS' view that legislative text requires this result. As I have made clear in previous statements, I do not believe the language, nor the intent behind the law, mandates this outcome.[2] The broad use of the word "any" throughout the statute is also another reason why non-Title 26 penalties can and should be considered for awards under the IRS whistleblower program. This needs to be corrected, and I encourage you to work with me to resolve this situation so that the program matches congressional intent.

I also am concerned that the proposed regulations define "planned and initiated" broadly, discouraging knowledgeable insiders from coming forward. On the other hand, it narrowly construes "proceeds based on," limiting awards.

There is a delicate balance that needs to be struck between weeding out bad actors while not discouraging knowledgeable insiders from coming forward. My concern is that the current language defining "planned and initiated" to include anyone who "knew or had reason to know" that there were "tax implications" to the underlying act fails to properly strike this delicate balance. This language completely ignores the letter I sent to then-Commissioner Shulman on September 13, 2011, that explained that the limitation for planners and initiators was intended to apply to the chief architect or chief wrongdoer.[3] My fear is that the IRS will use the "knew or had reason to know" standard as a means to arbitrarily reduce awards to whistleblowers. Moreover, the use of the phrase "tax implications" furthers my concerns that this provision will be used as a catch-all. Most any structural change or transaction is bound to have tax implications. There is no reason for the IRS to be recreating the wheel with regard to planners and initiators. There is already established law in this area with respect to FCA claims. The definition in the final regulations should be guided by this existing law.

The proposed regulations further limit awards to whistleblowers by narrowly defining "proceeds based on." Under the proposed regulations, the IRS is considered to proceed based on whistleblower information

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[2] June 21, 2012, Press Statement, "The 2006 legislation was intended to obtain valuable information about major tax fraud and prevent the IRS from shortchanging whistleblowers. So far, the IRS is using questionable tactics like the Justice Department did when the False Claims Act was updated 25 years ago to limit whistleblower awards, including now saying that collections of penalties under the Bank Secrecy Act aren't eligible for whistleblower awards, for example." http://www.grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=41422.

[3] September 13, 2011, Letter to Commissioner Shulman, "[The] limitations for planners and initiators was intended to apply to the *chief architect* or the *chief* wrongdoer. I ask that you take into consideration the established law in this area with respect to FCA claims." http://www.grassley.senate.gov/about/upload/Shulman-re-IRS-9-13-11.pdf. *See also,* April 30, 2012, Letter to Secretary Geithner and Commissioner Shulman, reiterating "there is no reason for the IRS to recreate the wheel [in its definition of planners and initiators]." http://www.grassley.senate.gov/about/upload/Document_.pdf.

> "*only* when the IRS initiates a new action that it would not have initiated, expands the scope of an ongoing action that it would not have expanded, or continues to pursue an ongoing action that it would not have continued but for the information provided."

The proposed definition narrows the statute by reading the word "only" into the statute. No such limitation is contained in the legislative text. This limitation could drastically limit the number of corporate whistleblowers, as the IRS could always claim that the information provided dealt with a topic that was covered in a regularly scheduled IRS audit. This would leave the whistleblower with no claim, even if the underpayment of tax would not have been discovered but for the whistleblower information.

The intent of the law is to reward whistleblowers under section 7623(b)(1) who have substantially assisted the IRS even in situations where the taxpayer is already under audit and even if the issue is already under audit – if the whistleblower has provided information that expands the amount of tax at issue and/or the information substantially assists the IRS in terms of succeeding on the issue and/or reduces the amount of time and resources the IRS has to devote to the examination. Given the IRS' workload and limited resources, the IRS needs to be encouraging – not discouraging – whistleblowers to come forward to assist in its work.

Further, the regulations do little to improve and expand on communications by the IRS with whistleblowers, one of the biggest sources of complaints that I hear about. The regulations take a small step forward by moving the beginning of administrative proceedings forward from when a final determination is made, as under the current Internal Revenue Manual (IRM), to when the whistleblower office sends out the preliminary award recommendation letter. However, it appears to be vague in the regulations when such a preliminary award recommendation letter would be sent prior to a final determination of tax. I would suggest that the IRS should have as a standard practice that such a letter should be sent at a minimum 90 days after taxes have been collected.

Even better, the IRS should begin administrative proceedings with the whistleblower and open communication once proceeds have been collected. Moving up the beginning of administrative proceeding further would be beneficial to both the IRS and the whistleblower. The whistleblower would have the benefit of not being kept in the dark. At the same time, the IRS would benefit from talking to the whistleblower prior to a preliminary award's being made. If the IRS' position is that this is prohibited by section 6103, please provide me the legal analysis that supports this conclusion.

While moving the start of administrative proceedings forward is a step in the right direction, the regulations should do more to clarify when and what type of information can be shared with the whistleblower so he or she may assist the IRS. I originally considered including an amendment to section 6103 in the 2006 whistleblower updates to allow for greater communication. However, the IRS informed my Finance Committee staff that such statutory changes were unnecessary because the IRS would use its existing contract authority to communicate with whistleblowers. The June 2012 memorandum issued by then-Deputy Commissioner Miller states, "a contract for services under section 6103(n) may be used when disclosure of taxpayer information is necessary to obtain a whistleblower's insights and expertise

into complex technical or factual issues." Yet to date, I am unaware of any case where the IRS has used its contract authority in this way.

As I made clear in comments related to Section 25.2.27(10) of the IRM, which takes a very narrow view of permissible assistance from whistleblowers and their advisors, "the intent of the law…was not simply to ensure that all relevant information is provided by the whistleblower. Rather the statute envisions having whistleblowers and their advisors helping to pull the oars in the examination and investigation."[4] The current lack of information is crippling the most successful program the administration has to go after the big time tax cheats. The regulations should clarify when the IRS will use its contract authority and establish protocols for its use. The Department of Justice has been successful at entering into confidentiality agreements with whistleblowers in False Claims Act cases; the IRS should establish regulations for utilizing its contract authority similarly.

I ask that you consider my above comments on the regulations, along with comments you will receive from others representing whistleblowers, while finalizing the proposed regulation. In considering revising the proposed regulation, I encourage you to take into consideration the False Claims Act and related whistleblower provisions that served as a basis for the IRS program. Additionally, I respectfully ask you provide me a thorough response to each of my my concerns and questions. If you believe that the current legislative language is a barrier to addressing any of my concerns to the proposed languages, I ask that you work with my staff and provide insight into appropriate changes that could be made.

I also continue to have concerns about the delay in issuing the Annual Whistleblower Report. The fiscal year 2011 report was not provided to Congress until June 15, 2011. That is eight and a half months after the end of the fiscal year. In a letter I sent last year to Secretary Geithner and then-Commissioner Shulman, I stressed the importance of getting this year's report out on a timely basis. I requested the report be completed on November 30, giving two months from the end of the fiscal year to complete the report. That should have been more than an adequate amount of time to complete the report. Yet, a new year has come, and there is still no report. My staff was recently informed that the whistleblower report may not come out for another month. This is unacceptable. Releasing this report in a timely fashion must be a priority. In the meantime, I request that you provide me updates to the data provided in Tables 3 and 4 of the August 2011 Government Accountability Office report (GAO-11-683) on the tax whistleblower program.

Furthermore, I continue to have concerns about how resources are being allocated to the whistleblower office. The IRS whistleblower office has proved pound-for-pound to be the best thing going at the IRS in terms of going after tax cheats. Yet, whistleblower claims continue to languish in the whistleblower office for years. The IRS should allocate its resources to get the biggest bang for its buck. This includes assigning staff according to where their labor will get its highest rate of return. Please provide me the actual number of staff working at the IRS whistleblower office month-by-month since its inception.

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[4] September 13, 2011, Letter to Commissioner Shulman. http://www.grassley.senate.gov/about/upload/Shulman-re-IRS-9-13-11.pdf

Similarly, the IRS has yet to implement any of the August 2011 recommendations made by GAO to improve the monitoring of the program and the tracking of claims. I have stressed in several of my previous letters that implementing these recommendations should be a priority. As I have indicated previously, revenues generated from whistleblower information more than cover the costs of improving the program. While I understand recoveries are not dedicated to the IRS, the Treasury Secretary and IRS leadership have the authority to allocate IRS resources as needed. Please update me on any planned action to implement the GAO recommendations. If the IRS has decided against implementing the recommendations, I would like an explanation beyond an excuse about limited resources.

Each of the concerns I have outlined needs to be addressed to ensure that the IRS whistleblower program functions as intended. I encourage you to address these matters immediately to ensure that good faith whistleblowers are not discouraged from coming forward, alerting the federal government to unpaid taxes or fraudulent tax returns. The American taxpayers deserve to know that this program is operating as efficiently and effectively as possible. I look forward to working with you all to correct these matters and to your prompt reply.

Sincerely,

Charles E. Grassley
U.S. Senator