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Tax Whistleblower Statute: Obtaining Meaningful Appeals Through the Appropriate Scope of Review

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TAX WHISTLEBLOWER STATUTE:
OBTAINING MEANINGFUL APPEALS THROUGH
THE APPROPRIATE SCOPE OF REVIEW

MATTHEW R. STOCK*

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INTRODUCTION

The Tax Relief and Healthcare Act of 2006 strengthened the incentives for whistleblowers to expose large-scale tax evasion.¹ For information provided to the Internal Revenue Service (IRS) after December 19, 2006, the new section 7623(b)² of the Internal Revenue Code (Code) authorizes whistleblowers to receive an award of 15% to 30% of proceeds collected from owed taxes as a direct result of their tip.³ Section 7623(b) of the Code applies to whistleblowing on taxpayers when the amount in dispute exceeds \$2 million.⁴ The percentage of an award is based on the extent to which the whistleblower “substantially contributed” to the collection.⁵

Incentives for whistleblowers have become increasingly necessary, especially in the context of tax evasion and tax deficiencies. The IRS estimates that the difference between what U.S. taxpayers should

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1. Tax Relief and Healthcare Act of 2006, Pub. L. No. 109-432, § 406, 120 Stat. 2922, 2958 (codified as amended at I.R.C. § 7623).

2. Prior to the amendment that added section 7623(b) of the Code, the statute only contained section 7623(a) of the Code, which was a discretionary payout system for information that led to the collection of evaded taxes. *See infra* Part II.A.

3. I.R.C. § 7623(b)(1) (2012) (“[A]s an award at least 15 percent but not more than 30 percent of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any related actions) or from any settlement in response to such action.”).

4. *Id.* § 7623(b)(5).

5. *Id.* § 7623(b)(1).

have paid and what they actually paid is \$385 billion annually.⁶ While many factors contribute to this gap, “the vast majority of the tax gap is attributable to underreported taxes.”⁷ Without the help of inside information, the IRS would likely not audit most of the people or entities that owe a substantial amount in unpaid taxes,⁸ much less uncover sophisticated tax evasion schemes.⁹

In 2009, it was discovered that the Swiss bank UBS was responsible for one of the largest tax evasion schemes in United States history.¹⁰ The scheme was not exposed until a former UBS banker, Bradley Birkenfeld, blew the whistle.¹¹ This act alone resulted in the discovery of over 14,000 wealthy Americans who were evading taxes.¹² As a result of tipping off the IRS, Birkenfeld was awarded \$104 million for the information.¹³ This award was issued even though he had to serve two and a half years in prison for withholding information about his own role in the tax evasion scheme.¹⁴ Thus, even if convicted of a crime relating to the tax evasion, whistleblowers may be able to receive an award if they did not “plan or initiate” the actions that led to the underpayment of tax.¹⁵

Luckily for the IRS, no shortage of tips exist. In 2013, the IRS received 9268 claims from whistleblowers.¹⁶ This added to the current

6. Karie Davis-Nozemack & Sarah J. Webber, *Lost Opportunities: The Underuse of Tax Whistleblowers* 4 (Aug. 16, 2014) (unpublished manuscript), available at <http://ssrn.com/abstract=2483064>.

7. *Id.*

8. *Budget Cuts Stopping IRS From Catching Tax Cheats*, N.Y. POST (Feb. 24, 2015), available at <http://nypost.com/2015/02/24/budget-cuts-stopping-irs-from-catching-tax-cheats/> (“Last year, the IRS audited 1.2 million individual tax returns. That’s less than 1 percent of the returns filed and the lowest rate since 2004” as a direct result of budget cuts.)

9. See Calvin Johnson, *Ending Reliance on Opinions of the Taxpayer’s Own Lawyer*, 141 TAX NOTES 947, 957 (2013) (“IRS agents are undertrained regarding sophisticated transactions.”).

10. The IRS reported collecting over \$5 billion in unpaid taxes after Bradley Birkenfeld blew the whistle. David Kocieniewski, *Whistle-Blower Awarded \$104 Million by I.R.S.*, N.Y. TIMES, Sept. 12, 2012, at A1, available at <http://www.nytimes.com/2012/09/12/business/whistle-blower-awarded-104-million-by-irs.html>.

11. *See id.*

12. *See id.*

13. *Id.*

14. *Id.* (“During the investigation Mr. Birkenfeld was charged with fraud for withholding crucial information from federal investigators, including details of his top client, the property developer Igor Olenicoff.”).

15. The statute does not allow individuals who “planned and initiated the actions that led to the underpayment of tax[es]” to receive awards. See I.R.C. § 7623(b)(3) (2012). However, individuals who participated in the action but who did not plan or initiate it are still able to receive awards. *See id.* The focus appears to be on the *main actors* rather than the participants like Birkenfeld.

16. INTERNAL REVENUE SERV., FISCAL YEAR 2013 REPORT TO THE CONGRESS ON THE USE OF SECTION 7623, 14 (2013) available at http://www.irs.gov/pub/whistleblower/Whistleblower_Annual_report_FY_13_3_7_14_52549.pdf.

backlog of over 22,300 open claims.¹⁷ While tips have increased after the enactment of section 7623(b) of the Code, the payouts have not been as plentiful.¹⁸ In fact, the IRS has paid out only *nine* awards under the new whistleblower statute.¹⁹

The lack of awards issued by the IRS is surprising considering how effective the new provision has been in the collection of taxes. From 2009 to 2013, the IRS collected nearly \$1.7 billion in back taxes as a direct result of whistleblowers.²⁰ Apparently Birkenfeld was not the only person aware of tax evasion. There was a substantial increase in tips after enactment of section 7623(b) of the Code²¹ because the section appeared to demand an award in certain circumstances.²² The Tax Court even acknowledged that the new section of the Code “provides for mandatory awards if certain requirements are met.”²³ However, in reality, payouts have remained relatively stagnant under section 7623(a) of the Code,²⁴ and have been almost nonexistent under section 7623(b) of the Code.²⁵ Denials of awards under the new whistleblower statute have been appealed to the Tax Court.²⁶

This Note will address the appropriate scope of review for the Tax Court. The “scope of review” refers to what evidence the Tax Court may consider when determining whether the IRS acted appropriately.²⁷ In theory, the Tax Court could either limit its review to the administrative record (the evidence the IRS considered when making its determination) or it could develop its own evidentiary record.²⁸

17. *See id.*

18. *Id.* at 21 (110 awards paid in FY 2009, 97 awards paid in FY 2010, 97 awards paid in FY 2011, 128 awards paid in FY 2012, and 122 awards paid in FY 2013).

19. *Id.*

20. *See id.* (\$1,678,316,545 total amounts collected from FY 2009 to FY 2013).

21. *Id.* at 14 (1117 claims received pre-2007 and 9268 in FY 2013); TREASURY INSPECTOR GEN. FOR TAX ADMIN., REF NO. 2009-30-114, DEFICIENCIES EXIST IN THE CONTROL AND TIMELY RESOLUTION OF WHISTLEBLOWER CLAIMS 6 (2009) [hereinafter DEFICIENCIES] available at <http://www.treasury.gov/tigta/auditreports/2009reports/200930114fr.pdf> (83 claims received in 2007 alleging \$8 billion in underreported income; 1890 claims in 2008 alleging \$65 billion in underreported income).

22. *See* INTERNAL REVENUE SERV., *supra* note 16, at 1 (stating that providing information under the new statute “generally requires the IRS to pay awards if information an individual provides substantially contributes to the collection” of evaded taxes).

23. *Lippolis v. Comm’r*, No. 18172-12W, 2014 WL 6603864, at *2 (T.C. Nov. 20, 2014).

24. *See* INTERNAL REVENUE SERV., *supra* note 16, at 14.

25. *See id.* at 21 (noting nine awards paid under section 7623(b) of the Code).

26. Whistleblowers must appeal an award determination within thirty days to the Tax Court. *See* I.R.C. § 7623(b)(4) (2012).

27. *Wilson v. Comm’r*, 705 F.3d 980, 989 (9th Cir. 2013).

28. *Id.* at 982.

Limiting the review to the administrative record is known as the “record rule.”²⁹ The record rule is considered a deferential standard because the agency determines what goes into the record.³⁰ Currently, there are no documents (for example, statutes, Treasury Regulations, Internal Revenue Manual provisions, or court decisions) that establish what should be included in the administrative file; there are only proposed Treasury Regulations.³¹

Alternatively, the Tax Court could consider evidence outside of the administrative record.³² Whistleblowers prefer this scope because of the IRS’s poor track record of maintaining evidence³³ and the current lack of guidance concerning what evidence is required to be in the administrative record.³⁴

This Note has four major parts. Part I describes the background of the whistleblower statute, detailing Congress’s amendments to the previous tax whistleblower statute. Part II explores the current state of the law, highlighting both the problems within the Whistleblower Office and the problems that whistleblowers have encountered when trying to obtain meaningful review after denials. These problems have largely been created by a lack of transparency as well as inadequacies within the IRS. Part III argues that the Tax Court should not limit itself to the administrative record. This part develops the argument by analyzing how administrative law, which generally requires the record rule on review of agency decisions,³⁵ does not confine the Tax Court to the record. Part IV concludes by describing the necessity of a review not limited to the administrative record.

I. DEVELOPMENT OF THE WHISTLEBLOWER PROGRAM

A. *Prior to the 2006 Amendments*

A program issuing awards for blowing the whistle on tax evasion is not a new concept. Since 1867,³⁶ the IRS has been authorized to

29. *Ewing v. Comm’r*, 122 T.C. 32, 58 (2004) (“The record rule refers to the general rule of administrative law that a court can engage in judicial review of an agency action based only on consideration of the record amassed by the agency (the administrative record).”).

30. *See* Treas. Reg. § 301.7623-3(e) (2012) (proposing what should be included in the administrative record).

31. *See id.*

32. *Wilson*, 99 T.C.M (CCH) at 1552 (“A trial *de novo* entails independent factfinding and legal analysis unmarked by deference to the administrative agency.”).

33. The IRS has continually experienced significant failures with its internal controls. These failures have cast substantial doubt on the reliability of the administrative record. *See infra* Part II.C.

34. *See* Treas. Reg. § 301.7623-3(e).

35. *See* Administrative Procedure Act [hereinafter APA], 5 U.S.C. § 706 (2012).

36. Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473 (codified as amended at I.R.C. § 7623(a) (2012)).

pay discretionary awards under section 7623(a) of the Code 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.”³⁷ This section gave the IRS complete discretion over whether to issue an award.³⁸ When issued, the amounts ranged from a minimum award of 1% to a maximum award of 15% of the amounts recovered, with a cap of \$10 million.³⁹

A 1% award was available for providing general information that caused an investigation but had no direct relationship to a recovery of taxes.⁴⁰ A 10% award was available if the whistleblower’s information indirectly led to a collection.⁴¹ A 15% award was available if the information directly led to the recovery.⁴² The only way to receive an award more than 15% was to enter into a special agreement with the IRS.⁴³ This discretionary system resulted in a great amount of uncertainty for whistleblowers.⁴⁴

Prior to enacting section 7623(b) of the Code, the whistleblower statute did not grant jurisdiction to a court for whistleblowers to appeal award determinations.⁴⁵ Whistleblowers attempted to obtain judicial review under the Tucker Act, which grants jurisdiction to the United States Court of Federal Claims to hear contract claims against the United States in excess of \$10,000⁴⁶ Thus, in order to appeal an award determination, a whistleblower would have to establish that a contract existed with the IRS regarding the award. However, courts consistently held that IRS administrative guidelines do not themselves create a contract.⁴⁷ Contracts were only recognized if

37. I.R.C § 7623(a).

38. Davis-Nozemack & Webber, *supra* note 6, at 10.

39. The cap was \$10 million for payments made after November 7, 2002, but before the 2006 amendments. S. REP. NO. 109-336, at 30-32 (2006).

40. INTERNAL REVENUE SERV. PUBL’N 733, REWARDS FOR INFORMATION PROVIDED BY INDIVIDUALS TO THE INTERNAL REVENUE SERVICE (2004), *available at* <http://www.unclefed.com/IRS-Forms/2005/p733.pdf>.

41. *Id.*

42. *Id.*

43. TREASURY INSPECTOR GEN. FOR TAX ADMIN., U.S. DEP’T OF TREASURY, REF. NO. 2006-30-092, THE INFORMANTS’ REWARDS PROGRAM NEEDS MORE CENTRALIZED MANAGEMENT OVERSIGHT 2 (2006) [hereinafter INFORMANTS’ REWARDS PROGRAM], *available at* <http://www.treasury.gov/tigta/auditreports/2006reports/200630092fr.pdf>.

44. Davis-Nozemack & Webber, *supra* note 6, at 10.

45. Compare I.R.C § 7623 (2012), *with id.* § 7623(b)(4) (the latter grants jurisdiction to the Tax Court).

46. 28 U.S.C. 1491(a)(1) § (2012). *Cf. id.* § 1346(a)(2) (the federal district courts have concurrent jurisdiction with the Court of Federal Claims over contract claims of \$10 thousand or less).

47. See, e.g., Cambridge v. United States, 558 F.3d 1331, 1333 (Fed. Cir. 2009); Krug v. United States, 41 Fed. Cl. 96, 98 (1998).

special negotiations took place between the IRS and the person seeking an award.⁴⁸ This requirement proved fatal for most appeals.

Furthermore, even if a contract was established, the Court of Federal Claims used an abuse of discretion standard of review.⁴⁹ This standard requires the whistleblower to prove that the IRS abused its discretion by acting arbitrarily and unreasonably in making or denying an award.⁵⁰ This was very difficult to prove because the IRS claimed to be unable to provide critical information about denials due to confidentiality and disclosure laws.⁵¹ The result was that determinations by the IRS were essentially final.⁵² With rare exception, there would be no recourse for a whistleblower that was denied an award.⁵³

While this program was a good start to narrow the annual tax gap of \$385 billion,⁵⁴ it failed to reach its full potential for several reasons. First, whistleblowers disliked the uncertainty of payouts, especially because there was, and currently still is, no protection against retaliation.⁵⁵ Why risk your career⁵⁶ or economic security⁵⁷ if there is no certainty of an award? Second, this uncertainty was exacerbated by the lack of options for a meaningful appeal. The statute did not provide jurisdiction to a specific court and appeal was nearly impossible due to the requirement of a contract with the IRS. Third, even if an appeal was allowed, the whistleblower had to overcome a deferential standard favoring the IRS with practically no workable information about why their whistleblowing did not lead to the collection of taxes.⁵⁸

48. *Lagermeier v. United States*, 214 Ct. Cl. 758, 760 (1977) (“The court has long recognized, absent special negotiations between the IRS and the person seeking an award, that there is no contractual obligation to make a definite award.”).

49. *See id.* at 760-61.

50. *See id.*

51. *See infra* Part II.B.

52. *See Krug v. United States*, 41 Fed. Cl. 96, 98 (1998) (“Absent factual allegations that raise substantial doubts to the integrity of the IRS procedure, plaintiff has no claim”), *aff’d*, 168 F.3d 1307 (Fed. Cir. 1999).

53. Whistleblowers could have also attempted to obtain relief through the APA. *See generally* 5 U.S.C. §§ 500–96 (2012). However, this did not appear to be a common course of action.

54. *Davis-Nozemack & Webber*, *supra* note 6, at 4.

55. INTERNAL REVENUE SERV., *supra* note 16, at 7 (“Unlike other laws that encourage whistleblowers to report information to the government, section 7623 does not prohibit retaliation against the whistleblower.”).

56. *See Lagermeier v. United States*, 214 Ct. Cl. 758, 759-60 (1977) (noting that the plaintiff quit his job of over twenty-eight years, forfeiting his benefits and pension, to turn over information of corporate tax fraud to the IRS).

57. *See Whistleblower 14106-10W v. Comm’r*, 137 T.C. 183, 192-206 (2011) (allowing a whistleblower to seal his or her identity in order to prevent retaliation and professional ostracism).

58. *See infra* Part II.B for further discussion on the lack of explanations from the IRS.

B. 2006 Amendments and Aftermath

The decision to overhaul the program came after the Treasury Inspector General for Tax Administration (TIGTA) audited the Program in June 2006.⁵⁹ Even with all of the notable flaws, the TIGTA audit revealed that the Program generated significant revenue but could potentially generate more.⁶⁰ Accordingly, Congress attempted to strengthen the existing statute through the Tax Relief and Healthcare Act of 2006, which created section 7623(b) of the Code.⁶¹

First, section 7623(b) of the Code provides a 15% to 30% award from the collected proceeds if the tip alleged tax delinquencies of \$2 million or more.⁶² The previous statute did not directly mention percentages.⁶³ By authorizing the specific 15% to 30% payouts, Congress seemed to remove award uncertainty for whistleblowing on tax evasions over \$2 million.⁶⁴ The focus on large-scale tax deficiencies was further emphasized by Congress's removal of the prior \$10 million award cap.⁶⁵ This removal signaled that Congress intended to offer bigger awards in exchange for better tips.⁶⁶ As was seen with the UBS banker, Bradley Birkenfeld, these awards can even be paid to whistleblowers that participated in the efforts to evade taxes.⁶⁷ The new statute appeared to aggressively pursue closing the tax gap, even if that meant issuing an award to someone who participated in the operation.

Second, the statute now authorizes whistleblowers to appeal the IRS's determination to the Tax Court.⁶⁸ The previous statute did not confer jurisdiction upon any court to hear such appeals.⁶⁹ However, while whistleblowers now have potential recourse to a specific court,

59. See Karie Davis-Nozemack & Sarah Webber, *Paying the IRS Whistleblower: A Critical Analysis of Collected Proceeds*, 32 VA. TAX REV. 77, 84-85 (2012).

60. INFORMANTS' REWARDS PROGRAM, *supra* note 43, at 1-2.

61. See Tax Relief and Healthcare Act of 2006, Pub. L. No. 109-432, § 406, 120 Stat. 2922, 2958 (codified as amended at I.R.C. § 7623 (2012)).

62. INTERNAL REVENUE SERV., *supra* note 16, at 3. Smaller claims (under \$2 million) are still allowed under section 7623(a) of the Code, but this Note focuses on section 7623(b) of the Code.

63. See I.R.C. § 7623.

64. Davis-Nozemack & Webber, *supra* note 6, at 10-11 ("Congress combined a high threshold for tax whistleblower claims with much needed award certainty to focus the Program on high dollar tax abuse cases.").

65. See *id.*

66. Tom Herman, *Tipster Rewards Require Patience*, WALL ST. J. (Dec. 26, 2007, 12:01 AM), <http://www.wsj.com/articles/SB119862937462949815> ("Congress hope[d] the lure of much bigger rewards w[ould] prompt more informants to offer better tips and help the IRS reduce the nation's . . . tax gap.").

67. See I.R.C. § 7623(b)(3); Kocieniewski, *supra*, note 10.

68. See I.R.C. § 7623(b)(4).

69. See *id.* § 7623.

a *meaningful* appeal still may not exist if the Tax Court is unable to review adequate and reliable evidence.

C. *Why Scope of Review Is Critical for a Meaningful Appeal*

Recent cases have demonstrated how reliance on the administrative record may frustrate judicial review and result in meaningless appeals. In *Insinga v. Commissioner*, Joseph Insinga, the managing director of the American operations of a privately held Dutch Bank, blew the whistle.⁷⁰ He alleged that the bank helped facilitate tax evasion by seven Fortune 100 companies and ninety-five other companies.⁷¹ Insinga had several meetings with the IRS and provided substantial evidence demonstrating the systematic tax fraud being orchestrated by the bank.⁷² After these communications, Insinga waited for several years while the IRS completed its investigations.⁷³

In November 2010, Insinga noticed that three of the companies he implicated for tax evasion had either settled or were about to settle with the IRS.⁷⁴ The IRS confirmed his suspicion but refused to comment on whether there was a “nexus” between his whistleblowing and the settlements.⁷⁵ These companies would be paying hundreds of millions of dollars to the Treasury before the end of May 2011.⁷⁶ General Mills alone had to pay \$425 million.⁷⁷

On September 30, 2011, Robert B. Gardner, the Whistleblower Office Program Manager, stated that he received all of the information needed from Insinga and passed along his award recommendation to the Whistleblower Office Director, Steven Whitlock.⁷⁸ An award appeared imminent because agent Gardner confirmed that all of Insinga’s claims were open and that none were even under consid-

70. Insinga blew the whistle on April 2, 2007. Petition for Whistleblower Action Under Code Section 7623(b)(4), *Insinga v. Comm’r*, No. 4609-12W, 2012 WL 864738 (Feb. 21, 2012) [hereinafter Petition for Whistleblower Action].

71. *Id.* at 3.

72. Insinga provided Internal Audit Reports, Internal Credit Applications and Reviews, and explained how the bank was assisting all of these companies in evading taxes in the United States. *Id.*

73. Insinga was contacted three years later on May 10, 2007, to schedule a meeting with the IRS. *Id.*

74. *Id.* at 11. Through SEC filings and other financial reports, it was “abundantly clear” that three of the companies had settled. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 12.

78. *Id.* at 12-13.

eration for rejection.⁷⁹ One week later, the Director returned the recommendation and requested additional information from the IRS field offices.⁸⁰

In early November 2011, Insinga was informed that the IRS discovered “other sources” of the detailed information that he had provided to the IRS in April 2007.⁸¹ In his petition to the Tax Court, Insinga emphasizes the near impossibility of the IRS obtaining “other sources” related to his claim.⁸²

Thus, after years of cooperation and patience, Insinga was denied an award without a reasonable explanation.⁸³ He is now appealing the IRS’s determination to the Tax Court.⁸⁴ Evidence related to these “other sources” is clearly paramount in this case. The Tax Court will either look at information that the IRS is able to compile to develop the administrative record⁸⁵ or it can develop its own record. This demonstrates the importance of the Tax Court’s scope of review and its potential effect on appeals of whistleblowers’ determinations.

II. THE CURRENT STATE OF THE WHISTLEBLOWER PROGRAM

Although section 7623(b) of the Code was enacted in 2006,⁸⁶ there has not been a significant amount of case law related to appeals. The Tax Court has ruled primarily on jurisdictional issues.⁸⁷ The lack of appeals to date is primarily because the IRS has been slow in processing tips.⁸⁸ Due to the increase in tips after the enactment of section 7623(b) of the Code,⁸⁹ it is expected that many whistleblowers

79. *Id.* at 12 (“Agent Gardner also stated in this conversation and in later emails that all of Petitioner’s claims were ‘open’ and that none were ‘even under consideration for rejection.’”).

80. *Id.* at 13.

81. *Id.*

82. Petition for Whistleblower Action, *supra* note 70, at 13 (“It is also noteworthy, if not incredible, that these new ‘other sources’ of information evidently attached equally, across the board, *and at the same time*, to the most sensitive activities of each and every one of the diverse, unrelated entities that were the subjects of Petitioner’s submission.”).

83. *Id.*

84. *Id.* at 15.

85. *See infra* Part II.C (explaining the internal control failures within the IRS).

86. Tax Relief and Healthcare Act of 2006, Pub. L. No. 109-432, § 406, 120 Stat. 2922, 2958 (codified as amended at I.R.C. § 7623 (2012)).

87. *See, e.g.*, *Kasper v. Comm’r*, 137 T.C. 37, 38 (2011) (holding that each Whistleblower Office letter that denies a whistleblower claim is a “determination” within the meaning of section 7623(b)(4) of the Code, which gives the Tax Court jurisdiction and starts the 30-day appeal period).

88. *Davis-Nozemack & Webber*, *supra* note 6, at 12 (“For many reasons, not the least of which is that a tax whistleblower may only be compensated from proceeds that the [IRS] actually collects from the taxpayer, the process may take the better part of a decade for a whistleblower.”).

89. INTERNAL REVENUE SERV., *supra* note 16, at 14.

will be appealing to the Tax Court in the coming years. A major issue yet to be resolved is the appropriate scope of review for appeals to the Tax Court.

This section explores the considerations that the Tax Court should weigh when determining the scope of review. It highlights three main issues: First, the initial appeals under section 7623(b) of the Code have demonstrated the IRS's lack of cooperation with whistleblowers. Currently, the relationship between the IRS and whistleblowers resembles adversaries. The lack of awards issued may be an indicator of the IRS's unwillingness to work with whistleblowers. Second, determinations that deny a whistleblower an award have provided no explanation for the denial. This lack of transparency may be detrimental to appeals if not compensated for elsewhere. Third, there is substantial reason to doubt the reliability of the administrative record.

A. *Lack of Cooperation by the IRS*

Even the limited case law to date relating to appeals of whistleblower determinations demonstrates the IRS's unwillingness to work with whistleblowers and issue appropriate awards. One such example is *Anonymous 1 and Anonymous 2 v. Commissioner*, in which two former employees of a consulting firm submitted a tip to the IRS in 2009.⁹⁰ The tip alleged that the consulting firm conducted bogus-refund schemes that totaled approximately \$150 million.⁹¹ In 2011, the IRS rejected the claim even though it opened its own "independent investigation" against that exact consulting firm after receiving the tip.⁹² The whistleblowers appealed the IRS's determination, and ultimately lost in Tax Court.⁹³ The Court dismissed the appeal because the IRS asserted that it "did not use the information the [whistleblowers] provided, did not proceed with an administrative or judicial action against the taxpayers based on [the whistleblowers'] information, and did not collect tax proceeds based on [the whistleblowers'] information."⁹⁴ The Court appeared suspicious of the IRS's independent investigation.⁹⁵ However, it ruled against the whistle-

90. Order and Order of Dismissal for Lack of Jurisdiction, *Anonymous 1 and Anonymous 2 v. Comm'r*, No. 12472-11W, at 1 (T.C. May 10, 2013), available at <https://www.ustaxcourt.gov/InternetOrders/DocumentViewer.aspx?IndexSearchableOrdersID=103945>.

91. Lynnley Browning, *Incentives for Tax Fraud Tipsters May Get Even Tinier*, FORTUNE (Mar. 4, 2013, 2:51 PM), available at <http://fortune.com/2013/03/04/incentives-for-tax-fraud-tipsters-may-get-even-tinier/>.

92. *Id.*

93. *Id.*

94. Order and Order of Dismissal for Lack of Jurisdiction, *supra* note 90, at 1.

95. *Id.* at 2. ("While we question whether the information provided by [the whistleblowers] was used in the subsequent investigation, section 7623 of the Code does not provide a mechanism for [the whistleblowers] to challenge [the IRS's] assertion.")

blowers based on the IRS's assertions.⁹⁶ These assertions proved to be misleading.

In 2013, the IRS changed its mind and sent the whistleblowers a letter to inform them that it was reopening their claim.⁹⁷ The IRS indicated that it was in fact using the whistleblowers' information to initiate administrative action against the consulting firm. Now hopeful, the whistleblowers requested that the Tax Court vacate its original order and reconsider an award after the IRS completed its investigation.⁹⁸ The IRS asked the Court to deny this request, asserting the Tax Court was aware of the possibility of a subsequent investigation when it denied the whistleblower's appeal.⁹⁹ The Tax Court disagreed.

In an Order dated May 10, 2013, Judge Foley expressed his dissatisfaction with the IRS. He found that the IRS's statements were misleading¹⁰⁰ because the IRS appeared to have actually used the information that it claimed it did not use.¹⁰¹ The IRS failed to mention to that Tax Court that it was considering subsequent action relating to the whistleblowers' original claims.¹⁰² And, most egregiously, the IRS failed to inform the Court that it did, in fact, reopen the whistleblower's original award claims.¹⁰³ Accordingly, the Court vacated its decision and allowed the whistleblowers another chance at an award.¹⁰⁴ Unfortunately for whistleblowers, this case is not an outlier.

In *Ringo v. Commissioner*, the IRS again tried to deny a whistleblower an award based on misinformation.¹⁰⁵ On November 7, 2012, the IRS sent the whistleblower a determination letter stating that he was ineligible for an award because he did not provide information that resulted in the collection of owed taxes from the target.¹⁰⁶ The whistleblower appealed and the IRS once again backpedaled on its

96. *Id.* at 1-2.

97. *Id.* at 2.

98. *Id.*

99. *Id.* (“The Court’s Order and Decisions specifically made reference to the [whistleblower’s] information and [the IRS’s] subsequent investigation; the Court granted respondent’s Motion for Summary Judgment, aware of that possibility.”).

100. *Id.* (“[The IRS’s] statement is misleading. The Court was aware that [the IRS] opened a subsequent investigation, however, [the IRS] assured the Court that the SB/SE investigation was independent and that the information [the whistleblowers] provided . . . was not being used.”).

101. *Id.* (“It appears, despite [the IRS’s] assertions to the contrary, that the information provided by [the whistleblowers] . . . has been used by [the IRS] in the SB/SE investigation.”).

102. *Id.* (“[The IRS] . . . failed to inform the Court that [it] was considering reopening [the whistleblowers’] original award claims.”).

103. *Id.*

104. *Id.*

105. *See Ringo v. Comm’r*, No. 29562-12W, 2014 WL 4976226, at *1 (T.C. Oct. 6, 2014).

106. *Id.*

determination.¹⁰⁷ On June 11, 2013, the IRS informed the whistleblower that the determination was sent in error and that it was still considering his application for an award.¹⁰⁸

As such cases demonstrate, complete reliance on the IRS may be ill-advised, and meaningful appeals are critical for whistleblowers. It would be very improbable for the Tax Court to invalidate a determination when the IRS asserts that it did not use the information to collect evaded taxes.¹⁰⁹ In order to overcome such assertions, whistleblowers would have to set forth specific facts indicating that the IRS, in fact, initiated an administrative action based upon the tip provided.¹¹⁰ Thus, the Tax Court must consider enough evidence in order to determine that the IRS's actions were appropriate. Whistleblowers, like the cases mentioned above, should not be denied appeals because of misinformation. This is particularly important because the IRS appears reluctant to issue awards.

While the IRS is currently sluggish at processing tips,¹¹¹ the biggest threat to the whistleblower statute's long-term success may be the lack of awards. Congress correctly recognized that strengthening the whistleblower statute would likely increase tips¹¹² and collections.¹¹³ Yet, despite these increases, the IRS has not responded accordingly with an increase in awards.¹¹⁴ Since 2006, only *nine* awards have been paid under section 7623(b) of the Code.¹¹⁵ The lack of awards may serve as a deterrent to future whistleblowers and undermine the legitimacy of the Whistleblower Office.

Senator Charles Grassley, the author of the new tax whistleblower statute, noted in a letter to Treasury Secretary Geithner dated June 21, 2010:

107. *Id.* at *2.

108. *Id.*

109. Order and Order of Dismissal for Lack of Jurisdiction, *supra* note 90, at 1.

110. U.S. TAX CT. R. PRAC. & PROC. 121(d) (2012), available at https://www.ustaxcourt.gov/rules/Title_XII.pdf ("When a motion for summary judgment is made and supported as provided in this Rule, an adverse party may not rest upon the mere allegations or denials of such party's pleading, but . . . must set forth specific facts showing that there is a genuine dispute for trial.")

111. DEFICIENCIES, *supra* note 21, at 3 ("A lack of standardized procedures and limited managerial oversight resulted in control weaknesses. It took more than 7 ½ years from the receipt of the initial claim to the payment of the award.")

112. *Id.* at 6 (83 claims received in 2007 alleging \$8 billion in underreported income, 1890 claims in 2008 alleging \$65 billion in underreported income); INTERNAL REVENUE SERV., *supra* note 16, at 14 (1117 claims received pre-2007, 9268 in FY 2013).

113. INTERNAL REVENUE SERV., *supra* note 16, at 21 (\$1,678,316,545 total amounts collected from FY 2009 to FY 2013).

114. *Id.* (110 awards paid in FY 2009, 97 awards paid in FY 2010, 97 awards paid in FY 2011, 128 awards paid in FY 2012, and 122 awards paid in FY 2013).

115. *Id.* (noting nine awards paid under section 7623(b) of the Code).

I have learned from my almost three decades of experience with whistleblowers that government agencies will often seek to undermine or undercut the whistleblower. Prior to the 2006 changes, there was a culture of hostility towards and intimidation of whistleblowers at the IRS. That is why I created an independent Whistleblower Office at the IRS and delegated authority for reviewing claims and determining awards with that office.¹¹⁶

The independent Whistleblower Office, however, has not proven to be much different than the IRS prior to 2006. In fact, the similarities between the Whistleblower Office and the IRS prior to 2006 have even continued to determination letters, which still offer little to no explanation for denials.¹¹⁷

B. Lack of Explanations

By relying on privacy and disclosure laws, the IRS issues determination letters providing no insight into why awards were denied.¹¹⁸ Section 6103 of the Code relates to the confidentiality and disclosure of returns and return information. It states that returns and return information shall be confidential and no one with access to returns or return information shall disclose any of this information, unless an explicit legislative exception applies.¹¹⁹ If there is an unauthorized disclosure, a taxpayer may bring criminal¹²⁰ and civil¹²¹ actions against individuals who violated section 6103 of the Code.

There are numerous exceptions to this general rule of confidentiality, but currently there is no exception that expressly permits the IRS to disclose taxpayer's information to whistleblowers or courts reviewing whistleblower claims.¹²² The IRS has hidden behind section

116. Letter from U.S. Sen. Charles Grassley to Timothy Geithner, U.S. Treasury Sec'y, at 3 (June 21, 2010), available at <http://www.finance.senate.gov/newsroom/ranking/download/?id=ce408abf-57e3-4cba-b611-73929b35583b>.

117. *Ringo*, 2014 WL 4976226, at *1.

118. *Kasper v. Comm'r*, 137 T.C. 37, 39 (2011) ("Federal disclosure and other prevailing laws prevent[] the Whistleblower Office from providing a specific explanation for the denials.").

119. I.R.C. § 6103(a) (2012).

120. Section 7213 of the Code imposes fines, imprisonment time, and discharge from his or her job for individuals who willfully disclose returns, or return information, as defined in section 6103(b) of the Code. See I.R.C. § 7213(a).

121. Section 7431 of the Code permits taxpayers to bring a civil suit against the individuals who knowingly or negligently inspected or disclosed the taxpayer's information. The amount of damages that may be recovered includes the greater of actual damages, or \$1000 for each unauthorized disclosure, plus costs and attorney fees in certain circumstances. See I.R.C. § 7431(a)–(c).

122. The current Treasury Regulations state that the IRS should use the exception under section 6013(h)(4) of the Code to authorize the disclosures made by the Whistleblower Office in the course of the whistleblower administrative proceeding. See *Treas. Reg.* § 301.7623-1 (2014).

6103 of the Code in refusing to provide specific information that would permit meaningful judicial review of its denials of whistleblower claims.

For example, in *Cooper v. Commissioner*, the IRS's reasons for denying the claim were taken verbatim from the Internal Revenue Manual (IRM) list of possible reasons for denying claims.¹²³ The letter stated that an award determination could not be made because the whistleblower "did not identify . . . federal tax issue[s] upon which the IRS will take action" and the whistleblower's information did not "result in the detection of the underpayment of taxes."¹²⁴ Similarly, in *Kasper v. Commissioner*,

the denial letter[] recited a boilerplate list of common reasons for not allowing an award, including: (1) The application provided insufficient information; (2) the information provided did not result in the recovery of taxes, penalties, or fines; or (3) the [IRS] already had the information provided or such information was available in public records.¹²⁵

In non-whistleblower cases, courts have invalidated similar agency determinations due to a lack of a reasonable explanation. In *Citizens to Preserve Overton Park v. Volpe*, the Supreme Court found that determinations should allow courts to assess whether the agency has been faithful to the statutes and whether its decision passed the arbitrary and capricious standard.¹²⁶ An agency's action is considered arbitrary and capricious if it "failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."¹²⁷ Similarly, courts have refused to accord deference to an agency's interpretation of a regulation that merely parroted the statutory language.¹²⁸

There are numerous benefits to transparency. Giving reasoned explanations in determinations forces the agency to "disclose the relevant data, the values and assumptions in play, and the trade-offs entailed in the choice."¹²⁹ It also helps facilitate political accountability, and demonstrates the respect that the government owes to its

123. See *Cooper v. Comm'r*, 135 T.C. 70, 76 (2010).

124. *Id.* at 72.

125. *Kasper v. Comm'r*, 137 T.C. 37, 39 (2011).

126. *Citizens to Pres. Overton Park v. Volpe*, 401 U.S. 402, 403 (1971).

127. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

128. *Gonzales v. Oregon*, 546 U.S. 243, 255-56 (2006).

129. Steve R. Johnson, *Reasoned Explanation and IRS Adjudication*, 63 DUKE L.J. 1771, 1788 (2014).

citizens.¹³⁰ Furthermore, it may improve the quality of agency's decision-making¹³¹ and promote consistency.¹³²

Many areas of tax law recognize these benefits and, after the enactment of section 7522 of the Code, require that the IRS state "the basis" for the certain determinations.¹³³ These areas include notices of deficiency, post-assessment notices and demands for payment, notices generated by IRS information-return matching programs, and revenue agent reports.¹³⁴ The new whistleblower statute was enacted after section 7522 of the Code;¹³⁵ thus, it is uncertain whether it should apply to section 7623(b) of the Code. However, legislative history suggests that the IRS is expected to make efforts to improve the clarity of all notices and explanations that are sent to taxpayers.¹³⁶

Furthermore, section 7522 of the Code "does not articulate specific standards for determining whether the description of the Commissioner's basis is adequate"¹³⁷ It has been held, however, that the notice must contain enough information to allow the taxpayer to craft a meaningful Tax Court petition challenging the notice.¹³⁸ By applying this standard, whistleblower determinations would likely be considered inadequate.

This Note is not arguing that the IRS should be required to provide better explanations in their notices. While reasoned explanations are useful, there are downsides as well.¹³⁹ This Note is arguing, however, that if the IRS continues to issue determinations with inadequate explanations, the Tax Court must compensate elsewhere in order to assess whether the agency has been faithful to the statutes and whether its decision is reasonable. This compensation should occur by reviewing an adequate and reliable amount of evidence.

130. *Id.*

131. *Id.* at 1789.

132. Steve R. Johnson, *An IRS Duty of Consistency: The Failure of Common Law Making and a Proposed Legislative Solution*, 77 TENN. L. REV. 563, 563 (2010) (arguing that the IRS should strive to treat similarly situated taxpayers in a similar fashion).

133. I.R.C. § 7522 (2012).

134. Johnson, *supra* note 129, at 1803.

135. Eighteen years after the enactment of section 7522 of the Code, to be exact. Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406, 120 Stat. 2922, 2958 (2006) (codified as amended at I.R.C. § 7623).

136. I.R.C. § 7522(b). The Senate bill would have applied the direction more broadly, and the Conference Committee stated: "Although the provision is limited to the specified notices, the conferees expect the IRS to make every effort to improve the clarity of all notices and explanations that are sent to taxpayers." H.R. REP. No. 100-1104, pt. 2, at 219 (1988) (Conf. Rep.), *reprinted in* 1988 U.S.C.C.A.N. 5048, 5279.

137. *Shea v. Comm'r*, 112 T.C. 183, 196 n.20 (1999).

138. *Cadwell v. Comm'r*, 136 T.C. 38, 49 (2011), *aff'd*, 483 F. App'x 847 (4th Cir. 2012).

139. Johnson, *supra* note 129, at 1789 (requiring explanations may lead judges to outcome-driven decision making and negatively affect the quality of agencies' efforts by adding additional requirements).

C. History of Internal Control Issues in the IRS

Based on the history of TIGTA audits of the IRS, there is serious reason to doubt the reliability of the IRS's evidence. The historical trend of internal control deficiencies within the IRS suggests that the administrative record is inadequate for appeals.¹⁴⁰

A 2006 TIGTA audit report revealed that 76% of claims provided insufficient justification for rejection.¹⁴¹ Approximately 14% of these files were missing important information (such as copies of key forms and records of letters to informants). In fact, four claims could not even be located despite the fact that they were listed on the database.¹⁴²

Even in the cases of paid claims, 32% did not contain enough evidence to determine the justification for the percentage paid.¹⁴³ Almost one-half (45%) of the case files reviewed had control issues, such as missing key evidence.¹⁴⁴ Overall, the 2006 audit expressed "that a lack of standardized procedures and limited managerial oversight" were evident in the results.¹⁴⁵

The creation of an independent Whistleblower Office did not produce better results. In 2009, TIGTA evaluated the period beginning with the implementation of the Whistleblower Office through 2009, and again cited major deficiencies in the internal controls.¹⁴⁶ With respect to rejected claims, the auditors were unable to determine the reviewer's rationale in rejecting those claims in 75% of the cases reviewed.¹⁴⁷ With respect to paid claims, 45% had problems with control issues, such as missing copies of key forms.¹⁴⁸ Also, 32% did not provide sufficient documentation to justify the award percentage.¹⁴⁹

Moreover, in 2009, the IRS attempted to consolidate claim information from three systems into one, which produced even more inaccuracies.¹⁵⁰ The IRS did not ensure that proper steps were taken to reconcile and correct inaccurate information from prior years.¹⁵¹

140. See *infra* Part II.C.

141. INFORMANTS' REWARDS PROGRAM, *supra* note 60, at 7 ("In 76 percent of the rejected informant claims included in our review, we were unable to determine the rationale for the reviewer's decision to reject the claim, based on information in the case file.").

142. *Id.* at 6.

143. *Id.* at 7.

144. *Id.* at 6.

145. *Id.*

146. DEFICIENCIES, *supra* note 21, at 15 ("The overall objective of this review was to evaluate the implementation of the Whistleblower Office," which was established in 2006.).

147. *Id.* at 4 (emphasis added).

148. *Id.* (emphasis added).

149. *Id.*

150. *Id.* at 8-9.

151. *Id.*

In 2012, an audit was conducted to follow up on the adequacy of the corrective actions the IRS agreed to implement subsequent to the 2009 audit.¹⁵² TIGTA concluded that the IRS “did not fully and adequately address the prior cited internal control weaknesses.”¹⁵³ It summed up the potential of the Program and its downfalls by stating: “The Whistleblower Program provides the IRS with an opportunity to recover potentially billions of dollars in taxes, penalties, and interest However, the IRS did not have an effective inventory control system or adequate procedures and processes at the time of our review.”¹⁵⁴ These deficiencies existed before enactment of section 7623(b) of the Code and still exist today.

III. TAX COURT’S SCOPE OF REVIEW

This Part explores how whistleblowers could obtain meaningful appeals through an appropriate scope of review. Due to the considerations discussed above, the Tax Court should not limit the evidence it considers to the administrative record; rather, it should take evidence as per its historical scope of review.¹⁵⁵ The Tax Court should not strictly confine itself to the Administrative Procedure Act (APA),¹⁵⁶ which generally requires that courts stay within the administrative record when reviewing agency actions.¹⁵⁷ Further, even if strictly applying the APA, the Tax Court is not bound to the administrative record. Rather it may, and should, require enough evidence so that it can justify the agency’s action.

A. *The Tax Court Should Apply Its Traditional Scope of Review*

The IRS has maintained that the APA applies to the Tax Court for whistleblower appeals.¹⁵⁸ It takes this position because the IRS is an

152. TREASURY INSPECTOR GEN. FOR TAX ADMIN., U.S. DEPT OF TREASURY, REF. NO. 2012-30-045, IMPROVED OVERSIGHT IS NEEDED TO EFFECTIVELY PROCESS WHISTLEBLOWER CLAIMS 5 (2012), available at <http://www.treasury.gov/tigta/auditreports/2012reports/201230045fr.pdf>.

153. *Id.*

154. Memorandum from Michael R. Phillips, Deputy Inspector Gen. for Audit, to the Deputy Comm’r for Servs. & Enforcement (Aug. 20, 2009), available at <http://www.treasury.gov/tigta/auditreports/2009reports/200930114fr.html>.

155. *Ewing v. Comm’r*, 122 T.C. 32, 55 (2004) (“Congress has not imposed a restrictive standard for this Court’s review of the Commissioner’s determinations under section 6015. Clearly, when it enacted section 6015, Congress was aware that this is a trial court that has historically resolved cases by taking evidence and has never been governed by the APA.”), *rev’d*, *Comm’r v. Ewing*, 439 F.3d 1009 (9th Cir. 2006) (holding that the Tax Court did not have jurisdiction over Ewing’s petition).

156. See APA, 5 U.S.C. §§ 551–59, 701–06 (2012).

157. See *id.* § 706.

158. See, e.g., *Wilson v. Comm’r*, 705 F.3d 980, 989-90 (9th Cir. 2013).

“agency” within the meaning of section 511 of the APA,¹⁵⁹ and the APA generally requires the record rule for review of agency determinations.¹⁶⁰ The Supreme Court has confirmed that administrative law applies to Tax Court cases.¹⁶¹

Applying the record rule, however, conflicts with the Tax Court’s traditional scope of review. The Tax Court has “historically resolved cases by taking evidence” unless Congress has imposed a restrictive standard.¹⁶² Also, the Tax Court has maintained that the APA does not govern it.¹⁶³ A longstanding example of this is seen in deficiency cases where the Court must re-determine a taxpayer’s liability.¹⁶⁴ During these re-determinations, the Court has traditionally taken evidence.¹⁶⁵

Furthermore, in Collection Due Process (CDP) cases, the Tax Court will take evidence outside of the administrative record.¹⁶⁶ CDP cases arise when a taxpayer has a deficiency and the IRS files notice of its tax lien or levies on a property.¹⁶⁷ The Tax Court has held that when the validity of the underlying tax liability is at issue, the Court may take evidence when reviewing the IRS’s determination.¹⁶⁸

Spousal relief cases also do not apply the record rule.¹⁶⁹ These cases arise when spouses file their tax returns jointly and there is an understatement of tax attributable to erroneous items of one of the

159. See APA, 5 U.S.C. § 551(1) (2012) (defining “agency” as “each authority of the Government of the United States, whether or not it is within or subject to review by another agency,” subject to exceptions not relevant here).

160. See *id.* § 706.

161. See *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 53-58 (2011).

162. *Ewing v. Comm’r*, 122 T.C. 32, 55 (2004) (“Congress has not imposed a restrictive standard for this Court’s review of the Commissioner’s determinations under section 6015. Clearly, when it enacted section 6015, Congress was aware that [the Tax Court] is a trial court that has historically resolved cases by taking evidence . . .”).

163. *Id.* (“[The Tax Court] . . . has never been governed by the APA.”).

164. *Id.* at 37 (“It is well established that the APA does not apply to deficiency cases in this Court; that is, cases arising under sections 6213 or 6214 in which we may redetermine the taxpayer’s tax liability.”).

165. *Id.* (“We make redeterminations under section 6213(a) de novo.”).

166. *Goza v. Comm’r*, 114 T.C. 176, 181-82 (2000) (applying a de novo standard of review “where the validity of the underlying tax liability is properly at issue”).

167. I.R.C. § 6330(a) (2012).

168. *Goza*, 114 T.C. at 181-82. Note that where the validity of the underlying tax liability is not properly at issue, the Court will review the agency’s determination under the deferential abuse of discretion standard of review. *Id.* at 182.

169. *Porter v. Comm’r*, 132 T.C. 203, 214 (2009) (“[W]e are no longer restricted to determining whether the Commissioner’s determination was an abuse of discretion. Under a de novo standard of review, we take into account all the facts and circumstances and determine whether it is inequitable to hold the requesting spouse liable for the unpaid tax or deficiency.”).

spouses.¹⁷⁰ The Tax Court will permit relief to the other individual if he or she did not know, and had no reason to know, that there was an understatement.¹⁷¹ Thus, the Tax Court will take evidence even when there is a *deficiency related to another individual*. This practice has continued after the enactment of the APA¹⁷² and after the Supreme Court's decision that administrative law applies to tax.¹⁷³

Accordingly, when Congress has not imposed a strict standard, the Tax Court has considered evidence it deems appropriate. Congress does not pass statutes in a vacuum and is aware that the Tax Court has historically resolved cases by taking evidence.¹⁷⁴ By conferring jurisdiction to the Tax Court, Congress may have intended that the Tax Court proceedings be conducted in accordance with the rules prescribed by the Tax Court. In determining Congressional intent, courts will often analyze the language of the statute.¹⁷⁵ The language of the new whistleblower statute is nearly identical to the language of the CDP statute. Thus, by analogy to CDP cases, precedent has already indicated that the language in the tax whistleblower statute does not confine the court to the administrative record.¹⁷⁶

The language from the CDP provision in section 6330(d) of the Code provides that “[t]he person may, within 30 days of a determination under this section, appeal such determination to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).”¹⁷⁷ Almost identically, section 7623(b) of the Code provides that “[a]ny determination regarding an award under paragraph (1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).”¹⁷⁸ Thus, as the Court has previously allowed new evidence in CDP cases, the statutory language alone does not constrict

170. I.R.C. § 6015(b)(1).

171. *Id.*

172. *Porter v. Comm’r*, 130 T.C. 115, 122 (2008) (“Review for abuse of discretion does not trigger application of the APA record rule or preclude us from conducting a de novo trial. Our longstanding practice has been to hold trials de novo in many situations where an abuse of discretion standard applies. In those cases, our practice has not been to limit taxpayers to evidence contained in the administrative record or arguments made by the taxpayer at the administrative level.”).

173. *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 53-58 (2011) (holding that administrative law applies to Tax Court cases).

174. *Steadman v. SEC*, 450 U.S. 91, 105 (1981) (Powell, J., dissenting) (“[T]he general provisions of the APA are applicable only when Congress has not intended that a different standard be used in the administration of a specific statute.”).

175. *Wilson*, 705 F.3d at 987 (“The first question in this case is whether the Tax Court properly considered new evidence in considering Wilson’s appeal. Resolution of the issue turns on statutory analysis.”).

176. *See Goza v. Comm’r*, 114 T.C. 176, 181 (2000).

177. *See* I.R.C. § 6330(d) (2012).

178. *Id.* § 7623(b)(4).

whistleblower appeals to the record. The Tax Court has suggested this view in a recent press release, discussed below.

In a June 2008 press release containing proposed amendments to the Court's rules regarding whistleblower actions, the Tax Court indicated that it does not consider itself strictly bound to the administrative record:

The Court's Rules generally contemplate disposition on the administrative record for disclosure actions and declaratory judgment actions, pursuant to specific legislative guidance. Without specific statutory authority or evidence of legislative intent establishing whether whistleblower award actions are to be decided on the administrative record, [the portion of the Tax Court rules applicable to whistleblower actions] as proposed follows the general procedures for deficiency and other types of actions before the Court.¹⁷⁹

The Tax Court revised this comment in an October 2008 press release stating that "[w]ithout 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."¹⁸⁰

The Tax Court's position appears contrary to the Supreme Court's decision in *Mayo Foundation*, which confirmed that administrative law applies to tax.¹⁸¹ However, that decision did not command that the Tax Court blindly apply the APA and ignore traditional rules and Congressional intent. The "general provisions of the APA are applicable only when Congress has not intended that a different standard be used in the administration of a specific statute."¹⁸² As such, District Courts have upheld that the Tax Court may take evidence based on the text, structure, and/or legislative history of the statute.¹⁸³

As noted, the text and structure of the whistleblower statute mirrors the CDP statute, which takes evidence. Furthermore, section 7623(b) of the Code came from one of two competing bills.¹⁸⁴ The bill that was not enacted, included in the Tax Shelter and Tax Haven Re-

179. Press Release, U.S. Tax Court (June 2, 2008), available at <http://www.ustaxcourt.gov/press/060208.pdf>.

180. Press Release, U.S. Tax Court (Oct. 3, 2008), available at <http://www.ustaxcourt.gov/press/100308.pdf>.

181. *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 53-58 (2011).

182. *Steadman v. SEC*, 450 U.S. 91, 105 (1981) (Powell, J., dissenting).

183. *Wilson v. Comm'r*, 705 F.3d 980, 1011 (9th Cir. 2013) (holding the Tax Court is still able to take evidence based on the text, structure, and legislative history of the spousal relief statute).

184. See Tax Shelter and Tax Haven Reform Act of 2005, S. 1565, 109th Cong. (2005), available at <http://votesmart.org/public-statement/117729/statements-on-introduced-bills-and-joint-resolutions#VJGLtWTF-ts>; 151 Cong. Rec. S9472, S9484 (daily ed. July 29, 2005) (statement of Sen. Levin), available at <http://www.gpo.gov/fdsys/pkg/CREC-2005-07-29/pdf/CREC-2005-07-29-pt1-PgS9472.pdf>.

form Act of 2005,¹⁸⁵ appeared to require a limited review, restricted to the administrative record.

The relevant portion of the bill read: “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, and shall be determined *at the sole discretion* of the Whistleblower Office.”¹⁸⁶ The enacted whistleblower statute removed the portion that provided “and shall be determined at the sole discretion of the Whistleblower Office.”¹⁸⁷ By limiting the IRS’s discretion, Congress may have implied that the Tax Court should be able to take evidence. Senator Levin, who introduced the bills, reinforced this interpretation by stating:

The one key difference between our bill and the Finance Committee provisions is that . . . our bill would not enable whistleblowers to appeal to a court to obtain additional sums. The fact-specific analysis that goes into evaluating a whistleblower’s assistance and calculating a reward makes court review inadvisable.¹⁸⁸

The bill that was passed, however, includes an option for this “fact-specific analysis.” It directs appeals to the Tax Court,¹⁸⁹ whereas the other bill did not provide jurisdiction to a specific court.

Accordingly, as the text, structure, and legislative history of the whistleblower statute do not impose a strict standard, the Tax Court does not have to confine itself to the administrative record. Similar to cases determining deficiencies or granting spousal relief, the Court should take evidence when analyzing deficiencies exposed by whistleblowers.

B. Even If the Record Rule Applies, the Tax Court May Take Evidence

Even if the Tax Court applies the record rule, Supreme Court precedent suggests that the Tax Court may, and will likely have to, consider new evidence.¹⁹⁰ The underlying principle for judicial review of an agency decision was outlined in the Supreme Court’s decision in *SEC v. Chenery Corp.* in 1943.¹⁹¹ The Court held that “the orderly functioning of the process of review requires that the grounds upon

185. See Tax Shelter and Tax Haven Reform Act of 2005, S. 1565, 109th Cong. (2005).

186. *Id.* at § 206(b)(1) (emphasis added).

187. I.R.C. § 7623(b)(1) (2012).

188. 151 Cong. Rec., *supra* note 184, at S9484.

189. I.R.C. § 7623(b)(4).

190. The Tax Court is a “Court of Law” within the meaning of the Appointments Clause and exercises judicial power to the exclusion of any other function, as it is independent of the Executive and Legislative Branches. *Freytag v. Comm’r*, 501 U.S. 868, 890 (1991).

191. *SEC v. Chenery Corp.*, 318 U.S. 80 (1943).

which the administrative agency acted be clearly disclosed and adequately sustained.”¹⁹² The Court further stated that “an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained.”¹⁹³

While courts are unable to impose additional procedural requirements on agencies,¹⁹⁴ these same restrictions do not apply when requesting additional evidence. The reviewing court must have an adequate record in order to fulfill its duties.¹⁹⁵ In order to obtain sufficient evidence, a court may either: (1) developed its own record, or (2) remand back to the agency so that it may supplement the administrative record to justify its actions.

In *Citizens to Preserve Overton Park v. Volpe*, the Supreme Court found that the administrative record did not allow for the “full, prompt review of the Secretary’s action . . . without additional delay which would result from having a remand to the Secretary.”¹⁹⁶ As the record was inadequate, the Court held that it was necessary for the reviewing court “to require some explanation in order to determine if the Secretary acted within the scope of his authority and if the Secretary’s action was justifiable under the applicable standard.”¹⁹⁷ In obtaining this additional evidence, the Supreme Court permitted the reviewing court to create its own evidentiary record.¹⁹⁸

In *Camp v. Pitts*, the Supreme Court held that remand to the agency is preferred over the reviewing court developing its own record in circumstances where there is “contemporaneous explanation of the agency decision.”¹⁹⁹ The Court was hesitant to “put aside the extensive administrative record already made” and held that a court would be permitted to go outside the record if there was a “failure to explain administrative action as to frustrate effective judicial re-

192. *Id.* at 94.

193. *Id.* at 95.

194. *Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519, 524 (1978) (“Agencies are free to grant additional procedural rights in the exercise of their discretion, but reviewing courts are generally not free to impose them if the agencies have not chosen to grant them.”).

195. *Friday v. Comm’r*, 124 T.C. 220, 221 (2005) (holding that courts, in reviewing administrative action, may remand for further factual determinations that are deemed necessary to complete an inadequate administrative record or to make an adequate one).

196. *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 419 (1971) (“Moreover, there is an administrative record that allows the full, prompt review of the Secretary’s action that is sought without additional delay which would result from having a remand to the Secretary. That administrative record is not, however, before us.”).

197. *Id.* at 420.

198. *Id.* at 420-21 (allowing additional evidence, including testimony related to the mental process of the agency persons involved in making the decision, such as the Secretary).

199. *Camp v. Pitts*, 411 U.S. 138, 143 (1973) (per curiam).

view.”²⁰⁰ If such a failure exists, the agency’s “decision must be vacated and the matter remanded to [the agency] for further consideration.”²⁰¹ Then the reviewing court must determine whether and to what extent “further explanation is necessary to a proper assessment of the agency’s decision.”²⁰²

The Tax Court, however, does not always allow for remand to the agency. In spousal relief cases, the Tax Court has held that “[s]ection 6015(e) not only makes no mention of remand, it instructs the Tax Court to proceed de novo when reviewing certain § 6015(f) petitions.”²⁰³ Furthermore, precedent restricts the Tax Court from remanding spousal relief cases to the Commissioner for further administrative consideration because it is a “stand alone” case.²⁰⁴ Accordingly, when the administrative record is insufficient, the Tax Court may develop its own evidentiary record or remand back to the IRS when it is allowed.

Currently, the Tax Court will be unable to justify the IRS’s actions by analyzing the bare determination letters.²⁰⁵ Furthermore, based on the substantial, pervasive, and consistent failures within the Whistleblower Office, the record is unreliable and will not adequately explain the agency’s action in a majority of appeals.²⁰⁶ Applying the record rule will undoubtedly frustrate effective judicial review, as already demonstrated in *Anonymous 1 and Anonymous 2* and *Ringo*.²⁰⁷ Strict enforcement of the record rule will not be an option in most appeals. As such, the Tax Court will either remand back to the agency or create its own record.

As indicated in *Camp*, remand is preferred in circumstances where there is an “extensive administrative record already made” and there is a “contemporaneous explanation of the agency decision.”²⁰⁸ In tax whistleblower appeals, neither of these exists. The administrative record has been inadequate and unreliable rather than “extensive.” Furthermore, there cannot be a “contemporaneous explanation” in a tax whistleblower appeal. If a claim is accepted for examination, the IRS will only issue or deny an award after it com-

200. *Id.* at 142-43.

201. *Id.* at 143.

202. *Id.*

203. *Wilson v. Comm’r*, 705 F.3d 980, 989 (9th Cir. 2013).

204. *Id.*

205. *See supra* Part II.B.

206. *See supra* Part II.C.

207. *See supra* Part II.A.

208. *Camp v. Pitts*, 411 U.S. 138, 142-43 (1973) (per curiam).

pletes its investigation.²⁰⁹ Finally, remand will be impossible in many cases as the IRS will be unable to appropriately supplement the administrative record due to missing evidence.²¹⁰

As in *Overton Park*, the Tax Court should develop its own record when the administrative record is insufficient. Remanding to the IRS does not currently appear to be a viable option due to material weaknesses in internal controls, which have resulted in missing evidence. Similar to spousal relief cases, when remanding to the agency is not an option, the Court must develop its own evidentiary record because that “appears to be the ‘only means by which [the Tax Court] can supplement an insufficient record’”²¹¹

District Courts may overrule more independent approaches in favor of remand, as per the Supreme Court holding in *Camp v. Pitts*. However, based on the widespread failures within the IRS, the most effective and efficient method of review may be for the Tax Court to develop its own evidentiary record.

CONCLUSION

The whistleblower statute could be the most effective method of narrowing the \$385 billion tax gap. The long-term success of the program, however, may be undermined if the Whistleblower Office does not cooperate with whistleblowers and issue awards as appropriate. The Tax Court may be able to influence the success of the program by providing meaningful appeals. However, these appeals will only be meaningful if the Tax Court is able to consider adequate and reliable evidence.

Currently, the administrative record does not constitute adequate or reliable evidence. Internal control failures within the Whistleblower Office have resulted in missing evidence in a majority of the cases. Furthermore, the lack of requirements for what must be included in the administrative record has led to even less protection for whistleblowers.

The Tax Court should develop its own evidentiary record to provide a meaningful appeal. The statutory text, structure, and legislative history point the Tax Court to utilize its traditional scope of review. Even if the record rule applies, the Tax Court will need to take evidence in a majority of cases or it will inadvertently reject proper appeals as already demonstrated in early cases.

209. DEFICIENCIES, *supra* note 21, at 2 (“A claim may be accepted for examination. The examination is conducted and when completed the operating division prepares a Confidential Evaluation Report on Claim for Reward (Form 11369).”).

210. See *supra* Part II.C.

211. *Wilson v. Comm’r*, 705 F.3d 980, 989 (9th Cir. 2013) (alteration in original) (quoting *Porter v. Comm’r*, 132 T.C. 203, 225 (2009) (Wells, J., dissenting)).