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WHISTLEBLOWER PROGRAM: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirement of IRC § 6103(p)

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Confidentiality*

PROBLEM

In 1976, when Congress amended Internal Revenue Code (IRC) § 6103 to generally prohibit the disclosure of tax return or return information, it also enacted what is now IRC § 7431, authorizing civil suits for damages for knowing or negligent unauthorized disclosures, and enhanced IRC § 7213, a criminal enforcement provision that penalizes willful unauthorized disclosures.² The maximum amount of statutory damages (\$1,000) or fines (\$5,000) under these provisions has remained the same for almost four decades. In 1997, Congress added IRC § 7213A, criminalizing the willful unauthorized inspection of returns or return information; eighteen years later, the \$1,000 maximum fine under this provision is the same.³

The Internal Revenue Service (IRS) discloses taxpayers' returns and return information to whistleblowers pursuant to exceptions to IRC § 6103.⁴ However, a whistleblower is not subject to the civil or criminal penalty provisions of IRC §§ 7431, 7213, or 7213A for unauthorized inspection or re-disclosure of that information. Tax whistleblowers are also not subject to the safeguarding requirements of IRC § 6103(p).

EXAMPLE

Whistleblower X, while assisting the IRS in detecting A's underpayments of tax, acquires return information about A, such as:

- The reporting positions on A's return that resulted in the underpayments;
- Other items on A's tax return, including A's earnings, the identity of A's dependents, the amount of alimony A claimed as a deduction, A's religious and political affiliations, and the recipients of A's charitable donations;
- A's tax compliance history, including the fact that A was audited several times over the past ten years and assessed additional amounts; and
- Communications between A and the IRS that would be embarrassing to A if made public.

1 See Taxpayer Bill of Rights available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), in § 1202(a) amending IRC § 6103; in § 1202(e) enacting IRC § 7217, later redesignated as IRC § 7431, authorizing civil suits for damages; and in § 1202(d) amending IRC § 7213(a) to make willful unauthorized disclosure of return information a felony rather than a misdemeanor, increase the maximum imprisonment from one year to five years, and increase the maximum fine from \$1,000 to \$5,000, among other things.

3 Taxpayer Browsing Protection Act, Pub. L. No. 105-35, § 2(a), 111 Stat. 1104 (1997), authorizing imposition of a maximum fine of \$1,000 and imprisonment of up to one year.

4 See, e.g., IRC § 6103(k)(6) and (h)(4), discussed below.

X does not take any measures to safeguard A's return information, such as maintaining a secure place to store it, restricting access to it, or returning or destroying the information when there is no longer a need for it.

Pursuant to IRC § 7623(b), X receives a portion of the proceeds the IRS collects after auditing A and assessing additional amounts. Thereafter, X makes public the return information he learned about A while assisting the IRS. IRC § 7431 provides for civil suits for the unauthorized inspection or disclosure of return information by IRS employees, among others, but with one exception not present here, the statute does not specifically apply to whistleblowers.⁵ Even if A could bring suit against X pursuant to IRC § 7431, A's recovery may not sufficiently compensate him or aid in the enforcement of confidentiality rules.

RECOMMENDATIONS

To address the lack of an effective remedy for injury sustained by taxpayers whose return information is inspected or disclosed by a tax whistleblower without authorization, and to aid in the enforcement of the confidentiality rules, the National Taxpayer Advocate recommends that Congress:

1. Amend IRC §§ 7431, 7213, and 7213A to provide that any whistleblower (*i.e.*, a person making a claim for award under IRC § 7623) or legal representative of a tax whistleblower who receives a taxpayer's return or return information pursuant to an exception under IRC § 6103 is subject to the civil and criminal penalty provisions of IRC §§ 7431, 7213, and 7213A for the unauthorized inspection or disclosure of that information;
2. Amend IRC § 7431, which authorizes a civil suit for the negligent or knowing unauthorized inspection or disclosure of return or return information, to increase statutory damages to a more substantial amount, such as \$5,000, for violations by tax whistleblowers seeking or obtaining an award pursuant to IRC § 7623(b);
3. Amend IRC §§ 7213 and 7213A, which sanction willful unauthorized disclosure or inspection of return or return information, to increase the maximum amount of fines to more substantial amounts, such as \$20,000 and \$1,500, respectively; and
4. Amend IRC § 6103(p) to make tax whistleblowers subject to its safeguarding requirements.

PRESENT LAW

Prior to 1976, income tax returns were "public records," open to inspection under regulations approved by the President, or under Presidential order.⁶ The Senate Finance Committee, in its report on H.R. 10612, the Tax Reform Act of 1976, proposed significant revisions to the treatment of tax returns and other information, noting:

Although present law describes income tax returns as "public records", open to inspection under regulations approved by the President, or under Presidential order, the committee felt that returns and return information should generally be treated as confidential and not subject

⁵ The exception is when the IRS enters into a contract, sometimes referred to as a "tax administration contract" with a whistleblower pursuant to IRC § 6103(n). See Treas. Reg. § 301.6103(n)-2(c). The IRS has never entered into a tax administration contract with a tax whistleblower.

⁶ S. REP. No. 94-938, 94th Cong., 2d Sess. (1976) at 318.

to disclosure except in those limited situations delineated in the newly amended section 6103 where the committee decided that disclosure was warranted.⁷

The Tax Reform Act of 1976 changed several aspects of IRC § 6103 (*e.g.*, by broadly defining “return” and “return information”), and added or amended other code sections to enhance enforcement of the nondisclosure rules.⁸ However, the Act did not extend the restrictions on disclosure to everyone who receives returns or return information; IRC § 6103 contains no provision concerning disclosures by whistleblowers specifically. Moreover, existing exceptions to the general rule of nondisclosure that allow the IRS to disclose return information to whistleblowers were left undisturbed. For example, IRC § 6103(k)(6) allows what are sometimes referred to as “investigative disclosures,” necessary to obtain information related to the IRS’s official duties or to accomplish properly any activity connected with such official duties. IRC § 6103(h)(4) allows the IRS to disclose returns and return information during an administrative proceeding, including a whistleblower administrative proceeding.⁹ A whistleblower and the IRS may enter into a contract under IRC § 6103(n), sometimes referred to as a “tax administration” contract, for the whistleblower’s services relating to the detection of violations of the internal revenue laws or related statutes, and the IRS may disclose return information in connection with the contract.

The 1976 Act added IRC § 7217, later designated IRC § 7431, “to redress any injury sustained and to aid in the enforcement of the confidentiality rules.”¹⁰ The statute provides that a taxpayer whose return or return information was knowingly or negligently inspected or disclosed in violation of IRC § 6103 may recover actual damages or statutory damages of \$1,000, as well as court costs and attorney’s fees, for such unauthorized inspection or disclosure. Congress provided for recovery of statutory damages in recognition of “the difficulty in establishing in monetary terms the damages sustained by a taxpayer as the result of the invasion of his privacy caused by an unlawful disclosure of his returns or return information.”¹¹

7 S. REP. NO. 94-938, 94th Cong., 2d Sess. (1976) at 318.

8 As amended, IRC § 6103(b)(1) defines “return” as “any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.” IRC § 6103(b)(2)(A) defines “return information” to include “a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.” See Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 343 (Dec. 29, 1976), noting that “Congress decided that the prior provisions of law designed to enforce the rules against the improper use or disclosure of returns and return information were inadequate.”

9 Treas. Reg. § 301.6103(h)(4)-1. The IRS’s notification to the whistleblower of a preliminary, or proposed, award through a preliminary award recommendation letter, which the whistleblower may dispute, is the beginning of an IRC § 6103(h)(4) administrative proceeding. Treas. Reg. § 301.7623-3(b)(1); Treas. Reg. § 301.7623-3(c)(1). Issuance of a preliminary denial letter or preliminary rejection letter in IRC § 7623(b) cases also marks the beginning of a whistleblower administrative proceeding. See Treas. Reg. § 301.7623-3(c)(7) and (8). The National Taxpayer Advocate recommends revising the regulations under IRC § 7623 to provide that a whistleblower administrative proceeding, within the meaning of IRC § 6103(h)(4) commences, with the whistleblower’s submission of Form 211, *Application for Award for Original Information*. See Most Serious Problem: *Whistleblower Program: The IRS Whistleblower Program Does Not Meet Whistleblowers’ Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers’ Confidential Information from Re-Disclosure by Whistleblowers*, *supra*.

10 S. REP. NO. 94-938, 94th Cong., 2d Sess. (1976) at 347; Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(e), 90 Stat. 1520, 1687 (1976). IRC § 7217 was redesignated as IRC § 7431 by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, § 357, 96 Stat. 324, 645-6.

11 Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 345 (Dec. 29, 1976).

The statute also provides for recovery of punitive damages if the inspection or disclosure was willful or the result of gross negligence.¹²

As noted, IRC § 7431 applies to inspections and disclosures “in violation of any provision of IRC § 6103,” and thus does not generally apply to disclosures by whistleblowers, who are not generally subject to the nondisclosure rules of IRC § 6103.¹³ An exception to this general rule is where a tax whistleblower discloses a taxpayer’s return or return information obtained in connection with a contract authorized by IRC § 6103(n). In that situation, regulations provide that the civil remedies afforded by IRC § 7431 would be available to a taxpayer whose return or return information was re-disclosed by the whistleblower.¹⁴ However, the IRS has never entered into an IRC § 6103(n) contract with a tax whistleblower.

The 1976 Act also adjusted IRC § 7213(a) to make the willful disclosure of returns or return information a felony rather than a misdemeanor, increase the maximum imprisonment from one year to five years, and increase the maximum fine from \$1,000 to \$5,000.¹⁵ The sanction applies to, among others, federal and state employees, and would apply to a tax whistleblower with whom the IRS entered into a contract pursuant to IRC § 6103(n).¹⁶ Where disclosure of return information to a whistleblower violates the law, *e.g.*, disclosure by a federal employee in violation of IRC § 6103, the whistleblower would be subject to the penalty for publishing the information.¹⁷ However, the sanction does not apply to whistleblowers who acquire return information legitimately pursuant to IRC § 6103(k)(6) or (h)(4) and then re-disclose the information.

In 1997, Congress further protected taxpayers’ returns and return information by enacting IRC § 7213A, a new criminal penalty providing for a fine of up to \$1,000 and imprisonment of up to one year for willful unauthorized inspection of any tax return or return information.¹⁸ Like IRC § 7213, this penalty would apply to tax whistleblowers with whom the IRS entered into a contract pursuant to IRC § 6103(n), but does not apply to tax whistleblowers who acquire return information pursuant to IRC § 6103(k)(6) or (h)(4).¹⁹

12 In 1982, Congress redesignated this statute as IRC § 7431 and amended it to provide that if a U.S. officer or employee knowingly or negligently discloses return information in violation of the disclosure restrictions, the wronged party will be permitted to bring a civil action for damages against the U.S. (rather than against the officer or employee). If a person other than a federal employee violates IRC § 7431, a suit may be brought against that person in District Court. The provisions setting the amount of liquidated damages was left unchanged. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, § 357, 96 Stat. 324, 645-6.

13 IRC § 7431(a)(2) provides: “If any person who is not an officer or employee of the United States knowingly, or by reason of negligence, inspects or discloses any return or return information with respect to a taxpayer *in violation of any provision of section 6103* or in violation of section 6104(c), such taxpayer may bring a civil action for damages against such person in a district court of the United States” (emphasis added).

14 Treas. Reg. § 301.6103(n)-2(c).

15 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(d), 90 Stat. 1520, 1686-7 (1976).

16 IRC § 7213(a)(1), (2); see also Treas. Reg. § 301.6103(n)-2(c).

17 IRC § 7213(a)(3) provides: “Other persons: It shall be unlawful for any person to whom any return or return information (as defined in section 6103(b)) is disclosed in a manner unauthorized by this title thereafter willfully to print or publish in any manner not provided by law any such return or return information.”

18 Taxpayer Browsing Protection Act, Pub. L. No. 105-35, § 2(a), 111 Stat. 1104 (1997).

19 IRC § 7213A(a)(1)(B); see also Treas. Reg. § 301.6103(n)-2(c).

The 1976 Act also amended IRC § 6103 to impose safeguarding requirements on Federal and State agencies, among others, that receive return information pursuant to exceptions to IRC § 6103.²⁰ The safeguarding requirements were intended as “a comprehensive system of administrative, technical, and physical safeguards designed to protect the confidentiality of the returns and return information and to make certain that they are not used for purposes other than the purposes for which they were disclosed.”²¹ Affected recipients of return information are required, as a condition of receiving the information, to explain how they will safeguard it.²² Thereafter, they are required to maintain a secure area for storing the return information, restrict access to it, return or destroy it when they are finished with it, and “provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information.”²³ The safeguarding provisions of IRC § 6103(p)(4) do not apply to whistleblowers specifically. A whistleblower who receives return information in connection with an IRC § 6103(n) contract, however, would be subject to separate safeguard provisions, including the requirement, as a condition to disclosure, that the whistleblower “permit an inspection of the whistleblower’s or the legal representative’s premises by the IRS.”²⁴

In 2006, Congress significantly expanded the reach of IRC § 7623, which authorizes the IRS to pay awards to tax whistleblowers who assist it in detecting underpayments of tax or “detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same.”²⁵ Under IRC § 7623(a), the IRS has discretionary authority to make awards to whistleblowers. The 2006 amendments added subsection (b) to the statute, making whistleblower awards mandatory in certain cases, generally specifying an award amount from 15 to 30 percent of the tax recovered (with no cap on the amount of the award), creating the IRS Whistleblower Office (WO), and providing for United States Tax Court review of whistleblower award determinations.²⁶ The new provision generally applies if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000.²⁷

REASONS FOR CHANGE

Since 2006, when Congress enhanced the provisions of IRC § 7623 by adding subsection (b), whistleblowers have responded by seeking awards pursuant to subsection (b), as well as continuing to seek discretionary awards under subsection (a).²⁸ Although the IRS shares return information with whistleblowers pursuant to exceptions to the general rule of nondisclosure under IRC § 6103, it has never entered into a tax administration contract with a whistleblower pursuant to IRC § 6103(n). Thus, in the event a whistleblower re-discloses return information legitimately acquired pursuant to an IRC § 6103 exception,

20 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(a), 90 Stat. 1520, 1683-4 (1976), adding subsection (p)(4) to IRC § 6103.

21 Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 341 (Dec. 29, 1976).

22 IRC § 6103(p)(4)(E).

23 IRC § 6103(p)(4)(B-D, F).

24 Treas. Reg. § 301.6103(n)-2(d)(3).

25 IRC § 7623(a).

26 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 406(b), 120 Stat. 2922, 2958-9, adding subsection (b) to IRC § 7623, including subsection (b)(4) which provides for Tax Court review of the IRS’s award determination, and creating the Whistleblower Office in an “off-Code” provision. IRC § 7623(b)(2) and (3) authorize awards of less than 15 percent in certain cases.

27 IRC § 7623(b)(5). If the award is made with respect to an individual taxpayer, the individual’s gross income must exceed \$200,000 for any taxable year subject to the IRS’s action.

28 See Most Serious Problem: *Whistleblower Program: The IRS Whistleblower Program Does Not Meet Whistleblowers’ Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers’ Confidential Information from Re-Disclosure by Whistleblowers*, *supra*.

no provision in the IRC provides for a civil suit against the whistleblower, and the whistleblower is not subject to any criminal sanction under the Code. That whistleblowers are not subject to the safeguarding provisions of IRC § 6103(p)(4) leaves taxpayers at an even greater risk of dissemination of their confidential return information.

Even if they applied to whistleblowers who do not have an IRC § 6103(n) contract, the maximum amount of statutory damages (\$1,000) and fines (\$5,000) imposed by IRC §§ 7431, 7213, and 7213A are insufficient to “redress any injury” or “aid in the enforcement of the confidentiality rules.” The \$1,000 maximum amount of statutory damages under IRC § 7431 and the \$5,000 maximum fine imposed by IRC § 7213 were both established in 1976, four decades or so ago. The same amounts in 2015 dollars, adjusted for inflation, are about \$4,000 and \$21,000, respectively.²⁹ The \$1,000 maximum fine under IRC § 7213A has been in place since 1997, and is about \$1,500 in 2015 dollars.³⁰

EXPLANATION OF RECOMMENDATIONS

The proposals would make the provisions of IRC §§ 7431, 7213, and 7213A applicable to whistleblowers whether or not the whistleblower has entered into an IRC § 6103(n) contract, and would make the safeguarding provisions of IRC § 6103(p)(4) applicable to such whistleblowers. These changes are intended to protect taxpayers’ fundamental right to confidentiality and thereby enhance voluntary reporting and compliance with the tax laws.

The statutory minimum award to a whistleblower under IRC § 7623(b), where the amount in dispute must be at least \$2 million, is generally 15 percent of the collected proceeds. Whistleblowers who seek these awards should be subject to greater liability if they re-disclose returns or return information they obtained while earning, or attempting to earn, their award, or in the award determination process. Thus, the proposal would increase the amount of statutory damages provided by IRC § 7431 to a more substantial amount, such as \$5,000, for violations by whistleblowers who request awards under IRC § 7623(b).

The penalties imposed by IRC §§ 7213 and 7213A apply to willful behavior, and the existing fines, which have been unchanged for decades, are insufficient to punish or deter it. Thus, the proposal would increase the amount of these fines to more substantial amounts, such as \$20,000 and \$1,500, respectively.

29 When adjusted for inflation, \$1,000 in 1976 is worth \$4,166 in 2015, and \$5,000 in 1976 is worth \$20,829 in 2015. TAS Research (Dec. 3, 2015).

30 When adjusted for inflation, \$1,000 in 1997 is worth \$1,477 in 2015. TAS Research (Dec. 3, 2015).