Whistleblower 11099-13W v. Commissioner of Internal Revenue, 147 T. C. 110 (2016)

In a significant ruling, the U. S. Tax Court granted a whistleblower's motion to compel the IRS to produce documents related to an investigation prompted by the whistleblower's tip. The case clarifies the scope of discovery in whistleblower award disputes under I. R. C. sec. 7623, emphasizing the importance of relevance in determining the discoverability of documents. This decision impacts how whistleblower claims are pursued, highlighting the court's role in ensuring access to necessary information for claim adjudication.

Parties

Whistleblower 11099-13W, as Petitioner, filed a petition for review against the Commissioner of Internal Revenue, as Respondent, in the United States Tax Court. The case was initiated in the Tax Court under Docket No. 11099-13W.

Facts

In year 1, the Petitioner filed a whistleblower claim with the IRS, alleging a tax evasion scheme (TES) by a target corporation and its affiliates, which involved manipulating inventory purchasing to artificially inflate the cost of goods sold due to the use of a last-in, first-out (LIFO) accounting method. The Petitioner was employed by a corporation affiliated with the target, which was involved in the commodities trading integral to the TES. The IRS acknowledged that the Petitioner's claim identified a previously unknown issue and conducted an investigation into the target's use of the TES. However, the IRS asserted that no adjustments were made to the target's tax returns based on the Petitioner's information. The IRS did make other adjustments to the target's returns for the years in question, which resulted in the collection of additional taxes. The Petitioner argued that the information provided led to changes in the target's inventory practices and increased tax payments.

Procedural History

The Petitioner filed a motion to compel the production of documents by the IRS, which had previously been ordered by the court on September 16, 2015. The IRS objected to the motion, primarily on the grounds of relevance. The court had previously ruled that the Commissioner could not unilaterally decide what constitutes an administrative record, and thus, the scope of discovery was broader than the IRS's position. The court, in this case, granted the Petitioner's motion to compel, finding that the requested documents were relevant to the whistleblower's claim.

Issue(s)

Whether the requested documents, specifically the 31 information document

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requests (IDRs) and responses, are relevant and discoverable under the Tax Court's rules of discovery in the context of a whistleblower's claim under I. R. C. sec. 7623?

Rule(s) of Law

Under I. R. C. sec. 7623(b)(1), a whistleblower is entitled to an award if the IRS proceeds with an action based on information provided by the whistleblower. The IRS is deemed to have proceeded based on the whistleblower's information when it "substantially contributes to an action against a person identified by the whistleblower. " (26 C. F. R. sec. 301. 7623-2(b)(1)). The scope of discovery is governed by Tax Court Rule 70(b), which allows for the discovery of any matter not privileged and relevant to the subject matter involved in the pending case.

Holding

The U. S. Tax Court held that the IRS's claim of lack of relevance presented an unsettled question of law regarding when the IRS proceeds on the basis of information provided by a whistleblower. The court determined that it would not resolve this legal question in the context of a discovery dispute and that the IRS had failed to carry its burden of showing that the requested documents were not relevant or discoverable. The court granted the Petitioner's motion to compel production of the requested documents.

Reasoning

The court's reasoning focused on the relevance of the requested documents in the context of the whistleblower's claim. The court emphasized that relevance in discovery is broader than at trial and includes matters that are reasonably calculated to lead to the discovery of admissible evidence. The court rejected the IRS's argument that the requested documents were not material because they did not directly relate to adjustments made based on the whistleblower's specific allegations. The court noted that the Petitioner's theory that the IRS's investigation prompted changes in the target's behavior, leading to increased tax payments, was a plausible interpretation of I. R. C. sec. 7623(b)(1). The court also considered the IRS's failure to fully develop its legal argument regarding the meaning of "proceeds based on" and suggested that a motion for summary judgment would be the appropriate vehicle for resolving such legal questions. The court concluded that the IRS had not met its burden to show that the requested documents were not relevant or discoverable.

Disposition

The U. S. Tax Court granted the Petitioner's motion to compel production of the requested documents, subject to the protective order governing pretrial discovery in the case.

Significance/Impact

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This case is significant for its clarification of the scope of discovery in whistleblower award disputes under I. R. C. sec. 7623. It underscores the court's role in ensuring that whistleblowers have access to necessary information to pursue their claims effectively. The decision also highlights the importance of relevance in discovery and the burden on the opposing party to show that requested documents are not discoverable. The ruling may encourage more robust discovery in whistleblower cases, potentially leading to increased transparency and accountability in the IRS's handling of whistleblower claims. Furthermore, the case leaves open the interpretation of "proceeds based on" under I. R. C. sec. 7623(b)(1), which may be addressed in future litigation or regulatory guidance.

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