Smith v. Commissioner of Internal Revenue, 148 T. C. 21, 2017 U. S. Tax Ct. LEXIS 23 (2017)

In Smith v. Comm'r, the U. S. Tax Court clarified that 'amounts in dispute' under IRC § 7623(b)(5)(B) include the total liability proposed during an IRS examination initiated by a whistleblower's information, not just the portion directly attributable to that information. This ruling significantly impacts the eligibility for nondiscretionary whistleblower awards, as it expands the threshold to encompass the entire tax dispute, potentially encouraging more whistleblower claims in large tax cases.

Parties

Ian D. Smith was the petitioner in this case, while the Commissioner of Internal Revenue served as the respondent. Smith filed his whistleblower claim at the trial level, and both parties proceeded to the U. S. Tax Court after the Commissioner's determination of the award amount.

Facts

Ian D. Smith filed a whistleblower claim with the IRS, alleging that a business was improperly handling barter transactions and employee compensation through gift certificates. This information led the IRS to initiate both employment and income tax examinations of the business. The employment tax examination resulted in the assessment and collection of $3,094,188. 12 in taxes and $618,837. 64 in penalties for the years 2006 through 2009. The income tax examination led to adjustments and collections totaling $14,543,098, with $1,593,024 directly attributed to disallowed barter-related expenses. The IRS attributed $1,771,911. 77 of the total collected proceeds to Smith's whistleblower information and awarded him $198,005. 52 under IRC § 7623(a), which allows for discretionary awards. Smith contested this determination, arguing that the total 'amounts in dispute' exceeded the $2 million threshold required for a nondiscretionary award under IRC § 7623(b).

Procedural History

Smith filed a petition with the U. S. Tax Court under IRC § 7623(b)(4), challenging the IRS's determination to apply the discretionary award provisions of IRC § 7623(a) instead of the nondiscretionary provisions of IRC § 7623(b). Both parties moved for summary judgment, with the court applying the standard of review for legal questions since the facts were undisputed. The court granted Smith's motion for summary judgment in part, holding that the IRS should have used IRC § 7623(b) to compute the award.

Issue(s)

Whether the phrase 'amounts in dispute' in IRC § 7623(b)(5)(B) includes the total amount of liability proposed by the IRS during an examination initiated by a

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whistleblower's information, or whether it is limited to the portion of 'collected proceeds' directly attributable to that information?

Rule(s) of Law

The controlling legal principle is found in IRC § 7623(b)(5)(B), which states that the nondiscretionary award regime applies if 'the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000. ' The applicable regulation, 26 C. F. R. § 301. 7623-2(e)(2)(i), defines 'amount in dispute' as 'the greater of the maximum total of tax, penalties, interest, additions to tax, and additional amounts that resulted from the action(s) with which the IRS proceeded based on the information provided, or the maximum total of such amounts that were stated in formal positions taken by the IRS in the action(s). '

Holding

The U. S. Tax Court held that 'amounts in dispute' under IRC § 7623(b)(5)(B) include the total amount of liability proposed by the IRS during an examination initiated by a whistleblower's information, not just the portion directly attributable to that information. Therefore, the $2 million threshold was met in Smith's case, and the IRS erred in applying the discretionary provisions of IRC § 7623(a) instead of the nondiscretionary provisions of IRC § 7623(b).

Reasoning

The court's reasoning focused on the plain language of IRC § 7623(b)(5)(B) and the purpose of the statute. The court noted that the phrase 'amounts in dispute' is not specifically limited to only those amounts directly or indirectly attributable to the whistleblower's information. The court rejected the IRS's argument that the term 'action' in IRC § 7623(b)(1) and (2) should be used to limit the 'amounts in dispute' under IRC § 7623(b)(5)(B), as the term 'action' is used differently in each subsection. The court also considered the legislative history and purpose of IRC § 7623(b), which was enacted to encourage whistleblowers to come forward in large tax cases. The court found that the IRS's interpretation would lead to anomalous results, as it would exclude significant tax collections from the nondiscretionary award regime. The court's interpretation aligns with the regulation at 26 C. F. R. § 301. 7623-2(e)(2)(i), which supports a broader definition of 'amount in dispute. '

Disposition

The court granted Smith's motion for summary judgment in part, holding that the IRS should have used IRC § 7623(b) to compute the whistleblower award. The court did not decide the specific award amount, as that issue was rendered moot by the holding that IRC § 7623(b) applies.

Significance/Impact

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The Smith decision significantly expands the scope of ‘amounts in dispute’ under IRC § 7623(b)(5)(B), potentially increasing the number of cases eligible for nondiscretionary whistleblower awards. This ruling clarifies that the threshold is based on the total liability proposed during an IRS examination, rather than the portion directly attributable to the whistleblower’s information. The decision may encourage more whistleblower claims, particularly in large tax cases, as it increases the potential for higher awards under the nondiscretionary regime. The ruling also underscores the importance of the statutory language and purpose in interpreting the whistleblower provisions, and it may influence future cases involving the interpretation of IRC § 7623.

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