Lewis v. Commissioner, 154 T. C. No. 8 (2020)

In Lewis v. Commissioner, the U. S. Tax Court clarified the definition of "collected proceeds" for IRS whistleblower awards and upheld the application of budget sequestration to these awards. The court ruled that reported and paid tax does not count as collected proceeds, even if influenced by an ongoing audit, and that no future proceeds could be anticipated from an estate with no tax liability. Additionally, the court affirmed that whistleblower awards are subject to budget sequestration, rejecting claims that such reductions are inappropriate under the law.

Parties

Timothy J. Lewis, the petitioner, was represented by Shine Lin and Thomas C. Pliske. The respondent, the Commissioner of Internal Revenue, was represented by Joel D. McMahan and A. Gary Begun.

Facts

Timothy J. Lewis, a former financial manager of a closely held corporation, filed a whistleblower claim alleging tax underpayments by the corporation and its shareholders for the year 2010 and prior years. The allegations primarily concerned improper wage deductions for the shareholders' sons and mischaracterized loans. Following Lewis's submission, the IRS audited the corporation's 2010 tax year and the shareholders' 2010 and 2011 tax years, resulting in adjustments and the collection of additional taxes. The corporation changed its reporting for 2011, not deducting wages for one son, but no additional tax was collected from this change. The shareholders filed gift tax returns, using unified credits to offset gift taxes. Upon one shareholder's death, his estate filed a return showing no tax liability. The IRS Whistleblower Office (WBO) determined Lewis's award based on the collected proceeds from the audit, excluding the 2011 reported tax and the deceased's unified credit, and applying budget sequestration to the award.

Procedural History

The WBO issued a preliminary award recommendation to Lewis, which he challenged. After revisions and further communications, the WBO issued a final decision letter, maintaining the award amount and applying sequestration. Lewis timely petitioned the U. S. Tax Court for review, contesting the exclusion of certain taxes from collected proceeds and the application of sequestration. The court reviewed the case under its jurisdiction to review mandatory whistleblower awards, as provided by I. R. C. sec. 7623(b)(4).

Issue(s)

Whether reported and paid tax from a year not originally audited but influenced by an ongoing audit constitutes "collected proceeds" under I. R. C. sec. 7623(c)?

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Whether the use of a unified credit by a deceased taxpayer, resulting in no estate tax liability, can be considered as potential future collected proceeds?

Whether the WBO abused its discretion by applying budget sequestration to reduce the whistleblower award?

Rule(s) of Law

Under I. R. C. sec. 7623(b), a whistleblower is entitled to a mandatory award of 15% to 30% of the collected proceeds from an IRS action based on the whistleblower's information. I. R. C. sec. 7623(c) defines "proceeds" to include penalties, interest, additions to tax, and other proceeds from laws the IRS is authorized to enforce. The Bipartisan Budget Act of 2018 amended this definition to include criminal fines and civil forfeitures. The Budget Control Act of 2011, as amended, mandates sequestration of certain government payments, including direct spending, unless specifically exempted.

Holding

The Tax Court held that reported and paid tax, even if influenced by an ongoing audit, does not constitute "collected proceeds" under I. R. C. sec. 7623(c). The court further held that there are no potential future proceeds from a deceased taxpayer's estate when the estate tax return shows no tax liability. Finally, the court held that the WBO did not abuse its discretion in applying budget sequestration to the whistleblower award, as such awards are direct spending subject to sequestration under the Budget Control Act of 2011.

Reasoning

The court reasoned that reported and paid tax from a year not originally audited but influenced by an ongoing audit does not constitute "collected proceeds" based on prior case law, specifically *Whistleblower 16158-14W v. Commissioner*. The court noted that while the corporation's change in reporting for 2011 might have been influenced by the whistleblower's information, such tax was not "collected" by the IRS and thus not included in the award calculation. Regarding the unified credit, the court found no possibility of future proceeds from the deceased's estate, as the estate tax return showed no tax liability, and the trust documents and applicable law indicated no future tax would be due upon the termination of the life estate. On the sequestration issue, the court rejected the argument that whistleblower awards are exempt from sequestration, finding that such awards are direct spending under the Budget Control Act, and the WBO's application of sequestration was not an abuse of discretion. The court's analysis included statutory interpretation, consideration of prior case law, and the application of sequestration rules as mandated by Congress.

Disposition

The Tax Court affirmed the WBO's determinations regarding the calculation of

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collected proceeds and the application of budget sequestration to the whistleblower award. The case was resolved without further proceedings, and an appropriate order and decision were to be entered.

Significance/Impact

The decision in *Lewis v. Commissioner* provides critical guidance on the definition of "collected proceeds" for whistleblower awards, clarifying that reported and paid tax does not qualify even if influenced by an ongoing audit. This ruling impacts how whistleblower claims are evaluated and awarded, potentially affecting the financial incentives for reporting tax violations. Additionally, the court's affirmation of the application of budget sequestration to whistleblower awards reinforces the fiscal policy measures enacted by Congress, ensuring that such awards are subject to the same budgetary constraints as other forms of direct spending. This decision may influence future cases and legislative considerations regarding the funding and payment of whistleblower awards.

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