CRIMINAL FINES, CIVIL FORFEITURES AND COLLECTED PROCEEDS; MORE ON MANDATORY WHISTLEBLOWER AWARDS UNDER THE INTERNAL REVENUE CODE

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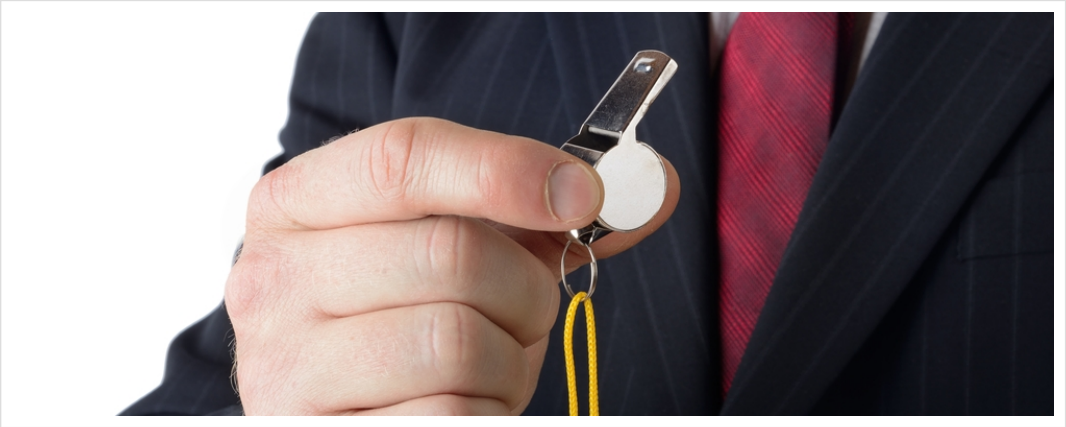

This will provide further analysis of the Tax Court's opinion in *Whistleblower 21276-13W v. Comm'r*, 147 T.C. No. 4, 2016 U.S. Tax Ct. LEXIS 20 (Aug. 3, 2016). As discussed previously, the court held that in calculating a mandatory whistleblower award under section 7623(b)(1) of the Code, criminal fines and civil forfeitures count, even though they cannot be used to pay an award because they are committed to other purposes. This result rested upon the court's construction of the term "collected proceeds" in section 7623(b)(1), which drives the determination of a mandatory award. The relevant portion of the Code provides for a mandatory award to be calculated as "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 . . . ." I.R.C. § 7623(b)(1) (emphasis added).

A mandatory award can result from "any administrative or judicial action described in subsection (a)," a cross-reference to the voluntary program for whistleblower awards, which is currently codified in section 7623(a) of the Code. Under the voluntary program, the Secretary of the Treasury is authorized to make an award if an individual provided information that aided either in "detecting underpayments of tax," or in "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same." I.R.C. § 7623(a). Consequently, the same governmental action will trigger either a discretionary award under section 7623(a) or a mandatory award under section 7623(b).

In *Whistleblower 21276-13W*, the Tax Court started its substantive analysis with a conclusion, indicating that "[t]he language of section 7623(b)(1) is plain." 2016 U.S. Tax Ct. LEXIS 20 at *10. Twenty-four pages of taut legal reasoning followed, as the court drove to its conclusion that criminal fines and civil forfeitures should be considered collected proceeds in calculating a mandatory award, even though they concededly would not be available to *pay* an award, and, accordingly, would not be considered in making a discretionary award. The court also concluded that fines and forfeitures counted towards the calculation

of a mandatory award, even though they did not count towards the statutory threshold (contained in section 7623(b)(5)(B)) that would make an award mandatory.

The Tax Court took appropriate steps, considering the ordinary meaning of terms, as well as their surrounding context, but it ultimately appears to have reached a result that is debatable. While it is hard to fault its determination that the term collected proceeds is potentially a very broad one, *see id.* at *11-*12, the court appears to have taken too narrow an approach to the surrounding legislative context.

Statutory phrases should not be read in a vacuum. *See United States v. Morton*, 467 U.S. 822, 828 (1984). Section 7623(b) was an amendment to the Code; the existing voluntary program became section 7623(a), and section 7623(b)(1) immediately followed it. The relevant portions of section 7623 now provide as follows:

The Secretary, under regulations prescribed by the Secretary, is authorized to pay such sums as he deems necessary 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,

in cases where such expenses are not otherwise provided for by law. *Any amount payable* under the preceding sentence *shall be paid from the proceeds of amounts collected* by reason of the information provided, *and any amount so collected shall be available for such payments*.

(b) Awards to whistleblowers

(1) In general-

If the Secretary proceeds with any administrative or judicial action described in subsection (a) based on information brought to the Secretary's attention by an individual, such individual shall, subject to paragraph (2), receive as 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 . . . .

I.R.C. § 7623(a), (b)(1) (emphasis added).

Given the surrounding context, the phrase "collected proceeds" in section 7623(b)(1) appears to paraphrase language from section 7623(a), specifically the phrases "shall be paid from the *proceeds* of amounts *collected*" and "any amount so *collected*." I.R.C. § 7623(a) (emphasis added). The logic behind this conclusion is simple; "a word is known by the company it keeps." *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 308 (1961).

The conclusion that the phrase collected proceeds in section 7623(b)(1) paraphrases language from section 7623(a) is reinforced by the fact that the trigger for a mandatory award under section 7623(b)(1) is administrative or judicial action under section 7623(a). Section 7623(a) and section 7623(b) are thus joined at the hip, and the Tax Court's failure to consider section 7623 as a whole appears to have been a

mistake: "We do not . . . construe statutory phrases in isolation; we read statutes as a whole." *Morton*, 467 U.S. at 828 (footnote omitted).

The surrounding context resolves another issue. In rejecting the government's argument that the items listed as examples of collected proceeds were all collected under the provisions of the Code, not other federal statutes, the Tax Court tersely noted that "the list of items deemed to be collected proceeds does not include 'tax.'" 2016 U.S. Tax Ct. LEXIS 20 at *21. The answer to this apparent conundrum is quite simple: Congress legislated in context; understatements of *tax* were plainly embraced by any "amounts collected by reason of the information provided" under section 7623(a), and the use of the parenthetical language in section 7623(b)(1) was therefore designed to ensure that "penalties, interest, additions to tax, and additional amounts" would *also* be considered in making an award under section 7623(b)(1). This was important because mandatory awards must fall within a specific range of percentages.

Another aspect of the surrounding context undercuts the Tax Court's holding: Section 7623(b)(1) provides that a mandatory award is to be calculated as a percentage of "the collected proceeds (including penalties, interest, additions to tax, and additional amounts)." I.R.C. § 7623(b)(1). Not all whistleblowers qualify for a mandatory award; section 7623(b)(5)(B) sets a minimum threshold using language that is very similar to the description of collected proceeds in section 7623(b)(1). A whistleblower only qualifies for a mandatory award "if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." I.R.C. § 7623(b)(5)(B). Previously, the court had held that FBAR penalties collected under the Bank Secrecy Act were not "additional amounts" for purposes of the threshold. *Whistleblower 22716-13W v. Comm'r*, 146 T.C. No. 10, 2016 U.S. Tax Ct. LEXIS 7, *13-*20 (Mar. 14, 2016). In *Whistleblower 21276-13W*, the Tax Court noted this prior holding, and it indicated that the prior holding rested on the fact that the term collected proceeds was broader than the language in the threshold. 2016 U.S. Tax Ct. LEXIS 20 at *22-*24. But the court never paused to ask a basic question: Why would Congress use one method to calculate the threshold governing qualification for an award and another method to set the award?

Technically, the two holdings can be reconciled: the issue in *Whistleblower 22716-13W* was whether FBAR penalties were "additional amounts" for purposes of the threshold in section 7623(b)(5)(B), not whether they were "penalties," within the ambit of section 7623(b)(1). Still, when a statute uses similar phrases in different places, the phrases should normally mean similar things unless there is a good reason to read them differently. *Cf. Helvering v. Stockholms Enskilda Bank,* 293 U.S. 84, 87 (1934) ("there is a natural presumption that identical words used in different parts of the same act are intended to have the same meaning") (citations omitted).

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The Tax Court's failure to ask why Congress would treat fines and forfeitures as collected proceeds under section 7623(b)(1) had a broad impact on its analysis. The court acknowledged that criminal fines never actually reach the Treasury; instead, "criminal fines are paid by the taxpayer directly to the imposing court, which in turn deposits them into the Crime Victims Fund." *Whistleblower 21276-13W*, 2016 U.S. Tax Ct. LEXIS 20 at *30. The Crime Victims Fund is established under 42 U.S.C. § 10601; it serves to fund a variety of programs, including grants to fund child abuse prevention and treatment. 42 U.S.C. §§ 10601(d)(2), 10603a. The fund also serves as a source of grants to fund improved victim services and a victim notification system. 42 U.S.C. § 10601(d)(3)(A).

The Crime Victims Fund thus provides no tangible benefit to the Treasury Department. The fund does exclude certain "fines available for use by the Secretary of the Treasury." 42 U.S.C. § 10601(b)(1)(A). But none of the excluded fines are collected in criminal tax cases. *See* 42 U.S.C. § 10601(b)(1)(A)(i) (excluding fines under the Endangered Species Act, 16 U.S.C. § 1540(d)), (ii) (excluding fines under the Lacey Act Amendments, 16 U.S.C. § 3375(d)). While the phrase collected proceeds is broad, it seems odd that Congress would sweep criminal fines within its ambit without more explicit language, particularly in light of the terms of the statute governing the Crime Victims Fund.

Similar problems plague the Tax Court's determination that funds recovered through civil forfeitures are also collected proceeds. The government argued that these funds are not collected proceeds because they are deposited into a designated forfeiture fund, but the court flatly rejected this argument: "This assertion is similar to that advanced by respondent with respect to the criminal fine; we reject it." *Whistleblower 21276-13W*, 2016 U.S. Tax Ct. LEXIS 20 at *32.

While the forfeitures do wind up in the Treasury Department, the relevant statute does not make them available for general purposes. *See* 31 U.S.C. § 9705(a). And the fund *excludes* certain forfeitures made under the Internal Revenue Code: "The Fund shall be available to the Secretary, without fiscal year limitation, with respect to seizures and forfeitures made pursuant to any law (*other than* section 7301 or 7302 of the Internal Revenue Code of 1986)." *Id*. (emphasis added). The fact that the statute governing the forfeiture fund excludes forfeitures made under the Code is difficult to reconcile with the idea that Congress intended to include civil forfeitures paid into the fund in calculating a mandatory whistleblower award under the Code.

The statute governing the forfeiture fund contains its own provision for "payment of awards for information or assistance leading to a civil or criminal forfeiture involving any Department of the Treasury law enforcement organization participating in the Fund." 31 U.S.C. § 9705(a)(2)(A). The Tax Court acknowledged this arrangement but dismissed its relevance. The government had presented the

argument by asserting that the language of section 7623(a), which provides for awards "not otherwise provided for by law," meant that the award program in 31 U.S.C. § 9705 precluded an award calculated to include forfeited funds. *Whistleblower 21276-13W*, 2016 U.S. Tax Ct. LEXIS 20 at *33. The court rejected the argument because the language in question related to discretionary awards under section 7623(a): "[T]his argument is flawed because section 7623(a) relates to discretionary whistleblower awards, whereas the type of award involved in these cases relates to a mandatory whistleblower award . . . ." *Id.*

But the implications of the separate award program for forfeitures go beyond the government's argument. The existence of a specific program for forfeitures suggests that the general tax whistleblower provisions were not intended to touch upon forfeited funds, since "it is a commonplace of statutory construction that the specific governs the general." *Morales v. TWA*, 504 U.S. 374, 384 (1992) (citations omitted). The separate award program for forfeited funds under 31 U.S.C. § 9705 also raises the prospect of double-counting; at least in theory, the same whistleblower could be granted an award under the forfeiture provision *and* have the forfeited funds applied to increase her award under section 7623(b) of the Code.

This potential for double-counting highlights another problem with the Tax Court's failure to consider whether there was a reason for Congress to include criminal fines and civil forfeitures in the calculation of a mandatory award: Since the funds would not be available to actually *pay* an award, the only reason to treat them as collected proceeds would be to increase the amount of the award. And while higher awards would be a rational way to improve the whistleblower program, that result could have been accomplished far more directly by setting higher percentages in section 7623(b)(1), which specifies a range of awards of "at least 15 percent but not more than 30 percent of the collected proceeds." I.R.C. § 7623(b)(1). The Tax Court should have considered whether its sweeping construction of section 7623(b)(1) served the goals of Congress: "As in all cases of statutory construction, our goal is to interpret the words of [the][statute] in light of the purposes Congress sought to serve." *Norfolk Redev. & Hous. Auth. v. Chesapeake & Potomac Tel. Co.*, 464 U.S. 30, 36 (1983) (quoting *Chapman v. Houston Welfare Rights Org.*, 441 U.S. 600, 608 (1979)) (alterations by the Court).

While the Tax Court's opinion is thoughtful, and the construction it offers is plausible, its conclusion nonetheless appears to be incorrect. The court seems to have focused too narrowly upon section 7623(b) without giving adequate consideration to section 7623 as a whole. Courts look at the surrounding context of a statute for a reason: "The maxim *noscitur a sociis*, that a word is known by the company it keeps . . . is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress." *Jarecki v. G.D. Searle & Co.*, 367 U.S. at 863 (citations omitted). Here, the Tax Court appears to have given section 7623(b)(1) an "unintended breadth."

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