WINSTON & STRAWN LLP

CLIENT ALERT

Legislation, IRS Guidance to Protect Whistleblowers; NY Recovers Big in Whistleblower-Initiated Case

MAY 24, 2017

In recent weeks, there has been a lot of activity involving federal and state whistleblower programs, as indicated in the summaries below.

Whistleblower Legislation

On March 29, the IRS Whistleblower Improvements Act of 2017 was introduced by Sens. Charles E Grassley (R-Iowa) and Ron Wyden (D-Ore.), which increases communication between the IRS and whistleblowers and protects whistleblowers from retaliation against employers for disclosing tax abuses.

The legislation permits IRS personnel to exchange information with whistleblowers if such exchange is helpful to the investigation. It also requires status updates to the whistleblower throughout the award review process, including notification when the case is referred to audit or examination and when payments are made with respect to such tax liability.

The legislation has been assigned to the Senate Finance Committee, of which Senator Wyden is ranking member and Senator Grassley is a senior member and former chairman. The bill is also endorsed by Taxpayers Against Fraud and the National Whistleblower Center.

CC-2017-005

On April 4, the IRS issued a chief counsel notice (CC-2017-005) providing attorneys with procedures for obtaining approval to disclose the existence or identity of a whistleblower. This notice only applies to civil tax cases at the administrative level or in litigation. Separate procedures apply to informants with respect to criminal investigations.

Noting that whistleblower confidentiality is of critical importance to both whistleblowers and the whistleblower program, the chief counsel's office also stated that in certain circumstances, the identity of a whistleblower must be disclosed in order to defend the IRS's position, such as when the whistleblower is an essential witness in a judicial proceeding. However, due to the importance of protecting a whistleblower's identity, the chief counsel's office has instituted a multilevel process for obtaining approval to disclose such identity "only after careful consideration and

high-level approval." Now, disclosures can only be approved by the Director of the Whistleblower Office and Deputy Chief Counsel (Operations).

The Notice provides that counsel should generally avoid responding to inquiries that could confirm or deny the existence of a whistleblower. It also states that where disclosure may be required, counsel must carefully consider and weigh the potential risks to the whistleblower and the IRS's need for disclosure and must also look for alternative solutions. When disclosure is necessary, counsel should also make every effort to notify the whistleblower prior to the disclosure.

New York's $40 Million Settlement

On April 18, New York State Attorney General Eric Schneiderman announced a $40 million settlement with an Alabama-based investment firm, Harbert Management Corporation. The case was initially brought to the state's attention by a whistleblower, who will receive an award of approximately $8.8 million. The settlement is the largest tax-related recovery by the Attorney General's office, resulting from an action filed under the New York False Claims Act, which was amended in 2010 to cover tax claims.

Harbert Management Corporation (the "Corporation"), chaired by CEO Raymond Harbert, sponsored and organized Harbinger Capital Partners (the "Fund"), a $26 billion hedge fund run by Philip Falcone out of an office at 555 Madison Avenue in Manhattan. When businesses operate both inside and out of New York City and State, they must apportion income to New York that is derived from or connected with the state. For many years Harbinger allocated zero percent of its earnings to New York and in other years it simply did not file state tax returns. On forms, it directly affirmed that it "has no nexus to New York state and has no income derived from New York sources."

As investment manager to the Fund from 2002 to 2009, Harbinger Capital Partners Offshore Manager LLC (the "Offshore Manager") earned performance fee income equal to 20 percent of the Harbinger Fund's net profits. The Offshore Manager's members, which included several senior executives at Harbert Management Corporation, were required to pay New York State income tax on this performance fee income earned by Mr. Falcone's trading activity in New York.

The Corporation paid Alabama tax on all its income, where its headquarters were located and back office and support functions for the Harbinger Fund were conducted. However, as the agreement states, the Harbinger New York investment team clearly generated investment ideas, developed strategy, conducted due diligence and interacted with players in the distressed investment community in New York. The success of the New York office even resulted in additions to its staffing.

In a statement, Attorney General Schneiderman stated, "our investigation uncovered a brazen and deliberate decision to avoid paying millions in taxes owed to New York State. Harbert Management made a clear choice to skirt the rules and as a result, ordinary New York taxpayers were left footing the bill." In addition to not filing state tax returns, the Corporation did not file required New York City returns from 2004 through 2007.

3 Min Read

Related Locations

New York

Related Topics

Tax | White Collar and Internal Investigations | Internal Revenue Service (IRS) | IRS

Whistleblower

Related Capabilities

Tax

Government Investigations, Enforcement & Compliance

Related Regions

North America

Related Professionals

Sara Monzet