

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Stephen A. Whitlock
Director
Whistleblower Office
Deputy Commissioner, IRS Services & Enforcement

from: Steven Musher
Associate Chief Counsel (International)

subject: Determination of Character, Source, and Withholding Requirements with respect to Whistleblower Awards paid to Nonresident Alien Individuals

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

This advice is intended solely for purposes of determining the U.S. or foreign source of awards paid to whistleblowers under section 7623¹ and to provide legal advice regarding the withholding obligations of the Whistleblower Office under section 1441. We conclude that the source of such award payments is to be determined based on the facts and circumstances under sections 861(a)(3), 862(a)(3), and 863, and under Treas. Reg. § 1.861-4, all relating to compensation for services. This analysis should not be taken to imply the existence of an employer-employee or other principal-agent relationship between the whistleblower and the United States government. Indeed, the facts and circumstances we have analyzed do not involve any direction, control, or influence of the whistleblower's activities by the U.S. government, which merely receives the information disclosed by the whistleblower.

ISSUES

1. What is the source of an award made under section 7623 by the Whistleblower Office (the "Office") to a nonresident alien individual ("NRA")?
2. Must the Office withhold tax under section 1441 on the award payment made to the NRA whistleblower?

¹ Unless otherwise indicated, all section and code references are to the Internal Revenue Code of 1986, as amended.

CONCLUSIONS

1. Solely for purposes of determining source, an award payment made under section 7623 is characterized as compensation for services. The payment will be U.S. source income to the extent of the portion attributable to the activities of the NRA whistleblower undertaken in the United States, if any, in order to provide information in accordance with the statute.
2. The Office must withhold tax under section 1441 on the U.S. source portion of the award payment it makes to an NRA whistleblower unless exempted by a U.S. income tax treaty.

LAW AND ANALYSIS

Background

Section 7623(a) provides that 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....

Any amount payable ... shall be paid from the proceeds of amounts collected by reason of the information provided....

Subsection (b), "Awards to Whistleblowers," was added to the Code in 2006 and established the Office to administer the whistleblower program. Section 7623(b)(1) provides as follows:

- (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% but not more than 30% 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. The determination of the amount of such award by the Whistleblower Office shall depend upon the extent to which the individual substantially contributed to such action.

(emphasis added).

Paragraph (2) of section 7623(b) limits the amount of the award to no more than 10% of the collected proceeds when the Office determines that the information provided by the

whistleblower is not the principal basis for the administrative or judicial action referred to in paragraph (1) of section 7623(b).

1. Character of Income

(a) Payment of compensation for performance of services

Under section 7623(b), an award payment is authorized only under certain, specified circumstances. In particular, the informant must “[bring] to the Secretary’s attention” information that ultimately results in collected proceeds resulting from an action based on such information. The act of bringing information to the Secretary’s attention may involve, for example, making the IRS aware of transactions, accounts, or arrangements implicated in the underpayment of tax or representing violations of the internal revenue laws. The informant’s entitlement to an award therefore requires the performance of an affirmative act, *i.e.*, the provision of information. Solely for purposes of determining the source of an award paid to an informant under section 7623(b), such performance is characterized as services.

This conclusion is consistent with the position taken by the Service in Rev. Rul. 70-576, 1970-2 C.B. 331. In that ruling, the IRS characterized an award payment made to an informant under section 7623 as compensation for personal services for purposes of applying the 1942 U.S.-Canada income tax treaty. The ruling describes the award payment at issue as “compensation or remuneration for services; a sum of money paid or taken for doing, or forbearing to do, some act.” *Id.* The ruling further describes the particular service, or act, performed by the taxpayer as “supplying information.” *Id.* Although Rev. Rul. 70-576 applies to a tax treaty that is no longer in force, the revenue ruling has not been obsoleted.

(b) Payment not within the scope of Treas. Reg. § 1.863-1(d)

Treas. Reg. § 1.863-1(d)(1) applies to “scholarships, fellowship grants, grants, prizes and awards.” Although section 7623 describes payments by the Office to whistleblowers as “awards,” Treas. Reg. § 1.863-1(d)(1), by its express terms, excludes payments in compensation for the performance of services. In light of the above analysis characterizing awards to whistleblowers as compensation for the performance of a service, Treas. Reg. § 1.863-1(d)(1) does not apply.

Additionally, Treas. Reg. § 1.863-1(d)(1) does not apply because the payments are not “[p]rizes and awards” as defined in section 74 and the regulations thereunder, as required by Treas. Reg. § 1.863-1(d)(3)(iii). Section 74 and the regulations thereunder provide that all awards are not necessarily covered by section 74, which addresses awards from charities and certain employee achievement awards. Treas. Reg. § 1.74-1(a)(1) states that “[p]rizes and awards which are includable in gross income include (but are not limited to) amounts received from radio and television giveaway shows, door prizes, and awards in contests of all types, as well as any prizes and awards from

an employer to an employee in recognition of some achievement in connection with his employment.” The fact that the regulation refers to only one type of an award that bears any connection to compensation for services – that being a payment from an employer to an employee in recognition of some achievement – indicates that the regulation was not intended to cover a broad category of payments for performance of services generally. The awards paid by the Office to whistleblowers are not within the definition of awards described in Treas. Reg. § 1.74-1(a)(1), and thus are not within the scope of Treas. Reg. § 1.863-1(d).²

(c) Status of the Office and the Whistleblower regarding the activities

Finally, although the payment by the Office to an NRA whistleblower is characterized as payment of compensation for the performance of services, the activities of the NRA whistleblower are not performed within an employer/employee relationship with the United States government. The Service set out its position on this issue most recently in GCM 37198 (July 18, 1977):

We agree ... that payments for information are not to be construed in any way as establishing an employer/employee relationship with the Internal Revenue Service. This has been the long-standing Service position on this issue. See Rev. Rul. 58-326, 1958-1 C.B. 287, obs., Rev. Rul. 72-619, 1972-2 C.B. 650. An informant is not under the control of the Service. The decision whether to provide the information, and how much information, and about whom, is up to the informant. Thus, not only the means and methods of accomplishing the result are in the control of the informant rather than the Service, but the result itself is chosen by the informant. And there is no guarantee of the amount to be paid to the informant, if any. Under these circumstances, the informant is clearly not an employee.

Thus, the characterization of a whistleblower’s activities as services for the present purposes should in no way be viewed as suggesting that there is an employer-employee or other principal-agent relationship between the whistleblower and the United States government. Indeed, the facts and circumstances we have analyzed do not involve any direction, control, or influence of the whistleblower’s activities by the U.S. government, which merely receives the information disclosed by the whistleblower.³

2. Source of Payment

² Had the payment been considered an award, the entire payment would be U.S. source income and subject to withholding under section 1441. Treas. Reg. § 1.863-1(d).

³ Further, because the payment made to an NRA whistleblower by the Office is not made to an employee the payment is not wages subject to withholding at source under section 3402(a).

The source of income derived from performance of services is determined under sections 861(a)(3) (U.S. source income for services performed in the United States), 862(a)(3) (foreign source income for services performed outside the United States), and 863 (mixed source income for services performed both within and without the United States). Treas. Reg. § 1.861-4(b)(2) provides guidance for determining the source of income of an individual derived from the performance of services both within and without the United States. Under that regulation, the determination of the source of compensation attributable to services performed outside of an employee/employer relationship both within and outside the United States is determined on the basis that most correctly reflects the proper source of the income under the facts and circumstances of the particular case.

Under the Code and regulations, the Office must consider the facts and circumstances of each case to determine what portion of an award paid to an NRA whistleblower, if any, is attributable to personal services performed in the United States by using a method that most correctly reflects the proper source of the income based on the facts and circumstances of that particular case. This determination will require an analysis of the extent to which the activities of the whistleblower undertaken in order to provide information to the Office were performed within the United States (including, potentially, actions taken on the whistleblower's behalf by an agent). The award payment will be U.S. source income to the extent of the portion attributable to the activities of the NRA whistleblower undertaken in the United States, if any, in order to provide the information in accordance with the statute. In such cases, in order to avoid any uncertainty at the time the payment is made, the Office may consider whether to clarify the documentation expected of the whistleblower/recipient in advance regarding his activities in and out of the United States in providing information to the Office in order to establish the portion, if any, of the award that will be treated as U.S. source income.

3. Withholding of Tax at Source

Section 1441(a) provides generally that any person making a payment of fixed or determinable annual or periodical income ("FDAP") to an NRA, to the extent such item constitutes gross income from sources within the United States, is required to withhold from such item a tax equal to 30% thereof, unless such rate is reduced (or eliminated completely) by an applicable exception or income tax treaty. Treas. Reg. § 1.1441-2(b). FDAP includes all income included in gross income under section 61, other than certain gains.⁴

(a) Effectively connected income exception

⁴ An amount subject to withholding generally must be reported on a Form 1042-S pursuant to Treas. Reg. § 1.1461-1(c)(2), regardless of whether the withholding tax is reduced by an income tax treaty or other exception to taxation in the Code.

Treas. Reg. § 1.1441-4 provides an exception from withholding for most income that is effectively connected with a trade or business in the United States. However, with respect to payments of compensation for the performance of personal services, this exception is not applicable unless that compensation is a payment made by an employer to an employee to which section 3402 applies.⁵ Therefore, because as discussed above, whistleblower awards paid by the Office constitute income from personal services that are not payments to employees, section 3402 withholding and the exception to section 1441 do not apply.

If, at the time the Office makes the award payment, it is unable to determine the amount that is subject to withholding because it does not have sufficient facts to determine the source of the income to the whistleblower, the Office should withhold on the entire payment an amount necessary to ensure that a sufficient amount is withheld. Treas. Reg. § 1.1441-3(d)(1). In such circumstances, the Office is authorized to treat the entire payment as U.S. source income and withhold up to the maximum 30% rate, subject to any reduction under an applicable exception or treaty. See also Treas. Reg. § 1.1441-2(a) (providing that for purposes of determining amounts subject to withholding, when the source of an amount is unknown at the time of payment, the amount shall be treated as from sources within the United States). Alternately, the regulations provide procedures for a withholding agent to set aside the withholding tax in an escrow account until the sourcing determination can be made. Treas. Reg. § 1.1441-3(d)(1). Please let us know whether further advice on this point would be helpful. However, no provision of the Code or regulations exempts a withholding agent from withholding on a payment simply because the source of that income cannot be determined. Thus, if the withholding agent wishes to avoid overwithholding, it is required to determine the portion of the payment constituting U.S. source income.

(b) Application of income tax treaties

The tax treatment of awards paid by the Office to NRA whistleblowers otherwise applicable under the Code and regulations may be modified by an income tax treaty, if the NRA whistleblower is entitled to treaty benefits and provides the Office with a beneficial owner withholding certificate (i.e., a Form W-8) with sufficient information to support a claim for treaty relief.

As stated above, although the award is characterized as income from the performance of services for sourcing purposes, the services are not performed in the context of an employer/employee relationship. Thus, the applicable treaty provisions are those that apply to personal services income that does not arise in an employment context. In many U.S. income tax treaties currently in force, the applicable article would be the Independent Personal Services article, which generally focuses on whether a service provider who is a resident of one Contracting State is physically present in the other

⁵ We note that compensation of an individual for personal services may also be exempt from withholding in certain other circumstances that are inapplicable here.

Contracting State for a specified number of days or has a "fixed base" available to him in that State to which the income is attributable.

Some of the newer U.S. income tax treaties have eliminated the Independent Personal Services article because no practical distinction can be made between a "fixed base" (as used in the Independent Personal Services article) and a "permanent establishment" (as used in the Permanent Establishment and Business Profits articles). A permanent establishment generally is a fixed place of business, although in certain circumstances a taxpayer without a fixed place of business may nevertheless have a permanent establishment because of the activities of a dependent agent. In these newer treaties, including the 2006 U.S. Model Income Tax Treaty, income from the performance of activities of an independent character generally would be taxable under the Business Profits article, but only to the extent attributable to a permanent establishment in the other Contracting State.

Although the applicable treaty provisions in the treaties currently in force vary greatly, they generally would exempt an NRA whistleblower who is a resident of a country with which the United States has an income tax treaty in force from U.S. tax on his or her whistleblower award. To the extent a particular NRA whistleblower is physically present in the United States in connection with the activities for which the award payment is made, the whistleblower's presence may be for only a brief period of time. Moreover, an award typically would not be attributable to a fixed base or permanent establishment that the whistleblower has in the United States.

This chart explains when NRA whistleblowers who are residents of a treaty country for treaty purposes will be taxable on their whistleblower awards (as of the date of this memorandum). With the exception of Greece and Trinidad & Tobago, an individual need only satisfy one of the shaded requirements to be taxable in the United States.

<i>Treaty Country</i>	<i>Award attributable to fixed base or PE in U.S.</i>	<i>Whistleblower present in U.S. for X days during taxable year</i>	<i>Whistleblower receives more than a specified amount for the services</i>
Australia		> 183	
Austria			
Bangladesh		> 183	
Barbados		90	US\$5,000
Belgium	n1		
Bulgaria	n1		
Canada	n1		
China		> 183	
Cyprus		183	
Czech Republic		> 183	
Denmark			

<i>Treaty Country</i>	<i>Award attributable to fixed base or PE in U.S.</i>	<i>Whistleblower present in U.S. for X days during taxable year</i>	<i>Whistleblower receives more than a specified amount for the services</i>
Egypt		90	
Estonia		> 183	
Finland			
France			
Germany	n1		
Greece (n5)		183	US\$10,000
Hungary		> 183	
Iceland	n1		
India		90	
Indonesia		120	
Ireland			
Israel		183	
Italy			
Jamaica		90	US\$5,000
Japan	n1		
Kazakhstan		> 183	
Korea	n3	183	US\$3,000
Latvia		> 183	
Lithuania		> 183	
Luxembourg			
Malta	n1		
Mexico		183	
Morocco	n4	183	US\$5,000
Netherlands			
New Zealand	n1		
Norway	n3	183	
Pakistan		> 183	
Philippines		90	US\$10,000
Poland		183	
Portugal		183	
Romania		> 183	
Russia		> 183	
Slovak Republic		> 183	
Slovenia			
South Africa		> 183	
Spain			
Sri Lanka		> 183	
Sweden			
Switzerland			

<i>Treaty Country</i>	<i>Award attributable to fixed base or PE in U.S.</i>	<i>Whistleblower present in U.S. for X days during taxable year</i>	<i>Whistleblower receives more than a specified amount for the services</i>
Thailand		90	US\$10,000
Trinidad & Tobago (n5)		183	US\$3,000
Tunisia		> 183	US\$7,500
Turkey		> 183	
Ukraine			
United Kingdom	n1		
USSR (n2)		> 183	
Venezuela			

Notes:

1. Permanent Establishment article
2. Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Uzbekistan
3. Resident must maintain fixed base in the United States for 183 days or more in the taxable year
4. Resident must maintain fixed base in the United States for 90 days or more in the taxable year.
5. Individual must satisfy both requirements to be taxable in the United States.

5. Examples

The examples below illustrate the tax consequences of NRA whistleblower awards made under the following circumstances.

Treaty Example: Facts.

Individual A provides information to the Service that results in the collection of tax, penalties, interest, or other amounts from one or more taxpayers. As a result, Individual A is paid a whistleblower award under section 7623. Individual A is a citizen and resident of Foreign Country Z, which has an income tax treaty in force with the United States that is identical in all material respects to the 2006 U.S. Model Income Tax Treaty. Individual A is not and has never been a citizen or resident of the United States. Individual A does not have and has never had a permanent establishment in the United States within the meaning of the U.S.-Country Z treaty. It is not known whether Individual A undertook any of the activities in the United States in order to provide the information to the IRS pursuant to the statute.

Analysis.

Generally, the Office would be required to ascertain the portion of the payment to Individual A representing compensation for services performed in the United States, and withhold 30% of that portion. However, because there is a treaty in effect between the

United States and Country Z, Individual A may be exempt from tax under the treaty or the treaty may permit a reduced rate of withholding.

The U.S.-Country Z treaty does not contain an Independent Personal Services article under which the award paid to Individual A would have been subject to U.S. tax if the award were U.S. source income. Rather, income from the performance of services outside of the employment context is only taxable under Article 7 (Business Profits), but only to the extent the income is attributable to a permanent establishment in the United States. Because Individual A does not have and has never had a permanent establishment in the United States the award is not taxable under Article 7(1). Accordingly, the Office is not required to withhold on any portion of the award provided that the Office has received a beneficial owner certificate containing sufficient information to support Individual A's claim that he is exempt from tax under the treaty.

Even though no withholding is required, the Office would be required to report the portion of the payment attributable to services performed in the United States as U.S.-source income received on a Form 1042-S. See Treas. Reg. § 1.1461-1(c). If the Office cannot obtain sufficient facts to determine the portion of the payment attributable to a U.S. source by the time the payment is made, it should report the entire payment as U.S.-source income.

Non-Treaty Resident, Never in U.S. Example: Facts.

Individual B provides information to the Service that results in the collection of tax, penalties, interest, or other amounts from one or more taxpayers. As a result, Individual B is paid a whistleblower award under section 7623. Individual B is a citizen and resident of Foreign Country Y, which does not have an income tax treaty in force with the United States. Individual B is not and has never been a citizen or resident of the United States. Individual B has never been in the United States.

Analysis.

Because, as discussed above, the whistleblower award constitutes a payment for services performed by Individual B and Individual B has never been in the United States, no portion of the award is attributable to services performed in the United States. Therefore, the award is not subject to withholding under section 1441 or information reporting under section 1461.

Non-Treaty Resident, Some Time in U.S. Example: Facts.

Individual C provides information to the Service that results in the collection of tax, penalties, interest, or other amounts from one or more taxpayers. As a result, Individual C is paid a whistleblower award under section 7623. Individual C is a citizen and resident of Foreign Country Y, which does not have an income tax treaty in force with the United States. Individual C is not and has never been a citizen or resident of the United States. Individual C has spent significant amounts of time in the United States engaging in activities related to the providing of the information to the IRS.

Analysis.

The Office is required to withhold 30% of that portion of the award paid to Individual C attributable to activities undertaken by Individual C in the United States. If the Office does not have sufficient facts to determine the portion of the award constituting U.S.-source income at the time of payment, the Office should treat the entire payment as U.S. source income and withhold 30% thereof. Alternately, the Office may hold in escrow a portion of the payment sufficient to cover the withholding tax that would be owed if the entire amount were U.S.-source income until the determination can be made as to the portion of the award constituting U.S. source income. See Treas. Reg. § 1.1441-3(d). The portion of the award treated as U.S. source income and the amount withheld must be reported on a Form 1042-S pursuant to Treas. Reg. § 1.1461-1(c).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Anne P. Shelburne in general at (202) 435-5265, Danielle Nishida with respect to withholding matters at (202) 622-5399, Cheryl Edson with respect to treaty matters at (202) 622-8555, or Richard Chewning with respect to source of income matters at (202) 622-3523 if you have any further questions.