

# IRS Whistleblower Program

## Annual Report to the Congress

Fiscal Year 2009



# **FY 2009 Annual Report to Congress on the Use of Section 7623**

## **Table of Contents**

I.	Executive Summary .....	1
II.	Program History .....	1
	A. Prior Law and Policy .....	1
	B. 2006 Amendments .....	2
	C. Implementing the Amendments .....	3
III.	FY 2009 Program Developments.....	3
	A. Staffing.....	3
	B. Case Management Information System.....	3
	C. Program Guidance.....	4
	D. Program Operations .....	4
	E. Outreach and Communications .....	5
IV.	Priorities for Fiscal Year 2010 .....	6
V.	Legislative and Administrative Issues .....	6
VI.	Whistleblower Awards Paid .....	7
VII.	Appendix: Revised Section 7623 and other provisions of law .....	9

## **FY 2009 Annual Report to Congress on the Use of Section 7623**

### **I. Executive Summary**

The Tax Relief and Health Care Act of 2006 (the Act) enacted significant changes in the IRS award program for whistleblowers. For information provided to the IRS after December 19, 2006, new section 7623(b) of the Internal Revenue Code (the Code) generally requires the IRS to pay awards if information an individual provides substantially contributes to the collection of tax, penalties, interest, and other amounts when the amounts in dispute are more than \$2 million. The law set award ranges based on percentages of the collected proceeds, and established a Whistleblower Office within the IRS to administer those awards.

The Secretary of the Treasury must conduct a study and report to the Congress each year on the use of section 7623, including an analysis of the use of section 7623 and the results obtained, as well as any legislative or administrative recommendations for section 7623 and its application (section 406(c) of the Act). This report discusses program activities for the fiscal year ended September 30, 2009. It includes a review of the law and regulations applicable to whistleblower awards, changes made in program administration since the Act, a description of internal and external program guidance, and data on awards paid. The IRS pays awards from collected proceeds after the completion of an audit or investigation and after the taxpayer has exhausted all appeal rights. Therefore, the IRS may not make payments for several years after the whistleblower has filed the claim. All award payments made during FY 2009 resulted from claims filed under the prior law.

The primary purpose of the Act was to encourage people with knowledge of significant tax noncompliance to provide that information to the IRS. In FY 2009, we received 460 submissions that appear to meet the section 7623(b) criteria, identifying 1,941 taxpayers. Many of the individuals submitting this information claim to have inside knowledge of the transactions they are reporting, and often provide extensive documentation to support their claims. We cannot yet tell how many of the cases will result in collected proceeds, and whether the whistleblowers' estimates of the amounts in dispute are accurate.

### **II. Program History**

#### **A. Prior Law and Policy**

The IRS has had the authority to pay awards to whistleblowers for many years. What is now section 7623(a)<sup>1</sup> of the Code has its origins in legislation the Congress enacted in 1867. The original law provided the Secretary with the authority "to pay such sums as he deems necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same." Before 1996, the IRS

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<sup>1</sup> The 2006 amendments re-designated the prior section 7623 as section 7623(a), added new provisions as section 7623(b), and included program administration requirements that were not incorporated into the Internal Revenue Code. The appendix to this report reprints section 7623, as amended, as well as additional provisions in the Act that the Congress did not incorporate into the Code.

made payments from appropriated funds. In 1996, section 1209 of the Taxpayer Bill of Rights 2 (PL 104-168) expanded the purposes for which the IRS may pay awards, adding “detecting underpayments of tax” as a basis for making an award and changed the source of funds from IRS operating funds to proceeds of amounts collected from the taxpayer (other than interest).<sup>2</sup>

Before the 2006 amendments to section 7623, awards to whistleblowers were discretionary, and IRS policy determined the amount.<sup>3</sup> The policy provided a framework for assessing the contribution of the information to the collection of proceeds from a taxpayer, and allowed for awards of 1 percent, 10 percent, or 15 percent of proceeds. The published policy set a cap on awards at \$10,000,000, but the IRS waived this cap from time to time under “special agreements” with a whistleblower.

The Internal Revenue Manual (IRM) provided several grounds for rejecting a claim for award, including participation in the evasion scheme that was the subject of the report the whistleblower provided. Common reasons for rejecting claims included:

- The information provided was of no value.
- The IRS already had the information or the information was available in public records.
- No collection of taxes and penalties existed from which the IRS could pay an award.

The information might be of no value because it did not provide a sufficient basis for initiating an examination or investigation of the issue presented, or because the examination resulted in a “no change” finding.

## **B. 2006 Amendments**

The Tax Relief and Health Care Act of 2006 (section 406) (PL 109-432) created section 7623(b) of the Code. This section set a new framework for the consideration of whistleblower submissions and established the Whistleblower Office within the IRS to administer that framework. Operating at the direction of the Commissioner of the IRS, the Whistleblower Office coordinates with other divisions of the IRS, analyzes information submitted, and makes award determinations. The statute provides that the Whistleblower Office may investigate the claim itself, or assign it to the appropriate IRS office for investigation. The Whistleblower Office does not currently investigate claims itself. Individuals may appeal Whistleblower Office award determinations under section 7623(b) to the U.S. Tax Court.

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<sup>2</sup> The IRS has separate authority to pay informant expenses from appropriated funds available for confidential criminal investigation expenditures. The IRS makes those payments under authorities delegated to Criminal Investigation and they are not within the scope of the Whistleblower Office or this report to the Congress.

<sup>3</sup> Regulations implementing what is now section 7623(a) appear at Code of Federal Regulations Title 26, section 301.7623-1. The IRS issued the most recent version of the policy in 2004, as Policy Statement P-4-27.

A whistleblower must meet several conditions to qualify for the section 7623(b) award program.<sup>4</sup> To qualify for a whistleblower award, the information must:

- Relate to a tax noncompliance matter in which the tax, penalties, interest, additions to tax and additional amounts in dispute exceed \$2,000,000
- Relate to a taxpayer, and for an individual taxpayer, one whose gross income exceeds \$200,000 for at least one of the tax years in question

If the information meets the above conditions and substantially contributes to a decision to take administrative or judicial action that results in the collection of tax, penalties, interest, additions to tax and additional amounts, the IRS will pay an award of at least 15 percent, but not more than 30 percent of the collected proceeds resulting from administrative or judicial actions (including related actions) or from any settlement in response to an administrative or judicial action. The maximum award percentage decreases to 10 percent for cases based principally on specific allegations disclosed in certain public information sources (such as government audit reports). The Whistleblower Office also can reduce the percentage if the whistleblower planned and initiated the actions that led to the underpayment of tax.

### **C. Implementing the Amendments**

On December 19, 2007, Notice 2008-4, 2008-2 Internal Revenue Bulletin 253,<sup>5</sup> provided initial guidance on how to submit information to the IRS. The IRS continues to develop and revise operating procedures to ensure the proper review of each submission. Individuals may appeal award determinations under section 7623(b) to the U.S. Tax Court. Procedures established to evaluate whistleblower submissions make a clear distinction between determinations the Whistleblower Office makes (such as eligibility for an award or the amount of an award) and tax administration decisions (such as the scope of an examination or investigation, or the assessment of taxes, penalties, and interest). The whistleblower has no role in tax administration decisions, and may not appeal or otherwise challenge an IRS tax administration decision.

## **III. FY 2009 Program Developments**

### **A. Staffing**

At the beginning of this fiscal year, the Whistleblower Office staff of 14 included both permanent employees and others detailed to the office. After reviewing case intake levels and the need for continuity in case analysis and follow-up, the IRS set the permanent employee staffing level at 17. As of the end of FY 2009, the staff includes ten analysts with decades of experience in a broad array of IRS compliance programs.

### **B. Case Management Information System**

The IRS began to receive whistleblower submissions alleging more than \$2 million in underpayment of tax almost immediately after enactment of the amendments to section 7623. Because programs to support the claims received under the new statutes did not

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<sup>4</sup> If the submission does not meet the criteria for section 7623(b) consideration, the IRS may consider it for an award under the pre-Act discretionary authority (what is now section 7623(a) of the Code).

<sup>5</sup> <http://www.irs.gov/pub/irs-drop/n-08-04.pdf>

exist, the IRS initially evaluated the submissions using processes and systems designed for the pre-amendment informant awards program. The IRS recognized that the case management information system designed for the pre-amendment program would not be adequate to manage the case load under the new law. Therefore, the IRS supplemented it with other automated and manual case management tools as a stop-gap until it could design and implement a new case management system. As a result, the Whistleblower Office had to rely on inefficient case management procedures and deal with data inconsistencies inherent in the use of multiple systems.

In January 2009, the IRS began using a new case management system based on commercial-off-the-shelf technology to record all new section 7623 claims. By the end of the fiscal year, the IRS converted all section 7623(b) claims recorded on the old systems to the new system, and began planning to convert legacy data on claims made under the prior law to the new system. The new system captures all of the data needed to manage section 7623 claims, from receipt to analysis and assignment to an operating division, as well as the award determination process when operating division actions result in collected proceeds. The Whistleblower Office also eliminated inefficient work processes associated with maintaining data on multiple systems, substantially reducing the time required to process cases through the office.

### **C. Program Guidance**

The IRS issued Notice 2008-4 on January 14, 2008, which provided initial guidance on how to submit information to the IRS. A revision to Form 211 Application for Award for Original Information<sup>6</sup> accompanied this notice. The notice addresses the most pressing guidance requirements—how to submit information and the criteria that the IRS will apply to determine whether the information qualifies for an award under section 7623(b). The notice includes the requirement that an individual submit the information under penalty of perjury and defines ineligible submissions. A submission may be ineligible because the person submitting it is disqualified (e.g., a federal employee who learned of the tax noncompliance in the course of performing his or her duties), or because the information does not provide a basis for IRS action. The latter category includes information that is speculative or that the IRS already knows. The notice also describes information that the whistleblower should include that the IRS will need to evaluate the submission.

The IRS revised IRM 25.2.2, *Information and Whistleblower Awards, Whistleblower Awards*, on December 30, 2008, regarding procedures and guidance for all IRS personnel to follow when dealing with whistleblowers' claims for award. This IRM superseded IRM 25.2.2 dated August 1, 2001. In general, these revisions updated references in the prior IRM to reflect the 2006 legislation, and provided procedures for intake and initial evaluation of whistleblower submissions.<sup>7</sup>

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<sup>6</sup> <http://www.irs.gov/pub/irs-pdf/f211.pdf>

<sup>7</sup> Following the end of FY 2009, the IRS revised IRM 25.2.2 again, to provide additional procedures and guidance for IRS personnel in the four areas described in Part V, below. These revisions, issued in June 2010, were not in effect for any portion of FY 2009 and will be addressed in the FY 2010 report.

## D. Program Operations

As noted above, in December 2007, the IRS directed that all section 7623 submissions go first to the Whistleblower Office. The Whistleblower Office reviews the information to identify matters that appear to meet the section 7623(b) criteria, and forwards those that do not to the Informant Claims Examination unit for further action. That unit evaluates all submissions that do not appear to meet section 7623(b) criteria to determine whether the information offered may materially contribute to the assessment or collection of unpaid taxes, penalties, interest, and other amounts.

During FY 2009, the IRS received 460 whistleblower submissions relating to 1,941 taxpayers<sup>8</sup> that appeared to meet the \$2 million of tax, penalties, interest, and additions to tax threshold in section 7623(b). Many of the individuals submitting information to the IRS claimed to have inside knowledge of the reported transactions, often with extensive documentation to support their claims. We cannot yet tell how many of the cases will result in collected proceeds after examination or investigation, as the amounts alleged reflect only the whistleblower's estimate of the potential recovery. Only 5 of 110 full paid claims in 2009 involved collections of more than \$2 million, and only one involved collections of more than \$10 million. However, because whistleblowers submitted all of the claims paid in 2009 under the old Informant Award Program, this data does not assist in making estimates about the claims brought under the revised statute.

(Table 1)

### FY 2009 MONTHLY RECEIPTS

#### 7623(b) Submissions

	Submissions	Taxpayers Identified		Submissions	Taxpayers Identified
<b>October 2008</b>	<b>39</b>	<b>736</b>	<b>April 2009</b>	<b>58</b>	<b>90</b>
<b>November 2008</b>	<b>23</b>	<b>217</b>	<b>May 2009</b>	<b>43</b>	<b>62</b>
<b>December 2008</b>	<b>19</b>	<b>160</b>	<b>June 2009</b>	<b>37</b>	<b>70</b>
<b>January 2009</b>	<b>43</b>	<b>193</b>	<b>July 2009</b>	<b>35</b>	<b>73</b>
<b>February 2009</b>	<b>34</b>	<b>82</b>	<b>August 2009</b>	<b>48</b>	<b>96</b>
<b>March 2009</b>	<b>49</b>	<b>96</b>	<b>September 2009</b>	<b>32</b>	<b>66</b>

<sup>8</sup> The Whistleblower Office often receives submissions that allege underpayment of tax by more than one taxpayer. In most cases, the IRS must evaluate the liability of each taxpayer individually—a single audit or investigation cannot resolve the issues for all taxpayers identified in the submission.

## **E. Outreach and Communications**

The IRS developed a communications plan to address outreach to both the public and IRS personnel on changes in the whistleblower program. The plan includes efforts to identify opportunities for improvement and potential barriers to change, and to manage expectations for the scope and pace of change. The Whistleblower Office has a page on the IRS intranet to make information available to IRS personnel, and provides articles for internal newsletters and speakers for professional education events to reach employees who are most likely to deal with a whistleblower case. A dedicated page on the public website, [www.irs.gov](http://www.irs.gov), contains information about the purpose of the Whistleblower Program, how to make a submission, and what to expect after making a submission, as well as links to Notice 2008-4 and Form 211.<sup>9</sup> The Whistleblower Office also makes presentations to professional groups involved in the representation of taxpayers and whistleblowers, both to describe program developments and to obtain outside perspectives on the program.

## **IV. Priorities for Fiscal Year 2010**

For FY 2010, the IRS has identified three priority initiatives for the whistleblower program:

- Revise and update the IRM to provide procedures and guidance to IRS personnel to follow when dealing with whistleblowers' claims for awards
- Develop baseline information
- Enhance communications

The first initiative is to update the IRM to provide procedures and guidance to IRS personnel regarding changes to section 7623 relating to the 2006 amendments, including the administrative procedure for award determination and computation, notification procedures, and miscellaneous changes to the processing of section 7623(a) and 7623(b) claims.<sup>10</sup>

The second initiative is to develop baseline information on process efficiency and effectiveness. In FY 2009, the IRS used initial information from the new case management information system to set performance measures for Whistleblower Office case processing. In FY 2010, the IRS will collect data on Operating Division and Chief Counsel action on cases to form the basis for additional performance measures and continued program improvement.

The third initiative is to enhance communications. Under this initiative, the IRS will improve communications among IRS personnel who work on whistleblower program issues. An intranet site provides a ready source for program information, which the IRS will update to address frequently asked questions. Further, the IRS will continue to reach out to the various stakeholders for recommendations on program development

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<sup>9</sup> <http://www.irs.gov/compliance/article/0,,id=180171,00.html>

<sup>10</sup> Revised IRM 25.2.2 incorporating these changes was issued in June 2010.



and to communicate our efforts to develop new regulations and other guidance for the program.

## **V. Legislative and Administrative Issues**

The Whistleblower Office continues to work with the Office of Chief Counsel and the Treasury Department Office of Tax Policy to develop appropriate administrative program guidance and potential legislative recommendations. During FY 2009, the IRS conducted a comprehensive review of all aspects of its procedures and guidance relating to the Whistleblower Program.

As of the end of FY 2009, the Whistleblower Office and the Office of Chief Counsel had identified four areas for which issuing guidance to IRS personnel was a priority:

- The whistleblower award process as an administrative proceeding;
- IRS authority to disclose information to whistleblowers in connection with pending award claims;
- Award determination criteria; and
- The extent to which administrative procedures applicable to section 7623(b) claims should apply to section 7623(a) cases.

## **VI. Whistleblower Awards Paid**

The table below provides information on informant claims paid. To date, all awards the IRS has paid have been based on information received before December 20, 2006, the date of the enactment of section 406 of the Act. Therefore, all of the awards, including those paid in FY 2009, were governed by the prior law, what is now section 7623(a). Thus, the applicable award percentages were those established in prior IRS policy, not the higher percentages set by the new law.

The number and amount of awards paid each year can vary significantly, especially when a small number of high-dollar claims are resolved in one year (as was the case in 2006 and 2008). One factor contributing to the lower award payments in FY 2009 was a change in the IRS definition of the point at which proceeds in a tax case are available to make an award payment. In the past, the IRS monitored the tax case to ensure that it collected proceeds before processing the award claim. If the taxpayer filed an administrative or judicial appeal, the IRS did not issue payment on the claim until the court finally resolved the appeal. After consultation with the Office of Chief Counsel, the Whistleblower Office determined that in cases where the taxpayer has not filed an appeal, the IRS should not pay the claim until the period for filing an appeal has lapsed. The general rule is that a taxpayer may file a claim for refund within two years of the last payment, unless he or she has waived that right. This means that until two years have passed after the last payment, the case is still subject to the possibility of appeal through the process of filing a claim for a refund. Thus, beginning in July 2009, the IRS monitors cases both for collection and then for the expiration of the period for filing a claim for refund. As a result, the IRS will not pay some claims that under prior policy it would have paid in FY 2009 until FY 2010 or FY 2011.

(Table 2)

**Amounts Collected and Awards Paid under 7623(a) FY 2005-2009**

	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Cases Received</b>	2,740	4,295	2,751	3,704	5,678 <sup>11</sup>
<b>Awards Paid</b>	169	220	227	198	110
<b>Collections over \$2 million</b>	NA	NA	12	8	5
<b>Amount of Awards Paid<sup>12</sup></b>	\$7,602,685	\$24,184,458	\$13,600,205	\$22,370,756	\$5,851,608
<b>Amounts Collected</b>	\$93,677,606	\$258,590,435	\$181,784,287	\$155,985,834	\$206,032,872

<sup>11</sup> The implementation of a new case management information system included changes in the way the IRS recorded submissions under 7623(a). The IRS cannot determine the extent to which this change was a factor in the higher number of cases received in FY 2009.

<sup>12</sup> The amount of awards paid includes fully paid awards and partially paid awards. In FY 2009, 4 informants received partial payments totaling \$3.2 million.

## **VII. Appendix: Revised Section 7623 and other provisions of law**

### **A. Revised 26 USC Section 7323**

TITLE 26 - INTERNAL REVENUE CODE

Subtitle F - Procedure and Administration

CHAPTER 78 - DISCOVERY OF LIABILITY AND ENFORCEMENT OF TITLE

Subchapter B - General Powers and Duties

Sec. 7623. Expenses of detection of underpayments and fraud, etc.

(a) In General- 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. 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.

(2) AWARD IN CASE OF LESS SUBSTANTIAL CONTRIBUTION-

(A) IN GENERAL- In the event the action described in paragraph (1) is one which the Whistleblower Office determines to be based principally on disclosures of specific allegations (other than information provided by the individual described in paragraph (1)) resulting from a judicial or administrative hearing, from a governmental report, hearing, audit, or investigation, or from the news media, the Whistleblower Office may award such sums as it considers appropriate, but in no case more than 10 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, taking into account the significance of the individual's information and the role of such individual and any legal representative of such individual in contributing to such action.

(B) NONAPPLICATION OF PARAGRAPH WHERE INDIVIDUAL IS ORIGINAL SOURCE OF INFORMATION- Subparagraph (A) shall not apply if the information resulting in the initiation of the action described in paragraph (1) was originally provided by the individual described in paragraph (1).

(3) REDUCTION IN OR DENIAL OF AWARD- If the Whistleblower Office determines that the claim for an award under paragraph (1) or (2) is brought by an individual who planned and initiated the actions that led to the underpayment of tax or actions described in subsection (a)(2), then the Whistleblower Office may appropriately reduce such award. If such individual is convicted of criminal conduct arising from the role described in the preceding sentence, the Whistleblower Office shall deny any award.

(4) APPEAL OF AWARD DETERMINATION- Any determination regarding an award under paragraph (1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).

(5) APPLICATION OF THIS SUBSECTION- This subsection shall apply with respect to any action--

(A) against any taxpayer, but in the case of any individual, only if such individual's gross income exceeds \$200,000 for any taxable year subject to such action, and

(B) if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000.

(6) ADDITIONAL RULES-

(A) NO CONTRACT NECESSARY- No contract with the Internal Revenue Service is necessary for any individual to receive an award under this subsection.

(B) REPRESENTATION- Any individual described in paragraph (1) or (2) may be represented by counsel.

(C) SUBMISSION OF INFORMATION- No award may be made under this subsection based on information submitted to the Secretary unless such information is submitted under penalty of perjury.'

## **B. Other provisions of Section 406 of the Tax Relief and Health Care Act of 2006**

(a)(2) ASSIGNMENT TO SPECIAL TRIAL JUDGES-

(A) IN GENERAL- Section 7443A(b) (relating to proceedings which may be assigned to special trial judges) is amended by striking `and' at the end of paragraph (5), by redesignating paragraph (6) as paragraph (7), and by inserting after paragraph (5) the following new paragraph:

(6) any proceeding under section 7623(b)(4), and'.

(B) CONFORMING AMENDMENT- Section 7443A(c) is amended by striking `or (5)' and inserting `(5), or (6)'.

(3) DEDUCTION ALLOWED WHETHER OR NOT TAXPAYER ITEMIZES- Subsection (a) of section 62 (relating to general rule defining adjusted gross income) is amended by inserting after paragraph (20) the following new paragraph:

(21) ATTORNEYS FEES RELATING TO AWARDS TO WHISTLEBLOWERS- Any deduction allowable under this chapter for attorney fees and court costs paid by, or on behalf of, the taxpayer in connection with any award under section 7623(b) (relating to awards to whistleblowers). The preceding sentence shall not apply to any deduction in excess of the amount includible in the taxpayer's gross income for the taxable year on account of such award.'

(b) Whistleblower Office-

(1) IN GENERAL- Not later than the date which is 12 months after the date of the enactment of this Act, the Secretary of the Treasury shall issue guidance for the operation of a whistleblower

program to be administered in the Internal Revenue Service by an office to be known as the 'Whistleblower Office' which--

(A) shall at all times operate at the direction of the Commissioner of Internal Revenue and coordinate and consult with other divisions in the Internal Revenue Service as directed by the Commissioner of Internal Revenue,

(B) shall analyze information received from any individual described in section 7623(b) of the Internal Revenue Code of 1986 and either investigate the matter itself or assign it to the appropriate Internal Revenue Service office, and

(C) in its sole discretion, may ask for additional assistance from such individual or any legal representative of such individual.

(2) REQUEST FOR ASSISTANCE- The guidance issued under paragraph (1) shall specify that any assistance requested under paragraph (1)(C) shall be under the direction and control of the Whistleblower Office or the office assigned to investigate the matter under paragraph (1)(A). No individual or legal representative whose assistance is so requested may by reason of such request represent himself or herself as an employee of the Federal Government.

(c) Report by Secretary- The Secretary of the Treasury shall each year conduct a study and report to Congress on the use of section 7623 of the Internal Revenue Code of 1986, including--

(1) an analysis of the use of such section during the preceding year and the results of such use, and

(2) any legislative or administrative recommendations regarding the provisions of such section and its application.

(d) Effective Date- The amendments made by subsection (a) shall apply to information provided on or after the date of the enactment of this Act.