

Whistle-Blower Awards Are Ordinary Income, Tax Court Says

By Andrew Zajac - Feb 25, 2014

A whistle-blower's \$6.8 million in awards must be taxed as ordinary income, a U.S. Tax Court judge ruled, rejecting arguments that the money should be recognized as [capital gains](#) and subject to a lower rate.

Craig Patrick, a former reimbursement manager for California medical device maker Kyphon Inc., helped win the [recovery](#) of tens of millions of dollars for the U.S. from an alleged Medicare fraud and his efforts "are to be applauded and were rewarded," Judge Diane Kroupa wrote in her ruling yesterday. "Rewards, however, are treated as ordinary income" and "subject to tax as such."

Kroupa's ruling upheld the U.S. [Internal Revenue Service](#)'s determination that Patrick, and his wife, Michele Patrick, with whom he filed joint returns, owed a total of about \$812,000 for 2008 and 2009.

The top [tax rate](#) for ordinary income in those years was 35 percent, compared with 15 percent for capital gains.

The Patricks' attorney, Robert Wood, of [San Francisco](#), declined to comment on the ruling.

The couple argued that Craig Patrick, who blew the whistle on allegedly fraudulent marketing, sold information to the government in exchange for a share in any recovery in the case.

Kroupa ruled that under the [False Claims Act](#), the government doesn't purchase information. Instead "it permits the person to advance a claim on behalf of the government. The award is a reward for doing so. No contractual right exists."

Craig Patrick claimed in his suit, which the government joined, Sunnyvale, California-based Kyphon, engaged in a years-long scheme to inflate Medicare bills by persuading hospitals to bill for a spinal procedure at inpatient rates rather than for less costly outpatient treatment.

The alleged fraud involved kyphoplasty, in which spinal gaps were filled with bone cement.

[Medtronic Inc. \(MDT\)](#) which acquired Kyphon in 2007, agreed to pay \$75 million to settle the case in May 2008.

The [case](#) is Patrick v. IRS, 16387-12, U.S. Tax Court, [Washington](#).

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