

“Back to Tax!”: A Mid-Year Overview of IRS Criminal Investigation*

By
David B. Palmer

David Palmer, Chief of IRS Criminal Investigation, discusses CI's progress in meeting its objectives to increase case initiations and refocus on tax administration.

Over the last two years, in conjunction with the IRS modernization effort, Criminal Investigation (CI) modified its business objectives to increase case initiations and refocus on tax administration. Last year we saw the initial fruits of our labor from these efforts through the number of our completed cases. We are very encouraged about this upward trend, and, mid-year through fiscal year 2003, our numbers continue to rise.

Case Initiations

One of CI's objectives last year was to increase case initiations on tax cases, both legal- and illegal-source income cases, and to scale back our efforts in narcotics. Between fiscal years 2001 and 2002, the total number of case initiations was up from 3,284 to 3,906. Halfway into fiscal year 2003, we are already at 2,033, a 16-percent increase above where we were at this same point last year. See Table 1.

A step further breaks case initiations down into our investigative priorities: Legal-source, Illegal-source and Narcotics cases.

Legal-Source Cases

Legal-source cases are our primary focus because they are critical to overall compliance, and we are the only federal agency with jurisdiction over tax investigations. In other words, if we don't do them, no one else can. Legal-source tax cases involve investigations of taxpayers in legal occupations and legal industries, where only tax or tax-related violations are investigated.

Legal-source cases increased by 52.35 percent between fiscal years 2001 and 2002; the first six months of fiscal year 2003 saw a 21-percent increase from where we were at this same time last year.

Illegal-Source Cases

Illegal-source financial crimes include money laundering and currency violations and are often intertwined with tax violations. In some cases, the criminal activity is tax-related

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*Table 1
Overall CI Statistics*

	FY2000	FY2001	FY2002	FY2003 10/1/02–3/31/03 (6 months)	% change Q1 and Q2 FY03 vs. Q1 and Q2 in FY02
Case initiations	3372	3284	3906	2033	+ 16%
Prosecution Recommendations	2434	2335	2133	1232	+ 36%
Indictments	2469	2292	1924	954	+ 16%
Convictions	2249	2251	1926	931	– 3%
Incarceration Rate	80.9%	84.0%	82.2%	83.5%	
Avg Mths to Serve	40	44	44	43	

and involves money-laundering techniques. Historically, money launderers used legitimate businesses to “launder” their illegal proceeds. Now money launderers use various schemes and types of transactions to conceal their income and/or assets. Some of these schemes include the manipulation of numerous currency-reporting requirements and the layering of transactions.

Between fiscal years 2001 and 2002, illegal-source case initiations increased by 13.09 percent; that statistic currently stands at nine percent above where we were at this same time last year.

*Narcotics-Related
Financial Crimes*

CI plays a unique role in the federal law enforcement counter-drug effort with its specialized financial tax and money laundering investigative expertise. Criminal drug organizations often go to great lengths to conceal the income earned and source of their illegal income. In doing so, these organizations perpetuate the erosion of our financial system, economy and fair commerce.

Last year, our goal was to bring expenditures in line with reimbursements for the narcotics cases on which we work. In fiscal year 2002, we decreased narcotics case initiations by 8.83 percent

and are maintaining that level in fiscal year 2003.

**Prosecution
Recommendations**

Our prosecution recommendations are currently 36 percent above where we were at this same time last year. Our completed investigations are forwarded to the Department of Justice (DOJ) for prosecution. Historically, CI consistently has maintained an acceptance rate of over 90 percent. Our DOJ Tax Division acceptance rate is currently 95.3 percent, and our U.S. Attorney acceptance rate is 92.6 percent.

How has CI been able to achieve these increases in case totals? First, there are more special agents on board. In fiscal year 2001, we had 2,800 special agents on board, and in fiscal year 2002 we were able to increase that to 2,903. We hope to maintain that number this year.

*Table 2
Questionable Refunds*

	FY 2001	FY 2002	FY2003 Q1&Q2 (6 months)
Invest. Initiated	170	328	146
Pros. Recommended	113	144	121
Indict/Information	95	125	91
Convictions	102	100	64
Incarceration Rate	88.3%	88.2%	89.8%
Avg Months To Serve (w/ Prison)	22	21	23
Avg Months To Serve (All Sent)	19	19	21

Secondly, CI is experiencing an increase in fraud referrals from other IRS operating divisions. Through our Lead Development Centers and internal training, we have provided “fraud referral specialists” to Small Business Self-Employed (SB/SE), Large and Mid-Size Business (LMSB) and Wage & Investment (W&I); thus, we are seeing a significant increase in the quality of referrals coming into CI. In the first six months of fiscal year 2003, our acceptance rate for fraud referrals from other operating divisions is 68.9 percent, which is up from 63 percent last year and 51 percent in fiscal year 2000.

Areas of Emphasis

Refund Fraud Program

CI continues to work with W&I to ensure there is an effective program to deal with refund-related crimes.

Fraud and abuse related to both the Questionable Refund Program (QRP) and the Return Preparer Program (RPP) is increasing. This increase applies to both the filing of paper returns and electronically filed personal and business returns. One of the contributing factors to the increase is identity theft and the use of the stolen identity to file fraudulent returns. The Earned Income Tax Credit (EITC) Program continues to motivate unscrupulous tax return preparers. Through the use of the IRS's Electronic Fraud Detection System and the enhanced analytical skills of the redesigned Fraud Detection Centers, CI and W&I have developed an effective deterrent in both QRP and RPP. This is a continuing process wherein our Fraud Detection Centers work with IRS submission processing to evaluate its effectiveness in identifying fraud. See Tables 2 and 3.

Nonfiler Program

The IRS has developed a national nonfiler strategy that formulates a long-term solution to address chronic compliance problems. The Tax Fraud Alerts on www.irs.gov (key word: "fraud") include summaries of recent criminal investigations and also provides the IRS Chief Counsel's legal opinions regarding the numerous arguments raised by some of the nonfiler community. See Table 4.

Employment Tax

A substantial portion of the total tax gap (the difference between what is owed and what is paid) is believed to involve employee withholdings. Ensuring that income taxes and employment taxes are withheld and paid to the government is an important compliance issue and a continuing emphasis area for CI this year. See Table 5.

Table 3
Return Preparers

	FY 2001	FY 2002	FY2003 Q1&Q2 (6 months)
Invest. Initiated	116	254	125
Pros. Recommended	73	89	56
Indict/Information	70	61	33
Convictions	63	64	25
Incarceration Rate	92.9%	86.8%	84%
Avg Months to Serve (w/Prison)	20	27	23
Avg Months to Serve (all Sent)	19	23	20

Table 4
Nonfilers

	FY 2001	FY 2002	FY2003 Q1&Q2 (6 months)
Invest. Initiated	464	503	270
Pros. Recommended	269	244	146
Indict/Information	257	233	72
Convictions	219	227	119
Incarceration Rate	83.2%	88.1%	78.9%
Avg Months to Serve (w/Prison)	43	45	39
Avg Months to Serve (all Sent)	36	49	39

Table 5
Employment Tax

	FY 2001	FY 2002	FY2003 Q1&Q2 (6 months)
Invest. Initiated	64	92	59
Pros. Recommended	40	56	31
Indict/Information	33	55	23
Sentenced	31	41	19
Incarceration Rate	74.2%	78.0%	68.4%
Avg Months to Serve (w/Prison)	20	19	24
Avg Months to Serve (all Sent)	15	15	16

Table 6
Abusive Trusts

	FY 2001	FY 2002	FY2003 Q1&Q2 (6 months)
Invest. Initiated	79	108	32
Pros. Recommended	30	55	47
Indict/Information	32	44	32
Convictions	45	26	23
Incarceration Rate	80.8%	88.2%	84.6%
Avg Months to Serve (w/Prison)	64	32	25
Avg Months to Serve (all Sent)	52	28	22

Abusive Trusts

For CI, part of our focus on compliance is geared toward promoter

schemes. In January of this year, we established new promoter codes within our Management Informa-

tion System to facilitate analysis of areas in which these promoters and some of their clients are most active. The Abusive Trust Program is one of the areas affected by this. While the number of investigations initiated in the Abusive Trust Program for FY 2003 Q1 and Q2 may appear low, they actually are on track with where we were at the same time last year. Other abusive schemes, such as cases initiated as a result of John Doe Summons, are currently captured in our general fraud program. When we refine that database to capture all schemes, we'll be able to report those results as well. See Table 6.

Counter-Terrorism

A total of 90 investigations relating to counter-terrorism have been referred to the Department of Justice from IRS since the beginning of 2002.

Compliance Initiatives

Voluntary Disclosure Practice

In December 2002, the language in the Voluntary Disclosure Practice was "modernized" to help clarify some questions people had about the program. While the practice has been in place since

the 1950s, the old language was a bit vague and this new update clarifies some issues and gives some examples to help explain our definition of "timeliness."

For example, it is now spelled out in the IRM that publicity or media coverage regarding enforcement and compliance efforts will not bar a taxpayer from making a voluntary disclosure.

It is our practice that a voluntary disclosure will be considered along with all other factors in the case in determining whether criminal prosecution will be recommended. In situations involving potential voluntary disclosures, the facts and circumstances need to be assessed on a case-by-case basis.

Basically, a voluntary disclosure occurs when:

- the communication is truthful, timely and complete;
- the taxpayer shows a willingness to, and actually does, cooperate in determining his/her correct tax liability; and
- the taxpayer makes good faith arrangements with the IRS to pay in full the tax, interest and any penalties determined to be applicable.

A voluntary disclosure will not in of itself guarantee immunity from prosecution; yet a voluntary disclosure may result in a no-prosecution recommendation. A voluntary dis-

closure does not bar the IRS from civilly assessing and collecting the tax along with interest and penalties. And, although the IRS makes a recommendation to the DOJ, the DOJ makes the final determination on whether or not to prosecute.

The clarification of "timeliness" did impact the offshore voluntary compliance initiative (OVCI). For example, if CI had a case numbered against a taxpayer, then they were not "timely" in making their voluntary disclosure for purposes of participation.

One of the goals of the OVCI was to gather information about scheme promoters and the offshore financial arrangements they set up for their clients. Some of those financial arrangements are with credit and debit cards, but there are others.

Additional Information

Additional information about CI's enforcement activities can be found on the IRS Web site at www.irs.gov (keyword: "fraud") or www.treas.gov/irs/ci. Information on the modernized Voluntary Disclosure Practice can be found at www.irs.gov under "Content," "Tax Professionals."

ENDNOTES

- * Researched and co-authored by Criminal Investigation Communications Specialists Marilyn Davidson and Jennifer Whaley.

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