

## **Appendix A: Abusive Schemes “Tipping Point” Study**

August 1, 2003

MEMORANDUM FOR NINA E. OLSON  
NATIONAL TAXPAYER ADVOCATE

FROM: Mark J. Gillen  
Director, Office of Program Evaluation and Risk Analysis

SUBJECT: Summary of OPERA’s Analysis of IRS’ Posture for  
Identifying and Mitigating Abusive Tax Avoidance  
Transactions and Schemes – Phase I

The attached briefing documents represent the Office of Program Evaluation and Risk Analysis’ observations from our review of the Service’s efforts for identifying and mitigating abusive tax avoidance transactions and schemes.

Our objective was to determine what approaches, processes, and procedures the Service has developed and/or implemented that would enable (1) early identification of abusive tax avoidance schemes and (2) mitigation of the impact of these schemes before they proliferate.

The attachments summarize the information compiled from reviewing the four operating divisions and other functions with responsibilities and activities relating to abusive tax avoidance transactions and schemes. This includes the offices and programs specifically developed to combat abusive schemes or scams. OPERA did not, however, validate any of the approaches, processes, and/or procedures noted by the divisions or functions.

Attachment A lists those individuals and organizations that we interviewed during our review. The additional attachments (Attachments B through G) provide a snapshot of the strategic initiatives and internal structures to detect and mitigate abusive schemes and scams as well as those schemes and scams already identified by the Service.

If you have any questions or need additional information, please contact me at (202) 927-5647, or have someone from your staff contact Timothy Morrison, Senior Manager at (202) 927-5641.

Attachments

# **OPERA Study of IRS' Posture for Identifying and Mitigating Abusive Tax Avoidance Transactions & Schemes**

## **Phase I Observations and Proposed Plans for Phase II**

### **Briefing for the National Taxpayer Advocate**

**August 1, 2003**

Since our initial briefing with you on May 21, 2003, and the briefing we gave to the Abusive Tax Evasion, Avoidance Schemes & Devices (ATEASD) Executive Steering Committee (ESC) on June 26, 2003, we have updated our compilation (updates are highlighted with gray shading) of the Service's efforts to identify and mitigate abusive tax avoidance transactions and schemes. In addition, we have annotated and updated this briefing (highlighted with gray shading) document that we originally gave to the ATEASD ESC and incorporated our modified proposed plans for the second phase of this project.

#### **Background**

- With the apparent increased appetite for tax avoidance schemes, like abusive tax shelters, and scams, such as slavery reparations, the National Taxpayer Advocate's Office requested analytical assistance from OPERA to identify what IRS is doing to detect emerging schemes or scams and to minimize the implications of those detected.
- NTA and OPERA have collaborated on a compilation of IRS detection and mitigation initiatives to identify the Service's current posture, capability, and direction relative to abusive schemes and scams.
- The collaboration started with those known to have explicit responsibilities for abusive taxpayer activities, like: OPERA's recent review of the communications/outreach activities related to slavery reparations; those in Criminal Investigation involved with fraud detection; those in Research who have studied IRS' previous Tax Protestor Program; and those in LMSB who have pursued abusive tax shelters.
- Between those contacted with known related responsibilities, Intranet research, and OPERA's work with the CFO's Office reviewing the FY2005 strategic planning submissions; we have learned that there are numerous units involved in the detection and mitigation of abusive schemes and scams and that their activities are being increasingly coordinated as well as made known to the public.
- We also learned about the ATEASD and other coordinating bodies that have been established to further and leverage the efforts of the many throughout the Service involved with the detection and mitigation of abusive shelters, schemes, and scams. We have received meaningful insights about these individual and collective efforts from the ATEASD membership and extensions of it in the respective organizations.

## Study Objectives

- Identify what approaches, processes, and procedures the Service has developed and/or implemented that would:
  - Enable early identification of abusive tax avoidance schemes, and
  - Enable the Service to mitigate the impact of these schemes before they proliferate.

## Methodology & Scope

- Conducted interviews with officials from various operating divisions and operating units who are known to play an active role in identifying, assessing and/or mitigating abusive tax avoidance transactions and schemes.
- Researched IRS Intranet and reviewed various documents related to abusive tax schemes and scams.
- Contacted others whose related activities were brought to our attention in the interviews or research to identify their role and relationship to IRS' abusive scheme and scam detection and mitigation efforts.

## Information Compiled

- Based on those interviewed, we learned that numerous IRS units have identified abusive taxpayer behaviors as serious concerns and have strategic initiatives and internal structures to detect and mitigate abusive schemes and scams. (*Attachments A, B, C-I, and C-II, CIII respectively*).
- We have also compiled information about the schemes and scams identified along with the unit identification and mitigation efforts, as well as illustrations of the unit structures and related activities. (*Attachments D-I, D-II, E & F, respectively*)
- IRS has also initiated efforts to coordinate and leverage these unit activities, including: establishing the ATEASD ESC and other coordinating bodies; and warning the public about the "Dirty Dozen" for 2003 of common scams, as well as others that have since been identified, including the advance child tax credit scam recently brought to the public's attention. (*Attachment G*)

## Observations

- IRS has **extensive efforts underway to combat abusive taxpayer behavior**. While the abusive tax shelter area is further along with regard to its coordinated detection and mitigation capabilities, the comparable efforts relating to abusive schemes and scams are being aggressively developed in literally every major unit, through their strategic plan

initiatives along with other activities, and coordinated through bodies like the ATEASD.

- While we noted that **W&I is the only major unit without a strategic initiative related to abusive taxpayer behavior**—beyond an OP to support the efforts of the other units—a structure or official responsible for schemes or scams, or full ATEASD membership; it has comparable strategic efforts to learn about its segment’s “taxpayer of the future”, W-4 initiative, EITC program activities, as well as the inclusion of individual taxpayers in the detection capabilities managed by CI and SBSE.
- The compilation of the collective efforts across the Service to identify and mitigate abusive shelters, schemes, and scams shows a considerable commitment to combat these behaviors. Most noteworthy may be the **range of the mitigation strategies, which employ the full arsenal of tools available to the tax administrator** from public information and alerts, new disclosure requirements for promoters and participants, other outreach and communication to affected areas, examination and investigation, and litigation. We were struck by the range of treatments applied to combating the abusive behaviors detected as well as the response from taxpayers to each of the techniques employed. This range illustrates and epitomizes the value of a combination of service and enforcement in IRS efforts to attain voluntary compliance.
- IRS units have identified numerous abusive taxpayer behaviors through a wide variety of shelters, schemes, and scams; and have **recently formed bodies to coordinate its collective efforts to combat the proliferation of these behaviors**. While the Service’s efforts to detect and combat abusive taxpayer behaviors are expansive, the generation and proliferation of these activities by promoters, scam artists, and others is imposing—especially through mass mediums like the Internet.
- The coordinating bodies are at a relatively formidable stage, with **their natural evolution to proceed from coordinating our activities relative to the known abusive behaviors to learn from our experience to attempt the earliest possible identification** of abusive behaviors to preclude their proliferation.
- Among the many challenges facing those combating abusive behaviors is **clustering or categorizing the shelters, schemes, or scams identified in meaningful ways**, especially since their identification emanates from a variety of sources and are initially assessed within the various unit structures.
- The other natural evolution of this extensive body of work is to analyze and assess our individual and collective capability, based on what has been identified and mitigated, to **determine how to get into a more proactive posture through early detection, proliferation assessment, and tailored mitigation strategies**. This capability would build upon the work that has been done and evolved to where we are today. It would build upon this work to achieve earlier identification and even predictive analytical capabilities. This would allow us to better target and leverage

our finite resources to preclude proliferation that casts us into a reactive mode and at a distinct disadvantage to minimize the compliance implications.

### **Where Do We Go From Here?**

- Possibly, draw upon those who collaborated with us to compile this portrayal to **learn more about the various means for clustering or categorizing** the identified abusive taxpayer behaviors.

Note: While we are continuing to coordinate with SB/SE/SPDER on the knowledge management initiative, we do not know the extent to which these efforts will align.

- During our June 26, 2003, presentation of our preliminary results of the first phase of the project to the Abusive Tax Evasion, Avoidance Schemes and Devices (ATEASD) Executive Steering Committee (ESC), ESC officials suggested that OPERA consider using schemes like the Misuse of the Disabled Access Credit and Home-Based Business, which have a broad base and have widely proliferated. Since the ATEASD meeting, we have talked with those in SB/SE involved with these schemes and others. We will be meeting as early as next week with the ATEASD Co-Chairs to discuss our interests and plans for the schemes we ultimately select.
- We plan to look at the schemes selected for the following reasons:
  - (1) To gain an appreciation for them from initial identification by the IRS, what parts of the Service were involved, what they did, when they did it, and to what effect. By doing this, we would gain an understanding of the IRS' coordination and mitigation efforts by seeing how the processes and structures described in our Phase I compilation were applied, which would include the Service's outreach, communication, and compliance activities.
  - (2) This would also involve determining how the scheme(s) proliferated; that is, the type of promoter, the method(s) employed by the promoter to disseminate the scheme, the characteristics of the scheme, and the characteristics of those who participated in the scheme.
  - (3) Then we will try to determine if any key traits can be identified, both of the scheme and those participating in it, that would assist the IRS in more quickly identifying and mitigating similar schemes in the future. This will include identifying whether other analytical tools could be employed to enhance the IRS' early detection capabilities and mitigation strategies for future schemes by trying to apply such tools, through a proof-of-concept, to the data already captured through the project or otherwise readily available.

<b>Interviews Conducted</b>
<b>Large and Mid-Size Business (LMSB)</b>
LMSB Office of Tax Shelter & Analysis (OTSA) Manager
Director Office of Pre-Filing & Technical Services (PTFS) & Co-Chair Abusive Tax Evasion, Avoidance Schemes and Devices (ATEASD)
<b>Small Business/Self Employed (SB/SE)</b>
Director SB/SE Reporting Enforcement
Program Manager Abusive Tax Schemes
SBSE Laguna Nigel Lead Development Center
Deputy Director SBSE Compliance Policy & Co-Chair ATEASD
Territory Manager (TEC) Houston, TX
Issue Specialist, Compliance Policy, Reporting Enforcement Abusive Tax Promotions
Director Centralized Workload Section & Delivery
Program Analyst- SBSE Reporting Compliance, Ogden Frivolous
<b>Criminal Investigation (CI)</b>
CI Financial Crimes
CI Refund Crimes
CI Philadelphia Lead Development Center
<b>Tax Exempt and Government Entities (TE/GE)</b>
Group Manager EO & EO Abusive Scheme Coordinator
Senior Technical Advisor to TEGE Commissioner
Tax Law Specialist, EP
Tax Law Specialist EO
<b>Wage &amp; Investment (W&amp;I)</b>
Chief Strategy & Selection, Reporting Compliance
<b>NHQ Communications &amp; Liaison (C&amp;L)</b>
National Director Office of Communications
Media Relations Branch Chief
<b>Appeals</b>
Office of Appeals, Director Technical Services
Office of Appeals, Technical Services, Tax Policy/Procedures
<b>Chief Counsel</b>
Special Counsel of the Chief Counsel
Senior Counsel to the Chief Counsel

**Abusive Tax Schemes Strategic Initiatives**

As result of OPERA’s analysis of the FY05 Strategic Assessment submissions, we learned that TEGE, LMSB and SBSE identified abusive tax schemes as one of their key initiatives. The table below shows the specific TIP for each Operating Division (OD) that addresses the abusive tax scheme issue.

Operating Division	TIP #	Initiatives to address Abusive Tax Schemes
TEGE	TIP #3	Abusive tax schemes involving various types of tax-exempt and government entities are beginning to surface and appear to be growing.
LMSB	TIP #5	Combat abusive tax avoidance transactions (ATAT) by encouraging voluntary disclosure and registration, providing early analysis and published guidance, initiating alternative resolution methods and maintaining a strong enforcement regime that includes promoter audits, summonses and targeted litigation.
SBSE	TIP #1	Compliance of SB/SE taxpayers continues to decline and tax avoidance continues to rise.
W&I	No TIP but did have an operating priority that commits to support the other OD’s efforts to combat abusive taxpayer behavior. <sup>1</sup>	Although W&I did not include a TIP specific to abusive taxpayer behavior in its strategic assessment, it does have some related strategic efforts underway, such as its “Taxpayer of the Future” analysis, W-4 initiative, EITC program activities as well as the inclusion of individual taxpayers in the detection capabilities managed by CI and SB/SE.

<sup>1</sup> **Operating Priority-** Select W&I Compliance work to support high-priority Service commitments, such as high-income taxpayers, NRP priorities, abusive schemes, and offshore credit card abuses, associated with **TIP #3**– Improving W&I Enforcement Programs May Reduce the Risks of Non-Compliance in W&I’s FY05 Strategic Assessment.

## Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters

Operating Division	Organization/ Group	Description
LMSB	Office of Tax Shelter & Analysis (OTSA)	<p>In February 2000, the Service announced the creation of the Office of Tax Shelter Analysis (OTSA) as part of the Pre-Filing and Technical Guidance (PFTG) function in the LMSB division. It is the focal point for IRS tax shelter activities and is responsible for implementing the Service's tax shelter initiatives. It also serves as a receptacle for information that comes to the attention of the Service relating to potentially improper tax shelter activity by corporate and non-corporate taxpayers.</p> <p>At the same time the IRS created OTSA, it also announced three separate groups of temporary and proposed regulations as part of a coordinated effort to combat shelters. The three regulations were:</p> <p>6011, Disclosure Rules: Requires taxpayers to disclose on their returns certain transactions that have characteristics common to tax shelters.</p> <p>6111, Registration Rules: Tax shelter organizers are required to register confidential corporate tax shelters with the IRS.</p> <p>6112, Investor Lists: Requires the seller or organizer of a potentially abusive tax avoidance transaction to maintain a list identifying each investor who was sold an interest in a transaction.</p> <p>OTSA is responsible for reviewing disclosure statements and maintains a disclosure database as a resource to help agents in the field and provide management reports. OTSA also reviews registrations filed with the Service and maintains a registration database to facilitate the compliance process. In addition, OTSA processes investor lists obtained and disseminates information to the field for compliance action. Working closely with the Office of Chief Counsel and Treasury's Office of Tax Policy, OTSA evaluates the tax treatment of new and emerging forms of tax structured transactions to identify improper transactions, while at the same time protecting legitimate business transactions.</p> <p>To facilitate the receipt of information, OTSA also maintains a Tax Shelter Hotline service with a toll free number to be used by persons wishing to submit information to the Service relating to particular tax shelter transactions.</p>
	Tax Shelter Committee	<p>On September 6, 2001, LMSB established a Tax Shelter Committee to provide leadership and executive oversight in implementing its tax shelter program. The committee is comprised of the Commissioner and Deputy Commissioner of LMSB, the Director of Pre-Filing and Technical Guidance, LMSB Division Counsel, the five Industry Directors, the Director, International, and the Directors of Field Specialists and Research &amp; Program Planning. Representatives from Chief Counsel, Appeals and Treasury may also be invited on an <i>ad hoc</i> basis, depending on the subject matter discussed.</p>



Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters

Operating Division	Organization/ Group	Description
	IRC Section 6700 Committee	<p>On December 10, 2001 LMSB established an IRC 6700 Committee to serve as a Subcommittee of the Tax Shelter Committee. The purpose of the Committee is to ensure consistency and uniformity in the identification of promoters selected for examination. It is authorized to approve all LMSB tax shelter promoter activities, including promoter contacts, examinations and penalties.</p> <p>Generally, examiners may not contact a promoter with respect to any tax shelter promotion unless approval is first obtained from the 6700 Committee. Examiners may, however, conduct an income tax examination of the promoter or investor without seeking approval of the Committee.</p> <p>Membership of the committee includes: Director, Financial Services Industry (Committee Chairperson), Senior Industry Advisor, Financial Services Industry, Director, Field Operations, Financial Services Industry, LMSB Area One Counsel, LMSB Senior Legal Counsel- Corporate Tax Shelters, and Manager, OTSA. A representative from Criminal Investigation is consulted as appropriate.</p>
SB/SE	SB/SE Lead Development Center-Laguna Niguel	<p>The LDC was established in April 2002 to provide a centralized, expedited process for identifying and approving promoter investigations. The center receives and develops leads on abusive tax schemes and promoters from external and internal sources, and researches abusive tax promotions for purposes of detection and case building. The center also systematically conducts Internet research to identify leads and detect sites, promoters, and promotional materials that market Abusive Tax Schemes over the Web. Effective April 1, 2002, Delegation Order SB/SE 4.60 provided the authority to the LDC Program Manager to approve SB/SE promoter investigations under IRC Sections 6700, 6701 and 7408. The office was moved to Laguna Niguel, CA in August 2002.</p>

**Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters**

Operating Division	Organization/ Group	Description
	Compliance Policy Reporting Enforcement, Abusive Tax Avoidance Transactions (ATAT) Program	<p>Reporting Enforcement’s ATAT Program develops and implements Division-wide policies and strategies to combat Abusive Schemes and Shelters. The ATAT Program consists of two HQ Program Managers (one covering Domestic Schemes and Shelters and the other covering Offshore Transactions), supported by two Field Executive Champions. The two ATAT Program Managers provide program coordination and ensure ATAT processes and policies are consistent across the Division. The specific programs within this section are:                      Abusive Tax Schemes,                      Abusive Trusts,                      Offshore (non-credit card), and                      Complex Tax Shelters</p> <p>Reporting Enforcement recently redesigned its ATAT Program infrastructure to include 7 additional Policy Technical Advisors, 2 Senior Program Analysts, and a new GS-15 Project Manager to support the ATAT Promoter Strategy and Issue Management. Case Building and Classification efforts have been restructured. Both are now centralized in two Campuses with classification now being conducted by Subject Matter Experts and Technical Advisors.</p>
	Issue Management Teams	<p>Issue Management Teams (IMTs) have been established to develop strategic approaches to working and resolving ATAT issues/promotions. Designed as high-powered, small teams that are integrated with Counsel, other Operating Divisions (ODs), TEC, SB/SE Executives, Compliance Policy, SB/SE Territory Managers, and Group Managers, the IMTs play a key role in identifying emerging issues, developing and implementing alternative resolution strategies, coordinating with Counsel and other ODs, developing guidance, monitoring field participant/promoter inventories, and coordinating with campus activities. The hiring of 6 field GS-14 Technical Advisor-Case Coordinators to support the IMTs has been authorized.</p>
	SB/SE Executive Steering Committee	<p>This Executive Steering Committee is a cross-functional group composed of the Director, Reporting Enforcement and other Compliance Policy, TEC, and Compliance Field Executives, including the Director, Compliance Area 11 (Denver), and the Director, Compliance Area 13 (Oakland). The Committee provides coordinated executive oversight of SB/SE’s ATAT Strategy and Issue Management Teams utilizing data contained in Integrated Process Reports, Risk Assessment Matrix, and research conducted by Policy Technical Advisors. Committee responsibilities include working with the Issue Management Teams in developing a strategic approach to working ATAT issues/promotions and emerging issues, developing and implementing alternative resolution strategies, inventory monitoring and brokering, and providing coordinated guidance to the field.</p>

Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters

Operating Division	Organization/ Group	Description
SBSE	Ogden Frivolous Return Program	<p>Service-wide consolidation of the receipt and processing of all frivolous documents at the Ogden Compliance Center (OCC) began August 14, 2000. The remaining nine service centers will refer frivolous documents to OCC. The IRS, through administration of IRC Section 6702, will address noncompliance based on unfounded legal or constitutional arguments.</p> <p>The Frivolous Return Program (FRP) was consolidated at the OCC on January 1, 2002. All receipts of frivolous filings with the exception of open controlled cases and Congressional cases should be routed to OCC per IRM instructions. The FRP identifies those individuals filing frivolous returns, documents, and/or correspondence and attempts to educate them as to their obligations to file and pay taxes. A frivolous return or response is defined as noncompliance with filing and/or paying tax based on unfounded legal or constitutional arguments per IRM Section 4.19.16.3. This program targets individual behaviors by responding to specific actions. This includes working frivolous filings by identifying them in initial submission processing to conducting audits and assessing tax and penalties and on to identifying promoters of the schemes and referring the promoters through Area Counsel to the Department of Justice for civil prosecutions.</p> <p>The FRP resides under SB/SE Compliance/Compliance Policy/Campus and Filing Compliance/ Service Center Compliance that is the policy area that structures the FRP. The FRP is a national program with a coordinator in every campus and the group that processes the work located at the Ogden Compliance Services. Service Center Compliance sets policy for other organizations on frivolous anti-tax schemes. The FRP also has an internal database and an employee process to discover new schemes as well as a couple of systemic extracts to identify existing frivolous filings. In addition, the FRP has a RIS to identify new types of frivolous filings and a request for an outside contractor to data mine new filings.</p> <p>All 10 campuses have been trained in how to identify frivolous returns during pipeline processing. They have streamlined the civil injunctions process and preparer penalties assessed at the campus rather than the field; created an IDRS extract to identify specific filings that meet pre-determined criteria; and created SERP Alerts to prevent processing of amended returns meeting FRP return criteria.</p>

Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters

Operating Division	Organization/ Group	Description
	Offshore Credit Card Project (OCCP) Oversight Board	<p>This Oversight Board is chaired by the Deputy Director, Compliance Policy (SB/SE), and includes members from SB/SE Compliance Policy, SB/SE Counsel, LMSB, CI, Appeals, and the Department of Justice. The Board has been established to ensure effective communication and coordination with all Operating Divisions. The Board initially focused on the offshore credit card project. It was later expanded to address issues from OTSA and the International Office within LMSB. Discussions include addressing promoters outside of the country. There is a seven country-meeting schedule to discuss issues. The DOJ is interested in tracking whatever inventory exists on abusive schemes.</p> <p>The OCCP is an initiative aimed at bringing back into compliance with U.S. tax laws participants who used “offshore” payment cards or other offshore financial arrangement to mask or shelter their income. Judicial summonses have been issued to credit card companies and merchants. Data obtained is being analyzed to identify U.S. persons from the offshore card transactions. The OCCP is lead by a Reporting Enforcement Project Manager.</p> <p>Ongoing efforts include building a pipeline to deliver cases to the field, development of a Collection Strategy, the Offshore Voluntary Compliance Initiative (OVCI), implementation of a Communication Plan, including taxpayer education on abusive scheme awareness, and field Counsel support to examiners.</p>
	Compliance Area 15 – Establishment of Special Enforcement Program (SEP)	Five Special Enforcement Program (SEP) groups have been created in Compliance Area 15 (International) to focus on the Offshore Abusive Tax Avoidance Transactions and the John Doe Summons cases. These groups and a Collection group will report to the same Area 15 Territory Manager.

**Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters**

Operating Division	Organization/ Group	Description
SBSE	Taxpayer Education & Communication (Centers for Excellence on Abusive Schemes) Toolkits)	<p>The TEC Abusive Schemes Center of Excellence (COE) Team is the creators of the toolkits. The toolkits that have been developed to address abusive schemes are a collaborative effort among TEC, Compliance, CAS, LMSB, CI, Chief Counsel, and Communications and Liaison. Also, the primary content of the toolkit is an accumulation of many of the initial products and tools developed through the collaborate efforts in addressing abusive schemes.</p> <p>The comprehensive strategy outlines that the COE’s tiered structure is designed to provide communication linkages between the COE, TEC Headquarters, and all TEC Areas and Territories in order to accomplish the following goals:</p> <ul style="list-style-type: none"> <li>Provide consistent guidance throughout TEC to address abusive scheme issues.</li> <li>Eliminate duplicative efforts in the creation of counter-marketing messages.</li> <li>Develop and deploy a consistent, nationwide abusive scheme counter-marketing strategy.</li> <li>Develop and deliver consistent messages to internal and external national and local stakeholders about abusive schemes.</li> <li>Identify locations and types of promotions to ensure this information is shared with other functions, such as Compliance and CI.</li> </ul>
TE/GE	Internal Abusive Scheme Committee	<p>The TE/GE Abusive Tax Scheme Committee has been in existence since January 2003. This group consists of representatives from each of the different areas within TE/GE – Employee Plans, Exempt Organizations and Government Entities. They are in the process of moving from education to actually discussing and addressing specific issues.</p>

Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters

Operating Division	Organization/ Group	Description
CI	CI Lead Development Center- Philadelphia	<p>As of the Summer of 2002 the CI Philadelphia Lead Development Center was designated to specifically work on researching and identifying abusive tax schemes and their promoters. This change of focus was dramatic and required extensive planning and implementation of new procedures and partnerships with other areas of the Service.</p> <p>For instance, the Philadelphia LDC installed several key databases for data mining and researching patterns of abusive schemes and their promoters. The Philadelphia LDC formed partnerships with Operating Divisions in the Philadelphia Campus that assist their LDC in the identification of abusive returns. These partnerships have been instrumental in the identification of abusive schemes.</p> <p>The CI Philadelphia LDC researches their databases by performing queries on known abusive patterns to identify potential cases. These cases are thoroughly developed and research packages are prepared and sent to the CI Field Office for further investigation.</p> <p>Also, they are partnering with the Examination and Collection Operating Divisions to send parallel investigations to their respective Field Offices. Both civil and criminal investigations are being worked in conjunction with each other. This is ground breaking territory. The Philadelphia LDC has invited Examination and Collection Revenue Officers and Revenue Agents to work in the LDC to form a "research lab" and partner with the analysts to research and identify abusive schemes, promoters and investors.</p> <p>The Philadelphia LDC has been identified in the CI Bulletin as the lead center for developing abusive schemes nationwide. This LDC was advertised as a "resource" for questions and specialized research involving offshore trusts and other flow-through entities. As a result, this LDC has received and is handling numerous field office requests for advice and research on established investigations.</p> <p>Some of the program areas and cooperative projects being worked with SB/SE includes the following:  Offshore Voluntary Compliance Initiative (OVCI)  Parallel Civil and Criminal Investigations (6700 Program)  Offshore Credit Card Program (OCCP) – Merchant Summons  Abusive Scheme Identification and Case Development.</p> <p>The Philadelphia LDC is working with HQ Financial Crimes on a recommendation to consolidate all CI abusive scheme investigations relating to foreign/domestic trusts in the Philadelphia LDC for coordination, control and development. A database is being developed to centralize information relating to abusive schemes to facilitate coordination nationwide.</p>

Internal Structures Established by Units to Identify and Combat Abusive Schemes and Shelters

Operating Division	Organization/ Group	Description
	Return Preparer Program (RPP)	<p>The Return Preparer Program was implemented in 1996, and established procedures to protect revenue by identifying, investigating, and prosecuting abusive return preparers. The program was developed to enhance compliance in the return-preparer community by engaging in enforcement actions and/or asserting appropriate civil penalties against unscrupulous or negligent return preparers.</p> <p>Return Preparer Fraud generally involves the preparation and filing of false income tax returns (in either paper or electronic form) by preparers who claim inflated personal or business expenses, false deductions, unallowable credits or excessive exemptions on returns prepared for their clients.</p>
	Questionable Refund Program (QRP)	<p>The Questionable Refund Program, administered by CI, is a nationwide multifunctional program established in January of 1977. The QRP was designed to identify fraudulent returns, to stop the payment of fraudulent refunds and to refer identified fraudulent refund schemes to CI field offices. While the primary focus is on individual tax returns, business tax returns are also reviewed under the QRP.</p> <p>In addition, QRP has been responsible for the identification of substantial abuse in other programs, which has resulted in the savings of hundreds of millions of dollars from fraudulent schemes in abusive tax shelters and fraudulent claims for the Earned Income Tax Credit (EITC).</p>
W&I	N/A	<p>W&amp;I does not have comparable structures for identifying and mitigating abusive tax schemes but supports many of those established by other units through its operating priority (OP) which specifically deals with W&amp;I Compliance work to support high-priority Service commitments such as high income taxpayers, NRP priorities, abusive schemes and offshore credit card abuses. In addition, W&amp;I work with others through its support of CI's Questionable Refund Program (QRP) and the Questionable W-4 Program.</p>

**Cross Cutting Structures Established to Identify and Combat Abusive Schemes and Shelters**

Operating Unit	Organization/ Group	Description
Cross-divisional	Abusive Tax Evasion, Avoidance Schemes & Devices (ATEASD) Executive Steering Committee (ESC) <sup>2</sup>	<p>The ATEASD ESC serves as a forum to develop a unified cross-divisional IRS strategy for dealing with abusive schemes and devices, both internally and externally. The ESC will ensure thorough coordination of enforcement activities and resource issues on promoters. The work of the ESC may involve all IRS divisions and functions as well as outside stakeholders including other federal and state agencies.</p> <p>The ESC will not supplant line authority and accountability, which resides within the Business Units. The ESC members include:</p> <ul style="list-style-type: none"> <li>Large &amp; Mid Size Business (LMSB) Division</li> <li>Small Business/Self Employed (SBSE) Division</li> <li>LMSB Counsel</li> <li>SBSE Counsel</li> <li>Tax Exempt &amp; Government Entities (TEGE) Division</li> <li>TEGE Counsel</li> <li>Chief Counsel, Special Counsel on Tax Shelters</li> <li>Criminal Investigation (CI) Division</li> <li>CI Criminal Tax Counsel (Adhoc)</li> <li>Appeals (Adhoc)</li> <li>Wage &amp; Investment Division (Adhoc)</li> </ul> <p>Other ad hoc members may be identified as needed to facilitate data gathering and analysis, address legal issues and consider decisions on use of enforcement tools. The ESC is co-chaired by the Director, Pre-Filing and Technical Guidance (LMSB) and the Deputy Director, Compliance Policy (SBSE).</p>

<sup>2</sup> An Executive Oversight Committee has recently been formed that is comprised of Senior Management Officials from each of the ODs, Chief Counsel and Appeals. The purpose of this group is to deal with broad overall policy decisions relating to abusive tax avoidance transactions and schemes. The status of this committee is pending.



**Cross Cutting Structures Established to Identify and Combat Abusive Schemes and Shelters**

Operating Unit	Organization/ Group	Description
<p>NHQ Communi- cations &amp; Liaison (C&amp;L)</p>	<p>Communi- cations Division &amp; Media Relations</p>	<p>The Communications Division, led by National and Field Media Relations, plays an important role in countering tax scams that have surfaced. In recent years, their activity has increased significantly. They have issued dozens of news releases and added exposure on IRS.gov for tax scams and schemes.</p> <p>Their basic goal is to relay information to the public, by way of the news media, when they become aware of scams or potential scams affecting taxpayers. These consumer alerts are designed to heighten awareness and prevent taxpayers from being scammed.</p> <p>They use a variety of methods to deliver the agency’s messages to the media and the public, including:                      Writing and distributing news releases and Tax Tips.                      Targeting e-mails for group distribution to the media, practitioners and others via Digital Dispatch, IRS Newswire and Tax Tips (Combined circulation: approximately 120,000).                      Posting material on IRS.gov on the front page and in The Newsroom section.                      Disseminating information for use by other parts of the agency, including C&amp;L’s Internal Communications National Public Liaison, Legislative Affairs and Government Liaison and Disclosure. Other parts of the agency using these include CI, TEC and SPEC.</p> <p>Media Relations learns about scams through several avenues:                      Internal Sources – Media Relations can be alerted to scams through internal channels, such as the Operating Divisions, CI and TIGTA. These contacts generally come through the imbedded communicators in these organizations.                      External Sources – Another frequent source of scams, particularly emerging scams, is through external sources. These can be from the news media, who contact Field or National Media Relations with questions. They also can hear from external groups that have contact with the agency through organizations such as Governmental Liaison (example state attorneys general office) and Legislative Affairs (congressional offices). The agency also gets outside information from groups such as the Better Business Bureau.</p>

### Cross Cutting Structures Established to Identify and Combat Abusive Schemes and Shelters

Operating Unit	Organization/ Group	Description
Chief Counsel	Senior Counsel Executive for Dealing with Potentially Abusive Tax Avoidance Transactions	<p>Beyond the normal Counsel activities for advice, guidance and litigation of cases or issues raised for its consideration, in December 2002, a new Senior Counsel position, reporting directly to the Chief Counsel, was created within the immediate Office of Chief Counsel to focus on potentially abusive tax avoidance transactions and other marketed tax products. The new Senior Counsel works with IRS personnel on early identification and interdiction of potentially abusive tax avoidance transactions through analyzing information obtained from various sources, including from disclosure initiatives, tax shelter registrations, taxpayer and promoter examinations and other sources (both public and private).</p> <p>In addition, the Senior Counsel supervises a staff of attorneys and leads multifunctional Task Forces composed of both Chief Counsel and IRS personnel formed to analyze particular transactions and structures and to make determinations as to whether listing notices or other forms of published guidance should be issued on the transaction or structure, and to expedite the publications of such guidance. In addition, the Senior Counsel acts as the Chief Counsel's principal representative on these matters in dealings with the Operating Divisions of the IRS and with the Department of the Treasury. Finally, the Senior Counsel will interact with the private sector to continually stress the attention, focus and priority the Office of Chief Counsel places on potentially abusive tax avoidance transactions, and to foster a dialogue with the private sector on matters such as the disclosure and registration processes and settlement initiatives.</p>
Appeals	Technical Services	<p>In addition to their traditional role in supporting IRS by resolving tax controversies, without litigation, Appeals is working with the ODs to combat abusive tax avoidance transactions and schemes.</p> <p>The Office of Technical Services within Appeals is comprised of two Tax Policy &amp; Procedure units as well as a Technical Guidance unit. These units are responsible for participating in working groups with the ODs to do independent assessments and develop settlement guidelines.</p> <p>Appeals has noted in its FY 2003 - 2004 Strategy and Program Plan that abusive tax shelters are expanding into additional areas and increasing in complexity. Tax shelter promoters are soliciting more industry and high-income individuals. Appeals will partner with LMSB and SBSE to make productive use of Appeals Alternative Dispute Resolution (ADR) Strategies for tax shelters across IRS business units. They have outlined their intent to accomplish this strategy through the following actions:</p> <p>Coordinate with the operating divisions and Counsel with respect to identification and development of abusive promotions and schemes. Continuously evaluate the success of the process applied and make adjustments, as warranted.</p> <p>Include abusive tax shelters in the Appeals Coordinated Issue (ACI) program. Select an ACI Specialist to coordinate issue resolution and articulate case resolution practices. A Specialist was selected. Timely develop Appeals settlement</p>

**Cross Cutting Structures Established to Identify and Combat Abusive Schemes and Shelters**

Operating Unit	Organization/ Group	Description
		<p>guidelines for each abusive tax position with an identifiable, well-defined fact pattern. (Note that some issues may be broad and encompass numerous fact patterns, and thus could be considered multiple shelters. In this case, the issue would be addressed in a different manner than a specific position with an identifiable fact pattern).</p> <p>Expand Delegation Order (DO) 247 to delegate settlement authority to LMSB and SB/SE following review and approval by the Appeals ACI coordinator. This was accomplished by DO 4-25.</p> <p>Tailor the resolutions process to individual shelters, utilizing the following Appeals tools, as appropriate:</p> <ul style="list-style-type: none"> <li>DO 247</li> <li>Fast Track Settlement</li> <li>Early Referral</li> </ul> <p>Traditional Appeals process including Post-Appeals mediation and arbitration programs.</p> <p>Conduct joint outreach strategies for internal and external stakeholders. Milestones for tax shelters are dependent upon the development and communication of the strategies by the Operating Divisions.</p>

## Research Projects in Support of IRS Efforts to Identify and Combat Abusive Schemes & Shelters

[For illustrative purposes only- not intended to be all inclusive account of Research Initiatives]

Research Unit	Description
NHQ Office of Research-Intelligent Business Group (IBS)	<p>The mission of the Intelligent Business Solutions (IBS) Group is to explore new, intelligent software technologies and apply these technologies to the solution of IRS business problems. Research's IBS group has been involved in providing support to combat abusive tax shelters since 1992 when they participated in a collaborative effort between Los Alamos, the AI Group and CI with the Electronic Fraud Detection System (EFDS) effort for CI. Many of IBS's recent projects were initiated to use advanced technologies (i.e, neural networks, fuzzy logic, data mining, &amp; behavior modeling) to help curtail the proliferation of abusive tax schemes and shelters. Some of NHQ Research's current efforts that are being developed in conjunction with the ODs include:</p> <p>Abusive Corporate Tax Shelter (ACTS) Model I &amp; II – This project was initiated as a proof-of concept to determine if neural networks is an appropriate tool for the IRS to employ. The purpose of this project was to 1) develop a probability model to detect the likelihood of non-compliance by corporations in the CIC, and 2) scope the size of the abusive tax shelters in terms of compliance/loss of revenue. (NHQ Research, LMSB Research, and HNC Contractor)</p> <p>Schedule K-1 Link Analysis – provides link charts showing entities that are connected and use Schedule K-1 to report taxable income or losses (S Corps, Trusts, &amp; Partnerships). Link analysis and visualization techniques will assist IRS in uncovering tiered structures both domestic and offshore, (flow-through entities) that are often used to camouflage taxable income with questionable schemes and abusive tax shelters. Graph mining is being used to look for structures of financial transactions using flow-through entities to avoid tax. (NHQ Research &amp; SB/SE, LMSB, CI, and MITRE)</p> <p>Financial Products – pilot to test application of internet software for the purpose of developing an automated system to analyze unstructured financial data for the purpose of identifying questionable financial products that are used by business entities to reduce tax liability. (NHQ Research &amp; LMSB Research)</p> <p>Off-Shore Credit Cards – application designed to uncover and develop leads for identifying taxpayers that are using an off-shore issued credit card account to camouflage income and/or evade taxes. (NHQ Research, SB/SE Compliance Policy, Reporting Enforcement, and a Contractor)</p>
SB/SE Research	<p>SB/SE Research in its current configuration was created upon the stand-up of SB/SE. Each of the major Operating Divisions, including SB/SE, acquired an embedded Research operation by virtue of receiving and incorporating a percentage of the former District Offices of Research and Analysis (DORAs). The allocation of DORAs to the new Operating Divisions was determined by various analyses and decisions made during the Modernization process.</p> <p>Some of the projects involving abusive schemes that SB/SE Research is engaged in include:</p> <p>Off-Shore Credit Cards – project researches offshore credit card holder information to identify abusive schemes. This information is also used to determine the best cases for Examination selection. (Contractor Supported)</p> <p>Internet Promoters – SB/SE Research has been profiling Internet promoters of abusive schemes, including their methodology. The purpose of this effort is to determine the feasibility of designing and implementing an efficient Internet search process for proactively identifying promoters or abusive schemes, and characterize the process that promoters may use to establish web sites and how taxpayers may find such web sites. Research has offered suggestions including having the IRS counter-market sites displayed at the top of Internet search results for certain keyword phrases such as “stop paying taxes”. Project results are also used in lead development and Examination case selection.</p>

**Research Projects in Support of IRS Efforts to Identify and Combat Abusive Schemes & Shelters**

[For illustrative purposes only- not intended to be all inclusive account of Research Initiatives]

Research Unit	Description
	<p>K-1s and Link Analysis-a joint project with NHQ Office of Research requested by SBSE Compliance. (See NHQ –Intelligent Business Group Schedule K-1 Link Analysis.)</p> <p>K-1s and Tiering of Flow Through Income from Partnerships, S-Corps, and Trusts-An analysis of tiering structures including such items as income flows and business relationships between the K-1 payers and payees to identify possible areas of compliance risk due to tiering. What is the relationship between tiering and abusive tax schemes/tax shelters? Do different patterns of tiering, income flows and loss flows exist when a tax shelter entity or abusive scheme is involved in the tiering structure?</p> <p>K-1 Profile Reports for Form Types 1041, 1120-S and 1065- Conduct research to build our knowledge base. This includes analysis of income and losses to foreign recipients, those with missing or invalid TINs or other potentially abusive situations.</p> <p>OVC I Profile-Profile Per Return and Amended Return Characteristics of Taxpayers that Self-Identify and/or File Amended Returns Under the <u>Offshore Voluntary Compliance Initiative</u>. Obtain information from examination and collection outcomes so that risk based scoring models can be developed.</p> <p>Profile the Universe of SB/SE Taxpayers With International Features-Describe the population of international filers and identify the needs of SB/SE international taxpayers with relation to the four TEC priorities of e-submission, abusive schemes, voluntary agreements, and burden reduction.</p> <p>Study Abusive Trust Audits After Examination to Determine Taxpayer Behavior Patterns.</p> <p>Profile Foreign Trusts that File a F1041NR to Identify Promoters and Participants of Offshore Abusive Schemes.</p> <p>Implement Strategies to Combat Abusive Tax Schemes by Identifying Schemes, Alerting the Public, Taking Enforcement Action Against Promoters and Participants, and Utilizing Research to Assess the Magnitude of the Problem.</p> <p>Assist in Quantifying the Measurement of TEC’s Effectiveness in Counter-Marketing the Promotion of Abusive Tax Schemes.</p> <p>Identify Schedule C legitimate businesses Versus Part Time Dabblers, Hobbyists, and Abusive Scenarios.</p> <p>Profile of Taxpayers Claiming the Disabled Access Credit -- This profile was completed as an example of initial research steps that would be useful when prioritizing abusive schemes for outreach and identifying markets for the outreach. The purpose was to characterize the taxpayer population claiming the disabled access credit, understand the background of the ADA and the disabled access credit, and offer recommendations and opinions on how to measure the extent of abuse and TEC impact on this abuse. The profile includes quantification and description of the market segment that could potentially abuse the credit, a literature survey on other research and oversight, and an overview of IRS processing related to this abusive scheme. Also included were conclusions and recommendations on next steps for TEC as they consider outreach for other abusive schemes.</p>
LMSB Research	<p>LMSB’s embedded Research function came to be in the same fashion as SB/SE’s. The LMSB Operating Division stood up a bit sooner than the others. Research is currently working on projects such as:</p> <p>Compliance Lab – This project looks at complex interrelationships between returns which are created solely to avoid tax.</p> <p>Abusive Tax Avoidance Transactions Predictive Model – predicts the likelihood a corporation is engaging in abusive tax avoidance transactions.</p>

## Research Projects in Support of IRS Efforts to Identify and Combat Abusive Schemes & Shelters

[For illustrative purposes only- not intended to be all inclusive account of Research Initiatives]

Research Unit	Description
W&I Research	<p>A major focus of the Wage and Investment Research function has been in support of the Division's efforts to fully engage and combat abusive tax avoidance transactions and schemes. Some of the projects W&amp;I Research is involved in include:</p> <p>Business Rules for Filing Analysis Module (FAM) – A joint venture between W&amp;I and SB/SE Research to develop a set of methodologies for particular tax issues to allow prototyping for identifying non-compliance. Early results from the customer are exceptionally positive and this project will result in these methodologies functioning as the “engine” for the FAM Module in the Remote Exam Reporting Compliance CONOPS.</p> <p>Questionable W-4 Program – This project profiled taxpayers who has shown evidenced of under withholding of their Federal Income Tax liabilities and did not pay their balances due upon filing of their returns or receipt of notices. The project included highlighting of multiple-year offenders and amount of income tax under withheld. This research now permits the ability to “hone in” on those taxpayers who clearly demonstrated the improper use of the W-4 system.</p> <p>Alimony Paid: Risk Determination and Application of Risk-Based Compliance Techniques – A project that is designed to test and analyze potentially non-compliant filers who claim payment or do not claim receipt of alimony. The research looks not only at a single year of non-compliance but the year-to-year use by certain taxpayers of alimony claimed payments as a means of incorrectly reducing tax liabilities by varying degrees.</p> <p>EITC Claims Study – A project that assesses the population of filers (and practitioners) who amend tax returns (1040X)</p> <p>EITC Implementation Team - Upcoming work with the IRS EITC Implementation Team, which is responsible for implementing the three increments of Treasury Task Force recommendations stemming from the 1999 EITC compliance study. The first piece of this study is a test of procedures for certifying qualifying children.</p> <p>Standard Mileage Rate Project – This project has identified the schemes taxpayers are using to avoid proper reporting of Schedule C expenses.</p> <p>Federal Case Registry (FCR) Evaluation Study – A project that analyzed the FCR data as applied to examinations of putative and 3<sup>rd</sup> party claimants of EIC. The study identified those taxpayers who attempted to claim EIC by using various dependents they were not entitled to claim under EIC rules.</p> <p>Child Tax Credit (CTC) Analysis – Research that identified the over-claim schemes in CTC filers' arena. The results are to be provided in July to those responsible for processing incoming returns in preparation for CY04 filing season. The application of the “flags” will enable the Service to identify false claimants of CTC.</p> <p>CI QRP Project - Research is working as part of the CI QRP project to identify those return preparers who may be incorrectly or illegally claiming dependents for their clients. This is the sixth consecutive year W&amp;I Research has assisted CI with this project.</p>
TE/GE Research	<p>TEGE Research is a small operation, which came about with the standup of the operating division. Discussion with the Director of Research indicates that there are currently no projects concerning tax avoidance schemes ongoing.</p>

**Research Projects in Support of IRS Efforts to Identify and Combat Abusive Schemes & Shelters**

[For illustrative purposes only- not intended to be all inclusive account of Research Initiatives]

<b>Research Unit</b>	<b>Description</b>
CI Research	<p>Criminal Investigation Research – The function spends the vast majority of its time working within and alongside the larger Criminal Investigation programs. One Research project they did conduct is the:</p> <p>The Pilot Connection Society (TPCS) Compliance Report – Criminal Investigation analyzed the results of a comprehensive compliance effort to counter the activities of TPCS, a frivolous non-filer organization. TPCS promoted the use of abusive trusts, “untax” packages, and other sophisticated means to enable members to evade their income taxes by concealing assets and withdrawing from traditional banking systems. The subsequent compliance of over 10,000 members of TPCS was also analyzed years later.</p>

**Snapshot of Unit Identification & Mitigation Activities to Combat Abusive Tax Schemes**

	<b>LMSB</b>	<b>SB/SE</b>	<b>TE/GE</b>	<b>CI</b>	<b>W&amp;I</b>
Issue Identification Activities	Office of Tax Shelter & Analysis (OTSA) Hotline Disclosure Initiative Resolution Initiatives for taxpayers engaged in selected tax shelters New Policy on Tax Accrual Workpapers Mandatory penalty consideration in tax shelter listed transaction cases Mandatory Information Document Requests (IDRs) Summonses to promoters 3 Regs: (Disclosure Statements Registration Rules, & Investor Lists) Promoter Investigations Field Audits Registration Filings Confidential Informants Referrals from the Field Investor Lists Other Operating Divisions (ODs) SB/SE's Lead Development Center (LDC) CI's LDC Corporate Tax Shelter	SB/SE Lead Development Center (LDC) Hotline Systematic Internet Research SB/SE LDC working with research and counsel to develop more aggressive techniques for finding promoters and schemes marketed over the web Promoter Investigations Secured revision to Services Voluntary Disclosure Practice (News Release IR 2002-135) Offshore Voluntary Compliance Initiative (OVCI) Last Chance Compliance Initiative (LCCI) Taxable Amended Returns Project Field Audits SB/SE redesigned its Abusive Tax Avoidance Transaction (ATAT) Program Infrastructure to support identification of emerging issues ATAT Promoter Strategy Issue Management Team (IMT) Strategy Centralized case building and centralized classification by subject matter experts (SMEs) and Technical Advisors (TAs) in 2 Campuses, to improve case quality and facilitate identification of inventory FTA - Information Sharing Agreements with State Tax Agencies	Determination Letter Program Exam Process Other OD Exams Tax Professionals (attorneys, accountants) Newspapers, Trade Publications ATEASD ESC Toll-Free Number Internal Training RICS/GuideStar Internal TE/GE Abusive Schemes Committee	Normal Investigative Process Produces Leads Informants Practitioners Employers External Stakeholders Questionable Refund Program (QRP) Return Preparer Program (RPP) Service Center Leads SB/SE LDC CI LDC Newspaper Research Compliance Strategy Enforcement Strategy	Questionable W-4 Program CI QRP EITC Program



Snapshot of Unit Identification & Mitigation Activities to Combat Abusive Tax Schemes

	LMSB	SB/SE	TE/GE	CI	W&I
	<p>Check Sheet Internal Training for examiners ATEASD ESC</p>	<p>Foreign Country tax information exchange agreements TEC/SPEC (internal/external communication) building coalitions with practitioner and other external groups to help identify emerging schemes Partnering with FinCen to obtain access to Bank Secrecy Act (BSA) data to conduct Trend Analysis / Data Mining Offshore Compliance Working Group (cross-divisional) exploring improved use of existing data, and new sources of data to identify offshore compliance risks and emerging issues OTSA Questionable W-4 Program CI-sharing of promoter lists CI's LDC Coordination with other ODs Newspaper Articles Cases from the field LMSB promoter investigations Ogden Frivolous Return Unit Internal Research SB/SE Executive Steering Committee OCCP Oversight Board ATEASD ESC Emerging Issue subgroup of ATEASD ESC DOJ Credit Card Summons</p>			

Snapshot of Unit Identification & Mitigation Activities to Combat Abusive Tax Schemes

	LMSB	SB/SE	TE/GE	CI	W&I
		Investor Lists Referrals from Field Internal Training			
Tax Schemes/Shelter Transactions	Listed transactions” are those identified by the IRS as abusive tax avoidance transactions. Summary of Listed Transactions 404,401 Accelerator Multi-employer welfare Lease Strip Foreign Tax Credits Transactions substantially similar to those at issue in ASA Investeringes Partnership and ACM Partnership Charitable Remainder Trusts Lease in Lease Out (LILO) BOSS 301 Reg re Liab Assumed, BOSS Fast Pay Using Conduit to artificially allocate income Debt Straddle Son of BOSS Stock Compensation Guam Trust	Domestic Abusive Trusts/Foreign Issues Abusive Preparers Charitable Trusts ADA Credit Anti-Tax Corporate Soles Offshore Compliance Projects <a href="#">“10 or More Employer VEBA Plans”</a> IRC 861 Stop Filing Scheme (Employer Abatement Project) Basis Shifting (IRC 302/318; Notice 2001-45) CARDS (Custom Adjustable Rate Debt Strategy) <a href="#">Cash or Deferred Arrangements (CODA)</a> (401k Accelerator Plans) <a href="#">Charitable Contribution Schemes</a> Corporate Owned Life Insurance (COLI) Constitutional Arguments Contingent Liabilities (IRC 351; Notice 2001-17) Domestic Abusive Trusts/Foreign Issues <a href="#">Eliminator I Notice 2002-50</a> <a href="#">Eliminator II (Notice 2002-65)</a> <a href="#">Equity Swaps (Notice 2002-35)</a> Executive Compensation	Listed Transactions: Certain Trust Arrangements Seeking to Qualify for Exception for collectively bargained welfare benefit funds Abuses associated with S Corp ESOPs Certain reinsurance arrangements (PORC) 401K Accelerators Intermediary Transactions LILO Transactions Certain trusts purported to be multiple employer welfare funds	Frivolous tax arguments Foreign & domestic abusive trust tax evasion schemes Refund fraud schemes Return preparer schemes	Questionable W-4 abuses EITC abuses Other Credits Schemes Questionable refund schemes High income taxpayers related schemes Offshore credit card abuses

**Snapshot of Unit Identification & Mitigation Activities to Combat Abusive Tax Schemes**

LMSB	SB/SE	TE/GE	CI	W&I
Intermediary Transactions Contingent Liability Basis Shifting Sec 302 NRPM- Redemptions taxable as Dividends CARDS Notional Principal Contract/Contingent Swaps Notional Principal Contract 401k Accelerator 401k Accelerator, not reportable Modified Rev. Rul. 2002- 45 for taxpayers electing to change method of Accounting Eliminator I-Tiered Partnership Straddle Eliminator II-S Corp & P/ship Straddles -Privately Owned Re- Insurance Corporations (PORC) Abuses assoc. with S Corp Employee Stock Ownership Plans (ESOPs) Offshore Deferred Arrangements Collectively Bargained Welfare Benefit Funds	Family Limited Partnerships Frivolous Filer <a href="#">Home-Based Businesses</a> Lease In - Lease Out (LILO) <a href="#">Lease Stripping (Notice 95-53)</a> Miscellaneous Credits (EITC, Housing, etc.) Offshore Credit Card Promotions (OCCP) Offshore Employee Leasing <a href="#">Producer Owned Reinsurance                      Company (PORC)</a> Private Foundations <a href="#">Questionable W-4 Program</a> Slavery <a href="#">Reparations</a> <a href="#">S-Corp – ESOP Ownership</a> <a href="#">Son of BOSS (Notice 2000-44)</a> <a href="#">Split-Dollar Life Insurance (Notice                      2002-59)</a> Stock Options – non qualified Stock Options – sales to family partnerships Synfuel Credit (IRC 29) Supporting Organizations – TE/GE <a href="#">Trust Owned Life Insurance (See                      Split-Dollar Life Insurance)</a> Taxable Amended Returns Zero Tax			

### Snapshot of Unit Identification & Mitigation Activities to Combat Abusive Tax Schemes

	LMSB	SB/SE	TE/GE	CI	W&I
Mitigation Efforts	Requiring Promoters to register shelter transactions Practitioner Coordination (i.e. ABA, AICPA, TEI) Published Guidance Outreach & Education (tax forums) Promoter & Investor Audits Coordination with ODs, Chief Counsel, Appeals, DOJ ATEASD ESC Internal RA Training Procedures & Handbooks Internal Memos, News Releases, Checksheets Issue Champions IRS Website Settlement Initiatives Issue Management Tools Pre-filing Agreements (PFA) Industry Issue Resolution (IIR) Fast Track Dispute Resolution Limited Issue Focused Examinations (LIFE) Other Alternative Dispute Resolution Tools	Internal & External Abusive Schemes Toolkits Developing Service-wide ATAT Toolkit that includes methodology for identifying, coordinating, and handling emerging issues, frivolous tax schemes, and complex technical issues Taxpayer & Stakeholder Outreach Practitioner Coordination IRS Website Tax Forums Consumer Awareness sites Issue Management Teams Issue Champions CI/SB/SE Parallel Investigations ATEASD ESC SB/SE Executive Steering Committee Offshore Compliance Oversight Board Offshore Compliance Working Group Media Outreach Civil (Injunctions) & Criminal Actions DOJ Press Releases IRS News Releases, and Public Notices Court Injunction Orders posted on enjoined promoter web site Treasury Statements Congressional Statements Promoter/ Promoter Penalty	Coordination with LMSB, SB/SE, CI Published Guidance Website (Soft Guidance) TE/GE Internal Abusive Schemes Committee ATEASD ESC Outreach/Education Internal Training Determination Letters Collaboration with DOL RICS/Guidestar data analysis	Investigations/Convictions Tax Fraud Alert (counter marketing) Intercept Searches with metatags or keyword tags Fraud Detection Centers Parallel Investigations Outreach/Media/Publicity Activities Tax Scheme Promoter Strategy (Non-filer Enforcement Program, Foreign & Domestic Abusive Trust Program, Fraud Program, Employment Tax Program, Return Preparer Program, & Questionable Refund Program) Enforcement Strategy Computer Crime Development Center DOJ Press Releases Coordination with other ODs IRS & CI Internet	Coordination with SB/SE & CI Outreach/Education Website IRS News Releases

Snapshot of Unit Identification & Mitigation Activities to Combat Abusive Tax Schemes

	LMSB	SB/SE	TE/GE	CI	W&I
		Investigations Participant Examinations Coordination with other ODs, Chief Counsel, Appeals, DOJ and other Government and State Agencies Return Preparer Program Taxable Amended Return Project Designed Risk Assessment Matrix and Prioritization Process Developed Inventory Brokering Model Developed Integrated Process Reports Cross Divisional Leadership and Coordination Initiated Guidance Projects to Support Field Developed Promoter Strategy Developed Issue Management Strategy Designated Field Case Coordinator positions Created Teams on emerging issues with LMSB/TEGE Questionable W-4 Program Bundling Offshore Collection Cases to DOJ to effectuate simultaneous Court filings and publicity		sites Practitioner Target CI Public Information Officers Coordination with other Government Agencies (FBI, FTC, SEC, DOJ, USAO)	

**Description of Select Programs Offered by SB/SE and LMSB****SB/SE Programs****Frivolous Return Program (FRP) (Ogden Campus)**

The FRP identifies those individuals filing frivolous returns, documents, and/or correspondence and attempts to educate them as to their obligations to file and pay taxes. FRP has been essential in countering abusive tax scheme activity surrounding Reparation claims, Foreign Tax Credit Claims, Zero Tax cases, Constitutional Arguments, etc. This centralized processing unit provides early and accurate identification of frivolous filings and appropriate tax assessments, denial of erroneous refund claims, and consistent treatment. This includes working frivolous filings from identifying them in initial Submission Processing to conducting audits and assessing tax and penalties as well as identifying promoters of the schemes. Since its inception in January 2000, the unit has received 293,838 cases and closed 179,671 cases. Revenue protected was \$3,200,000,000 with \$142,000,000 in additional tax assessments and 9,617 in frivolous return penalties assessed.

**Questionable W-4 Program**

SB/SE designated an executive to work closely with other SB/SE employees and W&I to develop a strategy for stemming the flow of Questionable W-4s. New tools to identify egregious W-4s are under development. The Questionable W-4 database was mated against the Frivolous Filer Database. This match was used to identify common characteristics and will be used in future decision-making processes. SB/SE is making employer contacts to ensure that their responsibilities are being met and to survey for potential promoters using the W-4 process to advise participants on strategies for “opting out” of their filing requirements.

**Offshore Credit Card Program (OCCP)**

The OCCP is an initiative aimed at bringing back into compliance with U.S. tax laws participants who used “offshore” payment cards or other offshore financial arrangement to mask or shelter their income. Judicial summonses have been issued to several major credit card companies and merchants. Data obtained is analyzed to identify U.S. persons from the offshore card transactions. Identified U.S. cardholders are forwarded to a central processing site in Philadelphia where relevant data is collected from internal and external sources to build case files with information useful for the classification and examination process. An outside vendor has been secured to automate the identification and case building process being used in the Philadelphia Campus. Sorted and prioritized cardholder data will be run against this automated process.

In January 2003, SB/SE announced the Offshore Voluntary Compliance Initiative (OVCI) aimed at encouraging the voluntary disclosure of unreported income hidden by taxpayers in offshore accounts and accessed through credit cards or other financial

**Description of Select Programs Offered by SB/SE and LMSB**

arrangements. Under the initiative, eligible taxpayers have to pay back taxes, interest, and certain accuracy and delinquency penalties, but will not face civil fraud and information return penalties. To obtain the benefits of the initiative, taxpayers must disclose information about who promoted or solicited their participation in the offshore financial arrangement. OVCI reflects an attempt to bring taxpayers back into compliance quickly while simultaneously gathering more information about the promoters of these offshore schemes.

The Taxable Amended Return Project is aimed at identifying high-income individuals who have attempted to avoid detection, penalties, and the disclosure of OVCI promoter information by filing amended or delinquent returns that do not identify offshore activities. An initial test review of a sample of delinquent and amended returns indicated that criteria established by the project did assist in identifying taxpayers attempting to avoid detection in offshore schemes. The project is still being tested.

Last Chance Compliance Initiative (LCCI)

Similar to OVCI, LCCI reflects a “last” attempt to bring taxpayers with unreported income from offshore transactions back into compliance quickly while simultaneously gathering more information about the promoters of these offshore schemes. The first waive of LCCI letters will go out June 16, 2003 to individuals identified in connection with OCCP but who failed to come in under OCVI.

ATAT Strategy

Reporting Enforcement recently redesigned its ATAT Program infrastructure to add an additional ATAT Program Manager to cover Abusive Offshore Transactions. Seven new Compliance Policy Technical Advisors, two Senior Compliance Policy Program Analysts, and a new GS-15 Project Manager will also be hired to support the ATAT Promoter, Emerging Issue, and Issue Management Strategies. Issue Management Teams (IMTs) that include Executive Champions, have been formed to identify emerging issues and to develop and implement alternative resolution strategies in ATAT promotions. The hiring of six fields GS-14 Case Coordinators to support the IMTs has also been authorized. Further, ATAT Case Building and Classification efforts have been significantly restructured. Both are now centralized in two Campuses (Philadelphia – offshore ATAT cases; Ogden – Domestic ATAT cases) with classification now being conducted by Subject Matter Experts (SMEs) and Technical Advisors (TAs).

Partnering with other Divisions to Identify Emerging Issues

SB/SE is working with FinCen to obtain access to Bank Secrecy Act (BSA) data to conduct Trend Analysis / Data Mining. SB/SE participates in the cross-divisional Offshore Compliance Working Group exploring improved use of existing data, and new

**Description of Select Programs Offered by SB/SE and LMSB**

sources of data to identify offshore compliance risks and emerging issues. SB/SE also participates on the “emerging issues” sub-group of the ATEASD ESC.

**LMSB Programs**3 Treasury Regulations under Sections 6011, 6111 and 6112 of the Internal Revenue Code

At the same time the Service announced the creation of OTSA, it issued three separate groups of temporary and proposed regulations as part of a coordinated attack on shelters. Disclosure Statements (section 6011)- Every corporate taxpayer that is required to file a return for a taxable year and that has participated directly or indirectly in a “reportable transaction” must attach to its return a disclosure statement. A separate disclosure statement is required for each “reportable transaction.” A reportable transaction is either a listed transaction (or a substantially similar transaction), or a transaction which meets two out of five prescribed characteristics, and that meets the projected tax effect test.

Note: Effective June 14, 2002, this regulation was modified to extend the same reporting requirements to individuals, trusts, partnerships, and S Corporations.

One of the items that must be included in the disclosure statement is: the names and addresses of any parties who promoted, solicited, or recommended the taxpayer’s participation in the transaction and who had a financial interest, including the receipt of fees, in the taxpayer’s decision to participate.

Tax Shelter Registrations (section 6111) & Maintenance of Investor Lists (section 6112)- IRC 6111 & 6112 require tax shelter organizers or sellers to register all tax shelters with the Secretary and to maintain lists of investors and information about the transactions.

Registration: An organizer or seller of a tax shelter must register the shelter no later than the day on which the first offering for sale of interests in a tax shelter occurs by filing Form 8264 with the Ogden Compliances Service Center. Information required on the registration includes identification and description of the tax shelter and the tax benefits represented to the investors.

Investor Lists: any person who organizes a potentially abusive tax shelter or sells an interest in such a shelter has to maintain a list identifying each person who invested in the shelter. Any person who is required to maintain a list shall make the list available to the Secretary for inspection upon request, and shall retain any information required to be included on such list for seven years.

**OTSA Hotline**

OTSA maintains a Tax Shelter Hotline, which allows interested persons to submit information to the Service relating to particular tax shelter transactions and activities. Persons wishing to submit information to OTSA may do so via mail, telephone, fax or email. All information received is entered into a log and a file is established. OTSA reviews the information and makes appropriate referrals for compliance or other action.



**Description of Select Programs Offered by SB/SE and LMSB**

Corporate Tax Shelter Check Sheet- OTSA disseminated a tax shelter check sheet to assist LMSB agents in identifying corporate tax shelters.

Information Document Request (IDR)- A mandatory IDR is required to be issued in all LMSB corporate examinations started after April 23, 2002, or in process on April 24, 2002. The purpose of the IDR is to assist agents in identifying and developing tax shelter issues.

**Issue Champions**

Issue champions are approved by the Commissioner, LMSB, upon recommendation of the LMSB Tax Shelter Committee. They are appointed when a particular abusive tax avoidance transaction becomes significant enough to warrant executive oversight and direction. For several transactions that impact more than one OD, multiple issue champions are appointed to ensure compliance and resolution matters are properly evaluated and coordinated.

**Large and Mid-Size Business (LMSB) Example on Disclosure Initiative**

[For illustrative purposes only – not intended to be a comprehensive account of LMSB OTSA initiatives and/or activities].

**Background Why IRS Offered This Disclosure Initiative**

IRS believed that many taxpayers entered into questionable transactions based on representations of financial advisors who marketed these transactions to them. These taxpayers became aware that those transactions may be challenged upon an IRS audit and result in additional tax and penalties. IRS recognized that taxpayers might have been reluctant to voluntarily come forward and disclose the transactions due to the potential substantial penalties that might follow. As a result, the IRS offered a disclosure initiative to give taxpayers a limited time to come forward and disclose transactions without fear of incurring a penalty.

Disclosure Initiative-Announcement 2002-2: The disclosure initiative, that began December 21, 2001 and concluded April 23, 2002, provided taxpayers with a 120-day opportunity period to voluntarily disclose their participation in questionable tax shelters and other items that may have resulted in an underpayment of tax. The initiative was designed to provide IRS with information that would help them more readily identify tax shelter promoters, find other taxpayers who have not disclosed their participation in a tax shelter and identify emerging abusive transactions.

Taxpayers making disclosures were required, among other things, to describe the material facts of the item, provide the names and addresses of the promoters who solicited their participation, provide copies of materials and documents requested, and sign a penalty perjury statement regarding the accuracy of the information provided.

IRS aggressively examines the activities of promoters, who by law are required to maintain lists of all investors who bought tax shelters from them. Once IRS receives the investor lists from the promoters, they are able to identify other taxpayers who may have participated in tax shelters but failed to disclose them.

OTSA received 1,664 disclosures from 1,206 taxpayers who disclosed their questionable transactions. Taxpayers have disclosed transactions in which they claimed deductions or losses amounting to billions of dollars. These disclosures have been assigned to field agents to audit and resolve the disclosed transactions.

**Mitigation Efforts**

For those who voluntarily disclosed a transaction in accordance with the announcement, IRS promised to waive certain accuracy-related penalties that might apply to tax shelters and other questionable items that resulted in an underpayment of tax.

Disclosure under this initiative did not affect whether the IRS would impose, as appropriate any other civil penalty applicable under Code, or investigate any associated criminal conduct or recommend prosecution for any violation of any criminal statute.

**Large and Mid-Size Business (LMSB) Example on Disclosure Initiative**

Published Guidance

Published Guidance such as notices, revenue rulings, and announcements provide the general public with IRS's position on certain transactions. The intended purpose of published guidance is to serve as an early warning system to inform and deter taxpayers from participating in abusive transactions.

It has been noted that although abusive tax avoidance transactions are not easy to define, once they are disclosed and discovered they can be easily recognized. For this reason, the best tool IRS has in dealing with abusive transactions is early identification. Identifying questionable transactions early enables IRS to gather information and issue published guidance, in some cases even before transactions show up on tax returns.

*[Note: Source of data is from OTSA documents, IRS News Releases, and discussions with OTSA officials]*

## Small Business and Self-Employed (SB/SE) Example on Lead Development Center Activity on Schemes and Promoters

[For illustrative purposes only – not intended to be a comprehensive account of SB/SE initiatives and/or activities].

The Office of Reporting Enforcement within SB/SE Compliance Policy has the responsibility of providing Division-wide policy guidance for Fraud, Anti-Money Laundering, and Abusive Tax Avoidance Transaction (ATAT) compliance processes. Also, the office has the Lead Development Center (LDC) that identifies and builds promoter cases.

Issue Identification

Lead Development Center

The LDC was established in April 2002 to centralize the receipt, identification, development of leads on Abusive Tax Schemes and Promoters, as well as authorize and refer 6700/ 7408 investigations to the Planning and Special Programs (PSP) offices to the field groups for examination. The Center receives internal and external leads, and researches abusive tax promotions for purposes of detection and case building. Also, the LDC systematically conducts Internet research to identify leads and detect sites, promoters, and promotional materials that market Abusive Tax Schemes over the Web. Currently, the LDC is working with research and Counsel to develop more aggressive techniques for finding promoters and schemes marketed over the internet.

The SB/SE Delegation Order 4.60 provides the authority to the LDC Program Manager to approve promoter investigations under IRC sections 6700, 6701 and 7408. As of July 1, 2003, there are 489 promoter investigations in the field and 526 promoter leads in the LDC to be evaluated and developed.

Mitigation Activities

Internal and External Toolkits

The ATAT *Internal Toolkits* (Anti-tax Law Evasion, Home-Based Business Schemes, Employee Leasing, Abusive Trusts, Disabled Credit Schemes, Offshore Schemes, Offshore Voluntary Compliance Initiative) were developed to provide SB/SE employees with the official language and products that they are expected to use in abusive scheme outreach efforts. Also, this is an effort to ensure consistent messages are delivered nationwide. The *External Toolkits* (Anti-Tax Law Evasion, Home-Based Businesses, Abusive Trusts, Disabled Credit, and Offshore Schemes) are prepared as an effort to reach the maximum audience by partnering with external stakeholders. These toolkits will aid stakeholders in assisting the IRS with counter-marketing against abusive tax schemes. It has been publicize that TEC has a major priority to counter-market against abusive tax schemes by educating potential investors to avoid the schemes.

## **Small Business and Self-Employed (SB/SE) Example on Lead Development Center Activity on Schemes and Promoters**

It is noted in the abusive schemes internal toolkits comprehensive strategy, that most of the schemes encountered, will fall within, or have components of the following general topics:

- Abusive Offshore Tax Avoidance Schemes
- Abusive Home-Based Business Schemes
- Abusive Trust Schemes
- Anti-Tax Law Evasion Schemes

However, the Service is working on developing additional toolkits that would address specific schemes. One of the more specific toolkits developed address the subject regarding Misuse of the Disabled Access credit. As of March 2003, TEC noted that 78% of the schemes match up to the five toolkits

Reporting Enforcement is also working with other ODs to develop a Service-wide ATAT Toolkit that includes a methodology for identifying, coordinating, and handling emerging issues, frivolous tax schemes, and complex technical issues.

### Parallel Investigations

A parallel proceeding between SB/SE and Criminal Investigation involves simultaneously investigating or litigating of separate civil and criminal aspects of a case involving a common set of facts. Due to the fact that the Service is facing numerous abusive schemes, it has been recommended that the Service perform parallel investigations. The Service's civil and criminal functions would consider all the potential benefits and risks involved in conducting parallel proceedings and make the best possible decision to enforce the tax laws, promote voluntary compliance and protect the revenue.

In the past, the Service has traditionally completed the criminal investigation before seeking civil remedies. This practice allowed the promoter(s) to continue marketing the abusive scheme while being investigated criminally.

The parallel approach does not mean the IRS should conduct civil and criminal investigations jointly. However, it allows simultaneously civil and criminal investigations to be conducted separately and distinctly.

An example of some of the civil remedies includes the following:

- Section 6700, penalties against promoters of abusive schemes.
- Section 6701, penalties against preparers.

**Small Business and Self-Employed (SB/SE) Example on  
Lead Development Center Activity on Schemes and Promoters**

Section 7408, authorizes an injunction in a U.S. District Court if a person violates 6700 or 6701.

Some of the criminal violations are:

Internal Revenue Code (IRC) 7201, Tax evasion.

IRC 7206(1), Filing false returns.

IRC 7206(2), Aiding and assisting in the preparation of false tax returns.

The SB/SE operating division with the IRS has developed procedures, which documents the process for starting a parallel investigation with the CI.

[Source: SB/SE web-site and discussions with SB/SE officials]

## Coordination Activities

[Efforts identified below may not include all coordination activities across IRS units on schemes and scams]

ATEASD ESC<sup>3</sup> - forum to develop a unified, cross-divisional IRS strategy for dealing with abusive tax schemes and shelters. The primary focus is on coordination of enforcement activities and resource issues. The ESC's efforts are also coordinated with outside stakeholders, including federal and state agencies.

Issue Champions- Issue Champions are appointed by the LMSB Commissioner upon the recommendation of the Tax Shelter Committee when a particular tax shelter issue is significant enough to warrant executive oversight and direction. In some instances, when an issue impacts another IRS Division, that division may appoint a co-issue champion to serve with the LMSB champion to ensure compliance and resolution matters are properly evaluated and coordinated. For example, for the Son of BOSS tax shelter issue, executives from both LMSB and SB/SE have been appointed to serve as joint issue champions.

Issue Management Teams- Similarly, SB/SE established Issue Management teams that include Executive Champions to provide a strategic approach to issue management.

Parallel Investigations- CI & SB/SE pursue civil and criminal investigations in parallel. A six-way conference is held between CI & SB/SE to ensure IRS makes business decisions about investigations that are in the best interest of IRS's efforts to stop the promotion of abusive schemes. LMSB is considering incorporating parallel investigation methods in its promoter investigations.

Coordinated Outreach/Communication Efforts- to educate and warn taxpayers through a consistent message about abusive schemes and the consequences of participating in them. One of the most prominent public warnings has been the "Dirty Dozen" of Tax Scams for 2003, which has appeared in every major media outlet and picked-up by many other local outlets as well. In addition, LMSB issues notices of "Listed Transactions", alerting the public to transactions it identifies as abusive and warning taxpayers not to invest in these transactions.

News releases developed by C&L are utilized by the various ODs to raise awareness to each of their respective customers about the IRS' position on abusive schemes.

SB/SE's internal and external toolkits are developed through a collaborative effort with TEC, Compliance CAS, LMSB, CI, Office Chief Counsel and the Office of Communications and Liaison (C&L). The internal toolkits are used by SB/SE employees in their abusive scheme outreach efforts and the external toolkits are used to aid stakeholders in assisting the IRS with counter marketing against abusive tax schemes.

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<sup>3</sup> An Executive Oversight Committee has recently been formed that is comprised of Senior Management Officials from each of the ODs, Chief Counsel and Appeals. The purpose of this group is to deal with broad overall policy decisions relating to abusive tax avoidance transactions and schemes. The status of this committee is pending.