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IRS CRIMINAL INVESTIGATION HITS BIG DESPITE SIGNIFICANTLY REDUCED RESOURCES – IT IS MORE IMPORTANT THAN EVER TO REMEDIATE PAST TAX RETURN ERRORS AND OMISSIONS

If you think it is open season and no one is minding the store for the IRS, think again. Despite unprecedented budget cuts to the IRS examination, collection and criminal investigation divisions, IRS Criminal Investigation ("CI") is going after taxpayers and tax advisors with a vengeance. They want everyone to know of and feel their presence. To increase the efficiency of CI, they have encouraged and are taking case referrals from the IRS examination and collection divisions. Accordingly, there is no longer such a thing as a routine IRS examination and collection case when there is any fact that could be interpreted as fraudulent. In these cases, CI already has the bulk of the work done for them. This is true especially with the help of the fraud technical advisors who, through the fraud referral program (including but not limited to the SEP – Special Enforcement Program – IRS group), work behind the scenes (in secret) to help IRS examination and collection turn mere badges of fraud into firm indications of fraud ready to be handed off to CI.

An effective way to avoid CI when the facts could be interpreted as fraudulent is to take advantage of IRS remediation through such a thing as the domestic and offshore voluntary disclosure programs and other IRS remediation options.

I. CHIEF'S MESSAGE

The Chief's Message in the IRS Criminal Investigation Fiscal Year 2015 National Operations Annual Business Report ("Report") is bursting with major victories for IRS Criminal Investigation. CI started the fiscal year with major budget cuts. Amazingly, CI hired merely 45 agents in the last three years, bringing staffing down to the lowest levels since the 1970s. Chief of CI, Richard Weber, when commenting on the reduction, stated reluctantly, "We finally came to realize that fewer agents and staff really do mean fewer cases."[1]

Despite the reductions in staffing, CI remained steadfast and busy during fiscal year 2015. Specifically, the FIFA investigation began as a tax evasion case and, thanks to CI agents, "snowballed" into something much more. CI also completed the case against the owner of the "Silk Road" website, resulting in a life sentence and a forfeiture order in excess of $183 million. Additionally, CI investigated Dr. Farid Fata, who purposefully misdiagnosed cancer to "get rich" and was an example to CI of "greed being a common link in all financial investigations."[2]

Next, CI took on identity theft, noting an increase in sophistication. The "Dark Net" created additional challenges in identity theft investigations along with the use of virtual currency. Over the last three years, CI has produced quality identity theft cases which, despite the budget and staffing challenges, have sent almost two thousand people to jail.

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[1] Report, p. 1.
[2] *Id*.

II. INVESTIGATIVE PRIORITIES

The 2015 Investigative Priorities[3] are:

1. Identity Theft Fraud;
2. Abusive Return Preparer Fraud & Questionable Refund Fraud;
3. International Tax Fraud;
4. Fraud Referral Program;
5. Political/Public Corruption;
6. Organized Crime Drug Enforcement Task Force (OCDETF);
7. Bank Secrecy Act and Suspicious Activity Report (SAR) Review Teams;
8. Asset Forfeiture;
9. Voluntary Disclosure Program; and
10. Counterterrorism and Sovereign Citizens.

III. CI STATISTICS

Investigations initiated fell from 5,314 in fiscal year 2013 to 4,297 in fiscal year 2014 to 3,853 in fiscal year 2015. This figure represents a 10% drop in investigations initiated from last year and a shocking 27.5% drop since fiscal year 2013.[4] The decrease in investigations is a major concern inside and outside of the IRS.

One reason for the decreased statistics is definitely the decrease in the number of IRS CI Special Agents. As of September 30, 2015, there were 2,316 CI Special Agents. This represents a 6% decrease when compared to the number of Special Agents at the conclusion of fiscal year 2014. Likewise, the professional staff in CI decreased 8.8%.[5] Think about the increase in the population of taxpayers since fiscal year 1995, which included the employment of a record high number of Special Agents at 3,363, compared to the reduced force of 2,316 Special Agents. The 31% reduction in the number of Special Agents is substantial. There is a belief that there is practically no one protecting the fiscal security of the country. Tax professionals throughout the country are encountering increasingly aggressive, and sometimes bizarre, tax schemes which at best straddle the civil criminal divide and often are actually criminal tax scams dressed up to resemble tax planning. While clients are lost to these charlatans, there is a grave concern that a number of tax practitioners will take the "if you can't beat them, join them" approach. With little perceived concern over being caught, this is a real danger. Congress must act quickly and decisively to save the tax system, a voluntary system which relies heavily on tax practitioners' advice to taxpayers.

[3] Report, p. 2.
[4] *Id*.
[5] Report, p. 3.

IV. LEGAL SOURCE TAX CRIMES

"Criminal Investigation's primary resource commitment is to develop and investigate Legal Source Tax Crimes."[6] Legal Source Tax Crimes are committed by taxpayers in industries and occupations that are legally permissible, whose actions are in violation of tax laws or "threaten the tax system." The prosecution of Legal Source Tax Crimes supports IRS compliance goals and enhances the voluntary compliance with tax laws.

A. FRAUD REFERRAL PROGRAM

CI "places a high degree of emphasis" on its fraud referral program. CI works closely with the civil divisions in Small Business/Self-Employed, Wage and Investment, Large Business & International, and Tax Exempt and Government Entities through the fraud referral program in these four divisions. Through the fraud referral program, CI is instituting core mission tax investigations. Finally, and most likely in response to criticisms of the past, CI is maintaining a commitment to the timely evaluation of every fraud referral from the fraud referral program.[7]

B. GENERAL TAX FRAUD: THE BACKBONE OF CI'S ENFORCEMENT PROGRAM

CI knows that general tax fraud investigations directly influence the public's tax compliance. This is of paramount importance. The entire system depends heavily upon self-assessment by taxpayers of the correct amount of tax and the voluntary filing of tax returns, including paying the amount of tax owed. Taxpayers from all different sectors of the economy, including corporate executives, small business owners, self-employed and wage-earners, through willful noncompliance, fail to report and pay their fair share of taxes. Accordingly, the financial investigative skills of CI Special Agents are the key to discovering the types of schemes that exist today. The following schemes[8] are on the CI radar:

1. Skimming by deliberately underreporting or omitting income;
2. Maintaining dual sets of books;
3. Creating false entries in books and records;
4. Classifying personal expenses as business expenses;
5. The use of false deductions or credits to decrease taxes; and
6. Hidden or transferred assets for the purposes of avoiding the payment of taxes.

An example of a general tax fraud investigation is a Pennsylvania man sentenced to 60 months in prison and ordered to pay $1.7 million in restitution for a scheme to use skimmed cash to pay expenses, resulting in the avoidance of paying millions of dollars in personal and employment taxes. The taxpayer pled guilty to conspiracy to commit tax evasion, filing false returns, loan fraud, and aggravated structuring of financial transactions.

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[6] Report, p. 6.
[7] *Id.*
[8] *Id.*

Another case involved a Las Vegas man who pled guilty to conspiracy, mail fraud, wire fraud, and tax fraud for a scheme to take control of a condominium homeowners association to secure contracts for himself. A final example of general tax fraud includes the old-fashioned obstruction of an IRS examiner through the provision of false and fictitious documents during the IRS examination of a pizza restaurant owner in a payroll tax evasion scheme.

C. REFUND FRAUD PROGRAM

Refund fraud continues to be a significant threat to the tax system. Criminals are attempting to misuse the tax system to obtain large refunds using false pretenses. CI is aware that in addition to the loss of much needed funds for vital programs, refund fraud directly impacts the confidence taxpayers have in the tax system and taxpayers' willingness to voluntarily meet their tax filing obligations. A major concern is violent criminal enterprises which have changed their modus operandi to focus on refund theft from the IRS and the U.S. government. The refund fraud program is broken down into two categories, the Return Preparer Program and the Questionable Refund Program. Both categories include an issue which has been a major thorn in the side of the Internal Revenue Service, as well as many ordinary taxpayers – specifically, identity theft.[9]

1. Identity Theft

CI continues to include identity theft-related crimes as a priority area of investigation. CI increased its emphasis with both administrative and grand jury investigations, and multi-regional task forces with state, local and federal law enforcement agencies. CI currently participates in over 70 task forces and working groups throughout the country.[10] CI has designated a management official to serve as the National ID Theft Coordinator to oversee nationwide efforts to combat identity theft. Additionally, within each of the 25 field offices, there is an ID Theft Coordinator.

A big driver for identity theft is data breaches. The uptick in tax-related identity theft can be linked to information acquired through data breaches. As a result of the impact and scale of false refunds based upon identity theft, 22 field offices initiated investigations linked to computer intrusions, account takeovers, and data compromises affecting tax administration.[11]

While identity theft continues to remain a large priority for CI, investigations initiated dropped from 1,063 in fiscal year 2014 to 776 in fiscal year 2015. However, with successful prosecutions, the amount in issue and the number of victims in the identity fraud cases continues to increase in magnitude as the IRS focuses on more elaborate and bigger refund schemes.[12]

2. Abusive Return Preparer Program

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[9] Report, p. 8.
[10] *Id.*
[11] *Id.*
[12] Report, p. 11.

The Abusive Return Preparer Program is focused on tax preparers who prepare and file false income tax returns. The false items include inflated personal expenses, inflated business expenses, false deductions, exemptions in excess of the proper amount, and tax credits which are not permitted under the Code. Sadly, the taxpayers for whom the dishonest return preparers are working may or may not have knowledge that the returns themselves are false. This is always a delicate subject, as the taxpayers range from innocent victims to co-conspirators with the bad return preparer. Even an innocent taxpayer must pay the full amount of tax and interest when the return is corrected by the Internal Revenue Service. Those taxpayers will generally enjoy penalty relief, but the tax and interest is often financially devastating to these unsuspecting, innocent taxpayers. On the other hand, co-conspiring taxpayers can expect to receive the full attention of CI and often will end up being indicted or will plead guilty to a tax crime.

The statistics for investigations initiated are down for fiscal year 2015. In fiscal year 2014, 305 preparer investigations were initiated, whereas in 2015, 266 preparer cases were initiated.[13] It can certainly be argued that dishonest preparers are one of the biggest dangers to the integrity of the entire tax system. This is the reason the IRS has gone to great lengths to determine different ways in which to regulate and, when appropriate, discipline bad preparers.

3. Questionable Refund Program

The Questionable Refund Program identifies fraudulent claims for tax refunds. The IRS not only wants to prosecute the promoters of these false returns, but also wants to understand these false returns well enough to place filters within the computer system to stop the issuance of false refunds. For example, an Alabama woman was sentenced to 145 months in prison based upon leading a $4 million stolen identity refund fraud ring which filed more than 1,000 fraudulent tax returns claiming refunds in excess of $4 million.

The statistics for investigations initiated are down for fiscal year 2015. In fiscal year 2014, 1,028 preparer investigations were initiated, whereas in 2015, 775 preparer cases were initiated.[14] Absent increased activity by CI, these dishonest preparers will flourish and multiply.

D. ABUSIVE TAX SCHEMES

The abusive tax schemes program focuses on promoters and taxpayers who willfully participate in schemes for the purpose of violating tax laws. These schemes include both domestic and offshore plans that typically include various layers of structures, onshore and offshore, which are meant to give the appearance that the U.S. taxpayer is not the true owner of assets or the true earner of income. Many of these schemes implement complicated structures utilizing entities such as trusts, foreign corporations and foreign partnerships designed for the appearance that a trustee, nominee, non-resident alien or other foreign entity owns assets and is the party for which income is attributable. In these structures, the domestic taxpayer is actually the proper recipient of the income.

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[13] Report, p. 14.
[14] Report, p. 17.

Topping the list of abusive tax scheme victories for IRS CI is the 55-month sentence of the designer of Tax Break 2000 which was marketed through the National Audit Defense Network. The fraud exceeded $36 million, while the intended tax loss to the government was more than $60 million. The scheme falsely promised that the Tax Break 2000 product entitled purchasers to tax credits and deductions under the Americans with Disabilities Act.[15]

E. HIGH-INCOME NON-FILER INVESTIGATIONS

Amazingly, there are high-earning taxpayers who simply stop filing and paying taxes. This phenomenon undermines public confidence and the IRS's ability to administer the tax laws fairly and efficiently. Too many taxpayers have been shocked when they fail to file a tax return that the IRS takes years to finally contact them. The problem for those taxpayers is that if the branch of the IRS who reaches out and touches them is CI, there is a commitment to devoting significant investigative resources. CI is focused on taxpayers who simply refuse to comply with the law.

CI has a category for high-income non-filers. Two examples involve relatively modest unpaid tax amounts of $520,351 and $439,515, respectively. A third case describes a millionaire businessman sentenced to 32 months in prison. The amount of tax loss that was subject to restitution amounted to $7,676,757.[16]

F. EMPLOYMENT TAX FRAUD

Rounding out the legal source tax crimes is employment tax fraud. Employment tax fraud is so damaging because many of the tax evasion cases involve a multiple number of employees. Typical methods of employment tax fraud include pyramiding, employee leasing, payment of employees in cash, false payroll tax returns, and simple failure to file payroll tax returns. Some business owners withhold taxes from employees' paychecks and intentionally fail to remit the taxes to the IRS, while only paying the employees the amount of the net payroll check.

The cases demonstrate the enormity of the payroll tax evasion problem. The sentences began with a low of 30 months in prison to a pair of 78-month sentences. The maximum sentences were two cases with separate 240-month sentences. On the tax loss side, the figures were enormous. The lowest was only $1.5 million. The remaining tax loss amounts were all in excess of $20 million, ranging from $21,442,173 to almost $26 million.[17]

V. CONCLUSION – BYPASS THE IRS CI THREAT BY BEATING THE IRS TO THE PUNCH THROUGH A VOLUNTARY DISCLOSURE

CI continues to commit substantial resources to direct investigative assets committed to legal source cases. With respect to legal source income cases, one of the most powerful tools in

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[15] *Id*.
[16] Report, pp. 18-19.
[17] Report, pp. 19-20.

avoiding being part of the IRS statistics is to take advantage of the IRS domestic and offshore voluntary disclosure programs.

Since the inception of the Offshore Voluntary Disclosure Program in fiscal year 2009, there have been more than 48,000 voluntary disclosures from individuals involving offshore accounts who have paid approximately $9.9 billion in taxes, penalties and interest.[18] The IRS rolled out streamline procedures to assist non-willful taxpayers with offshore compliance challenges. The streamline procedure has been utilized by 48,000 taxpayers who have paid approximately $400 million in taxes. Finally, old-fashioned domestic voluntary disclosures remain an extremely powerful tool to combat domestic reporting issues which, with the benefit of hindsight, could be interpreted as fraudulent.

The IRS has collected and mined the data received from the domestic and offshore voluntary disclosure programs. The IRS is using this data to pursue taxpayers who have not properly remediated past errors. Accordingly, despite rumors to the contrary, the IRS CI web continues to expand.

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[18] https://www.irs.gov/uac/newsroom/offshore-voluntary-compliance-efforts-top-10-billion-more-than-100000-taxpayers-come-back-into-compliance