

# IRS Criminal Investigation Fiscal Year 2017 Annual Business Report— Criminals Would Be Foolish to Mistake Declining Resources for a Lack of CI Commitment

By Josh O. Ungerman\*

*Josh O. Ungerman interviews Don Fort, Chief, IRS Criminal Investigation Division, and examines IRS-CI 2017 Annual Report.*



Wolters Kluwer

## I. Observations on the State of IRS Criminal Investigation

The Internal Revenue Service Criminal Investigation (“IRS CI”) 2017 Annual Report (“Report”) highlights the year’s accomplishments reflecting the positive and forward-thinking vision of Don Fort, Chief, IRS Criminal Investigation. However, the numbers show years of congressional budget cuts have taken their toll. From 2013 through 2017, the number of investigations initiated by the IRS CI dropped an alarming 36%. The 2017 incarceration rate was down to 67%.

The investigations initiated, however, are only a portion of the story. Out of the 15 identified categories in the annual report index, Money Laundering (1096) was the top category for number of investigations initiated, followed by Narcotics (735). The next highest category for investigations initiated is Bank Secrecy Act violations (499) and then Identity Theft (374). The obvious problem is that these categories exclude the vast majority of old-fashioned, run-of-the-mill tax violators. So, where do the old-fashioned legal source taxpayers show up? They typically surface in the International Operations (283), Questionable Refund Program (QRP) (280), Non-Filer (206), and Employment Tax (162) categories. Rounding out the categories for routine legal income source violators are Abusive Tax Scheme (77) and Corporate Fraud (48).

What do these investigation numbers actually show? The numbers show that the diminishing resources to IRS CI are having a profound effect. Many tax

**JOSH O. UNGERMAN** is a Partner  
with Meadows, Collier, Reed,  
Cousins, Crouch & Ungerman, LLP.

professionals wonder how low the resources to IRS CI will go before a portion of the taxpaying public no longer is motivated to comply with the tax laws and, indeed, actively works to evade them. Some tax professionals believe we could already be in a dangerous era of criminal non-compliance that is going unchecked. No matter how low the resources and initiated investigations for IRS CI decline, it is important to remember that once an IRS investigation commences, the chances of being investigated are 100%.

So the question becomes how can IRS CI, with so few resources, succeed in its mission of having tax prosecutions directly impact voluntary compliance through criminal deterrence? The answer is to increase the IRS's budget so the IRS can support a strong voluntary compliance tax system through increased examinations and investigations. Unless (or until) staffing is increased, IRS CI will pursue high-impact cases. Through intense data analytics, IRS CI is aiming to find these targeted taxpayers in a very efficient and futuristic manner.

## II. Chief's Message

The Chief's message emphasizes on the many successes IRS CI enjoyed in 2017, noting that, when there is a sophisticated financial component to an investigation, prosecutors usually contact IRS CI for assistance.

The Chief hits the budget issue head-on, stating that resource issues make it impossible to be involved in every investigation in which IRS CI is asked to participate. He discloses that IRS CI has the same number of special agents—around 2,200—as it did 50 years ago. Despite low staffing, the Chief lays out that financial crime has not diminished during that time—in fact, it has proliferated in the age of the Internet, international financial crimes, and virtual currency. Regardless of the challenges, IRS CI investigates some of the most complicated cases in the agency's history. The Chief warns “Criminals would be foolish to mistake declining resources for a lack of commitment in this area.” The size of IRS CI directly affects the number of cases opened each year but has not affected the fact that the quality and the complexity of the cases continues to remain at a high level.

The Chief is leveraging limited resources by publicizing the results of those cases and more efficiently utilizing of the troves of data IRS CI has access through the Nationally Coordinated Investigations Unit (NCIU). The Chief ends with a message of optimism regarding the future of IRS CI and the innovative initiatives IRS CI have underway to help IRS CI “continue to stay one step ahead of the criminals.”

## III. Nationally Coordinated Investigations Unit

IRS CI launched the NCIU on May 1, 2017. The NCIU partners with agents and analysts to supplement the case development activities of each field office. The NCIU will “pivot” IRS CI to a data-driven case selection process (Data Analytics/Artificial Intelligence) by developing and managing national initiatives approved by IRS CI's executive leadership. The case selection is designated to be both high impact and national in scope.

The Report lists four initiatives approved by IRS CI's executive leadership.

1. Microcap Stock project.
2. Employment Tax.
3. Biofuel/RIN Tax Credit Scheme.
4. International Bank Project.

In July 2017, the NCIU and the Securities and Exchange Commission hosted a multi-day microcap stock training to over 60 IRS employees. The NCIU is analyzing, building and referring microcap stock investigations to IRS CI field offices.

The NCIU utilizes wide range of data to identify and develop areas of non-compliance and will operate by:

1. Ensuring appropriate geographic coverage to IRS CI investigative priorities and emerging non-compliance threats.
2. Building and supporting investigations referred to field offices.
3. Promoting bi-lateral accountability for both NCIU and field offices.
4. Serving as a resource to field offices.
5. Educating and training field offices on the program areas NCIU supports.
6. Providing and coordinating targeted training to agents assigned to NCIU referrals.
7. Identifying emerging threats to the tax administration and financial system.
8. Partnering with DOJ tax and other litigation components to support efforts to litigate these investigations through prosecution.

## IV. Investigative Areas

Below is a list of the 2017 Investigative Areas.

### A. Tax Crimes

1. Employment Tax Fraud.
2. Identity Theft.
3. Data Compromises.
4. General Tax Fraud.

5. Abusive Tax Schemes.
6. Refund Fraud Program.
7. Cyber-crimes (including virtual currency).
8. Visual Currency.
9. International Tax Enforcement Group.

## B. Non-Tax Crimes

1. Public Corruption.
2. Corporate Fraud.
3. General Fraud.
4. Money Laundering.
5. Organized Crime Drug Enforcement Task Force (OCDETF)/High-Intensity Drug Trafficking Area (HIDTA), Transactional Organized Crime.

## V. IRS CI Business Results

One of the most talked about figures in the Report is the number of investigations initiated that plummeted from 5,314 in fiscal year 2013, to 4,297 in fiscal year 2014, to 3,853 in fiscal year 2015, to 3,395 in fiscal year 2016, and to 3,019 in fiscal year 2017. These figures represent an [11.1%] drop in investigations initiated from last year and an astronomical [43.2%] drop since fiscal year 2013. Such a decrease in investigations is a major concern for many inside the IRS, as well as many outside the IRS who view the drop as threatening the foundations of the voluntary tax system in the United States.

One reason for the decreased figures is certainly the drop in the number of IRS CI Special Agents. The report identifies IRS CI employed 2,159 Special Agents in 2017. How significant is this staffing figure for Special Agents? Consider an increase in the population of taxpayers since fiscal year 1995, which included the employment of a record high number of Special Agents totaling 3,363. That is over a [35.8%] reduction in the number of Special Agents, which is hard to imagine. These decreasing figures are alarming. Practitioners throughout the country are encountering increasingly aggressive, and sometimes non-sensical, tax schemes that at best straddle the civil/criminal divide and that are often straight-up criminal tax scams seemingly meant to resemble tax planning. As more and more tax practitioners lose clients to these persuasive charlatans, the question remains: Will those practitioners turn to the same type of tax planning to stay in business if they believe the chance of getting caught is exponentially diminishing? This is such a concerning proposition that Congress must act quickly and decisively to save the tax system, a voluntary

system that relies heavily on tax practitioners' advice to taxpayers.

## VI. Tax Crimes

"Criminal Investigation's primary resource commitment is to develop and investigate Tax Crimes, both legal and illegal Source." The Report emphasizes that prosecution of Tax Crimes supports the overall IRS compliance goals and enhances the voluntary compliance with tax laws.

### A. Employment Tax Fraud

The Report next addresses employment tax fraud. The damage from employment tax fraud can have a cascading effect, because many of the tax-evasion cases involve a multiple number of employees and their taxes. 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. The Report also identifies how some business owners are withholding taxes from employees' paychecks and intentionally failing to remit the taxes to the IRS, while only paying their employees the amount of the net payroll check. The Report specifically identifies the scenario in which unpaid employment taxes are utilized for a business owner's personal use. While IRS CI can criminally investigate and recommend prosecution on both business and personal use of unpaid taxes; this year personal use is specifically identified in the Report. The IRS takes a dim view of taxpayers who fail to remit employment taxes but nonetheless take full credit for the non-existent withholding on their own W-2s.

The cases reported demonstrate the enormity of the payroll-tax-evasion problem. Jail sentences begin with a minimum of 26 months in prison to a maximum of a 135-month sentence with tax loss amounts ranging from \$5.9 million to \$17 million.

### B. Identity Theft

IRS CI continues to include identity-theft-related crimes as a priority area for investigations. IRS CI has continued to increase its emphasis through both administrative and grand jury investigations, including multi-regional task forces with state, local and federal law enforcement agencies. IRS CI currently participates in task forces and working groups throughout the country. IRS 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.

The Report describes that identity theft-related tax refund fraud occurs by the use of the personal information of another taxpayer without permission to commit fraud or other crimes. The identity thief typically uses a legitimate taxpayer's identity to file a fraudulent tax return and claim a refund. Most often early in the filing season filing the fraudulent tax return before the legitimate taxpayer permits the identity thief to receive the refund before the victim files the legitimate tax return.

While identity theft has been such a huge priority for IRS CI, investigations initiated dropped from 1,063 in fiscal year 2014, to 776 in fiscal year 2015, to 573 in fiscal year 2016, and to 374 in fiscal year 2017. The amounts at issue and the number of victims in the identity fraud cases continue to increase in magnitude as the IRS focuses on more elaborate and bigger refund schemes.

### C. Data Compromises/Breaches

The Report has a new section for Data Compromises. IRS CI is investigating data compromises as tax-related identity theft described as data breaches, are linked to compromises targeting detailed financial records maintained by tax professionals and payroll administrators. There has been a substantial increase in phishing attempts to acquire payroll records to sell on the Dark web for use including filing false returns.

### D. General Tax Fraud

The Report emphasizes general tax fraud investigations directly influence the public's tax compliance and are the backbone of IRS CI's enforcement program. The Report acknowledges that 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 non-compliance, fail to report and pay their fair share of taxes. The financial investigative skills of IRS CI Special Agents are of paramount importance to uncovering and quantifying these cases. The following schemes are identified by the Report:

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

### E. Abusive Tax Schemes (Domestic and Offshore)

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 which are onshore and offshore and 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 also include very complicated structures utilizing entities such as trusts, foreign corporations and foreign partnerships which are designed to appear like a trustee, nominee, non-resident alien or other foreign entity owned assets and is the party for which income is attributable. In these structures, the domestic taxpayer is actually the proper recipient of the income.

### F. Refund Fraud Program

The Report identifies that refund fraud poses a significant threat to the tax system. Criminals are attempting to misuse the tax system to obtain large amounts of money from the government under false pretenses. The Report notes 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. It is not uncommon to read or hear about violent criminal enterprises that have shifted their *modus operandi* into organized and systematic tax refund theft. The refund fraud program is broken down into two categories: the Return Preparer Program (RPP) and the QRP. Both categories include an issue that has been a major thorn in the side of the IRS, as well as many ordinary taxpayers—specifically, identity theft.

#### 1. Abusive Return Preparer Program

The Abusive RPP is focused on dishonest tax preparers who orchestrate the preparation and filing of false income tax returns in both paper and electronic form. The falsity of these income tax returns, prepared by dishonest preparers, includes inflated personal and business expenses, false deductions, exemptions in excess of the proper amount, and tax credits which are not permitted under the Code. Importantly, the Report points out that the Taxpayers, for whom the dishonest preparers are working, may or may not have knowledge that the returns themselves are false. This is always a delicate subject, as the Taxpayers themselves can range from innocent victims to co-conspirators with the dishonest return preparer.



Even the innocent (victim) taxpayer must pay the full amount of tax and interest when the return is corrected by the IRS. Those taxpayers will generally enjoy some degree of penalty relief, but the tax and interest is often financially devastating to these unsuspecting taxpayers. On the other hand, co-conspiring taxpayers can expect to receive the full attention and wrath of IRS CI and often will end up being indicted or will plead guilty to a tax crime.

The number of investigations initiated is down for fiscal year 2017. In fiscal year 2014, 305 abusive preparer investigations were initiated; whereas in 2015, 266 abusive preparer cases were initiated; in fiscal year 2016, 252 abusive preparer cases were initiated; and in fiscal year 2017, 304 were initiated. It can certainly be argued that abusive preparers are one of the biggest dangers to the integrity of the entire tax system.

## 2. Questionable Refund Program

The goal of the QRP is to identify 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 bogus refunds.

The number of investigations initiated is down for fiscal year 2017. In fiscal year 2014, 1,028 questionable refund investigations were initiated; whereas in 2015, 775 questionable refund investigations were initiated; in fiscal year 2016, 495 questionable refund investigations were initiated; and in fiscal year 2017, only 280 were initiated. The IRS continues to examine large refund claims made after the payment of the refund in order to reduce the amount of refund interest paid.

## G. Virtual Currency

As Virtual Currency becomes more mainstream, the threat to tax administration increases. IRS CI virtual currency concerns include a tremendous loss of transparency in transactions that historically produced a useful paper trail. The IRS CI expertise in Identity Theft will transition nicely into virtual currency investigations. IRS CI Virtual Currency topics range from the straightforward reporting of capital gains and use to pay for goods and services to the critical danger of taxpayers desiring to evade taxes using virtual currency as the new offshore bank accounts.

## H. International Tax Enforcement Group

The Report describes how in August 2013, IRS CI and DOJ (Department of Justice) Tax Division initiated the Swiss Bank Program (SBP) which included bringing IRS CI Special Agents from across the country into Washington

D.C. to work directly with attorneys assigned from DOJ. Since the inception the Report notes of the SBP, 80 Swiss banks have entered into Non-Prosecution Agreements (NPAs) paying over 1.3 billion in penalties, with about 58 investigative leads being sent to various IRS CI field offices for investigation and action. Interestingly, the Report identifies over 18,000 leads not meeting criminal criteria were forwarded to IRS's LB&I Division for civil tax compliance action. While the SBP is completed, IRS CI on the other hand is ramping up an international tax enforcement group in IRS CI's Washington D.C. field office. This group's focus is to dismantle the most significant international tax schemes that have been identified as systemic threats to the integrity and fairness of the tax administration. Investigations initiated by this group will be long term in nature and utilize all tools at the Criminal Investigation Division's disposal.

*IRS CI continues to commit resources and direct investigative assets to legal source cases.*

Chief Fort is clear that the IRS CI is actively engaged in obtaining the identities of those with undisclosed foreign accounts with the use of information resources and increased data analytics. The new IRS CI elite international group will leverage off of members with a high level of expertise in order to identify sophisticated non-compliant taxpayers. International tax issues continue to be a high priority for IRS CI.

## I. Non-Filer Investigations

Though not a separate section in the 2017 Report, the 2016 Report identified taxpayers who simply stop filing and paying taxes as posing a serious threat to tax administration and the American economy. The 2016 Report described these actions as undermining public confidence and the IRS's ability to administer the tax laws fairly and efficiently. Many taxpayers are surprised, upon failing to file a tax return that the IRS may take 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 IRS CI, there is a commitment to devoting a significant amount of investigative resources. IRS CI remains focused on taxpayers whom IRS CI believes are simply refusing to comply with the law.

## J. Fraud Referral Program

Though not a separate section in the 2017 Report, the 2016 Report acknowledged that IRS CI "places a high

degree of emphasis” on its fraud referral program. IRS CI works closely with the fraud referral program in the civil divisions in Small Business/Self-Employed, Wage & Investment, Large Business & International and Tax Exempt and Government Entities. The 2016 Report described that, through the fraud referral program from the civil IRS divisions, IRS CI was instituting some of the core mission tax investigations. Finally, and most likely in response to criticisms of the past, the 2016 Report emphasized that IRS CI continued the commitment to the timely evaluation of each fraud referral from the fraud referral program.

*What do these investigation numbers actually show? The numbers show that the diminishing resources to IRS CI are having a profound effect.*

The Fraud Referral Program is alive and well in today’s environment. In light of reduced resources, the Fraud Referral Program is even more important today. The quality of the cases referred to IRS CI have been much better than many leads in the past. While IRS exam referrals are more traditional, IRS Collection Agents are referring an increasing number of cases to IRS CI. The collection cases are typically very well developed once they reach IRS CI.

#### ENDNOTE

\* Josh O. Ungerman practice focus includes estate planning and family wealth transfers along with IRS controversy matters at all levels. The tax and estate matters in which Mr. Ungerman is involved are typically very complex from both a factual and legal perspective. These matters often require legal and accounting skills. Mr. Ungerman is also a Certified Public Accountant. He works with families on wealth preservation and transfer strategies. A major focus is accomplishing family wealth preservation goals with an emphasis on the efficient transfer of family wealth to the next generation from a business and tax perspective. Mr.

Ungerman is also involved in defending taxpayers and issues against IRS inquiries and actions. His IRS defense practice covers civil and criminal exams, and investigations and trials. Many of Mr. Ungerman’s tax controversy matters include an offshore component. Prior to joining the firm in 1994, he was a civil prosecutor for the Internal Revenue Service, Dallas District Counsel office. He was also a Special Assistant United States Attorney for the Department of Justice in Dallas during his time as a civil prosecutor. Prior to becoming an IRS attorney of a special assistant U.S. attorney, he served as a law clerk to the Honorable Carolyn M. Parr at the United States

Tax Court in Washington, D.C. Mr. Ungerman is a frequent speaker on tax topics including such topics as exams, IRS estate tax strategies, tax shelter defense, recent tax legislation and IRS criminal tax. He is a member of the American College of Tax Counsel. Mr. Ungerman is often quoted and published on tax topics included in *The Wall Street Journal*, *The New York Times*, *Bloomberg*, *Daily Tax Report*, *Tax Notes*, *Journal of Tax Practice and Procedure* and the *Dallas Business Journal*. He can be reached at [jungerman@meadowscollier.com](mailto:jungerman@meadowscollier.com) and [www.meadowscollier.com](http://www.meadowscollier.com).

## VII. Undercover Operations

The Report proudly states that IRS CI has utilized undercover techniques throughout its history and undercover techniques played a significant role in bringing public enemy No. 1, Al Capone, to justice. Undercover techniques have been used in numerous investigations involving organized crime, illegal gambling operations, tax shelter schemes, illicit money movers, investment scams and many others. The Report discloses that in fiscal year 2017, over 450 undercover operations were conducted.

## VIII. Conclusion

IRS CI continues to commit resources and direct investigative assets to legal source cases. With respect to legal source income cases, one of the most powerful tools to avoid being part of the IRS’s statistics is to take advantage of the IRS’s domestic and offshore voluntary disclosure programs. The IRS has collected and analyzed the data from years of voluntary disclosure programs both in domestic and international matters. The IRS is using this data to pursue taxpayers who failed to proactively come in under one of the various IRS voluntary disclosure or remediation programs.

With fewer resources, IRS CI is committed to high impact/highly publicized cases that will likely be sourced from the use of Data Analytics/Artificial Intelligence using the huge trove of information already in the hands of IRS CI. Will Congress finally and consistently fully fund the IRS and IRS CI? Hopefully, the answer is yes. Regardless, IRS CI refuses to play the victim and is more focused than ever on enforcing criminal tax violations regardless of the number of Special Agents.

This article is reprinted with the publisher’s permission from the Journal of Tax Practice & Procedure, a bi-monthly journal published by Wolters Kluwer. Copying or distribution without the publisher’s permission is prohibited. To subscribe to the Journal of Tax Practice & Procedure or other Wolters Kluwer Journals please call 800-449-8114 or visit [CCHGroup.com](http://CCHGroup.com). All views expressed in the articles and columns are those of the author and not necessarily those of Wolters Kluwer or any other person.