

**The Criminal Investigation Function Has Made
Progress in Investigating Criminal Tax Cases;
However, Challenges Remain**

March 2005

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INSPECTOR GENERAL
for TAX
ADMINISTRATION

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MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Criminal Investigation Function Has
Made Progress in Investigating Criminal Tax Cases; However,
Challenges Remain (Audit # 200310042)

This report presents the results of our review of the Criminal Investigation (CI) function's efforts to increase the number of legal source income tax investigations. In general, legal source investigations involve legal occupations or industries and legally earned income in which the primary motive is the violation of tax statutes. The CI function also conducts investigations relating to illegally earned income and illegal activities. During Fiscal Year (FY) 2004, the CI function reported that legal source investigations represented about 35 percent of all subject investigations opened and about 43 percent of all direct investigative time (DIT).¹ This audit was initiated as part of the Treasury Inspector General for Tax Administration's FY 2004 Annual Audit Plan and due to concerns raised by the Senate Finance Committee about the CI function's efforts to increase legal source income tax investigations.

In summary, the CI function began addressing these concerns by creating a revised mission statement, developing a compliance strategy designed to guide the CI function to develop and investigate cases that foster confidence in the tax system, publicizing the results of its investigations, and conducting an empirical study to determine the effect investigations have on voluntary compliance.

The CI function's compliance strategy is comprised of three distinct, yet interdependent, program areas: legal source tax crimes, illegal source financial crimes, and narcotics-related financial crimes. Various strategic documents issued since July 2000

¹ DIT is defined as the time spent by special agents conducting investigations and other law enforcement activities.

illustrate the CI function's commitment to legal source and other tax-related² investigations. The CI function made a slight change to its investigative strategy (as illustrated in the FYs 2004 and 2005 Annual Business Plans) that emphasizes maintaining a focus on legal source investigations, rather than increasing its resources on these investigations. According to CI function executives, this current strategy focuses on developing and investigating those cases which would have the greatest compliance impact. The CI function will continue to emphasize investigations, both legal and illegal source, that adversely affect tax administration. Further, CI function management believes success toward achieving this strategy is measured by such case closing statistical indicators as completed investigations, Department of Justice acceptance rates, publicity rates, and average months sentenced.

We compiled various statistics that depict the CI function's inventory and results for all tax-related and legal source income tax investigations for FYs 1999 through 2004. The CI function has made progress in increasing all tax-related investigations, but the level of legal source income investigations did not materially change during this period. Further, recent trends for FYs 2002 through 2004 are mixed for both tax-related and legal source investigations.

Because there are no specific criteria that govern the mix of the CI function's workload, we could not conclusively determine whether the CI function is conducting enough legal source income tax investigations or to what extent it can or should increase the number. We believe it is up to CI function management and the Internal Revenue Service (IRS) Commissioner, in concert with Congressional and Administration budget and tax law enforcement priorities, to determine how the CI function should devote resources to pursue those cases that have the greatest impact on voluntary compliance.

To assist in this effort, we identified several areas in which the CI function can make improvements to the legal source investigative program and more effectively measure the program. First, we believe the CI function can do more to increase its focus on investigations developed from internal sources, starting with the fraud referral program. Although the CI and compliance functions have made efforts, they have been unable to reinvigorate the fraud referral program. In addition, the CI function has not fully maximized the use of general investigations (GI)³ as a means to identify and develop legal source income investigations.

In addition, the CI function faces a continuing challenge to make choices on the types of investigations to pursue that have the greatest impact on tax compliance. The CI function has a reputation as being one of the best financial investigative agencies in the Federal Government, and other agencies are continually asking for assistance. The

² The CI function defines tax-related as any violation of Title 26 United States Code (U.S.C.) (the Internal Revenue Code) and the following Title 18 U.S.C. sections (§): §§ 286 and 287 (2004), § 371 (k) (2004) relating to a Title 26 violation, and § 371 (b) (2004) relating to a Title 26 and a Title 31 violation. Title 18 includes false claims and money laundering, and Title 31 involves currency reporting requirements.

³ A study, survey, or canvassing activity on a number of individuals or entities within categories, such as occupation or industry. It is initiated to identify noncompliance with the laws enforced by the IRS.

CI function also participates in many other Federal law enforcement initiatives. Its participation in these investigations has to be balanced with the need to ensure the CI function meets its primary mission of investigating criminal tax violations.

We also identified inaccuracies and inconsistencies in the recording of data in the CI function's management information system that may prevent CI function management from properly evaluating the status or effectiveness of their programs, including efforts in the legal source investigations program.

We recommended the Chief, CI, establish a fraud coordinator in each field office, establish control procedures for processing fraud referrals, issue guidelines to emphasize the use of GIs, ensure appropriate management tools are used to monitor and evaluate the results of GIs, and issue guidelines on the types of GIs that should be classified as legal source investigations. We also recommended the Chief, CI, establish national goals on key statistical indicators (such as the percentage of legal source income investigations or DIT) the CI function should strive to achieve and establish additional criteria for accepting referrals from other government agencies and the United States Attorneys Offices. Finally, we recommended the Chief, CI, conduct an analysis to determine the impact inconsistent coding has on the classification of investigations and, if warranted, modify the management information system so the coding properly reflects the nature of the investigation and the measurement of the CI function's compliance strategy.

Management's Response: The Chief, CI, agreed with seven of the eight recommendations in this report and has already taken steps to correct some of the issues identified. The Chief, CI, issued a detailed policy memorandum designating fraud referral coordinators and reemphasizing fraud referral operating procedures. The Chief, CI, also agreed to reemphasize the need to monitor all GIs and CI function management will issue a memorandum reminding the field not to neglect the appropriate use of GIs in developing future legal source income investigations. In addition, the CI function's Annual Business Plan requires CI function management to continue to focus its investigative resources on legal source tax investigations and the FY 2005 performance agreements contain a commitment to work cooperatively with the Department of Justice and law enforcement partners to investigate other high-impact financial crimes and money laundering cases, with an emphasis on increasing or maintaining the balance of Title 26 and Title 31 violations. Finally, the Chief, CI, agreed to clarify the fraud scheme code section of the CI function's management information system (CIMIS) and to determine what investigations are incorrectly coded in the CIMIS and correct them.

The Chief, CI, did not agree with our recommendation to establish a national goal on key statistical indicators such as the percentage of legal source income investigations or direct investigative time. The Chief, CI, believes that since there is no empirical data on which to base a specific target level of legal source investigations, creating such a goal would be arbitrary. Further, the statistical indicators reveal the CI function is currently working at or near an optimal case mix, which is supported by the conclusions of a

recent empirical study. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: We made the recommendation to establish a national goal on key statistical indicators because we believe it is difficult to effectively measure program success or identify and investigate deviations without having an established standard or goal. In the formal response, the Chief, CI, indicated the priority given to legal source income tax cases is clearly stated in the performance management commitments as follows, "I will continue to focus on legal source tax investigations by increasing or maintaining the percentage of legal source inventory and legal source direct investigative time (DIT) to reinforce CI's core mission." We believe it is necessary to establish a numeric goal to provide an effective means for measuring and analyzing progress. While we recognize the CI function's concerns that its work is cyclical and it needs flexibility to be able to respond to emerging issues, we believe establishing any goal as a range would provide the needed flexibility. While we still believe our recommendation is worthwhile, we do not intend to elevate our disagreement concerning it to the Department of the Treasury for resolution.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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Background

In support of the overall Internal Revenue Service (IRS) mission, the Criminal Investigation (CI) function's mission is to serve the American public by investigating potential criminal violations of the Internal Revenue Code (I.R.C.) and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law.

The IRS Strategic Plan for Fiscal Years (FY) 2005 to 2009 provides that enforcing tax compliance is critical to maintaining Americans' expectation that the system is fair and outlines several objectives to meet the goal of enhanced enforcement, including discouraging and deterring noncompliance with emphasis on corrosive activity by corporations, high-income individual taxpayers, and other contributors to the tax gap (the difference between taxes paid and owed). The IRS Commissioner has also repeatedly stressed the importance and role of tax enforcement in overall tax compliance by recognizing the need to increase levels of various enforcement activities to provide a proper balance between service and enforcement.

The CI function is the only law enforcement organization with the authority to investigate criminal tax violations. Its financial investigative expertise has been recognized and increasingly sought by prosecutors and other investigative agencies, and its investigative jurisdiction has expanded over the years to include money laundering¹ and Bank Secrecy Act² criminal violations. These laws have led to greater participation by the CI function in the financial investigative environment and have enabled the IRS to identify and investigate tax evasion cases involving legal and illegal income sources. The CI function also participates in many other Federal Government enforcement initiatives.

In general, legal source investigations involve legal occupations or industries and legally earned income in which the primary motive is the violation of tax statutes. Illegal source investigations involve illegally earned income

¹ 18 United States Code (U.S.C.) Sections (§§) 1956 and 1957 (2004).

² Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.) Regulations for the Bank Secrecy Act, and other related statutes, are 31 C.F.R. § 103.11-103.77 (2002).

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and include money laundering and currency reporting crimes. Illegal source investigations may or may not include tax or tax-related violations.³

This review was performed in the CI function National Headquarters (HQ) office in Washington, D.C., and the Denver, Colorado; New York, New York; and Charlotte, North Carolina, CI function field offices during the period February through August 2004. In December 2004, we updated the charts that depict various statistical indicators relating to the CI function's workload and performance to incorporate FY 2004 data. The review was initiated as part of the Treasury Inspector General for Tax Administration's (TIGTA) FY 2004 Annual Audit Plan and because the Senate Finance Committee (SFC) raised concerns about the CI function's efforts to increase legal source income tax cases.

Our overall objective was to evaluate the CI function's efforts to increase the number of legal source income tax investigations. We encountered a significant scope limitation that precluded us from fully addressing this objective. We were not granted full access to entire administrative investigative case files. Rather, the CI function provided, as mutually agreed, the requested case information necessary to accomplish our objective, which we did not review at the source point.

However, we did not receive sufficient, competent, relevant, and timely information to complete all of our audit tests, particularly those tests that involved a review of grand jury cases. Under Federal rules of evidence, certain investigative information in grand jury cases may not be shared with individuals who are not shown on a list authorizing such access. As part of the grand jury procedures governing disclosure of information, the CI function engaged local IRS

³ The CI function defines tax-related as any violation of Title 26 U.S.C. (the I.R.C.) and the following Title 18 U.S.C. sections: §§ 286 and 287 (2004), § 371 (k) (2004) relating to a Title 26 violation, and § 371 (b) (2004) relating to a Title 26 and a Title 31 violation. Title 18 includes false claims and money laundering, and Title 31 involves currency reporting requirements.

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Criminal Tax Counsel⁴ and the Assistant United States Attorneys (AUSA) to determine what information, if any, from the cases we requested was considered grand jury material and, thus, was restricted from being provided to us. Ultimately, the AUSAs were the final authority on what we could review.

In addition, the CI function instituted procedures that prevented us from obtaining any documents directly from the field offices, requiring the field offices to first provide the information to the CI function HQ office to determine if the request was within the scope of the audit. The purpose of this procedure was to ensure we received requested information timely and in an orderly manner and all documents provided were responsive to our request. We are unaware of any instances in which the CI function HQ office eliminated documents from the field in responding to the audit. Nonetheless, because we could not examine documents at the source, we could not independently confirm that all examples of pertinent documents submitted to the CI function HQ office from the field were, in turn, forwarded to us.⁵

CI function and TIGTA management cooperated to the fullest extent possible on this matter; however, due to the aforementioned grand jury process, we either did not receive any information, or received only partial and incomplete information, on a majority of the grand jury cases. Since a majority of investigations are categorized as grand jury, without access to certain information from those investigations, we could not fully answer our objectives with a sufficient degree of confidence. Therefore, some of our review results are based on limited observations and analyses and may not be representative of the population.

With the exception of the scope limitation described above, the audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit

⁴ A function within the IRS Office of Chief Counsel responsible for providing legal guidance to the CI function.

⁵ We subsequently met with CI function management to establish a revised process that would allow us to conduct our audit work more independently and minimize these types of scope limitations in the future.

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objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Throughout this audit, we discussed our preliminary results with CI function management and made changes to the report where applicable. In the management response to this report, the Chief, CI, provided further explanation on the CI function's position on many of the issues presented in this report. We acknowledge this additional information, and believe we previously addressed the underlying issues in the report text, footnotes, or appendices. Further, we are pleased that the Chief, CI, has already taken or plans to take corrective actions to seven of our eight recommendations, which should strengthen the legal source income tax program. Management's complete response to the draft report is included as Appendix V.

The Criminal Investigation Function Has Taken Actions to Address Concerns About Criminal Tax Investigations

Through the years, the Government Accountability Office (GAO)⁶ and the Webster Report⁷ have raised concerns about the CI function's ability to show how its resources were being used to address allegations of criminal tax violations.

- In a November 1997 report, the GAO reported that two IRS studies conducted in the early 1990s raised questions about the CI function's investigative priorities because its investigative workload was increasingly comprised of nontax investigations, to the detriment of tax investigations.
- In April 1999, the Webster Report expressed concern that the CI function had drifted away from its primary mission of supporting the administration of the internal revenue laws.

The CI function addressed these concerns by taking three major steps:

- Creating a revised mission statement and developing a compliance strategy to help guide the CI function to develop and investigate cases that foster

⁶ *Tax Administration: IRS' Efforts to Place More Emphasis on Criminal Tax Investigations* (GCD-98-16, dated November 1997).

⁷ *Review of the Internal Revenue Service's Criminal Investigation Division* (Publication 3388; 4-1999), also known as the Webster Report.

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confidence in the tax system and compliance with the laws.

- Aggressively publicizing the results of its investigations.
- Conducting an empirical study to determine the effect investigations have on voluntary compliance.

Compliance strategy

The CI function's revised strategy, established in October 1999, is comprised of three distinct, yet interdependent, program areas: legal source tax crimes, illegal source financial crimes, and narcotics-related financial crimes.

Various strategic documents issued since July 2000 illustrate the CI function's commitment to legal source and other tax-related investigations. The priority for legal source income tax investigations follows from the fact that the CI function is the only law enforcement organization with the authority to investigate these types of allegations. CI management clearly articulated this priority in its strategic documents. For example:

- The Strategic Plan for FYs 2000 to 2002, dated July 2000, listed as a major strategy for the CI function to focus resources on increasing tax compliance through legal source income cases.
- The Strategy and Program Plan (SPP) for FYs 2002 and 2003, dated July 2001, reaffirmed the CI function's primary mission – the investigation of legal source income tax cases. The first strategy provided for increased support of compliance efforts in the operating divisions through increased application of resources on legal source income tax cases.
- The FY 2003 Annual Business Plan (ABP), dated October 2002, provided that the CI function would continue to emphasize legal source and other tax-related investigations and listed legal source tax crimes as the top investigative priority. The plan also described that the CI function will increase

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support of Servicewide compliance efforts by increasing the application of resources on legal source tax cases.

In the FYs 2004 and 2005 ABPs, the CI function made a slight change to its investigative strategy that emphasizes maintaining a focus on legal source investigations, rather than increasing its resources on these investigations. The CI function will continue to emphasize investigations, both legal and illegal source, that adversely affect tax administration.

According to CI function executives, this current strategy focuses on developing and investigating those cases which would have the greatest compliance impact. Further, CI function management believes success toward achieving this strategy is measured by such case closing statistical indicators as completed investigations, Department of Justice acceptance rates, publicity rates, and average months sentenced.

The CI function believes it has achieved its strategic goal of optimizing the number of tax investigations. In addition, the Chief, CI, stated that, with a renewed focus on investigative priorities, the CI function is pursuing exactly the right mix of cases that will most effectively target the compliance gap.⁸

Increased publicity

The CI function established an aggressive media campaign to publicize the results of its investigations. A former Chief, CI, stated publicity helps accomplish the Webster Report recommendation to increase public knowledge and respect for the CI function's tax deterrence mission. The CI function established Public Information Officer positions in each of its field offices to serve as a liaison to promote publicity of its cases and to provide outreach of CI function activities.

These efforts have resulted in an increase in publicity on both legal and illegal income source investigations. Since FY 1999, the publicity rates for legal and illegal source

⁸ Source: American Bar Association Quarterly Newsletter – August 2004.

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investigations have increased 13 and 8 percentage points, respectively.

Empirical study

According to the Webster Report, it was unknown with reasonable certainty what, if any, effect the CI function's investigations have upon voluntary compliance or general deterrence. The Webster Report recommended the CI function craft its caseload based on empirical research and an IRS compliance strategy that focuses on tax enforcement and the fostering of voluntary compliance.

To address this, the CI function contracted with a consultant to conduct a study using empirical data to determine whether its investigative activities have a measurable impact on compliance. The CI function also requested the outside consultant test three other variable data sets as they relate to compliance impact as follows: 1) mix of investigation type, 2) impact of publicity, and 3) difference in impact of incarceration versus probation.

The study concluded CI function activities have a measurable effect on voluntary compliance and the mix of CI function sentenced cases (relating to tax versus money-laundering investigations) is not a significant determinant of tax compliance, perhaps because the mix has already been optimally set. As of December 2004, the study results had not been formally published.⁹

The Status of the Criminal Investigation Function's Legal Source Program

The premise of the Webster Report was the CI function had drifted from its primary mission and needed to redefine its strategy to focus its investigations on legal occupations in legal industries where the untaxed income is derived from legal sources. Also, as historically perceived by the IRS, legal source income tax investigations, on average, carry a stronger deterrent against tax crimes to the American public than illegal source tax investigations. In an October 2003 memorandum to the TIGTA, the SFC expressed concerns about the CI function's efforts to increase legal source income tax investigations and requested we begin our planned coverage of this issue.

⁹ This study has been submitted through the academic peer review process for publication.

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We compiled various statistics that depict the CI function's inventory and results for all tax-related and legal source investigations for FYs 1999 through 2004. The CI function has made progress in increasing all tax-related investigations, but the level of legal source investigations did not materially change during this period. Also, recent trends for FYs 2002 through 2004 are mixed for both tax-related and legal source tax investigations. Appendix IV provides graphs that depict these trends.

Because there are no specific criteria that govern the mix of the CI function's workload, we could not conclusively determine whether the CI function is conducting enough legal source income investigations or to what extent it can or should increase the number. Furthermore, the aforementioned scope limitations precluded us from reviewing sufficient numbers of investigations to determine the nexus of these investigations to tax administration.

In discussing our preliminary review results, the Chief, CI, expressed concern that our conclusion might imply that the sheer number of increases in legal source investigations is the goal, rather than an inventory of high-quality, high-impact legal source cases balanced with illegal income source cases. Also, the Chief, CI, stated the CI function has attained 4-year highs in several case closing statistical indicators in the legal source program, which convey progress in achieving the CI function's strategies.

We recognize that mere increases in legal source investigative activity are not the only measure of program success and the results of the investigations also play an important role in evaluating program achievements.

We agree with the CI function that setting the right mix of case types is a matter of skilled judgment. CI function management and the IRS Commissioner, in concert with Congressional and Administration budget and tax law enforcement priorities, should determine how the CI function devotes its resources to pursue those cases that have the greatest impact on voluntary compliance. We also believe, when results of the previously mentioned study are published, the CI function should consider them in the context of all of its stated objectives and investigative priorities when evaluating the proper mix of legal source,

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Improvements Are Needed in the Fraud Referral Program and the Use of General Investigations

tax-related, and nontax-related types of investigations. To assist in this effort, we identified several areas in which the CI function can make improvements to the legal source investigative program and more effectively measure the program's impact on tax compliance.

Historically, internal IRS programs have been the primary sources of cases involving pure tax violation investigations. Between FYs 1999 and 2004, almost 60 percent of legal source investigations came from within the IRS, while less than 20 percent of legal source investigations came from a United States Attorney Office (USAO) or other government agencies. We evaluated certain aspects of the CI function's fraud referral and general investigation (GI) programs to gauge their effectiveness in the CI function's efforts to increase legal source tax investigations.

In our opinion, the CI function could do more to cultivate investigations from within the IRS to address the various concerns that have been raised by the Webster Report, the Congress, and the GAO on increasing legal source investigations or to fully conform to its stated ABP priorities. Specifically:

- IRS efforts to reinvigorate the fraud referral program have not been effective.
- The CI function has not made effective use of GIs.

IRS efforts to reinvigorate the fraud referral program have not been effective

The Webster Report cited concerns about the declining number of quality criminal referrals to the CI function from the IRS compliance functions. In response, both the CI and compliance functions took steps to reinvigorate the fraud referral program, including:

- Creating fraud referral specialist positions in the compliance functions.
- Establishing a communication and feedback process.

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- Assigning processing responsibility to the CI function Lead Development Centers (LDC).¹⁰

According to the IRS Strategic Plan for FYs 2000 to 2005, the IRS will focus on increasing tax compliance in legal source income investigations through invigorating the fraud referral program.¹¹ An operational priority, as listed in the CI function's FY 2004 ABP, is to continue to promote fraud awareness, actively support efforts to enhance the fraud referral program, timely evaluate referrals, and hold conferences with the compliance functions.

Despite these attempts, the fraud referral program has not been reinvigorated. After a dramatic decline in FY 2000, referrals increased steadily through FY 2003. However, even with the emphasis on referrals, the total number of referrals decreased slightly in FY 2004 and is still below the level at the time the Webster Report was issued, as shown by Chart 1.

¹⁰ The CI function currently operates five LDCs. Their primary function is to identify and develop quality investigations to meet the CI function's business plan. The LDCs assist CI field offices by conducting research and analysis on alleged noncompliance.

¹¹ The IRS Strategic Plan for FY 2005 to 2009, published in June 2004, does not contain a specific reference to the fraud referral program.

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Chart 1: Summary of Fraud Referrals

	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Referrals Received ¹²	605	436	486	526	559	530
Percentage of Referrals Accepted	44.3%	50.8%	53.8%	62.9%	61.2%	58.0%
Percentage of Subject Investigations from Referrals	9.4%	9.3%	9.3%	11.1%	10.9%	10.7%
Percentage of Prosecution Recommendations from Referrals	11.5%	11.0%	8.7%	8.8%	7.6%	8.1%

Source: The CI function's Business Performance Reviews, TIGTA analysis of the CI function Management Information System (CIMIS), or CIMIS Report 11, Program Summary Analysis.

We analyzed the CIMIS data relative to fraud referrals, reviewed all 25 fraud referrals rejected by the 3 field offices, and interviewed CI function field office management and compliance function fraud referral specialists. The results of these reviews indicate the CI function has not placed enough emphasis on timely working referrals, communicating results with the compliance functions, and establishing or using existing controls to manage the processing of referrals. For example:

- During FY 2003, the CI function took an average of 93 calendar days to make a decision to accept or decline 521 referrals. The goal was 30 workdays.¹³
- In the 25 cases we reviewed, there were no records that the CI function held 51 percent of the required conferences with the compliance functions.
- Some CI function managers and fraud referral specialists believed fraud has a low standing in the compliance function, and others believed fraud referrals are not a high priority with the AUSA offices.

¹² This is the number of initial referrals (primary investigations) received from the compliance functions. The CI function will evaluate these referrals and, if criminal potential exists, will open a subject investigation.

¹³ Accounting for weekends and holidays, 30 workdays would be about 42 calendar days.

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We believe these factors contribute to the inability to increase the number and quality of fraud referrals. We also believe the absence of a fraud referral coordinator in the CI function field offices has a negative impact on the fraud referral program. We had recommended in a prior review of the LDCs¹⁴ that fraud referral coordinators in the CI function field offices, rather than the LDCs, receive, number, and assign fraud referrals. In response to our LDC report, the CI function's proposed redesign of the LDCs provided that fraud referrals would be sent directly to the CI function field offices. However, the three field offices we visited during our current review did not have a fraud referral coordinator.

The CI function field offices have coordinators for many program areas (including questionable refunds, terrorism, suspicious activity reports, and more recently, corporate fraud) who act as liaisons for the respective program areas. For example, the terrorism coordinators are responsible for contacting representatives of the various terrorism-related task forces (e.g., Joint Terrorism Task Force and the USAO anti-terrorism task force) and reporting the terrorism-related activities of the field office to the CI function HQ office. We believe not having a designated fraud coordinator to handle referrals from the civil functions is an indication the CI function is not fully committed to improving the fraud referral program.

The CI function recently conducted an assessment of the fraud referral program and concluded the program continues to be a logical and critical source of legal source income tax investigations; therefore, the CI and compliance functions must continue to find ways to elevate their partnership to identify emerging areas of fraud.

¹⁴ *Lead Development Centers Do Not Significantly Contribute to Increases in Legal Source Cases* (Reference Number 2003-10-201, dated September 2003).

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The CI function has not made effective use of GIs

A GI is a study, survey, or canvassing activity on a number of individuals or entities within categories, such as occupation or industry. GIs are initiated to identify noncompliance with the laws enforced by the IRS. The CI function also uses GIs to identify the time special agents spend on specialized projects, such as imprest funds, liaison contacts, coordinating various programs, and various task forces. For purposes of our review, we considered only those GIs designed to identify noncompliance with the law.

Whether initiated as a result of noncompliance identified by the compliance function or from a CI function initiative, GIs can serve as a valuable means to identify legal source investigations. However, according to the CIMIS data, the CI function initiated a total of 1,506 legal source investigations during FY 2003, but only 120 of these (8 percent) resulted from a field-generated GI.¹⁵

CI function management advised us the CIMIS does not clearly show those GIs that are designed for administrative purposes, time tracking, or legal source investigations. According to the CIMIS, there were 976 open GIs as of September 30, 2003. We analyzed 98 GIs that were open in the 3 selected field offices and determined 13 were designed to identify legal source investigations. Many of these GIs have been open for many years, and only three investigations from these GIs were opened in FY 2003. Further, as of the end of FY 2003, only 53 legal source investigations had resulted since these GIs were opened.

There was a wide range of opinion among CI function field office management regarding the value of a GI. The SAC in one field office instituted a requirement that each group open a GI to develop legal source investigations. However, the SAC in another office indicated GIs were inefficient.

In addition, we reviewed the Review and Program Evaluation (RPE)¹⁶ reports from 10 field offices to

¹⁵ We excluded investigations that resulted from the return preparer and questionable refund programs since they are generally identified at the Fraud Detection Centers and not in a CI function field office.

¹⁶ A process whereby the CI function HQ office periodically conducts a review to evaluate the operations of the field offices.

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determine the extent they addressed the field offices' efforts to use GIs. These reports showed varying degrees of emphasis placed on GIs. Although all of the RPE reports contained a reference to GIs, they did not always address uniform issues and CI function management did not use these reports to identify trends. In fact, we are not aware of any CI function reports that will provide an analysis of the number of open GIs or the effectiveness of those GIs to identify legal source investigations.

In October 2003, the CI function proposed the realignment of the LDCs to address concerns raised by our report.¹⁷ The realignment specifically called for reprioritizing the work of the LDCs to include identifying and developing leads that fall within the strategic plan. Accordingly, each of the consolidated LDCs was assigned the GI case development responsibilities for a national program priority area in the strategic plan (e.g., offshore and abusive schemes).

This renewed emphasis of having the LDCs involved with developing GIs based on program priorities should help increase legal source income investigations. However, we believe the experiences of the special agents are also a valuable source to identify areas of noncompliance in which a GI would be appropriate. Therefore, we believe it is important the CI function use appropriate management tools to monitor and evaluate the effectiveness of GIs on increasing legal source cases. In addition, this information could be helpful in identifying nonproductive legal source GIs, so those resources could be directed toward other initiatives to increase legal source investigations.

Recommendations

The Chief, CI, should:

1. Establish a fraud coordinator position in the CI function HQ office and in each of the 33 field offices. This could be a collateral duty.

¹⁷ *Lead Development Centers Do Not Significantly Contribute to Increases in Legal Source Cases* (Reference Number 2003-10-201, dated September 2003).

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Management's Response: The Chief, CI, advised that an analyst from the Financial Crimes Section has been assigned fraud referrals as a program area and a detailed policy memorandum was issued in August 2004 directing all field offices to designate fraud referral coordinators.

2. Establish control procedures to ensure referrals are processed timely.

Management's Response: The Chief, CI, advised that a detailed policy memorandum was issued in August 2004 that implemented a fraud referral tracking system and reemphasized established operating procedures. In addition, the FY 2005 performance commitments for all Supervisory Special Agents include a requirement to timely evaluate fraud referrals.

3. Ensure the appropriate management tools are used to monitor and evaluate the results of GIs on legal source investigations.

Management's Response: CI function management will issue a memorandum that reemphasizes the need to monitor all GIs. Further, the memorandum will encourage the closure of nonproductive GIs and will remind the field offices to appropriately link any resulting primary and subject investigations to the GI.

4. Issue guidance emphasizing the use of GIs as a means to identify legal source investigations that have the greatest impact on tax administration.

Management's Response: The Chief, CI, stated although employees have been encouraged to use GI projects to develop investigations of noncompliant areas, experience indicates GIs are not the most productive means to develop significant legal source investigations. Nonetheless, CI management agreed to issue a memorandum reminding field offices to consider the appropriate use of GIs in developing future legal source income investigations, but will not insist they do so to the exclusion of other case development sources.

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The Criminal Investigation Function Must Make Choices on the Types of Investigations to Pursue That Affect Compliance

With a reputation as being one of the best financial investigative agencies in the Federal Government and based on the various laws it is authorized to investigate, other agencies and the USAOs call upon the CI function to assist in various investigations. This often puts the CI function at odds with balancing its resources between mainstream tax compliance issues, for which it has sole investigative authority, and law enforcement against other crimes using tax or money-laundering charges as a tool. In addition to cultivating legal source investigations from within the IRS, the CI function must also be judicious in deciding which investigations to work with other agencies. The following issues, real or perceived, affect the CI function's efforts to balance its resources and increase the level of legal source investigations:

- Inherent barriers beyond the CI function's direct control.
- The relationship of illegal source criminal investigations to tax compliance.
- The lack of a goal on the mix of investigations to pursue.

Inherent barriers beyond the CI function's direct control

We realize there are many barriers beyond the CI function's direct control that affect its ability to increase the level of legal source investigations. Foremost are competing national law enforcement initiatives (e.g., terrorism, corporate fraud, etc.). While these are important in protecting our nation, they may not always result in legal source investigations.

One significant factor that influences the CI function's selection of workload is the relationship between the CI function and the USAOs. While the CI function is responsible for investigating matters that have criminal tax fraud prosecution potential, the USAOs have the responsibility of accepting or declining the prosecution of those criminal matters.

The tax enforcement process works most effectively if the CI function and the various USAOs have the same

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priorities. However, where the CI function's primary responsibility is in tax investigations, the USAOs have assorted prosecutorial goals, of which tax enforcement is only one. The acceptance of a tax case for prosecution may depend not only on the type of violation but also on the geographic location and economic and vocational status of the violator. Given the CI function in essence competes with other agencies for inclusion in the various local USAOs' agendas, there is a need for the CI function to maintain an effective working relationship with the USAOs. This relationship includes participating in joint investigations which might not always have a strong link to mainstream tax compliance.

The Webster Report raised the concern that the USAOs, and not the IRS, determine the CI function's investigative agenda. The report concluded the CI function was pursuing overall Federal law enforcement initiatives at the expense of tax enforcement. The CI function managers we interviewed in general indicated, while the USAOs' priorities do have an influence on their workload decisions, it was not an undue influence. Some managers indicated (as do some RPE reports we reviewed) some USAOs might not be inclined to accept a lot of tax cases for prosecution. Some reasons suggested that could cause this in some locations included a generalization that tax cases are more difficult and take more time to prosecute or certain types of tax violations usually are of relatively low financial value (such as many fraudulent refund schemes).

We also believe workload decisions may be influenced because the lengths of sentences for tax violations are often less than those for sentences associated with the other criminal violations being investigated. Since sentences often run concurrently, there is no additional punitive benefit to pursuing the tax violation.

Nationally, the percentage of investigations opened based on requests from the USAOs has remained relatively constant over the past 4 fiscal years – between 19 and 26 percent of initiations per year. These same case initiations resulted in between 7 and 15 percent of the legal source investigations initiated during the same periods. The CI function managers we interviewed in general indicated a case is often selected based on the merits of the

The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

investigation, regardless of whether it would be a legal source investigation. The managers also indicated awareness that legal source cases were a high priority.

One of the steps in our audit plan was to review all 20 investigations (from the 3 field offices) which started as a tax investigation but the tax charges were later dropped and other nontax charges were pursued. Our objective was to determine whether the CI function was involved in the AUSA's decision to drop the tax charge. We did not receive 13 of the 20 files requested because of the grand jury restrictions previously described. As a result, we could not assess the efficacy of the observation that AUSAs influence the CI function's workload.

The relationship of illegal source criminal investigations to tax compliance.

According to CIMIS data, about 54 percent of the CI function's investigations during FY 2003 came from the USAOs and other government agencies; however, only 17 percent of all legal source investigations came from these sources. In addition, the CI function opened 1,535 illegal source subject investigations, 869 of which had a tax-related charge. The remaining 666 investigations did not have tax-related charges.

We selected a judgmental sample of 30 of the 205 illegal source subject investigations (from the 3 field offices) to determine if the CI function is investigating cases that have an impact on overall tax compliance. However, because of the grand jury secrecy provisions and the limited access to case information, we were able to review limited source documents on only 17 investigations opened by 2 of the offices. Based on what we could review, the case initiation documents for 7 of the 17 investigations did not describe the tax compliance of the subject, regarding either legal or illegal income, and had no tax-related allegation associated with the case. The apparent emphasis of each of the seven investigations was stopping and deterring the criminal activity of the subject. In addition, in 7 of the 17 investigations we did not identify evidence that suggested a special need for complex financial analysis warranting the assistance of the CI function; however, it was not clear if the other agency involved could have conducted

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the investigative steps done by the CI function. The alleged illegal activities in these investigations included crimes such as insurance, consumer, mail, or credit card fraud and embezzlement.

According to the CIMIS, during FY 2003, the CI function opened 273 subject investigations involving these 5 illegal activities. About 65 percent were referred from other agencies or the USAOs, and about 26 percent did not have a tax-related violation.

The CI function is authorized to work these types of investigations; however, other government agencies also have the authority to investigate these crimes. We are not implying that these were not the best investigations for the CI function to work at that particular time. However, given the CI function's limited resources, the demands on these resources, and that the CI function is the only agency that can investigate tax violations, we believe these are the types of investigations—absent a clear connection to tax—that the CI function could reevaluate before accepting.

The lack of a goal on the mix of investigations to pursue

A key management control is to establish goals and then monitor the effectiveness of the efforts to achieve those goals. In 1996, the CI function established a range of 57 to 61 percent of Direct Investigative Time (DIT) to be spent on tax gap investigations as its goal for FY 1997 and beyond. However, other than narcotics-related investigations,¹⁸ the CI function no longer has any goals or targets on the percent of time or number of investigations that should be targeted to legal source income investigations or other investigative program areas.

The CI function managers we talked to are aware of the emphasis to increase legal source investigations, and many stated they work the right case at the right time. The managers generally did not express a strong opinion regarding either the proper mix of investigations or the

¹⁸ The CI function established a goal of 15 percent of DIT for the narcotics program in FY 2004, which is about the amount that is reimbursed for its participation in the Department of Justice Organized Crime Drug Enforcement Task Force investigations.

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pursuit of a specific investigation to attain a certain mix. The Chief, CI, has also recently stated, with a renewed focus in investigative priorities, the CI function is pursuing exactly the right mix of cases that will most effectively target the compliance gap.

With the demands for its resources and the Congress' concerns on how these resources are used, we believe the CI function should continue to assess its impact on tax compliance and consider deriving goals for key statistical indicators, such as the percent of investigations initiated or DIT, so resources can be directed to those program areas best suited to achieve these goals. This will also allow the CI function to align its resources with the strategic objectives and investigative priorities described in SPPs and ABPs. We acknowledge the difficulty in establishing goals when existing empirical data do not directly and conclusively provide for such, but we believe some guidance is essential to measure progress in achieving SPP and ABP objectives and priorities.

Recommendations

The Chief, CI, should establish:

5. Additional criteria to guide the field offices in accepting investigations from other government agencies or the AUSA offices when the cases do not involve tax compliance.

Management's Response: The Chief, CI, indicated the FY 2005 ABP provides guidance to assist field offices in developing local plans and action items to support the CI function's SPP. Special Agents in Charge (SAC) utilize the ABP strategy to set priorities based upon regional and local conditions. Additionally, all SAC performance agreements for FY 2005 include the commitment to work cooperatively with the Department of Justice and other law enforcement partners to investigate other high-impact financial crimes and money laundering cases, with an emphasis on increasing or maintaining the balance of Title 26 and Title 31 violations.

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6. National goals on key statistical indicators, such as the percentage of legal source income investigations or direct investigative time, the CI function should strive to achieve. These goals can be expressed as a range within major program areas to provide needed flexibility and can be based on the best available information from CIMIS, CI management's strategic processes, and other data sources and studies.

Management's Response: The Chief, CI, did not agree with this recommendation. The CI function has no empirical data on which to base a specific target level of legal source investigations. The CI HQ office has directed field management to maintain or increase levels of legal source income investigations and to direct attention to other significant financial investigations which affect tax administration. According to CI function management, the statistical indicators reveal the CI function is currently working at or near an optimal case mix. In addition, CI function management noted the only category for which the CI function can appropriately provide specific DIT target ranges is the Organized Crime Drug Enforcement Task Force Program. This target level is tied directly to the level of funding reimbursement the CI function receives as a result of its involvement in these cases.

Office of Audit Comment: We made this recommendation because we believe it is difficult to effectively measure program success or identify and investigate deviations without having an established standard or goal. In the formal response, the Chief, CI, indicated the priority given to legal source income tax cases is clearly stated in the performance management commitments as follows, "I will continue to focus on legal source tax investigations by increasing or maintaining the percentage of legal source inventory and legal source direct investigative time (DIT) to reinforce CI's core mission." We believe it is necessary to establish a numeric goal to provide an effective means for measuring and analyzing progress. While we recognize the CI function's concerns that its work is cyclical and it needs flexibility to be able to respond to

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The Criminal Investigation Management Information System Does Not Accurately Reflect Efforts to Increase Legal Source Investigations

emerging issues, we believe establishing any goal as a range would provide the needed flexibility.

As in some of our prior audits,¹⁹ we have identified inaccuracies and inconsistencies in recording data in the CI function's various management information systems that may prevent management from properly evaluating the status or effectiveness of the CI function's programs, including efforts to increase legal source investigations. Our limited tests identified the following issues relating to the CIMIS.

- The definitions of legal and illegal source investigations do not accurately reflect the substance of the investigation.
- The classification of GIs is not accurate.
- The numbers of fraud referrals and rejections are overstated.

The definitions of legal and illegal source investigations do not accurately reflect the substance of the investigation

The Webster Report cited concerns with the CI function's broad definition of tax gap investigations, explaining that the definition obscured any meaningful attempt to assess the degree to which the CI function's work promotes tax compliance.²⁰ As a result, the CI function changed the classification of investigations to legal source, illegal source, and narcotics-related. In simple terms, the CI function defines legal source income investigations as investigations that involve taxpayers in legal industries and legal occupations who earned income legally but chose to

¹⁹ *Courts Are Not Always Notified When Criminals Fail to Comply With Their Sentences to Settle Civil Tax Liabilities* (Reference Number 2004-10-060, dated March 2004) and *Lead Development Centers Do Not Significantly Contribute to Increases in Legal Source Cases* (Reference Number 2003-10-201, dated September 2003).

²⁰ Prior to issuance of the Webster Report, the CI function classified investigations as fraud and narcotics; fraud was further subdivided between tax gap and other fraud. The tax gap fraud category pertained to investigations of legal industries with alleged criminal tax violations; the other fraud category involved illegal industries or money laundering with no tax-related charges.

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evade taxes by violation of the tax laws. Illegal source income involves money obtained through illegal sources (other than narcotics) and includes all tax and tax-related, as well as money-laundering and currency reporting, violations.

The CI function modified the CIMIS to reflect these changes and classified investigations based on a combination of various data entered into the CIMIS. However, in our opinion, two factors have caused inaccurate classification of the CI function's investigations.

First, CI function officials advised us the former IRS Commissioner wanted to specifically differentiate those cases that only the CI function could investigate. As a result, the definition of legal source income includes only those investigations in which no other Federal or state agency is involved. Cases are classified as illegal source once another agency assists in the investigation.²¹

During FY 2003, the CI function opened 4,001 investigations, 1,535 of which were classified as illegal source. Analyzing the CIMIS data, we determined that, based on the current CIMIS definitions, 406 of these 1,535 investigations were classified as illegal source solely because another agency was involved, even though the CI function was pursuing only tax or tax-related violations. Because we did not review these cases, we do not know whether any additional nontax charges were brought against the subjects of the investigations by the other agencies; the CIMIS would also not contain this information.

As a result of classifying investigations as illegal source when another agency participates, the CIMIS may be understating the time spent on and the number of legal source income investigations. As many as 48 percent of the investigations initiated and 58 percent of the DIT would have been classified as legal source for FY 2003, compared to about 38 and 42 percent, respectively, as reported.

²¹ The exceptions are cases in the Return Preparer Program (RPP) and Questionable Refund Program (QRP). Investigations in these programs are automatically classified as legal source regardless of another agencies' participation. During FY 2003, 88 of the 520 RPP/QRP investigations opened involved other agencies.

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Second, the existing data fields and codes within the CIMIS do not properly define or classify the investigation according to the CI function's strategy, and the CIMIS does not contain a specific code that captures whether the investigation relates to legal or illegal source income. Two examples illustrate this.

- The subject was an owner of a business and allegedly skimmed receipts from the business by having checks made payable to himself or herself personally in amounts under \$10,000. The CIMIS showed the taxpayer was in a legal industry and occupation, there was an alleged tax violation, and no other agency participated. However, the case was considered an illegal source investigation because the nontax-related violation of money laundering was pursued.

An analysis of the CIMIS showed there were 991 investigations opened in FY 2003 involving subjects in legal industries and occupations classified as illegal source on which the CI function pursued a nontax-related violation in addition to the tax violation. Of these, 239 were classified as illegal solely because of the nontax-related charge. Another agency also participated in the other 752 investigations.

- The subject was alleged to have embezzled a large sum of money from his or her employer and did not report the income on his or her tax returns. The CIMIS showed the taxpayer was in a legal industry and occupation, had a tax charge, had no nontax charges, and no other agency participated in the investigation. Since all existing criteria were met, the CIMIS listed this case as a legal source investigation. However, the source of the income, embezzlement, is an illegal source.²² The CIMIS does not use the illegal activity code when classifying cases.²³

²² Embezzlement is generally considered the illegal act of taking money entrusted to one's care, such as from an employer.

²³ The illegal activity code is a code used in the CIMIS that best describes the alleged illicit source of income, the alleged unlawful activities which affect tax administration, or an area of noncompliance being probed.

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The illegal activity as recorded in the CIMIS was “embezzlement” in 154 investigations opened in FY 2003. However, 55 of the 154 investigations were classified as legal source. A review of the description of the allegation in the CIMIS indicates 36 of the 55 (65 percent) investigations classified as legal source income may be illegal source income investigations.

The first example results in understating the number of legal source investigations; the second example illustrates an overstatement of the number of legal source investigations because the case involves embezzlement or other illegal activity. Due to the nature of the inconsistencies of the coding within the CIMIS, we are unable to determine the overall impact the inconsistent reporting of case type had on the CI function’s compliance strategy. To do so would also require a review of investigative case files.

The CI function attempted to use the existing codes in the CIMIS to automatically define investigations according to its compliance strategy. CI function management considered having the field offices determine which codes to use but decided to use standard definitions to remove the subjectivity of the classification from the field offices.

However, as indicated by the above examples, the existing coding in the CIMIS is not flexible enough to accurately measure the CI function’s compliance strategy, especially relating to legal source investigations, which have the most significant impact on the broadest range of taxpayers.

We recognize the CI function desires to separately tabulate information on those cases that only the IRS has authority to investigate; we concur that the capability to do so has merit. However, CI function management has acknowledged the current definition applied to the legal source category is not perfect. Many of the CI function managers we interviewed agreed the current definition is not always reflective of their workload.

The classification of GIs is not accurate

The CI function originally classified all GIs as illegal source income investigations (except for those designed to identify narcotics-related investigations or questionable refund or return preparer projects) in an effort to be conservative. We

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questioned this because we believed this did not properly record the time devoted to legal source investigations. On April 1, 2004, the CI function issued a memorandum requesting the field offices to review all open GIs and, where appropriate, reclassify those designed to identify legal source investigations.

As a result of that memorandum and subsequent follow-up by the CI function HQ office, the CI function classified 174 GIs as legal source with over 46,000 staff days, including over 4,000 staff days of DIT in FY 2004 as of June 15.

We reviewed these 174 GIs and determined field offices were inconsistent in their classification and 38 investigations were misclassified, based on the following:

- GIs used to track administrative activities – 25.
- GIs in which the majority of resulting investigations were illegal source – 12.
- GI used to track liaison time – 1.

These errors existed because the CI function did not issue guidelines to the field offices on the criteria to use to classify the GIs as legal source. In addition, there are no guidelines to apply as new GIs are initiated. According to the CIMIS data, as of June 15, 2004, these 38 investigations had about 1,400 staff days erroneously charged as legal source investigations in FY 2004, resulting in a potential overstatement of about 53 percent of the time recorded on legal source GIs.

The numbers of fraud referrals and rejections are overstated

According to the CIMIS, during FY 2003, the CI function rejected 194 referrals received from IRS compliance functions. We reviewed all 32 referrals rejected by the 3 field offices we visited. However, we determined the CI function misclassified 7 of the referrals (22 percent) because the CI function:

- Opened multiple investigations on related individuals (for example, a corporation and its

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officer) rather than establishing one investigation per related case.

- Recorded investigations from other sources as referrals.
- Classified investigations from the Offshore Credit Card Program as referrals prior to the Small Business/Self-Employed (SB/SE) Division conducting an audit.

This resulted in overstating the number of referrals and understating the acceptance rate. Since these investigations were improperly classified as referrals, they would also have an adverse effect on the average time it takes the CI function to make an investigative decision on a referral.

As a result of recent reviews of the fraud referral program, the CI function and SB/SE Division plan to establish a fraud referral tracking number beginning in FY 2005. This should enhance the accuracy of controlling fraud referrals. As a result, we made no recommendations with respect to accounting for the number of fraud referrals.

Accurate management information is critical to establishing, measuring, and evaluating program goals and accomplishments. We believe the statistical information currently provided from the CIMIS, because of the issues described, may mislead or be misinterpreted and thus contribute to some of the concerns expressed by external stakeholders on the CI function's workload, including the level of legal source investigations.

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Recommendations

The Chief, CI, should:

7. Conduct an analysis of the CIMIS to determine the impact that inconsistent coding has on the classification of investigations and, if warranted, modify the CIMIS and definitions so the coding properly reflects the true nature and disposition of the investigations and the measurement of the CI function's compliance strategy.

Management's Response: CI function management reemphasized that all multi-agency investigations are properly coded as illegal source investigations. However, they agreed to initiate a study to determine if there is any commonality among the use of incorrect compliance strategy codes in the CIMIS. The CI function will make appropriate corrections and recommend future changes to the new CIMIS system, if warranted.

8. Issue guidelines on the types of GIs that should be classified as legal source. Only those GIs in which the primary purpose is to identify legal source income should be classified as legal source investigations.

Management's Response: The CI function's initial attempts to correct the CIMIS data were not entirely successful and it subsequently clarified the fraud scheme code section of the CIMIS handbook and provided better instructions. The Office of Financial Crimes will follow-up to ensure the necessary corrections are made.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the Criminal Investigation (CI) function's efforts to increase the number of legal source income tax investigations. To accomplish our objective, we obtained an extract from the CI function's Management Information System (CIMIS)¹ for the period ended September 30, 2003. We validated the data received from the CIMIS by comparing the results of various queries to the CI function's management information reports. However, we did not verify the accuracy of the data entered into the CIMIS. We selected the Denver, Colorado; New York, New York; and Charlotte, North Carolina, field offices based upon a combination of factors, including total number of investigations worked, percentage of cases that are legal source, percentage of investigations with tax-related charges,² fraud referral acceptance rate, percentage of investigations with tax charges dropped, and percentage of legal source investigations resulting from a general investigation (GI). Specifically, we:

- I. Identified the sources of the CI function's legal source workload and determined what the CI function is doing to cultivate and increase the number of legal source income tax investigations from those sources.
 - A. Conducted various analyses of the CIMIS to identify the source and other characteristics of the CI function's inventory and results.
 - B. Reviewed a judgmental sample of 10 of the 25 CI function Headquarters (HQ) Review and Program Evaluation (RPE)³ reports issued during Fiscal Years (FY) 2002 and 2003, including those for the 3 offices visited, and determined if the depth of review, results, and related recommendations indicated any emphasis on increasing legal source income tax investigations or investigations with tax-related statutes. We also determined if any trend reports were prepared from these reviews. We used judgmental sampling techniques since the results of evaluating reviews could not be projected to a universe.
 - C. Identified and reviewed CI function studies, initiatives, or task forces that were designed to increase legal source investigations.

¹ The CIMIS is a database that tracks the status and progress of criminal investigations and the time expended by special agents. It is also used as a management tool that provides the basis for decisions of both local and national scope.

² The CI function defines tax-related as any violation of Title 26 United States Code (U.S.C.) (the Internal Revenue Code) and the following Title 18 U.S.C. sections (§): §§ 286 and 287 (2004), § 371 (k) (2004) relating to a Title 26 violation, and § 371 (b) (2004) relating to a Title 26 and Title 31 violation. Title 18 includes false claims and money laundering, and Title 31 involves currency reporting requirements.

³ The RPE is a process whereby the CI function HQ office periodically conducts a review to evaluate the operations of the field offices.

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- D. Reviewed a judgmental sample of the Special Agents in Charge group operational reviews conducted during FY 2003 for 17 of the 32 groups in the 3 field offices visited. We used judgmental sampling techniques since the results of evaluating reviews could not be projected to a universe.
- E. Evaluated the CI function's efforts to increase legal source investigations from the fraud referral program.
 - 1) Reviewed all 25 referrals rejected during FY 2003 in the 3 offices selected and determined if the required conferences were conducted, the referrals were timely evaluated, and feedback was provided and was timely.⁴
 - 2) Analyzed the CIMIS to determine the time it takes the CI function field office to accept or reject a fraud referral.
 - 3) Determined if CI function field offices have a fraud referral coordinator.
- F. Evaluated the CI function's efforts to increase legal source investigations from GIs.
 - 1) Discussed and obtained information from the CI function HQ office on the number of GIs that are designed to increase legal source investigations, the results of those projects, and if these projects were initiated based on the empirical studies or other known areas of noncompliance.
 - 2) Analyzed the CIMIS to determine the number of GIs opened, those that relate to legal source investigations, and the number of subject investigations resulting from the GIs.
- G. Determined if the CI function is investigating cases that have an impact on overall tax compliance by selecting a judgmental sample of 30 of the 205 illegal source investigations opened during FY 2003 in the 3 selected offices. We used judgmental sampling techniques due to the small universe and because we did not plan to project our results.

Auditor's Note: We were unable to complete this test. We did not receive 13 of the case files requested due to the grand jury secrecy provisions. Our results are based on the review of limited documentation in 17 of the 30 case files.

- II. Identified the barriers that prevent the CI function from increasing legal source workload and determined what the CI function is doing to minimize or eliminate those barriers.
 - A. Interviewed CI function management to determine their perceptions of what is preventing the CI function from increasing legal source investigations.
 - B. From the 3 field offices visited, selected all 20 investigations in which the case started as a tax case but was recommended for prosecution without a tax charge and attempted

⁴ The CIMIS shows the CI function rejected 32 referrals. However, the CI function erroneously classified seven investigations as fraud referrals.

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to determine if the CI function was involved in the Assistant United States Attorney's decision to drop the tax charge.

Auditor's Note: We were unable to complete this test. Due to the grand jury secrecy provisions, we did not receive 13 of the 20 investigations requested. The limited information we received precluded us from reaching any conclusions from this test.

- III. Determined if the CIMIS is sufficiently reliable to enable CI function management to make informed decisions and evaluate its ability to increase legal source investigations.
 - A. Interviewed CI function management to discuss the reasons for the existing definition of legal source tax investigations.
 - B. Analyzed the CIMIS to identify investigations that were classified as illegal income because another government agency was involved in the case.
 - C. Determined whether the CI function issued any guidelines for entering the Strategy Codes⁵ for GIs into the CIMIS.
 - D. Analyzed the CI function's reclassification of GIs to legal source investigations.
 - E. Used the results of our tests on fraud referrals to determine the accuracy of reporting fraud referrals on the CIMIS.

⁵ The strategy codes are: legal source tax crimes, illegal source financial crimes, and narcotics-related financial crimes.

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Appendix II

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Appendix III

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Appendix IV

Criminal Investigation Function Statistical Indicators

To evaluate the Criminal Investigation (CI) function's progress in investigating criminal tax violations, we compiled various statistics that depict inventory and results for all tax-related¹ and legal source tax investigations for Fiscal Years (FY) 1999 through 2004. Where data were available, we present two charts for each statistical indicator: the first chart depicts the relationship between tax-related and nontax-related investigations; the second chart depicts the relationships among the CI function's three program areas of legal source, illegal source, and narcotics-related financial crimes (narcotics). We also calculated in the second chart within each section below the percentage of legal source investigations to the total number of investigations. We included both views because legal source investigations are an important component of all tax-related investigations, and the CI function has consistently described legal source tax cases as a top investigative priority.

Subject Investigations Initiated

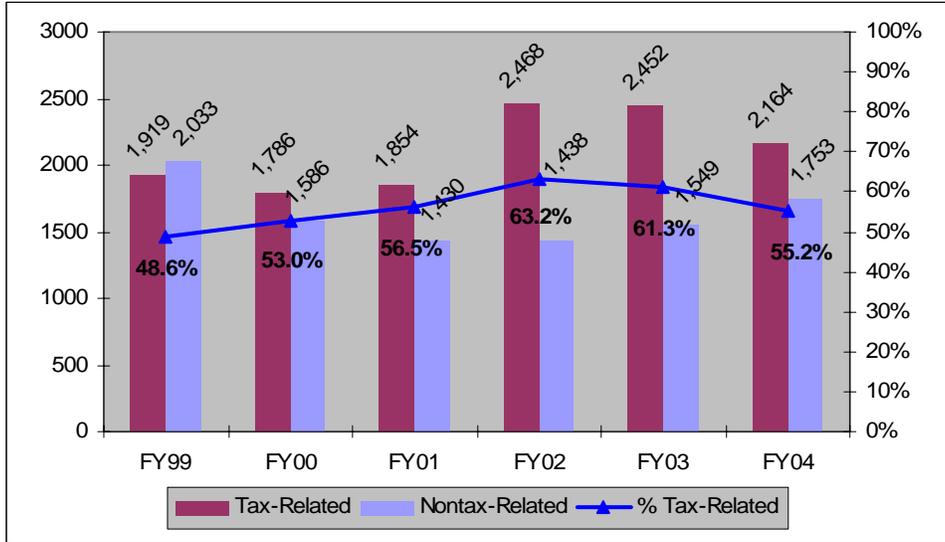
The CI function initiates a subject criminal investigation when it believes a taxpayer has committed a crime and there is likelihood for successful criminal prosecution. Thus, the percentage of all tax-related and legal source income tax investigations initiated is an important element in evaluating the CI function's efforts to investigate tax fraud.

As Chart 1 depicts, tax-related investigations comprised 48.6 percent of all investigations initiated in FY 1999; that increased 6.6 percentage points to 55.2 percent in FY 2004. However, as depicted in Chart 2, the percentage of investigations initiated that were classified as legal source was virtually unchanged during the same period (34.8 percent in FY 1999 compared to 35 percent in FY 2004). Further, between FYs 2002 and 2004, the percentages of tax-related and legal source tax investigations initiated both declined, by 8 and 4.8 percentage points, respectively. CI function management has attributed the recent decline from FYs 2003 to 2004 to its efforts to reduce the number of overage investigations. Rather than opening new investigations, special agents are putting more resources into completing existing investigations.

¹ The CI function defines tax-related as any violation of Title 26 United States Code (U.S.C.) (the Internal Revenue Code) and the following Title 18 U.S.C. sections (§): §§ 286 and 287 (2004), § 371 (k) (2004) relating to a Title 26 violation, and § 371 (b) (2004) relating to a Title 26 and a Title 31 violation. Title 18 includes false claims and money laundering, and Title 31 involves currency reporting requirements.

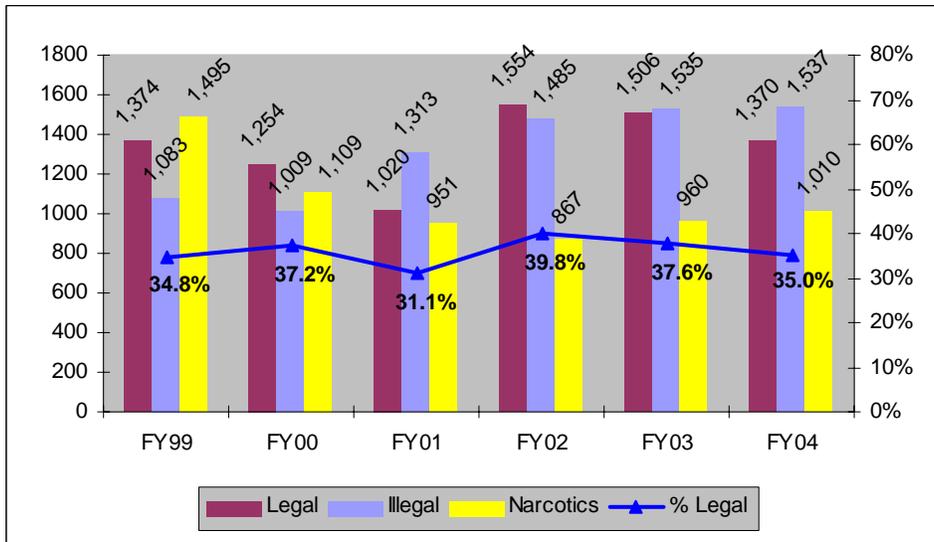
The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Chart 1: Number of Tax-Related and Nontax-Related Subject Investigations Initiated and the Percentage That Is Tax-Related (by fiscal year)



Source: The CI function's Business Performance Reviews (BPR).

Chart 2: Number of Subject Investigations Initiated by Compliance Strategy and the Percentage That Is Legal Source (by fiscal year)



Source: The CI function's BPRs.²

² The numbers for legal source investigations in Charts 2, 3, 5, 7, and 9 reflect the classification at the end of the fiscal year and may be slightly overstated in FYs 1999 and 2000. These were transition years in which the CI function reclassified investigations from tax gap (the difference between taxes paid and owed) and other fraud to legal and illegal source investigations. As a result, some investigations classified as legal source at the fiscal year end were subsequently reclassified as illegal source. The CI function reports the original numbers to maintain consistency.

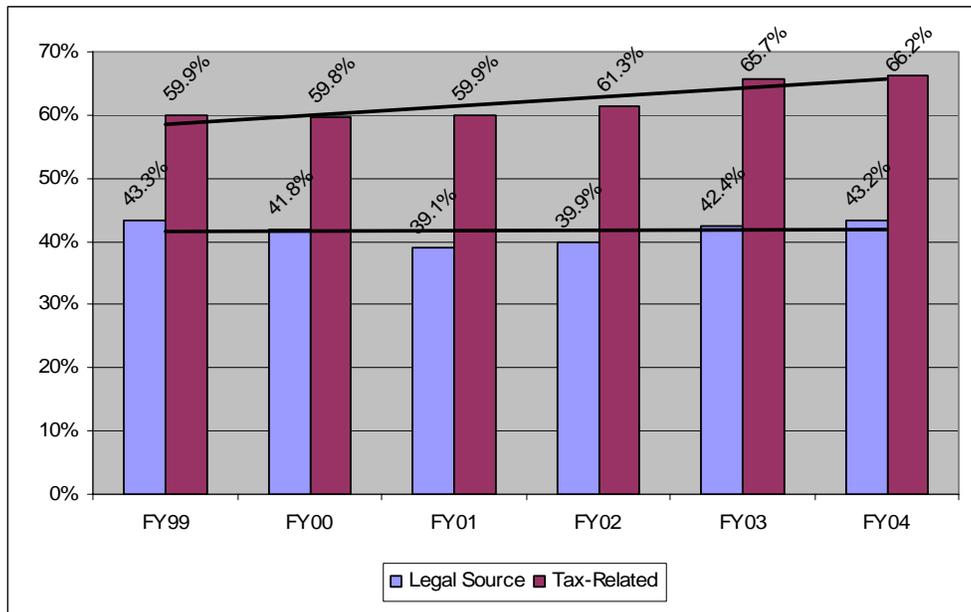
The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Direct Investigative Time

Direct investigative time (DIT) is defined as the time spent by special agents conducting investigations and other law enforcement activities. As with investigations initiated, DIT is another important element in evaluating efforts to increase tax-related and legal source tax investigations. The percentages of DIT depict where the CI function is expending its resources.

The amount of DIT on all tax-related and legal source tax investigations shows results comparable to investigations initiated. The CI function increased its DIT on all tax-related investigations by 6.3 percentage points, from 59.9 percent in FY 1999 to 66.2 percent in FY 2004. However, the DIT spent on legal source tax investigations was virtually unchanged during the same period, having gone from 43.3 percent in FY 1999 to 43.2 percent in FY 2004. Unlike investigations initiated, the trend for the last 2 fiscal years for DIT expended is positive, with tax-related and legal source tax investigations increasing 4.9 and 3.3 percentage points, respectively. Chart 3 depicts these trends; we have included a 6-year trend line to further illustrate the relative movement for FYs 1999 through 2004 for these 2 categories.

Chart 3: Percentage of Tax-Related and Legal Source DIT



Source: The CI function's BPRs and analysis of the Criminal Investigation Management Information System (CIMIS).³

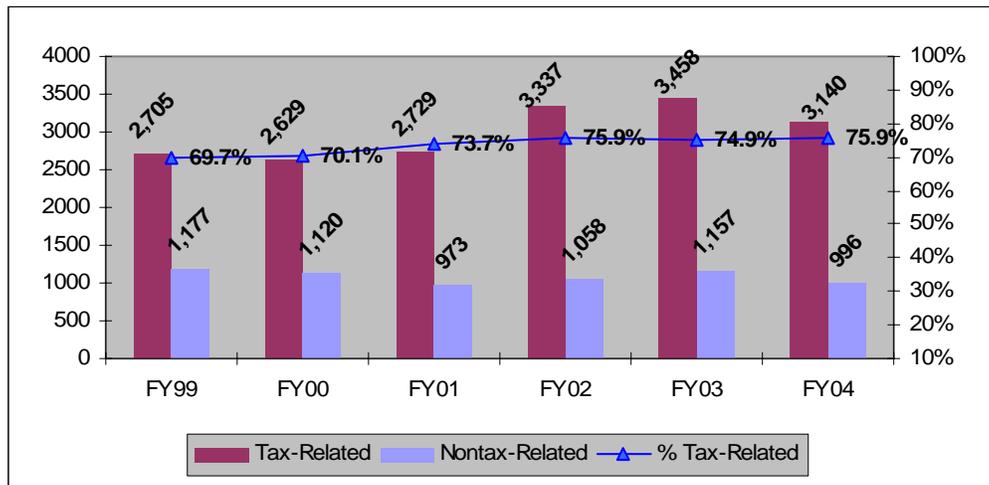
³ The CI function calculated tax-related DIT based on all legal source investigations being tax-related. In addition, some indirect time, considered tax administration-related, was included as legal source DIT. Chart 3 reflects that definition. The CI function began reporting tax-related DIT in the FY 2004 BPR based on the tax violation. The tax-related DIT reflected in the chart is slightly higher than that reported in the FY 2004 BPR because some legal source cases do not have a tax-related charge, and indirect time does not have any violation associated with it.

The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Subject Investigations in Inventory

Inventory levels at fiscal year end provide a snapshot of the relative mix of open subject investigations the CI function has available. Again, as shown in Charts 4 and 5, the figures are comparable. The percentage of tax-related investigations in inventory in FY 1999 was 69.7 percent and has increased 6.2 percentage points to 75.9 percent in FY 2004. However, as shown in Chart 5, the percentage of legal source tax investigations in inventory remained virtually unchanged, declining slightly from 50.7 percent in FY 1999 to 49.6 percent in FY 2004. The trends for the last 2 fiscal years for both tax-related and legal source tax investigations are relatively flat. CI function management advised that the decreases in the total number of investigations in all categories from FYs 2003 to 2004 can also be attributed to their efforts to reduce older investigations.

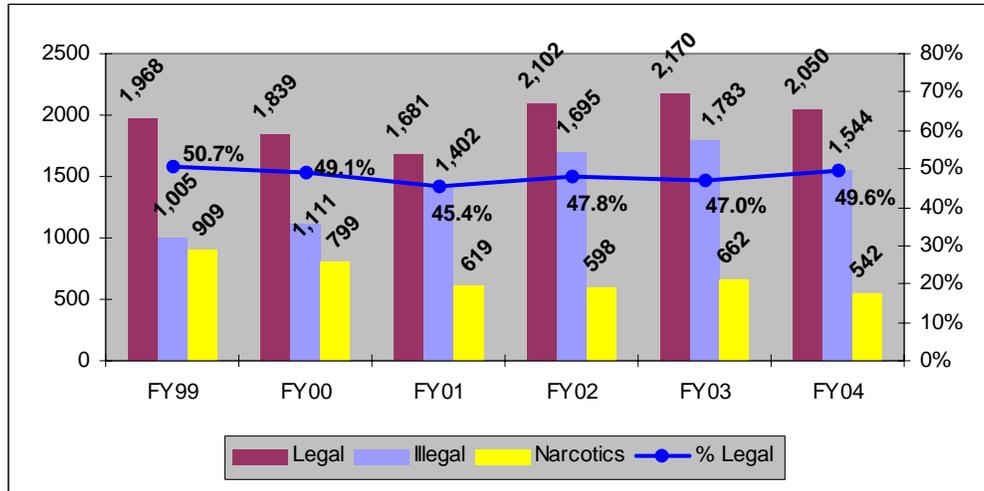
Chart 4: Number of Tax-Related and Nontax-Related Subject Investigations in Inventory and the Percentage That Is Tax-Related (by fiscal year)



Source: The CI function's BPRs and analysis of the CIMIS.

The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Chart 5: Number of Subject Investigations in Inventory by Compliance Strategy and the Percentage That Is Legal Source (by fiscal year)



Source: The CI function's BPRs and analysis of the CIMIS.

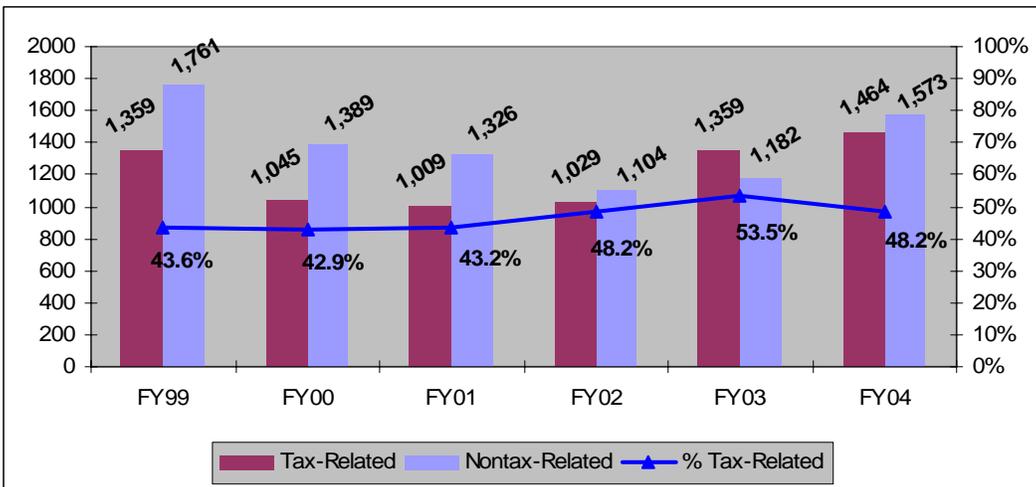
The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Prosecution Recommendations

When the CI function completes an investigation, the case is either discontinued, meaning there are no further prospects for proceeding with criminal charges, or the case is provided to the Department of Justice Tax Division or a United States Attorney Office for consideration of criminal prosecution. Thus, prosecution recommendations are reflective of successful criminal investigations and reflect on the quality of the investigation.

Chart 6 shows the percentage of prosecution recommendations involving tax-related investigations increased 4.6 percentage points, from 43.6 percent in FY 1999 to 48.2 percent in FY 2004. However, as shown in Chart 7, recommendations on legal source tax investigations declined 2.7 percentage points, from 31.3 percent in FY 1999 to 28.6 percent in FY 2004. Also, for FY 2004, the percentages for both tax-related and legal source tax investigations decreased to FY 2002 levels, after increasing in FY 2003.

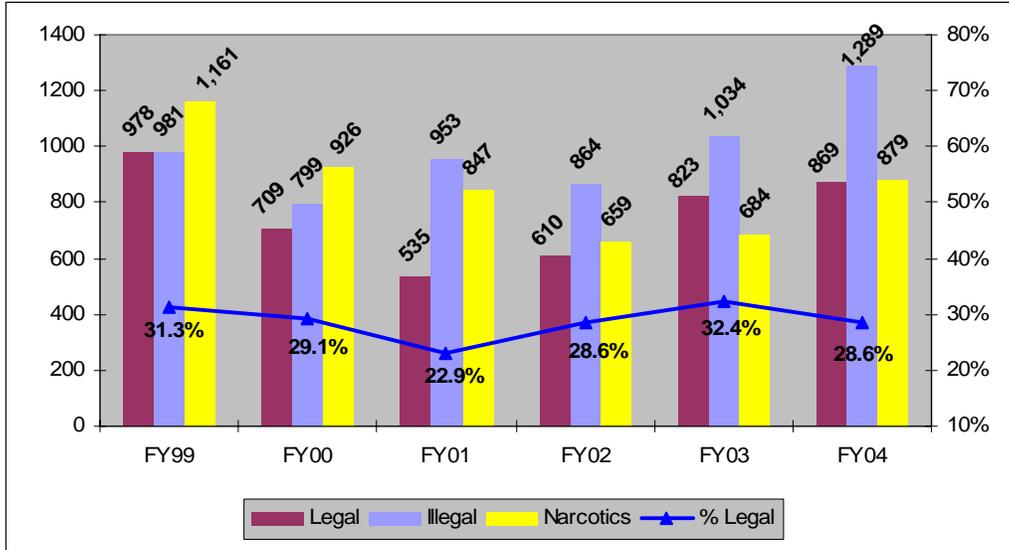
Chart 6: Number of Tax-Related and Nontax-Related Subject Investigations Recommended for Prosecution and the Percentage That Is Tax-Related (by fiscal year)



Source: The CI function's BPRs and analysis of the CIMIS.

The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Chart 7: Number of Subject Investigations Recommended for Prosecution by Compliance Strategy and the Percentage That Is Legal Source (by fiscal year)



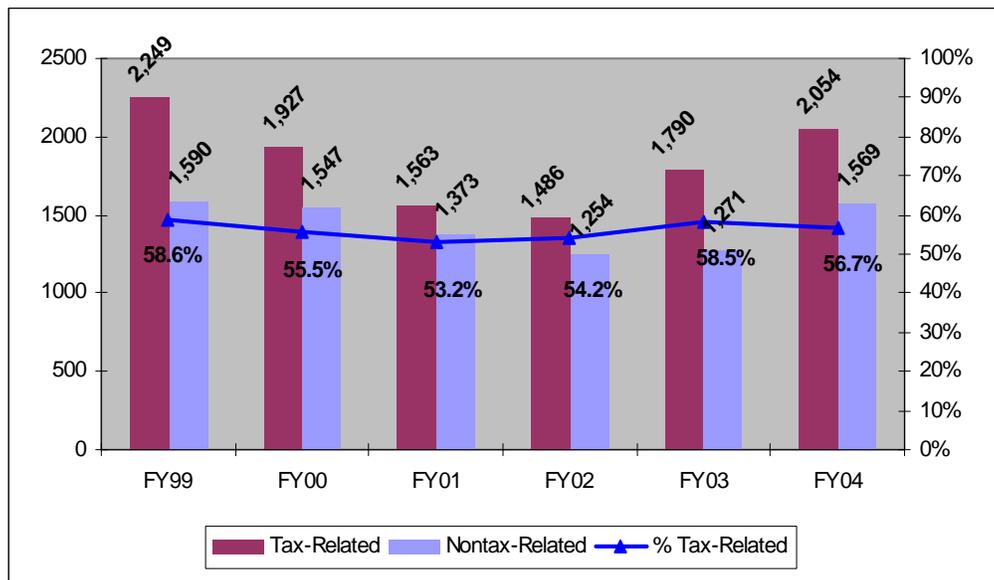
Source: The CI function's BPRs and analysis of the CIMIS.

The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Pipeline Inventory

The CI function defines pipeline inventory as investigations that have been recommended for prosecution and are awaiting final actions by the criminal justice system (i.e., the subject has not been convicted, acquitted, or dismissed). As shown in Chart 8, the percentage of tax-related cases in pipeline inventory decreased 1.9 percentage points from FYs 1999 to 2004. Chart 9 also shows a declining trend for legal source tax investigations for the same period. The percentage of legal source tax investigations decreased 7.4 percentage points, from 40.8 percent in FY 1999 to 33.4 percent in FY 2004. Further, while the number of tax-related pipeline cases is at a 5-year high and legal source investigations are at a 4-year high, the percentages of tax-related and legal source investigations declined from FY 2003 to FY 2004.

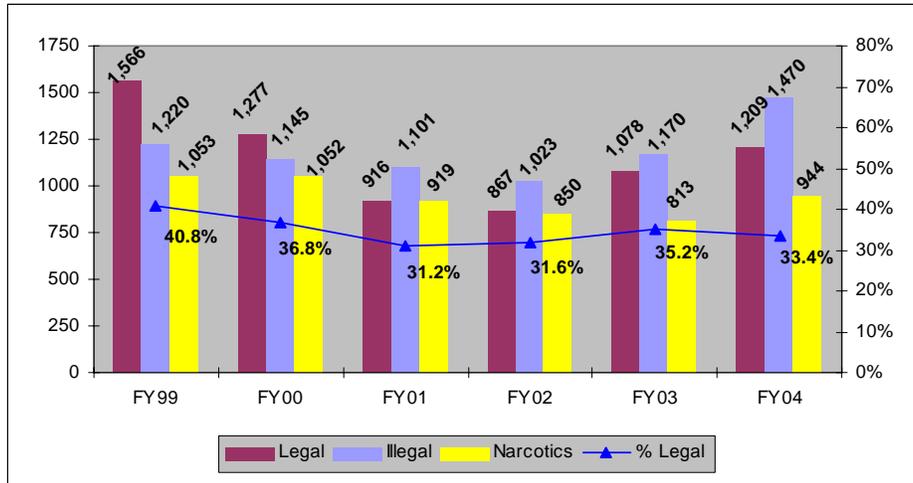
Chart 8: Number of Tax-Related and Nontax-Related Subject Investigations in the Pipeline and the Percentage That Is Tax-Related (by fiscal year)



Source: The CI function's BPRs and analysis of the CIMIS.

The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Chart 9: Number of Subject Investigations in the Pipeline by Compliance Strategy and the Percentage That Is Legal Source (by fiscal year)



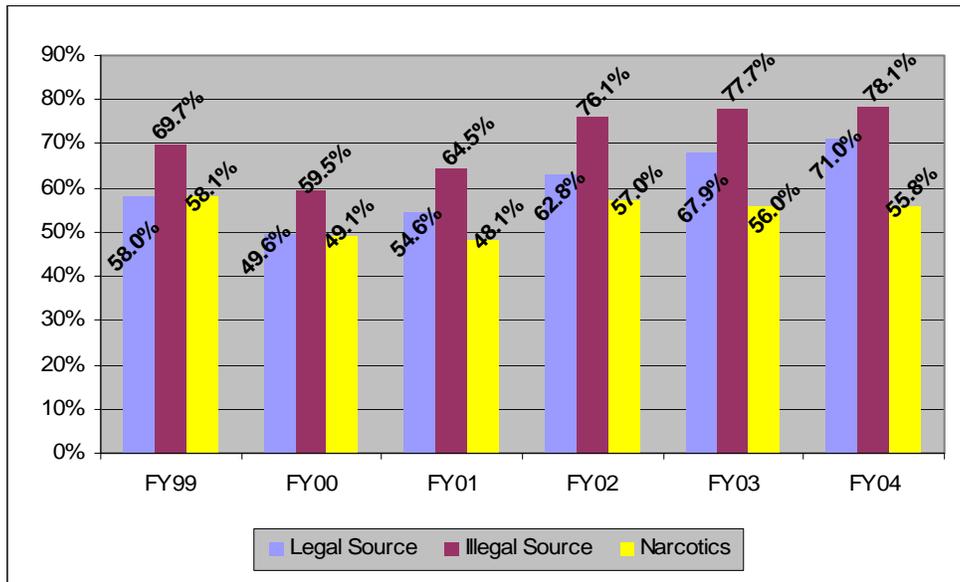
Source: The CI function's BPRs and analysis of the CIMIS.

The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain

Publicity Rate

The publicity rate is the percentage of investigations that receive media exposure (whether local or national coverage) during the course of an investigation. As part of its strategy to encourage compliance, the CI function embarked on an effort to increase the publicity on cases it investigates. As depicted in Chart 10, the publicity rate on legal source investigations rose from 58 percent in FY 1999 to 71 percent in FY 2004. Similarly, the publicity rate on illegal source investigations rose from 69.7 percent to 78.1 percent.

Chart 10: Publicity Rate on Subject Investigations by Compliance Strategy



Source: The CI function's BPRs and analysis of the CIMIS.

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Appendix V

Management's Response to the Draft Report



Criminal Investigation

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 24, 2005

MEMORANDUM FOR PAMELA J. GARDINER
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Nancy J. Jardini  
Chief, Criminal Investigation

SUBJECT: Response To Draft Report: The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain (Audit #200310042)

The Internal Revenue Service (IRS) Criminal Investigation function (CI) reviewed the Treasury Inspector General for Tax Administration (TIGTA) draft audit report, concerning CI's efforts to increase legal source income tax investigations, and agrees that legal source investigations should be a major priority. In fact, legal source investigations have and continue to be a top priority for CI.

In 1999, The Webster Report concluded that CI suffered from "mission drift" and was placing insufficient emphasis on its core responsibility of investigating tax crimes in support of the IRS's overall compliance strategy. As a result, CI's fiscal year (FY) 2000 Interim Compliance Strategy reaffirmed legal source cases were critical to promoting voluntary compliance. Since then, it has not only been reiterated in every Annual Business Plan (ABP) and strategy document, but has been clearly and repeatedly emphasized to all levels of the organization.

Fiscal year-end 2004 quantity and quality measures for legal source cases, reached a 4-year high water mark as a result of this emphasis. For example, CI completed 45 percent more legal source investigations when compared to FY 2001. The direct investigative time (DIT) applied to legal source investigations exceeded 43 percent of total DIT, an increase of over four percent from FY 2001. The Department of Justice (DOJ) acceptance rate reached 96 percent and the conviction rate topped 95 percent. Average prison sentences and the publicity rate increased 38.5 percent and 16.4 percent respectively. Collectively, these results clearly demonstrate CI's progress in achieving this important strategic objective.

Criminal Investigation continues to strive to further improve the legal source income program, not only focusing on maintaining or increasing the quantity of legal source investigations, but also improving their quality and impact on non-compliance. In particular, CI has taken a number of positive steps to bolster the Fraud Referral

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Program. These steps, covered in detail later in this response, have already produced significant results. For example, referrals received and accepted during the first quarter of FY 2005 both increased by over 52 percent when compared to the same time frame in FY 2004.

Criminal Investigation's emphasis on legal source income cases did not diminish the importance of illegal source income, narcotics, money laundering, or currency violation investigations in enhancing voluntary compliance, but it did establish an unambiguous priority. This priority is clearly stated in the Chief's and Deputy Chief CI's FY 2005 performance management commitments: "I will continue to focus on legal source tax investigations by increasing or maintaining the percentage of legal source inventory and legal source direct investigative time (DIT) to reinforce CI's core mission."

In 2001 and 2004 two research documents answered several important compliance questions. Collectively, they provide a useful perspective from which to evaluate past, present, and future compliance strategies.

The first report prepared by IRS for the Secretary of the Treasury in July 2001 was entitled Money Laundering's Role in IRS Tax Administration. This report explores the widely recognized use of money laundering by domestic and international criminal enterprises to conceal illegal, untaxed proceeds. More importantly, it brought into sharp focus the pivotal role money laundering plays in many legal source income evasion schemes, particularly, the most ambitious and sophisticated abusive tax schemes. Since this report was issued, its conclusions regarding the threat money laundering poses to voluntary compliance have been repeatedly validated.

The second report prepared by Professor Jeffrey A. Dubin in July 2004 attempts to ascertain the relationship between Criminal Investigation Enforcement Activities and Taxpayer Noncompliance. Professor Dubin concluded that CI's activities do have a measurable effect on voluntary compliance and the mix of cases may be optimally set.

Criminal Investigation's experience since the 2000 reorganization, coupled with the conclusions contained in these reports validate CI's past and present case mixes and their effect on voluntary compliance. The following comments present CI's perspective on the important issues discussed in the draft report.

Page 2, Second Full Paragraph and Page 3, First Full Paragraph

"...We were not granted full access to entire administrative investigative case files. Rather, the CI function provided, as mutually agreed, the requested case information necessary to accomplish our objectives, which we did not review at the source point."

"In addition, the CI function instituted procedures that prevented us from obtaining any documents directly from the field offices, requiring the field offices to first provide the information to the CI function HQ office to determine if the request was within the scope of the audit. The purpose of this procedure was to ensure we received requested information timely and in an orderly manner and that all documents

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provided were responsive to our request. We are unaware of any instances in which the CI function HQ office eliminated documents from the field, in responding to the audit. Nonetheless, because we could not examine documents at the source, we could not independently confirm that all examples of pertinent documents submitted to the CI function HQ office from the field were, in turn, forwarded to us."

Criminal Investigation wishes to reinforce that at all times we worked with TIGTA to ensure that they received all applicable documentation to conduct their work. Criminal Investigation conducted an extensive presentation well in advance of the opening conference detailing the components of investigative case files, and TIGTA represented at that time that the submission of entire files was unnecessary. At the opening conference TIGTA and CI agreed to the procedures quoted above from the draft report. Per this agreement, Headquarters CI (HQ/CI) provided TIGTA with specific requested documents, which were within the scope of the audit and not subject to grand jury restrictions. When TIGTA subsequently expressed dissatisfaction with these procedures, CI agreed to grant direct access to the sources of requested documentation during future audits.

Page 2, Last Paragraph and Page 3, Second Full Paragraph

"However, we did not receive sufficient, competent, relevant, and timely information to complete all of our audit tests, particularly those tests that involved a review of grand jury cases..."

"CI function and TIGTA management cooperated to the fullest extent possible on this matter; however, due to the aforementioned grand jury process, we either did not receive any information, or received only partial and incomplete information, on a majority of the grand jury cases. Since a majority of investigations are categorized as grand jury, without access to certain information from those investigations, we could not fully answer our objectives with a sufficient degree of confidence. Therefore, some of our review results are based on limited observations and analyses and may not be representative of the population."

The release of grand jury information is outside of CI's control. As the Senate Finance Committee pointed out in its October 29, 2003 pre-audit letter, "I understand that the grand jury secrecy provisions outlined in Rule 6(e) of the Federal Rules of Criminal Procedure prohibit TIGTA from obtaining information on matters that could be presented to a grand jury. I expect that TIGTA will be mindful of any restrictions these provisions may impose on your work." In spite of the disclosure restrictions, CI provided its full cooperation to give TIGTA all requested documentation possible within the confines of Rule 6(e).

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Page 5, Second Full Paragraph

"In the FYs 2004 and 2005 ABPs, the CI function made a slight change to its investigative strategy that emphasizes maintaining a focus on legal source investigations, rather than increasing its resources on these investigations. The CI function will continue to emphasize investigations, both legal and illegal source, that adversely affect tax administration."

In addition to the ABP guidance, the following language is included in the Chief's and Deputy Chief's FY 2005 Executive Performance Agreement commitments: "I will continue to focus on legal source tax investigations by **increasing** or maintaining the percentage of legal source inventory and legal source DIT to reinforce CI's core mission..." (emphasis supplied). This commitment was directed to all field management officials for inclusion in their Performance Management Agreements as well. This change in CI's guidance is directly attributable to two factors. The first is the conclusion drawn in the Dubin report that CI's sentenced case mix is not a significant determinant of tax compliance because the current case mix may already be optimal. Secondly, all quantity and quality indicators signal that CI is pursuing an appropriate mix of legal and illegal source investigations, creating a significant deterrent impact.

Page 6, First Full Paragraph

"The CI function believes that it has achieved its strategic goal of optimizing the number of tax investigations. In addition, the Chief, CI, stated that with a renewed focus in investigative priorities, the CI function is pursuing exactly the right mix of cases that will most effectively target the compliance gap."

Rather than focusing on generalized public statements, the more important indicators of CI's investigative priorities are clearly stated in the Strategy and Program Plans (SPPs), the ABPs, and managers' performance agreement commitments. The latest ABP states, "Criminal Investigation will continue to focus its investigative resources on legal source tax investigations by working closely with the other operating divisions to develop and investigate cases on significant violators." The FY 2005 SPP specifically emphasizes the focus on tax and legal source tax as follows:

"Strategy 1: Increase support of compliance efforts in operating divisions through increased application of resources in tax administration investigations

Criminal Investigation will continue to focus its investigative resources on legal and illegal source tax investigations to increase compliance with tax laws through tax law enforcement. Criminal Investigation will work closely with the four operating divisions to investigate and prosecute significant violators of tax fraud and money laundering."

Due to the nature of CI's work, the actual mix of investigations may change from year to year. Legal source investigations, however, have consistently remained a top

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priority. Formal direction from HQ/CI to the field has repeatedly reinforced this mandate.

Page 7, Second Full Paragraph

"...Also, as historically perceived by the IRS, legal source income tax investigations, on average, carry a stronger deterrent against tax crimes to the American public than illegal source tax investigations."

This perception was based on all facts available at the time, including the Webster Report conclusions. However, the Dubin study, casts doubt on prior assumptions. Specifically, Dubin concluded that:

1. Criminal Investigation activities have a measurable and significant effect on voluntary compliance.
2. The mix of sentenced cases (tax and money laundering) is not a significant determinant of tax compliance.
3. Incarceration and probation, rather than fines, have the most influence on taxpayers.

Page 7, Third Full Paragraph and Page 31, Third Paragraph

"...The CI function has made progress in increasing all tax-related investigations, but the level of legal source investigations did not materially change during this period."

"...However, as depicted in Chart 2, the percentage of investigations initiated that were classified as legal source was virtually unchanged during the same period (34.8 percent in FY 1999 compared to 35.0 percent in FY 2004). Further, between FYs 2002 and 2004, the percentages of tax-related and legal source tax investigations initiated have both declined, by 8 and 4.8 percentage points, respectively. CI function management has attributed the recent decline from FY 2003 to FY 2004 to its efforts to reduce the number of overage investigations. Rather than opening new investigations, special agents are putting more resources into completing existing investigations."

The draft report does not present a comprehensive analysis of all statistical indicators reflecting CI's gains in tax-related and legal source case work or the resulting impact. A critical analysis of all relevant statistical data, particularly quality measures including DOJ acceptance rate, average months to serve, and publicity rate, demonstrate CI is successfully transitioning its tax-related and legal source inventory to the most sophisticated investigations that have the greatest impact on voluntary compliance.

Fiscal years 1999 and 2000 statistics on legal source case inventory levels are not directly comparable to FY 2001 through FY 2004. The legal source income definition was not implemented in CIMIS until FY 2000. As a result, CI did not consistently capture multi-agency data during the transition year. It was not until January 2001

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that the multi-agency code became a mandatory entry in the Criminal Investigation Management Information System (CIMIS). Therefore, FY 2001 is the first year of reliable data, based on the current legal source definition. If FY 2001 is used as the comparison year, the percentage of legal source investigations initiated increased 34.3 percent by FY 2004. During the same time frame, overall tax and tax related¹ case initiations increased by 16.7 percent.

Historic statistical trends establish that CI's work flow is cyclical. Basing broad conclusions on limited statistical indicators can be misleading. Analyzing the data in Chart 1 on page 32 of the draft report from a 3-year cycle perspective, tax-related subject investigation initiations increased 27 percent from the FY 1999 through FY 2001 average of 1,853 to the FY 2002 through FY 2004 average of 2,361. Comparing the same 3-year periods, the data depicted in Chart 2 reflects a 21.5 percent increase in legal source initiations—from an average of 1,216 to 1,477. The percentages of legal source inventory, using the same 3-year average method, increased 3.1 percent. Looking beyond individual years to broader patterns, the data in the tables show CI has in fact significantly increased its level of tax-related and legal source subject investigations. If the FY 1999 and FY 2000 data were more reliable, the above results would be even more favorable.

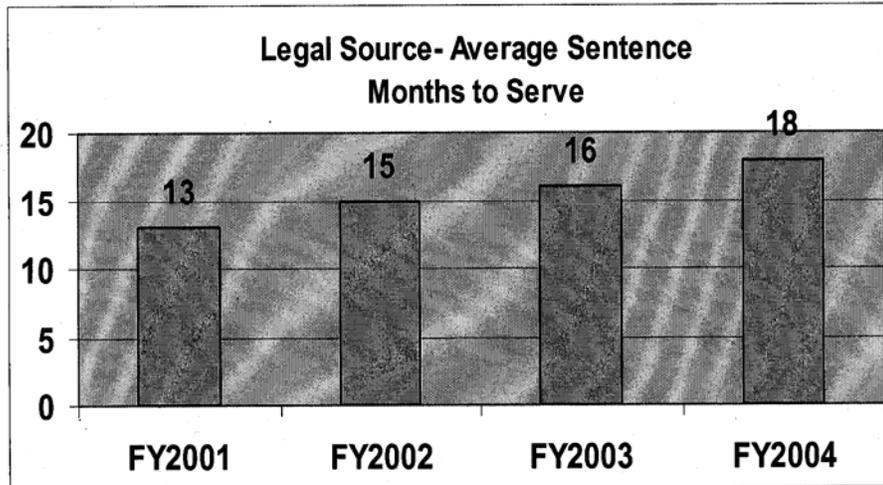
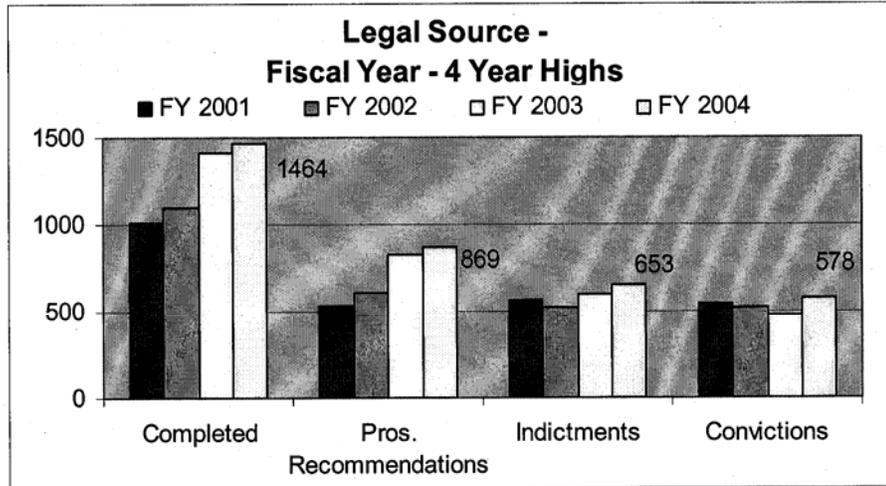
The most relevant statistical indicators, revealing a significant increase in the quality and impact of CI's legal source work from FY 2001 to FY 2004, are reflected by the following:

ITEM	FY 2001	FY 2004	INCREASE
Completed Investigations	1010	1464	45.0%
Open Inventory	1681	2050	22.0%
Prosecution Recommendations	535	869	62.4%
DOJ Acceptance Rate	88.6%	96.0%	7.4%
Indictments	560	653	16.6%
Convictions	548	578	5.5%
Average Prison Sentence	13 months	18 months	38.5%
Publicity Rate	54.6%	71.0%	16.4%

¹ Investigations involving Titles 26; 33, Sections 1521 through 1533; and 18, Sections 286, 287, 514 and/or 371(k)

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Criminal Investigation's legal source case initiation rate, the subject of charts one and two in the draft report, has been influenced by two factors. The first was Commissioner Everson's FY 2003 mandate to significantly reduce cycle time². This change in priority required greater emphasis on completing existing investigations, prior to initiating new ones. Criminal Investigation successfully reduced cycle time over the past three completed fiscal years by 9.8 percent, while completing

² Elapsed days on completed investigations

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37.1 percent more investigations. The second factor is the burgeoning pipeline inventory.³ Legal source investigations in the pipeline inventory steadily increased during the past three completed fiscal years from 866 to 1209, an approximate 49.6 percent increase. The percentage of DIT expended on pipeline investigations also increased from 14.5 percent in FY 2002 to 18.5 percent in FY 2004. Sixty percent of the total DIT expended on pipeline investigations in FY 2004 involved tax related and legal source investigations.

The fiscal year-end 2004 average total inventory⁴ of 8.16 cases per agent remains the highest completed fiscal year level since FY 2001. While caseloads increased, the number of CI field special agents declined to 2,495 by fiscal year-end 2004, 4.6 percent below the fiscal year-end 2002 level of 2,616. However, despite a declining agent workforce and larger overall inventory, CI completed 2,382 tax and tax-related investigations in FY 2004, up from 1,775 in FY 2002. These facts indicate CI's special agents were fully engaged and highly productive. Additionally, CI continues to demonstrate significant progress as reflected by the following FY 2005 year-to-date statistics:

ITEM	FY 2002 (October - February)	FY 2005 (October - February)	TOTAL INCREASE	LEGAL SOURCE INCREASE
Total Completed Investigations	1110	1650	48.6%	52.3%
Total Investigations in Inventory	3931	4275	8.8%	21.7%
Total Pipeline Investigations	2791	3784	35.5%	46.9%
Total Indictments	640	886	38.4%	10.9%

Viewed in its totality, the information above demonstrates that CI has made significant strides in the areas of both tax and tax related investigations.

Page 10, First Paragraph

"Despite these attempts, the fraud referral program has not been reinvigorated. After a dramatic decline in FY 2000, referrals have increased steadily through FY 2003. However, even with the emphasis on referrals, the total number of referrals decreased slightly in FY 2004 and is still below the level at the time the Webster Report was issued..."

³ Referred cases awaiting prosecution

⁴ Primary investigations (PIs), open and pipeline SCIs, and subject seizure investigations (SSIs)

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Criminal Investigation's commitment to maximizing the number of quality fraud referrals from the civil divisions has not wavered.⁵ As early as the summer of 2003, CI recognized the need for greater headquarters oversight of the Fraud Referral Program and took action. An analyst from the Financial Crimes Section was assigned fraud referrals as a program area and began participating in Fraud Referral Specialist manager meetings and conference calls. Currently, the assigned analyst also reviews monthly statistics and makes necessary field inquiries. Representatives from the Office of Operations, Policy, and Support (OPS) regularly communicate with the Director of Fraud/BSA to discuss the results and the potential improvement of the Fraud Referral Program. Starting in FY 2004 and continuing through the current Fiscal Year, CI and SB/SE have taken dramatic steps to increase the quality and quantity of fraud referrals. Since the draft report now encompasses all of FY 2004 and references actions taken in FY 2005 (draft report page 24) it should fully reflect the totality of CI's effort to enhance the Fraud Referral Program including:

- In 2004, the Small Business/Self-Employed (SB/SE) Operating Division and CI conducted extensive reviews of their referral programs and made recommendations for improvement to appropriate executives.
- In March 2004, during Supervisory Special Agent (SSA) workshops, the importance of the Fraud Referral Program was discussed with all SSAs. The SSAs in turn provided information on barriers to success. This information was shared with the National Fraud Program Manager, a position imbedded in SB/SE but with involvement in the entire IRS fraud program, in an effort to improve the overall program.
- Also in March 2004 a referral aging report was sent to all Directors of Field Operations (DFO) requesting they contact their respective field offices to determine if the elapsed time in evaluating selected referrals was reasonable. Oversight of the elapsed time required to evaluate fraud referrals is now an ongoing process.
- Criminal Investigation and SB/SE selected a sample of declined referrals to ascertain whether the reasons for these declinations were appropriate and adequately documented in the declination memorandums. The review also attempted to identify any commonalities among the declinations that might be corrected in the future. The results of this evaluation were shared with the National Fraud Program Manager for use in proposing potential improvements and incorporated into the fraud referral training program.
- In August 2004, a detailed policy memorandum was issued establishing fraud referral coordinators in each field office, implementing a fraud referral tracking system, and clarifying important operating procedures.
- Throughout FY 2004, CI expended considerable time assisting the Large and Mid-size Business (LMSB) Operating Division in the development of

⁵ Criminal Investigation and the civil divisions reached an agreement in FY 2004, that only one referral would be made when multiple individuals/entities are at issue. For instance, even if the referring agent believes both an individual and his/her closely held corporation have fraud potential, only one referral is made. This contrasts with the prior method whereby each individual/entity constituted a separate referral. Ultimately, CI may initiate multiple investigations from each referral. This procedural change had an impact on the decline in fraud referrals from FY 2003 through FY 2004. This decline is not necessarily indicative of a reduction in Fraud Referral Program productivity.

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LMSB fraud training. It is scheduled for delivery in FY 2005. Criminal Investigation will play an important role in presenting this training.

- Criminal Investigation also worked with the Tax Exempt and Government Entities (TE/GE) Operating Division to develop fraud referral procedures and fraud training. This training will be delivered to TE/GE front line employees, with CI's assistance during FY 2005.
- Other efforts to emphasize the importance of fraud referrals continue in FY 2005, specifically:
 - The Chief, CI's comments in the FY 2005 ABP Guide are as follows: "It is important to maximize cooperation with our operating division partners. Over the past several years, these efforts have produced notable successes in the areas of abusive tax scheme, non-filer, employment tax and general fraud investigations. It is paramount that we build on these successes and continue our efforts to enhance the Fraud Referral Program."
 - The commitment to continue improvements in the Fraud Referral Program was included in all FY 2005 CI management performance agreements.
 - The Director of Fraud/BSA spoke at the CI senior leadership meeting in October.
 - The Chief and Deputy Chief along with the Director and Deputy Director of OPS addressed the Fraud Technical Advisor Managers at a meeting in November.
 - Successful efforts to develop quality fraud referrals are being appropriately recognized in field offices throughout the country.
 - The Director and Deputy Director of OPS participated in conference calls between the SB/SE Commissioner and all SB/SE Area Directors expressly for the purpose of emphasizing SB/SE and CI's joint commitment to the Fraud Referral Program.
 - The National Fraud Program Manager spoke to Special Agents in Charge at a Southeast Area DFO's staff meeting. This presentation will be given to area DFO staffs throughout the country during 2005.
 - Criminal Investigation, Financial Crimes section representatives meet monthly with the National Fraud Program Manager and SB/SE analysts to discuss progress, problems, and issues of mutual concern.
 - Criminal Investigation's Knowledge Management system now provides online guidance regarding the Fraud Referral Program, including answers to frequently asked questions, best practices, and a fraud referral specialists directory. In the near future, a Power Point presentation for use in fraud referral training programs will be added.

As a result of these efforts, first quarter FY 2005 referrals received and accepted increased 53.2 percent and 52.5 percent, respectively, from first quarter FY 2004 levels. After declining in FY 2004 to 58 percent, the acceptance rate rebounded to 67.9 percent at the end of the first quarter of FY 2005. The percentage of fraud referrals in inventory less than 45 days in the first quarter of FY 2005 improved 24.1 percent over the first quarter FY 2004. In addition, although the percentage of total SCI initiations originating from fraud referrals remained relatively constant

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(approximately 11 percent) over the past three fiscal years, the percentage increased to 13 percent for the first quarter of FY 2005.

The preceding section details affirmative steps CI has taken to improve the Fraud Referral Program. These continuing efforts are evidenced by the fact that the fraud referral acceptance rate has significantly exceeded the FY 1999 rate in each of the three subsequent years. Commitment to enhancing the fraud referral program extends beyond CI as well. For example, delivering quality fraud referrals is part of the management commitments for all SB/SE managers for FY 2005. Further, K. Steve Burgess, Director of Examination issued a memorandum on December 28, 2004 reiterating SB/SE's commitment to the Fraud Referral Program. It stated in part, "To achieve SB/SE's critical business objective of ensuring quality fraud referrals when the affirmative indicators of fraud are recognized in the course of examinations, time and care should be taken to fully develop these cases."

Page 10, Second Paragraph

"We analyzed the CIMIS data relative to fraud referrals, reviewed all 25 fraud referrals rejected by the 3 field offices, and interviewed CI function field office management and compliance function fraud referral specialists. The results of these reviews indicate the CI function has not placed enough emphasis on timely working referrals, communicating results with the compliance functions, and establishing or using existing controls to manage the processing of referrals."

The Fraud Referral Program is a top priority for the entire IRS. The numerous, vigorous steps taken to improve the program, as detailed in the preceding section, are prime examples. The following items evidence CI's commitment to conduct timely evaluations of fraud referrals.

- The Chief's and Deputy Chief's FY 2005 Executive Performance Agreements contain the commitment to: "Foster effective partnerships with other IRS operating divisions to bolster the Fraud Referral Program and timely evaluate fraud referrals, in accordance with Internal Revenue Manual (IRM) guidelines."
- The Chief CI authored an article for the quarterly SB/SE Technical Digest (January 2005 issue) regarding CI's commitment to the Fraud Referral Program. The article outlined specific steps CI will take to ensure timely review and feedback on SB/SE referrals.
- All area DFOs now utilize monthly fraud referral aging reports to review the progress of individual fraud referral evaluations.

Page 11, Second Full Paragraph

"...We believe not having a designated fraud coordinator to handle referrals from the civil functions is an indication that the CI function is not fully committed to improving the fraud referral program."

Criminal Investigation designated fraud referral coordinators in each field office during the audit period. In 2001, SB/SE designated fraud referral specialists to coordinate

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with CI field management. When flaws in the program became apparent, particularly after the Lead Development Centers were relieved of their responsibilities for managing and tracking referrals, CI designated field office coordinators.

Page 12, "The CI Function has not Made Effective Use of GIs"

Criminal Investigation will continue to attempt to leverage GIs to generate significant legal source investigations. However, historically results attributable to legal source GIs have not been commensurate with the resources expended. This is primarily because the allegation often lacks sufficient specificity to permit an informed evaluation. Frequently, allegations are shown to be specious, untrue or purely civil in nature. In contrast fraud referrals or referrals received from the United States Attorneys Offices contain more highly developed allegations against specific individuals. Further, any potential civil issues are often resolved by the time a referral is made. Given, CI's current resource limitations it is paramount that they be utilized as effectively as possible.

Over the years, CI has achieved success in developing significant investigations through GIs; however, successful GIs typically involve emerging areas of illegal activity, such as healthcare fraud. The use of this type of GI allows CI to coordinate with the U.S. Attorneys' Offices and other agencies to effectively address law enforcement issues of mutual concern. This is not to say that legal source income GIs can not be effective but it is essential that their inherent limitations be clearly understood.

Criminal Investigation plans to analyze information from the IRS's National Research Program, to assist in identifying characteristics of individuals or market segments suitable for GIs, with a high probability of meeting CI's Law Enforcement Manual (LEM) criteria. This approach may help CI initiate more productive GIs in the future.

Page 17, Second and Third Full Paragraphs

"According to the CIMIS, the CI function opened 273 subject investigations during FY 2003 involving these 5 illegal activities. About 65 percent were referred from other agencies or the USAOs, and about 26 percent did not have a tax-related violation."

"The CI function is authorized to work these types of investigations; however, other government agencies also have the authority to investigate these crimes. We are not implying that these were not the best investigations for the CI function to work at that particular time. However, given the CI function's limited resources, the demands on these resources, and that the CI function is the only agency that can investigate tax violations, we believe these are the types of investigations, absent a clear connection to tax, that the CI function could reevaluate before accepting."

Seventy-four percent of the referenced cases did involve tax violations. Further, 100 percent of them included violations within CI's investigative jurisdiction. It is impossible to assess the significance of an individual case by looking only at CIMIS data. As pointed out on pages 6 and 7 of the draft report, Professor Dubin concluded

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that the mix of CI investigations sentenced, tax versus money laundering, "is not a significant determinant of tax compliance, perhaps because the mix has already been optimally set."

Page 21, Second Paragraph

"As a result of classifying investigations as illegal source when another agency participates, the CIMIS may be understating time spent on and the number of legal source income investigations."

The current categorization of the CI caseload as legal source, illegal source or narcotics provides the clearest description and most effective accountability for the CI investigative workload. These definitions were adopted in 2000 because of the Webster Report mandate to reform the "Tax Gap" caseload definition. Tax Gap investigations included all legal industry cases, regardless of other agency involvement, so long as the primary violations CI was investigating were tax or tax related. The Webster Report sharply criticized the Tax Gap definition as too broad and susceptible to undue influence by the agendas of local United States Attorneys' Offices.

The current definitions allow CI to clearly capture and report those investigations which are within the exclusive ambit of IRS jurisdiction. The CIMIS also allows CI to evaluate all tax and tax-related investigations whether they are categorized as legal or illegal source. The combination addresses the concerns raised by the previous Tax Gap definition while, at the same time, fully represents the total tax and tax-related investigative efforts of CI. One of the supporting examples in the draft report, an investigation of a legal industry taxpayer with no other agency involvement that included a money laundering violation, is exactly the type of case properly categorized as an illegal income investigation. The presence of a money laundering charge, per se, requires fraudulent non-tax conduct. While such cases are important, they cannot be characterized as legal income cases. To do so would be to revert to the Tax Gap definition.

No perfect definition exists that accurately captures the essence of each of the over 4,000 cases CI completes each year. However, the current legal income/illegal income definitions come as close as possible. They accurately account for the CI investigative caseload, clearly provide guidance to the field regarding priorities, and effectively insulate CI from the criticism faced in the Webster Report.

Page 24, "The Numbers of Fraud Referrals and Rejections are Overstated"

The prominence of this section header diminishes TIGTA's subsequent comments concerning CI's implementation of improved procedures for accurately tracking fraud referrals.

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Page 24, Second Paragraph and Third Bullet Item

“According to the CIMIS, during FY 2003, the CI function rejected 194 referrals received from IRS compliance functions. We reviewed all 32 referrals rejected by the 3 field offices we visited. However, we determined that the CI function misclassified 7 of the referrals (22 percent) because the CI function...”

Criminal Investigation recognizes that field office interpretation of CIMIS source codes was not consistent and has corrected the problem. On August 31, 2004, HQ/CI issued a detailed policy memorandum titled “Fraud Referral Program Guidance.” This memorandum reviewed the entire referral process including CIMIS coding. To now qualify as a referral, the item must be received through a fraud referral specialist via Form 2797 (Referral Report of Potential Criminal Fraud Cases). These procedures were implemented to ensure investigations were included as referrals only if the following two factors exist:

1. The investigation originated from information provided by an IRS civil division.
2. CI had no knowledge of the matter, but for the civil division’s efforts.

In addition to more restrictive categorization criteria, some special types of referrals, such as those in the Offshore Credit Card Program (OCCP) are now being tracked using specific fraud referral control number procedures outlined in detail in the August 31, 2004 memorandum. This permits CI to review fraud referral statistics for special categories separately, if required. The result is a more accurate analysis of fraud referral trends without the risk of unduly skewing referral statistics because of variances in individual program categories that could occur over time.

The OCCP referrals mentioned in the draft report were early examples of CI’s attempt at expedited referral procedures. In those instances, CI reviewed SB/SE Lead Development Center OCCP files and selected certain ones for further development as primary investigations. These files contained raw information and were all coded as referrals. The current referral categorization criteria will facilitate better selection of expedited referrals in the future. CI will continue to use expedited referral procedures when appropriate to investigate egregious tax fraud schemes and effectively support SB/SE programs.

Page 36, First Paragraph

“When the CI function completes an investigation, the case is either discontinued, meaning there are no further prospects for proceeding with criminal charges, or the case is provided to the Department of Justice Tax Division or a United States Attorney Office for consideration of criminal prosecution. Thus, prosecution recommendations are reflective of successful criminal investigations and reflect on the quality of the investigation.”

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Prosecution recommendations alone are not the only indicators of quality and success. Criminal Investigation Special Agents conduct investigations in an impartial and professional manner. It is, therefore, inevitable that a percentage of investigations will ultimately be discontinued; either because the allegation is proven false or insufficient evidence exists to meet the government's burden of proof. Some of these investigations may result in subsequent referrals to IRS operating divisions for civil action. Recognizing these limitations and taking the appropriate action in a timely manner is the hallmark of a skilled investigator. It not only conserves valuable resources but serves the greater interests of justice. It is not indicative of a lack of success or a poorly conducted investigation.

A better reflection of the overall quality of CI's investigations can be gained by examining two other national statistics in conjunction with prosecution recommendations. These statistics are the DOJ acceptance rate and the CI Quality Measurement System (CIQMS). When viewed together these two measures reflect that CI's tax and tax related investigations exhibit high quality, irrespective of outcome.

Most tax and tax related prosecutions are subject to review by the DOJ, Tax Division (DOJ Tax). The DOJ acceptance rate denotes the percentage of prosecution recommendations ultimately approved by DOJ Tax. It is an important quality indicator. The average DOJ acceptance rate over the past four fiscal years exceeds 93 percent.⁶

Criminal Investigation also conducts a review of discontinued administrative investigation reports, known as the CIQMS. This is a relatively new measure, begun in FY 2003. It is used to evaluate the overall quality of discontinued investigations. The CIQMS score is based on a maximum 5.0 point scale. A national benchmark for discontinued investigations was set at 4.0. For FY 2003 and FY 2004, the national average CIQMS scores were 4.47 and 4.5, respectively.

Recommendation Comments

Recommendation 1

"Establish a fraud coordinator position in the CI function Headquarters office and in each of the 33 field offices. This could be a collateral duty."

On August 31, 2004, HQ/CI issued a detailed policy memorandum which directed all field offices to designate fraud referral coordinators. This action has been successfully implemented.

⁶ The DOJ acceptance rate rose even higher to 97.3% as of the end of February 2005.

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Recommendation 2

“Establish control procedures to ensure referrals are processed timely.”

The previously referenced August 31, 2004 policy memorandum implemented a fraud referral tracking system and reemphasized established operating procedures. Additionally, all CI Supervisory Special Agents' (SSAs) FY 2005 performance commitments now include a requirement to timely evaluate fraud referrals. Despite this emphasis, factors outside CI's control occasionally affect the time required to properly evaluate a referral. Such factors include the inability to timely obtain original tax returns or records. Inflexible adherence to review time frames is undesirable since it could result in an increased number of premature rejections or acceptances. Justifiable extensions of time to evaluate referrals are not only permissible but prudent.

Recommendation 3

“Ensure the appropriate management tools are used to monitor and evaluate the results of GIs on legal source investigations.”

The CI Measures for Managers (MOM) program provides the ability for field offices to determine the number of GIs open. Additionally, custom MOM queries available to all field offices, allow for the creation of reports to determine how many PIs and SCIs have resulted from each GI. These reports also include a Compliance Strategy Indicator that permits management to easily determine if the investigations resulting from a GI are legal source, illegal source, or narcotics cases.

Criminal Investigation utilizes the Review and Program Evaluation (RPE) section to study GI results during field office reviews. Further, local field office management constantly evaluates the productivity of GIs and makes necessary adjustments. In spite of this however, CI management will reemphasize the need to monitor all GIs.

Recommendation 4

“Issue guidance emphasizing the use of GIs as a means to identify legal source investigations that have the greatest impact on tax administration.”

Though CI field office employees have been encouraged to use GI projects to develop investigations of non compliant industries or market segments, experience indicates GI's are not the most productive means to develop significant legal source investigations. Nonetheless, the Director of OPS will issue a memorandum reminding the field not to neglect the appropriate use of GI's in developing future legal source income investigations.

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Recommendation 5

"The Chief, CI, should establish additional criteria to guide the field offices in accepting investigations from other government agencies or the AUSA offices when the cases do not involve tax compliance."

The FY 2005 ABP provides guidance "intended to assist the Area and Field Offices (FO) in developing local plans and action items to support the CI Strategy and Program Plan." It specifically requires CI to "continue to focus its investigative resources on legal source tax investigations" and to "pursue significant investigations involving illegal source tax and other financial crimes, including money laundering, that adversely affect tax administration." Special Agents in Charge (SAC) utilize the ABP strategy to set priorities based on regional and local conditions. Achieving an optimal case mix is difficult. However, the guidance already provided allows individual SACs to make informed choices.

Additionally, all SAC performance agreements for FY 2005 include the commitment to work cooperatively with the Department of Justice and law enforcement partners to investigate other high-impact financial crimes and money laundering cases, with an emphasis on increasing or maintaining the balance of Title 26 and Title 31 violations.

Recommendation 6

"The Chief, CI, should establish national goals on key statistical indicators such as the percentage of legal source income investigations or direct investigative time, the CI function should strive to achieve. These goals can be expressed as a range within major program areas to provide needed flexibility and can be based on the best available information from CIMIS, CI management's strategic processes, and other data sources and studies."

Criminal Investigation has no empirical data on which to base a specific target level of legal source investigations. Thus, creating such goals would be largely arbitrary. HQ/CI has directed field management to maintain or increase levels of legal source income investigations and to direct attention to other significant financial investigations which affect tax administration. Such an approach facilitates the proper use of the limited resources available to maximize tax compliance. The statistical indicators reveal CI is currently working at or near an optimal case mix, which is supported by the conclusions in Professor Dubin's report.

It should be noted that the only category for which CI can appropriately provide specific DIT target ranges to the field offices is the Organized Crime Drug Enforcement Task Force Program. This target level is tied directly to the level of funding reimbursement CI receives as a result of its involvement in these cases.

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Recommendation 7

“Conduct an analysis of the CIMIS to determine the impact that inconsistent coding has on the classification of investigations and, if warranted, modify the CIMIS and definitions so the coding properly reflects the true nature and disposition of the investigations and the measurement of the CI function’s compliance strategy.”

Criminal Investigation recognized some time ago that improvements and upgrades to the CIMIS system were required. It further recognized a more user friendly system would facilitate increased accuracy of CIMIS data. Development of an upgraded CIMIS system is underway. This new system will include fraud scheme codes, identifying case-specific criminal activity, grouped according to areas of noncompliance. It will also include guidance to assist users in properly classifying and entering data and permit the entry of multiple reasons for selected activities.

All multi-agency investigations are properly coded as illegal source investigations. However, CI will determine what investigations are incorrectly coded, correct them, and determine whether similar errors can be prevented in the new CIMIS system.

Recommendation 8

“Issue guidelines on the type of GIs that should be classified as legal source. Only those GIs in which the primary purpose is to identify legal source income should be classified as legal source investigations.”

Criminal Investigation began working on corrections to the classification of GIs as early as April 2004. The initial attempts to correct the CIMIS data were not entirely successful because of confusion as to proper fraud scheme coding for legal source GIs. Subsequently, CI clarified the fraud scheme code section of the CIMIS handbook and provided better instructions. The Financial Crimes Section is following up to ensure necessary corrections are made.

Other Comments

Criminal Investigation agrees that the draft audit report and CI’s response should be available to the public. Below are CI’s responses to TIGTA’s recommendations:

Recommendation 1

“Establish a fraud coordinator position in the CI function Headquarters office and in each of the 33 field offices. This could be a collateral duty.”

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Corrective Action(s)

Criminal Investigation took these actions during the audit period.

Implementation Date

Completed August 31, 2004 Proposed N/A

Responsible Official(s)

N/A

Corrective Action(s) Monitoring Plan

N/A

Recommendation 2

"Establish control procedures to ensure referrals are processed timely."

Corrective Action(s)

On August 31, 2004, HQ/CI issued a detailed Policy Memorandum, which implemented a fraud referral tracking system. In addition, the memorandum provided an overview of applicable fraud referral procedures, which include timeframes allowed for evaluation and procedures for obtaining extensions when necessary.

Implementation Date

Completed August 31, 2004 Proposed N/A

Responsible Official(s)

N/A

Corrective Action(s) Monitoring Plan

N/A

Recommendation 3

"Ensure the appropriate management tools are used to monitor and evaluate the results of GIs on legal source investigations."

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Corrective Action(s)

The Director, Operations Policy and Support, will issue a memorandum reminding field office management to be conscientious in evaluating the results of GIs. The memorandum will encourage the closure of non-productive GIs, so that field office resources can be directed toward more productive activities. It will also remind the field offices to ensure PIs resulting from GIs are appropriately linked.

Implementation Date

Completed _____ N/A _____ Proposed 06/15/2005

Responsible Official(s)

Director, Operations Policy and Support

Corrective Action(s) Monitoring Plan

The Director, Operations Policy and Support, will ensure that all field offices receive the memorandum referenced above.

Recommendation 4

"Issue guidance emphasizing the use of GIs as a means to identify legal source investigations that have the greatest impact on tax administration."

Corrective Action(s)

The Director, Operations Policy and Support will issue a memorandum reminding field offices to consider GIs, but will not insist that they do so to the exclusion of other case development sources.

Implementation Date

Completed _____ N/A _____ Proposed 06/15/2005

Responsible Official(s)

Director, Operations Policy and Support

Corrective Action(s) Monitoring Plan

The Director, Operations Policy and Support will ensure all field offices receive this guidance.

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Recommendation 5

"The Chief, CI, should establish additional criteria to guide the field offices in accepting investigations from other government agencies or the AUSA offices when the cases do not involve tax compliance."

Corrective Action(s)

This guidance has been provided via the SPPs, ABPs, and most recent SAC annual performance commitments.

Implementation Date

Completed 10/22/2004 Proposed N/A

Responsible Official(s)

N/A

Corrective Action(s) Monitoring Plan

N/A

Recommendation 6

"The Chief, CI, should establish national goals on key statistical indicators, such as the percentage of legal source income investigations or direct investigative time, the CI function should strive to achieve. These goals can be expressed as a range within major program areas to provide needed flexibility and can be based on the best available information from CIMIS, CI management's strategic processes, and other data sources and studies."

Corrective Action(s)

Criminal Investigation is reluctant to establish national goals on key statistical indicators such as a percentage of legal source income investigations because clear guidance concerning investigative priorities has been provided. Current quantity and quality measures support this conclusion. Further, such indicators would be arbitrary, potentially limiting CI's ability to react to emerging areas of noncompliance or particular regional or local problems. An optimal case mix can only be developed by giving managers the flexibility to make informed decisions.

Implementation Date

Completed 10/22/2004 Proposed N/A

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Responsible Official(s)

N/A

Corrective Action(s) Monitoring Plan

N/A

Recommendation 7

"The Chief, CI, should conduct an analysis of the CIMIS to determine the impact that inconsistent coding has on the classification of investigations and, if warranted, modify the CIMIS and definitions so the coding properly reflects the true nature and disposition of the investigations and the measurement of the CI function's compliance strategy."

Corrective Action(s)

Criminal Investigation will initiate a study to determine if there is any commonality among the use of incorrect compliance strategy codes in CIMIS. It will make appropriate corrections and recommend future changes to the CIMIS system if warranted.

Implementation Date

Completed _____ N/A _____ Proposed 10/15/2005 (pilot date)

Responsible Official(s)

Director, Operations Policy and Support
Director, Strategy
Director, Technology Operations and Investigative Services

Corrective Action(s) Monitoring Plan

The Director, Operations Policy and Support and the Director, Strategy will assign analysts to work together in conducting the aforementioned study.

The office of TOIS has assigned a senior analyst to manage the new CIMIS project to ensure the upgrade is implemented within appropriate timeframes.

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Recommendation 8

“The Chief, CI, should issue guidelines on the type of GIs that should be classified as legal source. Only those GIs in which the primary purpose is to identify legal source income should be classified as legal source investigations.”

Corrective Action(s)

Criminal Investigation clarified the fraud scheme code section of the CIMIS handbook and provided additional guidance to field offices.

Implementation Date

Completed 01/18/2005 Proposed N/A

Responsible Official(s)

Director, Operations Policy and Support

Corrective Action(s) Monitoring Plan

The Office of Financial Crimes will follow-up to ensure field offices make necessary corrections to the CIMIS database by May 31, 2005, so that all GIs are appropriately categorized as to legal source or illegal source.

If you have any questions, please call me at (202) 622-3200, or a member of your staff may contact Ken Riche, Director, Office of Strategy at (202) 622-5876.