

**Statistical Portrayal of the
Criminal Investigation Function's
Enforcement Activities From
Fiscal Year 1999 Through Fiscal Year 2004**

May 2005

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

May 16, 2005

MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Statistical Portrayal of the Criminal
Investigation Function's Enforcement Activities From Fiscal
Year 1999 Through Fiscal Year 2004 (Audit # 200510011)

This report presents the results of our review of statistical information that reflects activities of the Criminal Investigation (CI) function from Fiscal Years (FY) 1999 through 2004. The overall objective of this review was to provide statistical information and trend analyses of the CI function statistics since the issuance of the Webster Report¹ in April 1999. The audit was conducted as part of the Treasury Inspector General for Tax Administration's (TIGTA) FY 2005 Annual Audit Plan.

Beginning in FY 2002, the CI function began to turn around the downward trends from earlier years. Specifically, the number of subject investigations increased, more time was spent directly on subject investigations, and fewer days were expended to discontinue an investigation. Many of the CI function's performance indicators continued to show improvement in FY 2003. While the number of subject investigations initiated and direct time spent on investigations decreased slightly, FY 2004 continued to show gains in the total numbers of subject investigations completed, prosecution referrals, pipeline investigations, indictments, convictions, and sentences.

The CI function continues to lose special agents due to attrition faster than it can replace them. Increasing staffing in the enforcement areas of the Internal Revenue Service (IRS), in general, remains a challenge. The Government Accountability Office (GAO) testified stating priorities other than enforcement, including unbudgeted expenses, have consumed IRS budget increases and savings over the last several

¹ *Review of the Internal Revenue Service's Criminal Investigation Division* (Publication 3388; 4-1999), also known as the Webster Report.

years.² In addition, the FY 2005 budget contains almost a \$20 million decrease in funding for the Organized Crime and Drug Enforcement Task Force (OCDETF) program. As a result, the CI function will reduce the amount of direct investigative time spent on narcotics investigations and will shift some resources to tax-related investigations. The FY 2006 budget proposes a change in the funding source for the OCDETF program. Instead of receiving reimbursements from the Department of Justice (DOJ), the DOJ will transfer about \$56 million from its appropriation to the Department of the Treasury's appropriation.

In an October 2003 letter to the TIGTA, the Senate Finance Committee outlined some concerns about the CI function's productivity. We recently completed a review to address one of the concerns about the CI function's efforts to increase legal source income tax investigations and concluded the CI function has made progress in increasing all tax-related investigations, but the level of legal source investigations did not materially change from FYs 1999 through 2004.³ The other concerns relating to the length of time to prepare and present a case to the DOJ for prosecution and the small number of investigations (as few as two) per special agent will be taken into consideration when developing our FY 2006 Annual Audit Plan.

The CI function initiates investigations from many different sources, both from within and outside the IRS. During FY 2004, about 58.4 percent of subject investigations initiated came from the United States Attorney Offices (USAO) or other government agencies. In contrast, only 30.1 percent of subject investigations initiated came from within the IRS.⁴ Historically, internal IRS programs have been the primary sources of investigations involving pure tax violations. Between FYs 1999 and 2004, almost 60 percent of legal source investigations came from within the IRS. During FY 2004, 65.8 percent of legal source investigations and 47.4 percent of tax-related investigations came from internal IRS sources. On the other hand, almost two-thirds of the cases initiated from the USAO and other government agencies were nontax-related investigations.

Further, the total number of tax and tax-related investigations initiated from FYs 2002 to 2004 declined by 12.3 percent. Since actions on criminal investigations may span more than 1 year, the more recent decline in tax and tax-related investigations initiated may result in a decline in tax and tax-related convictions and sentences in later years.

We made no recommendations in this report. However, key CI function management officials reviewed the report and provided written comments that were considered prior to its issuance. Management's complete response to the discussion draft report is included as Appendix VI. The Office of Audit's response to identify changes we made

² *Internal Revenue Service: Assessment of Fiscal Year 2005 Budget Request and 2004 Filing Season Performance* (GAO-04-560T, dated March 2004).

³ *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (Reference Number 2005-10-054, dated March 2005).

⁴ The remaining 11.5 percent came from the public or other sources.

to the discussion draft report based on management's comments is included as Appendix VII.

Copies of this report are also being sent to the IRS managers affected by the report. 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.

**Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities
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Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Background

In recent years, the Internal Revenue Service (IRS) has made tremendous efforts to improve customer service and make it easier for taxpayers to comply with their tax obligations. However, overall enforcement activities began to erode and surveys indicated that 17 percent of the population believed it was acceptable to cheat on their taxes. Since 2003, the IRS Commissioner has emphasized the importance and role of tax enforcement in overall tax compliance by recognizing the need to enhance levels of enforcement activity to provide a proper balance between service and enforcement.

The IRS Strategic Plan for Fiscal Years (FY) 2005 to 2009 provides that enforcing tax compliance is critical to maintaining the American taxpayers' expectation that the tax 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 owed and paid).

The Criminal Investigation (CI) function is the only law enforcement organization with the authority to investigate criminal tax violations. The vigorous enforcement of criminal statutes within the CI function's jurisdiction is an integral component of the IRS' efforts to enhance voluntary compliance and foster confidence in the fairness and integrity of the tax system.

Over the last few decades, the Congress and the Department of the Treasury have expanded the CI function's jurisdiction to cover offenses under money laundering and currency reporting statutes.¹ Accordingly, the CI function has been involved with both legal and illegal source income investigations, including those involving organized crime and narcotics.

¹ 18 United States Code (U.S.C.) Sections (§§) 1956 and 1957 (2004) and Title 31 U.S.C., Money and Finance, sections.

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In April 1999, Judge William Webster issued a report² of his review of the CI function's operations and concluded the CI function had drifted away from its primary mission of investigating criminal violations of the Internal Revenue Code. Judge Webster recommended the CI function refocus on its primary mission of investigating criminal violations of the internal revenue laws.

The CI function addressed many of the Webster Report 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, reducing the resources placed on narcotics investigations, publicizing the results of its investigations, and conducting an empirical study to determine the effect investigations have on voluntary compliance. The CI function executives have recently emphasized the importance of developing and investigating those cases that have the greatest affect on tax administration, whether the sources of income in those investigations are derived from legal or illegal industries.

We initiated this review of the CI function's enforcement statistics as part of the Treasury Inspector General for Tax Administration's (TIGTA) FY 2005 Annual Audit Plan. While our trend analyses covered FYs 1999 through 2004, our report concentrates on providing a perspective for the 2 most current fiscal years.

Our data analyses were done in the TIGTA Chicago, Illinois, office during the period February through April 2005 using data accumulated by the IRS. The audit was conducted in accordance with *Government Auditing Standards*. However, we relied on information accumulated by the IRS and did not verify its accuracy. Much of the data in this report were updated from the prior TIGTA report on criminal enforcement trends.³

² *Review of the Internal Revenue Service's Criminal Investigation Division* (Publication 3388; 4-1999), also known as the Webster Report.

³ *Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2003* (Reference Number 2004-10-115, dated June 2004).

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Many Performance Indicators Showed Improvements in Fiscal Years 2003 and 2004

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II. A glossary of terms is included in Appendix IV. Detailed charts and tables referred to in the body of the report are included in Appendix V.

We previously reported⁴ that, beginning in FY 2002, some of the CI function performance indicators began to show improvements. For example, the number of subject investigations initiated increased, the percentage of direct investigative time (DIT) increased, and it took fewer days to discontinue an investigation.⁵

Although the number of subject investigations initiated decreased slightly (2.1 percent) in FY 2004, many of the trends showed improvements from FY 2003. For example, the total number of subject investigations completed increased 16.5 percent and prosecution referrals increased 19.5 percent.⁶ In addition, the number of indictments increased 17 percent; convictions increased 10.1 percent; and number of sentences increased .5 percent from FY 2003.⁷ Finally, the total number of investigations in the Department of Justice (DOJ) pipeline increased 18.4 percent.⁸ The CI function has attributed the increased pipeline inventory to its efforts to reduce elapsed days on completed investigations. This also may account for the slight decline in subject investigations initiated.⁹

Also, while the average number of days to refer an investigation for prosecution continued to improve from FY 2003 to FY 2004 (down 4.2 percent), the average number of days to discontinue a subject investigation increased 7.8 percent.¹⁰ In addition, the percent of time

⁴ *Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2003* (Reference Number 2004-10-115, dated June 2004).

⁵ Appendix V, Figures 2, 6, and 16.

⁶ Appendix V, Figure 15.

⁷ Appendix V, Figures 23 and 25.

⁸ Appendix V, Figure 22.

⁹ Appendix V, Figure 4.

¹⁰ Appendix V, Figure 16.

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spent conducting investigations, the DIT, decreased slightly to 56.9 percent.¹¹

Other noteworthy trends include:

- Since FY 2001, the number of subject investigations initiated has increased 19.3 percent from 3,284 to 3,917.¹²
- The total number of investigations completed is at a 6-year high, and has increased 37.1 percent from 3,201 to 4,387 since FY 2002.¹³
- Both the total number of prosecution referrals and discontinued investigations are up over the last 2 years; 42.4 percent and 26.4 percent, respectively.¹⁴
- The number of investigations in the DOJ pipeline is at a 5-year high and is up 32.2 percent from FY 2002.¹⁵

These indicators demonstrate that the CI function is becoming more efficient in carrying out its duties. We believe this is attributable to CI management's and the Commissioner's continued emphasis on improving productivity and compliance.

Challenges Remain to Increase Enforcement Activities

Between FYs 1999 and 2004, special agent staffing decreased almost 2 percent from 2,849 to 2,795. However, field office special agent staffing declined by about 6.5 percent from 2,669 to 2,495 during the same period.¹⁶ An analysis of the CI function's hiring and attrition data for FYs 1999 to 2004 shows the CI function was losing special agents to attrition faster than it could replace them. Since FY 2002, budget limitations caused the CI function to limit hiring to a level at or below attrition. The CI function originally planned to hire over 500 special agents in FY 2005; it now plans to hire only about 200 special agents.

¹¹ Appendix V, Figure 2.

¹² Appendix V, Figure 25.

¹³ Appendix V, Figure 15.

¹⁴ Appendix V, Figure 15.

¹⁵ Appendix V, Figure 21.

¹⁶ Appendix V, Figure 1.

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Factoring anticipated attrition, the CI function estimates a net increase of about 48 special agents from FY 2004.

While the entire IRS is faced with an increasing number of employees who are eligible to retire, the issue is more pronounced in the CI function because special agents are generally eligible to retire 5 years earlier. According to the CI function's FY 2005 Strategy and Program Plan, there were 2,828 special agents on the rolls as of May 2003. Of these, 956 are eligible to retire between FYs 2003 and 2008.

Increasing staffing in the enforcement areas of the IRS, in general, remains a challenge. The Government Accountability Office (GAO) testified that priorities other than enforcement, including unbudgeted expenses such as rent increases and Congressionally mandated pay raises, have consumed IRS budget increases and savings over the last several years.¹⁷

Proposed changes in the Organized Crime Drug Enforcement Task Force (OCDETF) program funding may have an effect on resources

Another factor that affects the CI function's ability to sustain increases in enforcement activities is funding for the OCDETF program. Since its inception in 1982, the CI function has participated in OCDETF program investigations and other narcotics-related cases. The Webster Report recommended the CI function limit its narcotics-related investigations to the amount that is reimbursed from the DOJ for the OCDETF program. As a result, the CI function reduced the DIT on narcotics-related investigations to a range of about 15 to 17 percent.

According to the FY 2005 budget, OCDETF program funding decreased by almost \$20 million from the original appropriated amount of \$72 million. As a result, the CI function field offices reduced the DIT range to 10 to 12 percent to correspond with the funding decrease. In addition, the CI function planned to complete about

¹⁷ *Internal Revenue Service: Assessment of Fiscal Year 2005 Budget Request and 2004 Filing Season Performance* (GAO-04-560T, dated March 2004).

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11 percent fewer investigations in FY 2005, as it shifts staff from narcotics to tax-related investigations, which generally take longer to complete.

The CI function advised they continually monitor narcotics related funding levels and have since reduced the DIT range to 9 to 11 percent to remain aligned with the reimbursement level. In addition, due to early FY 2005 results and to create ambitious performance goals, the CI function increased its estimate of completed investigations to 4,380, slightly below the 4,387 investigations completed in FY 2004.

The FY 2006 budget proposes an overall increase of \$85 million for the CI function, including a change in the funding source for the OCDETF program. Instead of receiving reimbursements from the DOJ, the DOJ will transfer about \$56 million from its appropriation to the Department of the Treasury's appropriation. Since the FY 2006 budget is currently undergoing review by the Administration and Congress, it is uncertain what the final increase, if any, of the OCDETF program funding will be provided to the Department of the Treasury. We believe the CI function will need to remain mindful that its commitment to the narcotics programs remains within the level of the funding received.

Congressional Interest in Criminal Investigation Activities

In an October 2003 letter to the TIGTA, the Senate Finance Committee (SFC) expressed concern about the CI function's productivity and its ability to increase the number of legal source income tax investigations. In addition, the SFC was concerned there may be as few as 2 investigations per special agent, and that it takes on average 2 years to prepare and present a case to the Department of Justice for prosecution.¹⁸

Trends related to legal source income tax investigations

The CI function has consistently described legal source tax cases as a top investigative priority, and we believe these cases are an important component of all tax-related

¹⁸ We plan to take this information into consideration in developing our FY 2006 Annual Audit Plan. Also, see page 9 of this report for additional information on the length of time to prepare a case for prosecution.

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investigations. At the request of the SFC, we conducted an audit to evaluate the CI function's efforts to increase legal source income tax investigations. We recently issued that report¹⁹ and concluded the CI function has made progress in increasing all tax-related investigations, but the level of legal source investigations did not materially change from FYs 1999 through 2004. Also, recent trends for FYs 2002 through 2004 are mixed for both tax-related and legal source tax investigations. In the management response to this report, the Chief, CI, provided a further explanation on the CI function's position regarding the legal source income statistics and reliability of the data in its management information system. Management's complete response to the discussion draft report is included as Appendix VI.

The percentage of tax-related investigations initiated increased 6.6 percentage points during FYs 1999 through 2004.²⁰ However, the percentage of legal source investigations initiated was virtually unchanged during this same period. After a significant increase in FY 2002, the number of legal source investigations initiated has decreased the last 2 years, and are down 11.8 percent in FY 2004.²¹

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 source cases. Also, the Chief, CI, stated the CI function has attained 4-year highs in several quality indicators (e.g., the DOJ acceptance rate, average months to serve, and publicity rate) in the legal source program, which illustrates progress in achieving the CI function's strategies.

Investigations referred for prosecution also reflect on the quality and success of the CI function's work. The numbers of tax-related and legal source tax investigations referred for prosecution have been consistently increasing and were at 6- and 5-year highs in FY 2004, respectively. However, the

¹⁹ *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (Reference Number 2005-10-054, dated March 2005).

²⁰ Appendix V, Figure 5.

²¹ Appendix V, Figure 6.

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percentages of each type of investigation decreased in FY 2004 to FY 2002 levels.²²

Also, while the numbers of tax-related and legal source tax investigations in the pipeline are at 5- and 4-year highs, respectively, the percentages of each type of investigation have been about the same and declined slightly during FY 2004.²³

Although we could not conclusively determine whether the CI function was conducting enough legal source income tax investigations or to what extent it can or should increase the number, our recent report 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 compliance.

Trends related to the number of investigations per special agent

In FY 2002, the average inventory of subject investigations per special agent was 1.86. This increased to 2 in FY 2003, and then decreased to 1.84 in FY 2004.²⁴

Taking this number alone creates a false sense of a CI function special agent's workload. The average inventory calculation includes only open subject investigations. The CI function does not consider subject investigations referred for prosecution as an open investigation, even though the special agent could devote significant time assisting with trial preparation.²⁵ These are considered pipeline investigations. In addition, special agents may also be working on primary investigations and seizure investigations.

The CI function recognized the open investigation per agent calculation does not always convey the actual workload of special agents when evaluating a special agent's total

²² Appendix V, Figures 17 and 18.

²³ Appendix V, Figures 21 and 22.

²⁴ Appendix V, Figure 10.

²⁵ Generally, subject investigations that have been recommended for prosecution and the subject has not been convicted or acquitted are referred to as "pipeline investigations." The CI function reported 9.1 percent of its DIT was spent on pipeline investigations during FY 2004.

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inventory workload. As a result, the CI function refers to all open and pipeline subject investigations, primary investigations, and seizure investigations as the "total inventory."

According to the CI function, total inventory per agent decreased from 8.83 in FY 1999 to 7.4 in FY 2002 and increased to 8.16 in FY 2004.²⁶

Trends related to the time it takes to prepare and present a case to the Department of Justice for prosecution

The elapsed time to recommend a case for prosecution has decreased 11.1 percent from FY 2002 to FY 2004 to 367.5 days. The elapsed time to discontinue a case has decreased 6.2 percent during the same period to 460.8 days. This includes a 7.8 percent increase over FY 2003.²⁷ The CI function officials attributed the increase in elapsed time on discontinued investigations to their effort to close old cases.

Investigations Initiated From External Sources Remain a Concern

The CI function initiates investigations from many different sources, both from within and outside the IRS. The primary sources from within the IRS include fraud referrals from the IRS' compliance functions and investigations developed by the CI function from the Questionable Refund Program and Return Preparer Program. The primary sources of investigations from outside of the IRS include the United States Attorney Offices (USAO) and other government agencies, both Federal and State. In addition, the CI function initiates investigations based on information received from public sources, including the media, informants, and the toll-free tax fraud hotline.

During FY 2004, about 58.4 percent of subject investigations initiated came from the USAOs or other government agencies. This increased from 51.6 percent and 54.8 percent in FYs 2002 and 2003, respectively.

In contrast, during FY 2004, only 30.1 percent of subject investigations initiated originated from within the IRS. This is trending down from the 34.2 percent and 31.6 percent

²⁶ Appendix V, Figure 10.

²⁷ Appendix V, Figure 16.

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reported in FYs 2002 and 2003, respectively.²⁸

Furthermore, the number of subject investigations initiated from a public source has decreased 18.7 percent during the last 2 fiscal years. During FY 2004 subject investigations from a public source represented 11.5 percent of the total investigations initiated.

In a prior TIGTA report,²⁹ we determined referrals from the toll-free tax fraud hotline were rarely assigned to the CI function field offices for evaluation, even though these referrals could reveal significant fraud allegations and thus should be given consideration. The Chief, CI, believed the hotline call sites provided only a limited number of informant communications that met criminal prosecution potential, but agreed the CI function had a shared responsibility to provide instructions and guidance on potential informant communications that meet criminal criteria to the Wage and Investment Division, the business owner of the hotline call site function.

Historically, internal IRS programs have been the primary sources of investigations involving pure tax violations. Between FYs 1999 and 2004, almost 60 percent of legal source investigations came from within the IRS. During FY 2004, 65.8 percent of legal source investigations and 47.4 percent of tax-related investigations came from internal IRS sources. On the other hand, almost two-thirds of the cases initiated from USAOs and other government agencies were nontax-related investigations.

Initiating more cases from sources external to the IRS concerns us. Our recently issued report recognized that the tax enforcement process works most effectively if the CI function and the various USAOs have the same priorities.³⁰ Given the CI function competes with other agencies for inclusion in the various local USAOs' agendas, it is necessary for the CI function to maintain an effective

²⁸ Appendix V, Figure 8.

²⁹ *The Tax Fraud Hotline Has Not Been an Effective Source for Criminal Tax Investigations* (Reference Number 2003-10-210, dated September 2003).

³⁰ *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (Reference Number 2005-10-054, dated March 2005).

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working relationship with the USAOs. We believe the CI function must also be judicious in deciding which investigations to work with other agencies, especially in those cases where the connection to tax administration is not clear. In the management response to this report, the Chief, CI, provided further explanation and reemphasized the CI function's commitment to working the highest impact cases with the greatest deterrent effect.

Further, the total number of tax or tax-related investigations initiated from FY 2002 to FY 2004 declined by 12.3 percent from 2,468 to 2,164.³¹ Since actions on criminal investigations may span more than 1 year, the more recent decline in tax and tax-related investigations initiated may result in a decline in tax and tax-related convictions and sentences in later years.

Recent developments in the fraud referral program

Our recently issued report³² concluded that IRS efforts to reinvigorate the fraud referral program have not been effective. Although the percentage of referrals accepted increased since FY 1999, the total number of referrals received has decreased. Also, after a sharp decline in FY 2000, the number of referrals steadily increased through FY 2003, but declined slightly in FY 2004.³³

The CI function has taken several steps to improve the fraud referral process. In addition, both the CI and Compliance functions appear to have made a renewed effort to increase referrals. Through the first quarter of FY 2005, the CI function has received 167 referrals, a 53.2 percent increase over the same period in FY 2004, and accepted 67.9 percent of the referrals, a 9.2 percent increase over the first quarter of FY 2004.

The FY 2005 results are encouraging and we believe the CI and Compliance functions need to maintain this emphasis as fraud referrals remain a viable and important source of legal source income tax investigations.

³¹ Appendix V, Figure 5.

³² *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (Reference Number 2005-10-054, dated March 2005).

³³ Appendix V, Figure 9.

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We also believe the other proposed corrective actions in our recently issued report will assist the CI function in making improvements in the legal source tax program and more effectively monitoring the program's performance.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to provide statistical information and trend analyses of the Criminal Investigation (CI) function statistics since the issuance of the Webster Report¹ in April 1999.

To accomplish our objective, we reviewed Internal Revenue Service (IRS) data publications and CI function management information to analyze data and identify trends. We relied on information accumulated by the IRS and the CI function in established reports and the CI function's management information system and did not verify its accuracy. The major issues we focused on included:

- Special Agent Staffing.
- Investigation Initiations.
- Open Investigations.
- Pipeline Investigations.
- Investigation Closures.
- Investigations Referred for Prosecution.
- Subsequent Legal Actions.
- Compliance Strategy Programs.

¹ *Review of the Internal Revenue Service's Criminal Investigation Division* (Publication 3388; 4-1999), also known as the Webster Report.

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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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Glossary of Terms

Business Performance Review – On a quarterly basis, the Criminal Investigation (CI) function reports on its performance measures, business results, employee and customer satisfaction, and other items of importance to the CI function.

Compliance Strategy – The CI function strategy comprised of three interdependent program areas: Legal Source Tax Crimes, Illegal Source Financial Crimes, and Narcotics-Related Financial Crimes.

Criminal Investigation Management Information System – A database that tracks the status and progress of criminal investigations and the time expended by special agents.

Direct Investigative Time – Time spent by special agents conducting investigations and other law enforcement activities.

Discontinued Investigation – A subject investigation that resulted in a determination there was no prosecution potential.

Elapsed Days – The number of days between the initiation of a subject investigation to another date such as the date discontinued or date referred for prosecution.

Field Special Agent – A special agent in 1 of the CI function's 33 field offices.

Fraud Detection Center – A CI function organization responsible for identifying and detecting refund fraud, preventing the issuance of false refunds, and providing support for the CI function field offices.

Grand Jury Investigation – Investigation conducted through the use of a Federal grand jury to determine if a subject should be charged with a crime. The use of the Federal grand jury to investigate the potential crime(s) may be initiated by the CI function or by an attorney for the Federal Government.

Illegal Source Financial Crimes – Those crimes involving illegally earned income. They include crimes involving money laundering, 18 United States Code (U.S.C.) Sections (§§) 1956 and 1957, sections of U.S.C. Title 31, Money and Finance, and U.S.C. Title 26 violations investigated in conjunction with other agencies.

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Inventory/Agent – The number of open subject investigations divided by the number of field special agents whose salary grade level is 13 or below and having various position descriptions including those of coordinator and reviewer.

Legal Source Tax Crimes – Those crimes involving legal industries and occupations and legally earned income.

Organized Crime Drug Enforcement Task Force (OCDETF) Program– Organized in 1982, the OCDETF program is a multi-agency effort to identify, investigate, and prosecute members of high-level drug trafficking enterprises.

Narcotics-Related Financial Crimes – Those crimes involving tax and money laundering that are related to narcotics and drug trafficking.

Pipeline Inventory – A subject investigation that has been recommended for prosecution and the subject has not been convicted or acquitted, or the case dismissed. It excludes investigations where the subject became a fugitive after indictment.

Primary Investigation – An evaluation of an allegation that an individual or entity is in noncompliance with the internal revenue laws and related financial crimes.

Questionable Refund Program - A nationwide multifunctional program designed to identify fraudulent returns, stop the payment of fraudulent refunds, and refer identified fraudulent refund schemes to CI function field offices.

Referred for Prosecution – A subject investigation that resulted in the determination of prosecution potential referred to the Department of Justice or a United States Attorney Office.

Return Preparer Program - A program that pursues unscrupulous return preparers who knowingly claim excessive deductions and exemptions on returns prepared for clients. The clients may or may not have knowledge of the false claims.

Special Agent – A CI function law enforcement employee who investigates potential criminal violations of the internal revenue laws and related financial crimes.

Subject Investigation – An investigation of an individual or entity alleged to be in noncompliance with the laws enforced by the Internal Revenue Service and having prosecution potential.

Subject Seizure Investigation – An investigation to locate and seize assets that are subject to seizure or forfeiture under various U.S.C. titles and sections such as 26 U.S.C. § 7302 or 18 U.S.C. §§ 981, 982, or 984.

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Tax-Related Violation – A violation involving a Title 26 section or one of the following Title 18 sections: § 286, § 287, or § 371 associated with a Title 26 violation or § 371 associated with a Title 26 and a Title 31 violation.

Title 18 – U.S.C. Title 18, Crimes and Criminal Procedure. Various sections of Title 18 apply to violations that are within the jurisdiction of the CI function. Examples include § 286, Conspiracy to Defraud the Government with Respect to Claims; § 287, False, Fictitious, or Fraudulent Claims; § 371, Conspiracy to Commit Offense or to Defraud United States; and §§ 1956 and 1957, Laundering of Monetary Instruments and Engaging in Monetary Transactions in Property Derived from Specified Unlawful Activity. The most common section investigated under this statute is money laundering.

Title 26 – U.S.C. Title 26, Internal Revenue Code.

Title 31 – U.S.C. Title 31, Money and Finance. Several sections of Title 31 apply to violations that are within the jurisdiction of the CI function. Examples include § 5322, Criminal Penalties (for willful violations of Title 31 sections), and § 5324, Structuring Transactions to Evade Reporting Requirement Prohibited.

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Appendix V

Detailed Charts of Statistical Information

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Figure 18 – Number of Subject Investigations Referred for Prosecution Each Fiscal Year by Compliance Strategy Program and the Percentage That Is Legal Source Tax CrimesPage 30

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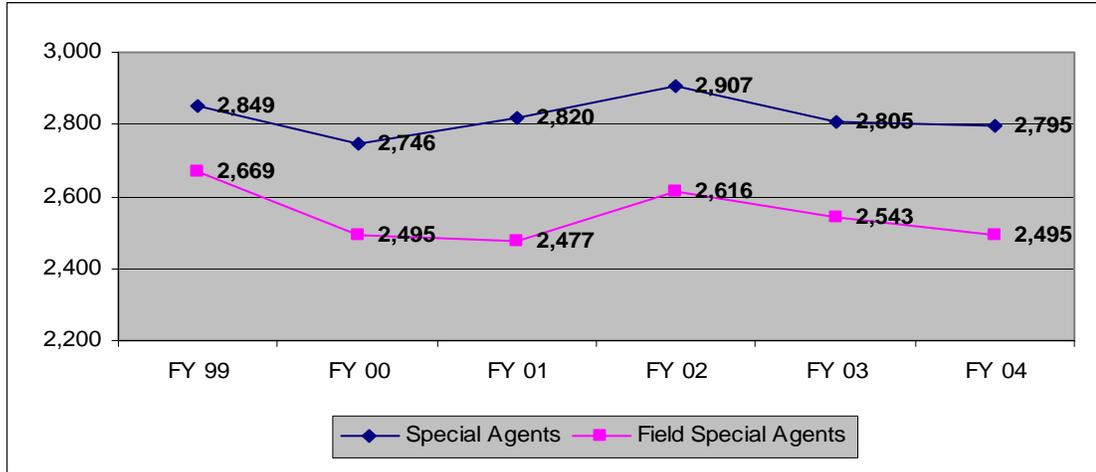
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Figure 30 – Percentage of Investigations That Received Publicity Each Fiscal Year by Compliance Strategy ProgramPage 36

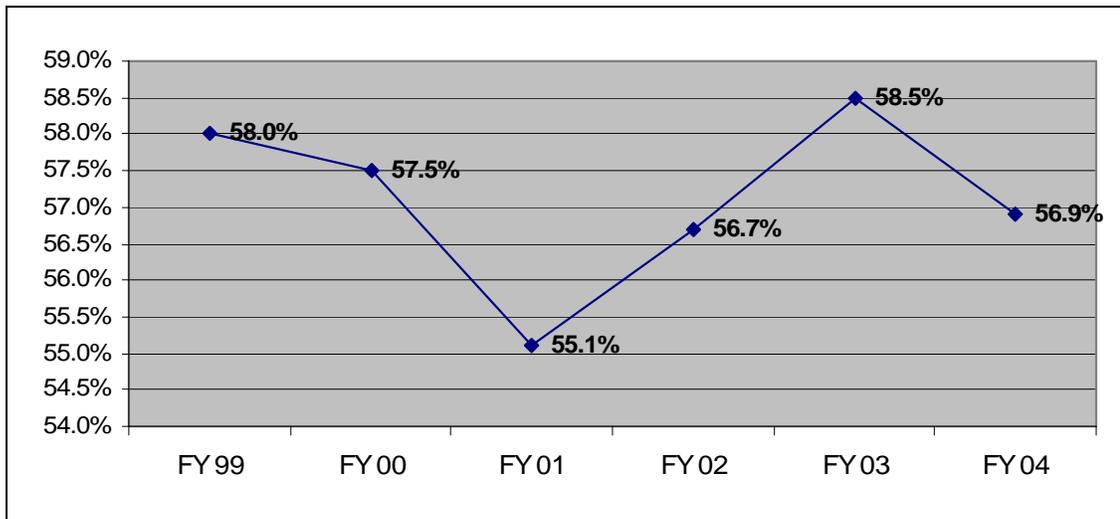
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 1: Special Agent and Field Special Agent Staffing at the End of Each Fiscal Year.



Source: Internal Revenue Service (IRS) Data Book, Publication 55B, for special agents. The Criminal Investigation (CI) function's Business Performance Review (BPR) reports for field special agent staffing.

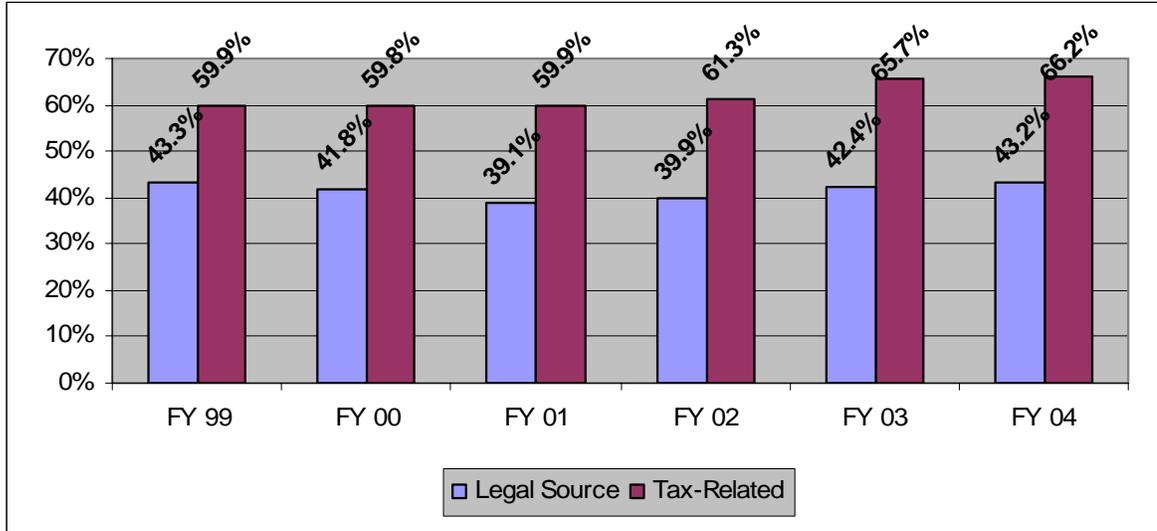
Figure 2: Special Agent Direct Investigative Time Expended Each Fiscal Year.



Source: The Criminal Investigation Management Information System (CIMIS) Report 2, Total Time by Criminal Investigation Program and Activity.

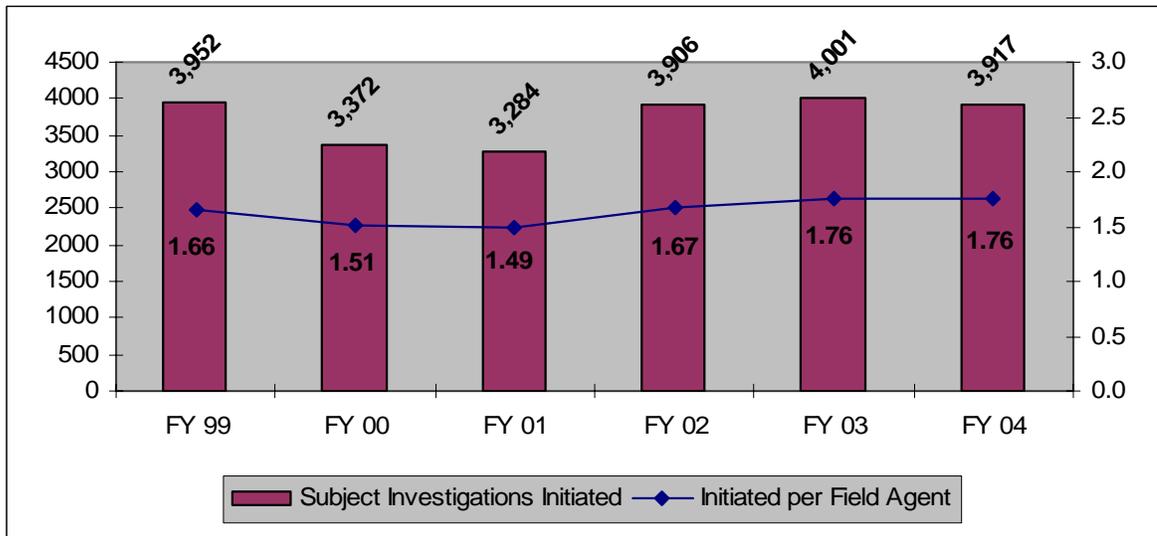
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 3: Percentage of Direct Investigative Time Spent on Legal Source and Tax-Related Investigations Each Fiscal Year.



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

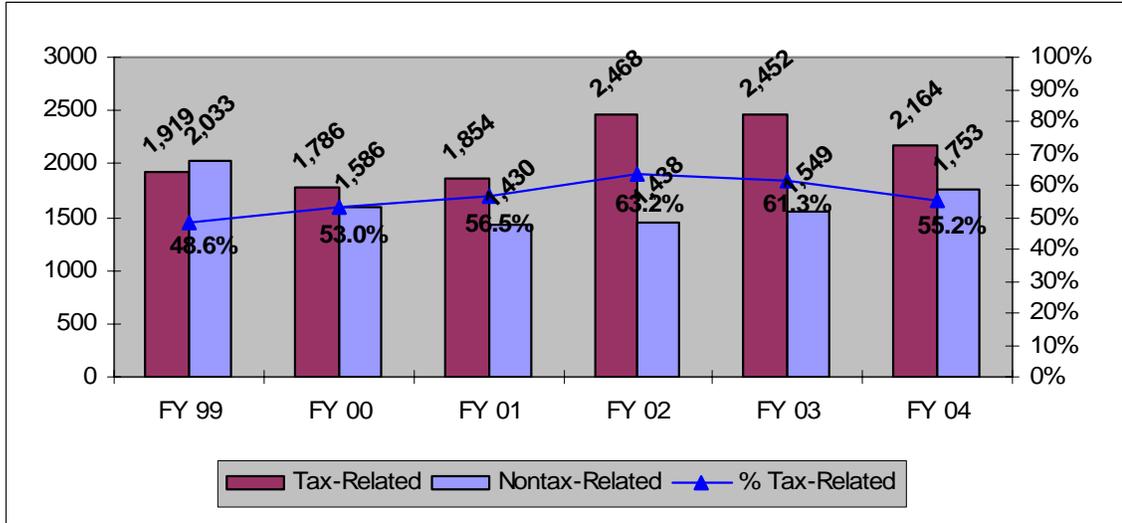
Figure 4: Number of Subject Investigations Initiated and the Number Initiated per Field Special Agent Each Fiscal Year.



Source: IRS Data Book, Publication 55B, for investigations initiated. Treasury Inspector General for Tax Administration (TIGTA) analysis based on the number of field agents provided by the CI function.

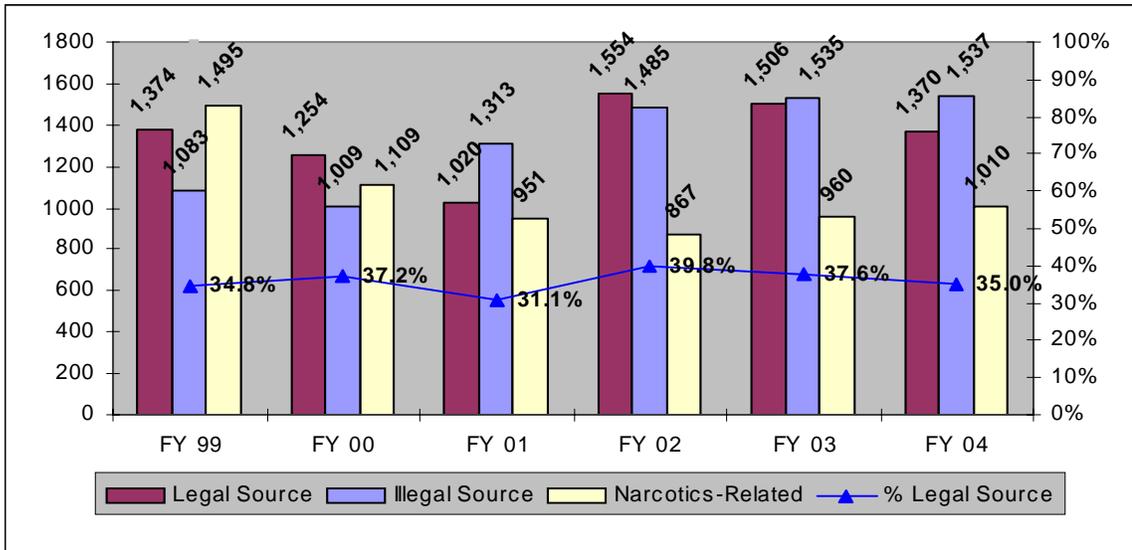
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 5: Number of Subject Investigations Initiated Each Fiscal Year for a Tax-Related or Nontax-Related Violation and the Percentage That Is Tax-Related.



Source: The CI Function's BPR reports and analysis of the CIMIS.

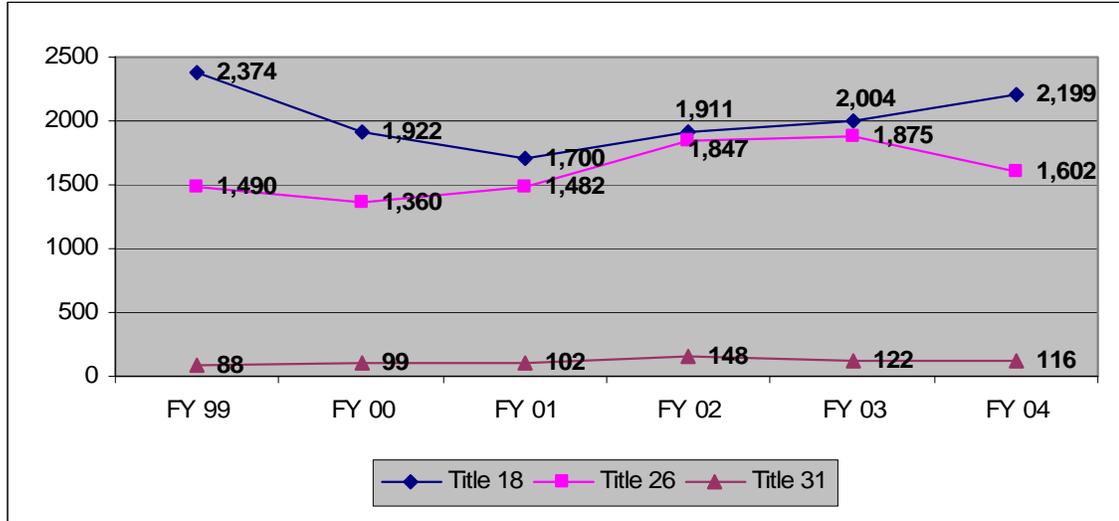
Figure 6: Number of Subject Investigations Initiated Each Fiscal Year by Compliance Strategy Program and the Percentage That Is Legal Source Tax Crimes.



Source: IRS Data Book, Publication 55B. The CI function's BPR report for Fiscal Year (FY) 1999.

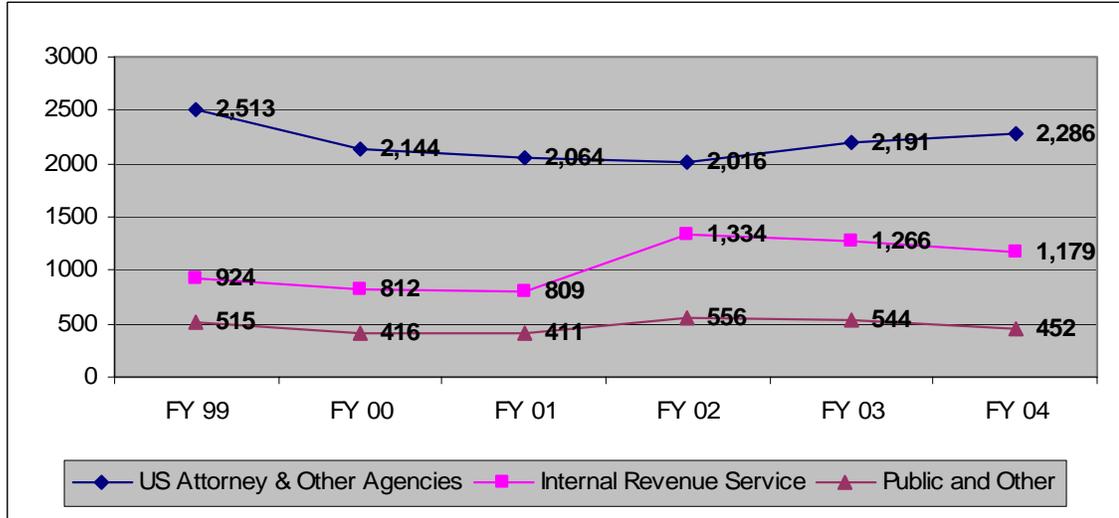
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 7: Number of Subject Investigations Initiated Each Fiscal Year by Principle United States Code Title. See Glossary of Terms in Appendix IV for definitions.



Source: CIMIS Report 11, Program Summary Analysis.

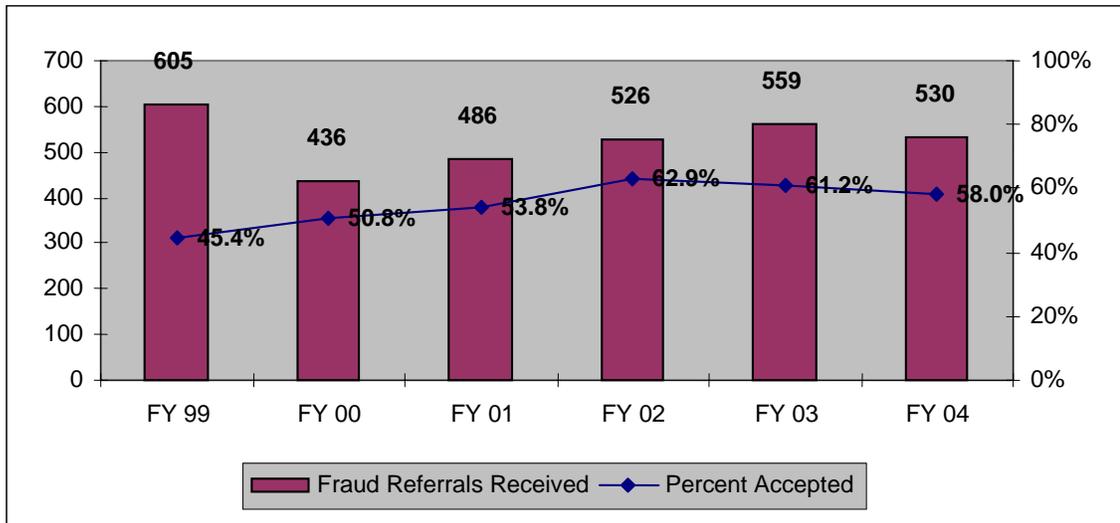
Figure 8: Number of Subject Investigations Initiated Each Fiscal Year by Source of the Allegation or Information. IRS sources include fraud referrals from the Compliance functions, investigations developed by the Fraud Detection Centers and Lead Development Centers, and currency transactions.



Source: TIGTA analysis of the CIMIS Report 11, Program Summary Analysis. The TIGTA reclassified some investigations from Public and Other to IRS based on our analysis of the CIMIS and the CI function advising that some sources in Report 11 were misclassified.

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

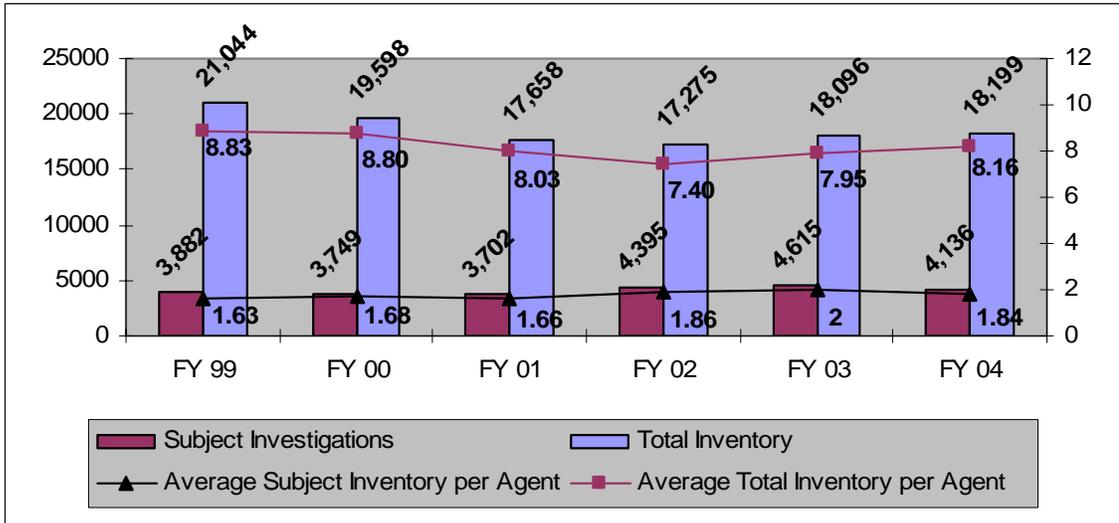
Figure 9: Number of Fraud Referrals Received and the Percentage Accepted Each Fiscal Year.



Source: The CI function's BPR reports for FYs 2000 to 2004, and the TIGTA analysis of the CIMIS and CIMIS Report 11, Program Summary Analysis for FY 1999.

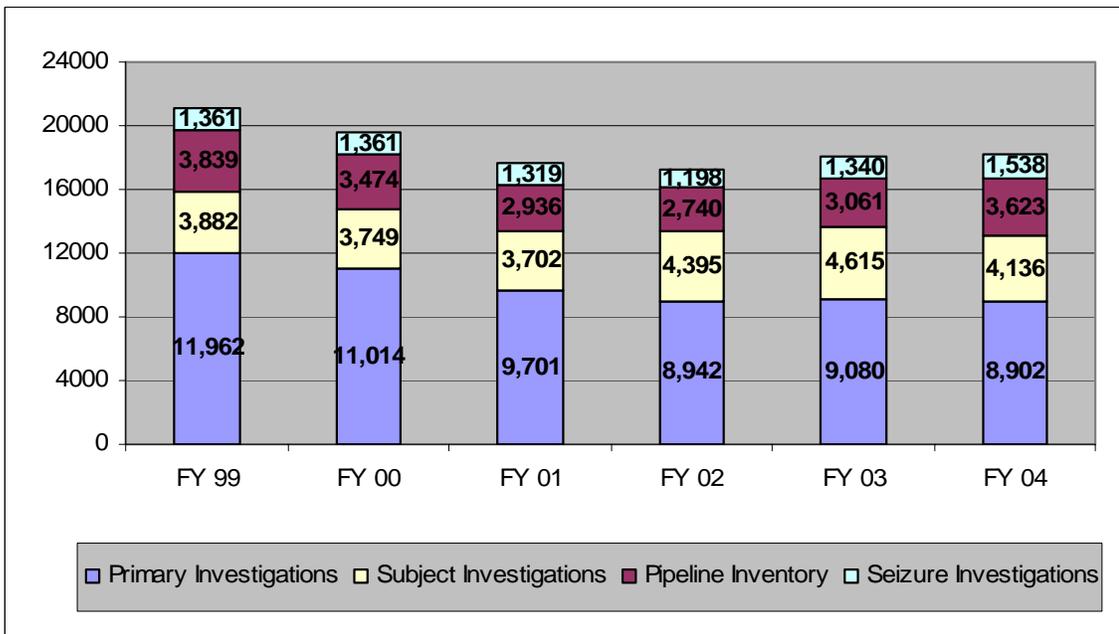
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 10: Number of Open Subject Investigations and the Total of All Investigations at the End of Each Fiscal Year and the Number per Nonsupervisory Special Agent in Field Offices. The total inventory includes open subject investigations, as well as other investigations agents may have been assigned concurrently with open subject investigations, such as primary investigations, subject seizure investigations, and subject investigations that have been referred for prosecution (pipeline).



Source: The CI function's analysis of the CIMIS and Nation Criminal Investigation Statistics.

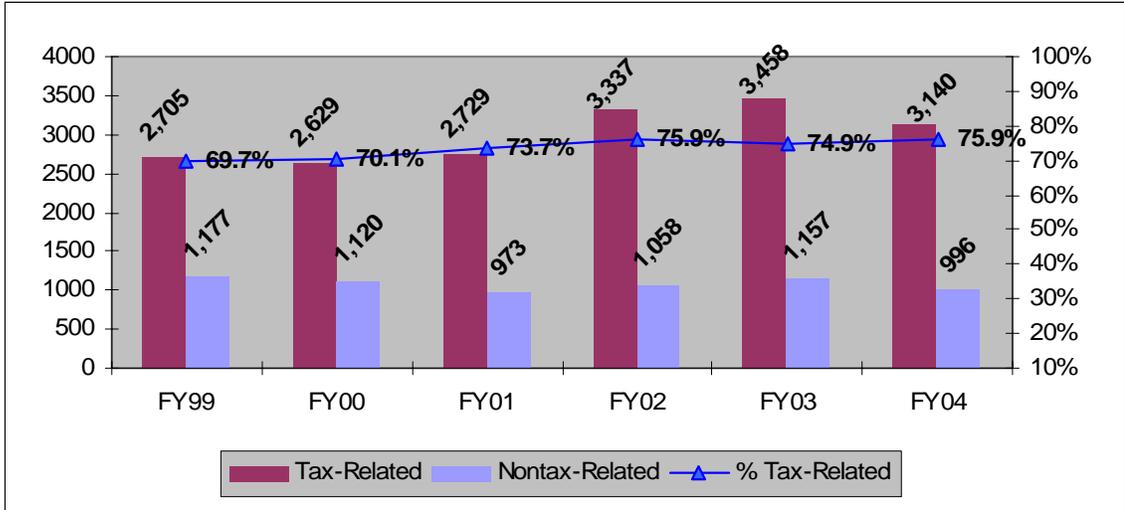
Figure 11: Number of All Types of Investigations Open in Various Stages at the End of Each Fiscal Year.



Source: The CI function's analysis of the CIMIS and Nation Criminal Investigation Statistics.

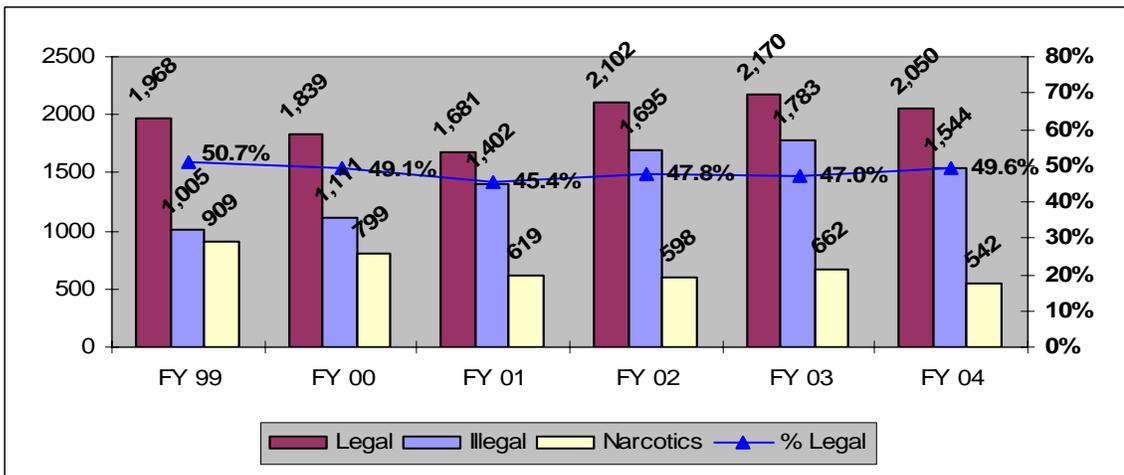
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 12: Number of Open Subject Investigations Each Fiscal Year for a Tax-Related or Nontax-Related Violation and the Percentage That Is Tax-Related.



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

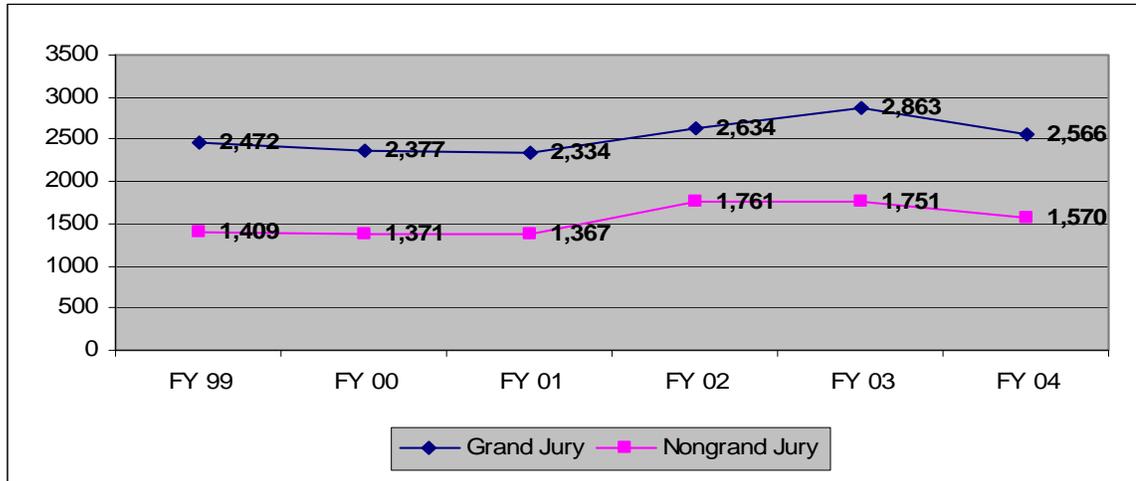
Figure 13: Number of Open Subject Investigations Each Fiscal Year by Compliance Strategy Program and the Percentage That Is Legal Source Tax Crimes.



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

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

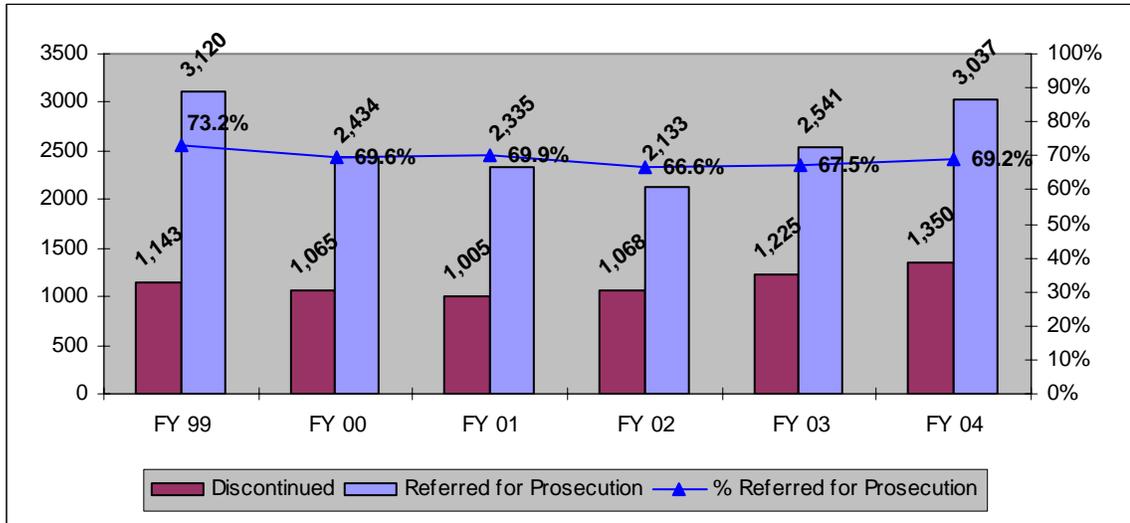
Figure 14: Number of Open Subject Investigations at the End of Each Fiscal Year by Type of Investigation: Grand Jury or Nongrand Jury Investigation.



Source: CIMIS Report 11, Program Summary Analysis.

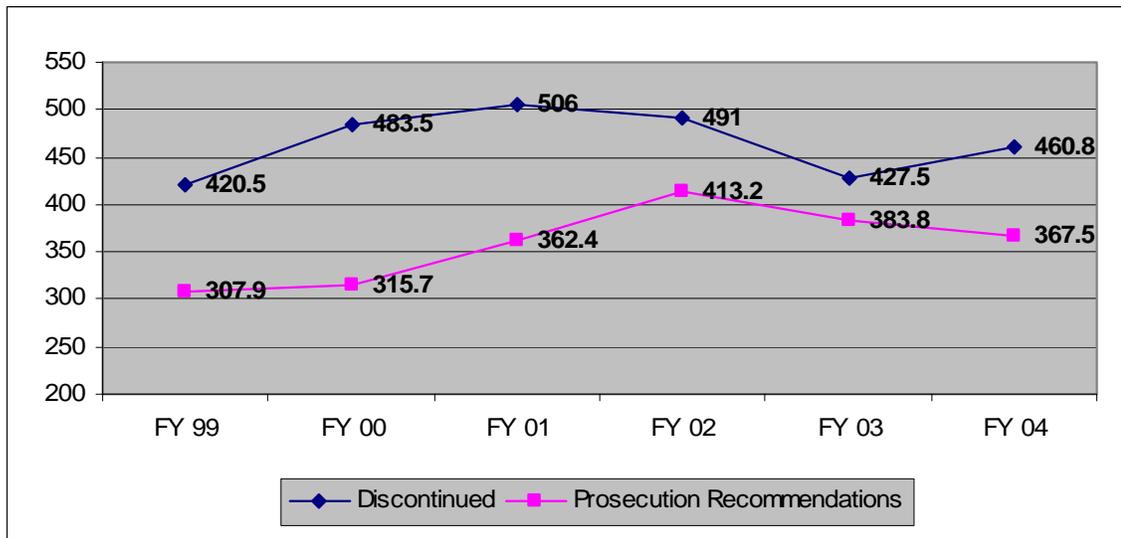
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 15: Number of Subject Investigations Discontinued or Referred for Prosecution Each Fiscal Year and the Percentage Referred for Prosecution.



Source: IRS Data Book, Publication 55B.

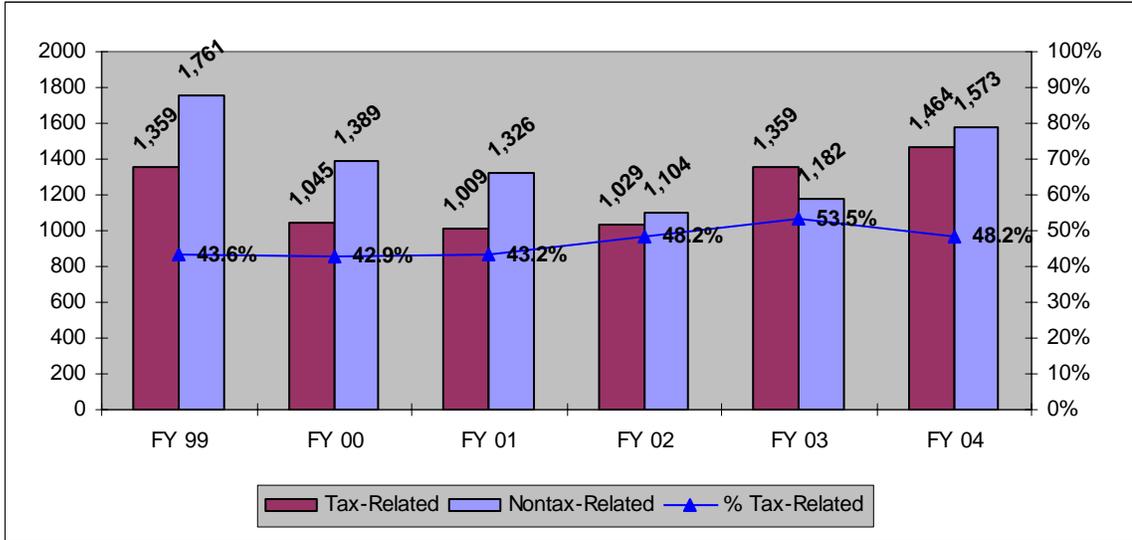
Figure 16: Average Elapsed Days of Subject Investigations Discontinued and Referred for Prosecution Each Fiscal Year.



Source: The CIMIS Report 11, Program Summary Analysis.

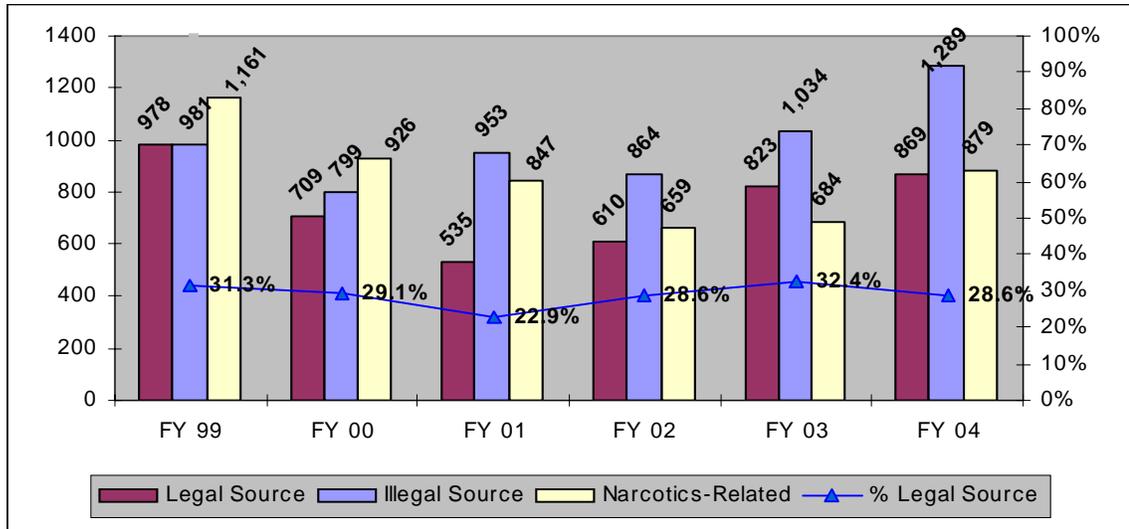
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 17: Number of Subject Investigations Referred for Prosecution Each Fiscal Year for a Tax-Related or Nontax-Related Violation and the Percentage That Is Tax-Related.



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

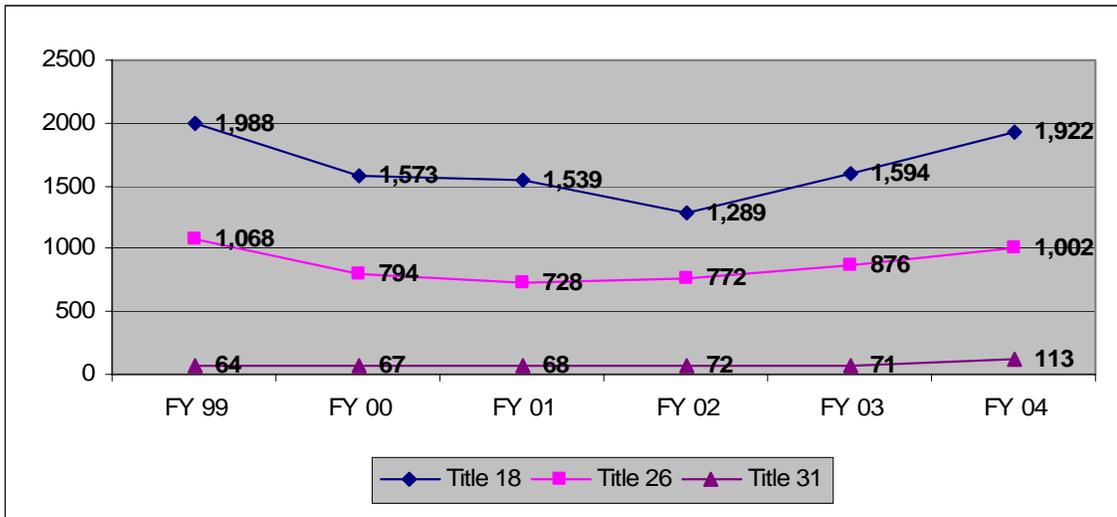
Figure 18: Number of Subject Investigations Referred for Prosecution Each Fiscal Year by Compliance Strategy Program and the Percentage That Is Legal Source Tax Crimes.



Source: IRS Data Book, Publication 55B, for FYs 2000 through 2004. The numbers of Illegal Source Financial Crimes and Legal Source Tax Crimes were not published for FY 1999. FY 1999 numbers were obtained from the CI function based on its analysis of the CIMIS.

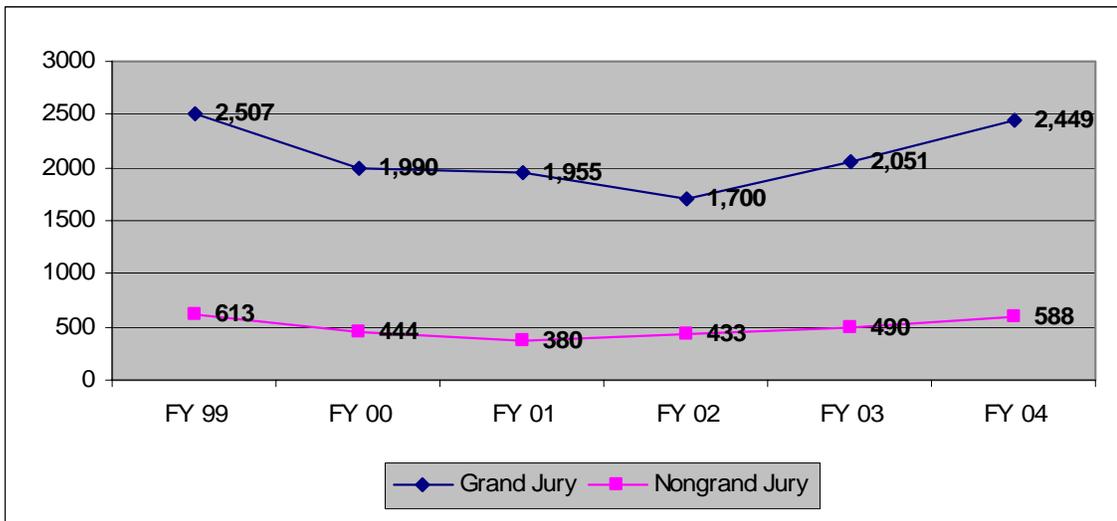
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 19: Number of Subject Investigations Referred for Prosecution Each Fiscal Year by Principle United States Code Title.



Source: *The CIMIS Report 11, Program Summary Analysis.*

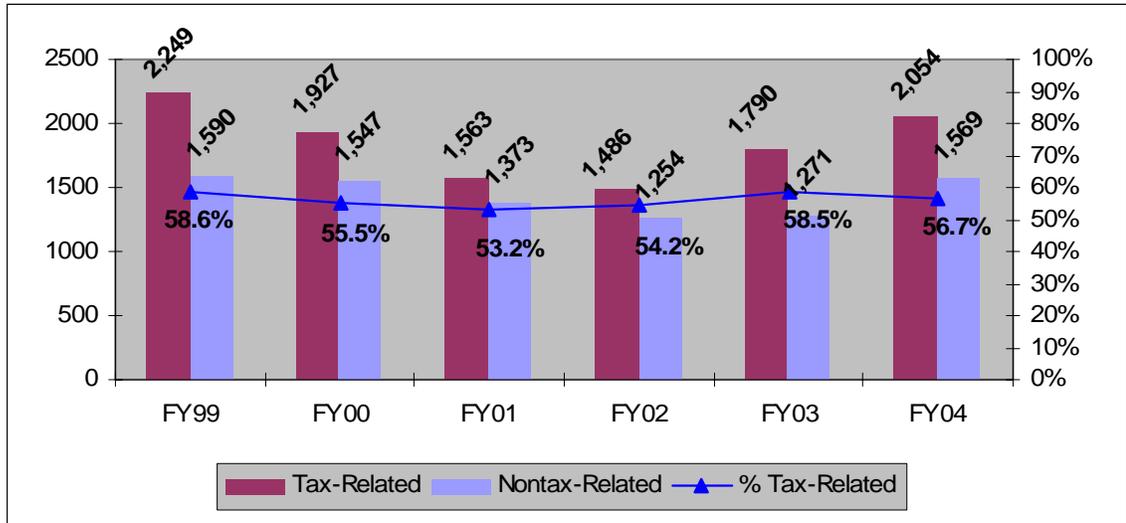
Figure 20: Number of Subject Investigations Referred for Prosecution Each Fiscal Year by Type of Investigation: Grand Jury or Nongrand Jury Investigation.



Source: *The CIMIS Report 11, Program Summary Analysis.*

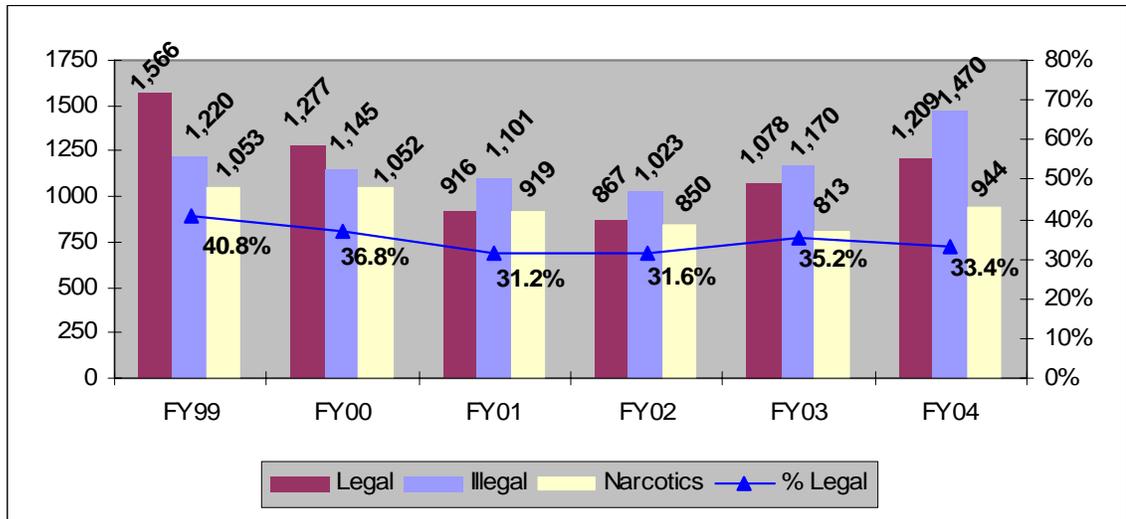
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 21: Number of Tax-Related and Nontax-Related Subject Investigations in the Pipeline Each Fiscal Year and the Percentage That Is Tax-Related.



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

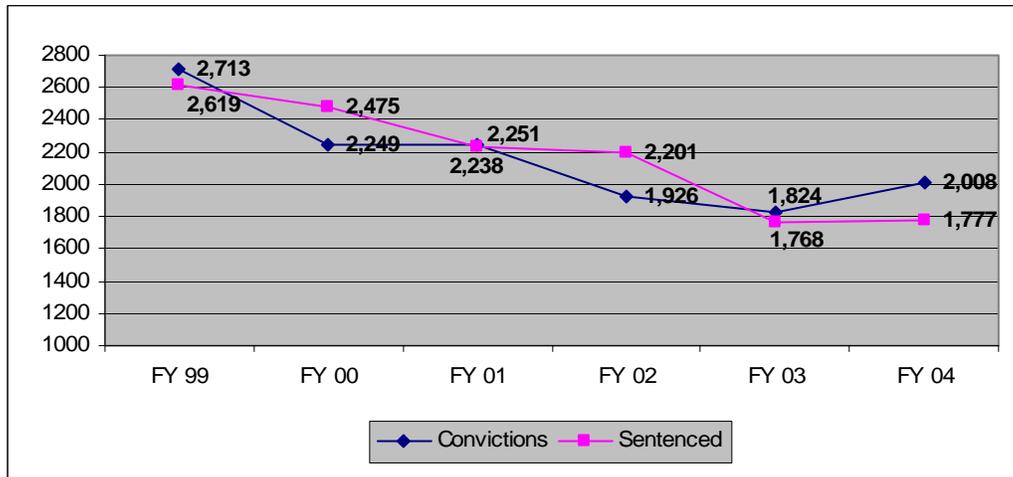
Figure 22: Number of Subject Investigations in the Pipeline Each Fiscal Year by Compliance Strategy Program and the Percentage That Is Legal Source Tax Crimes.



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

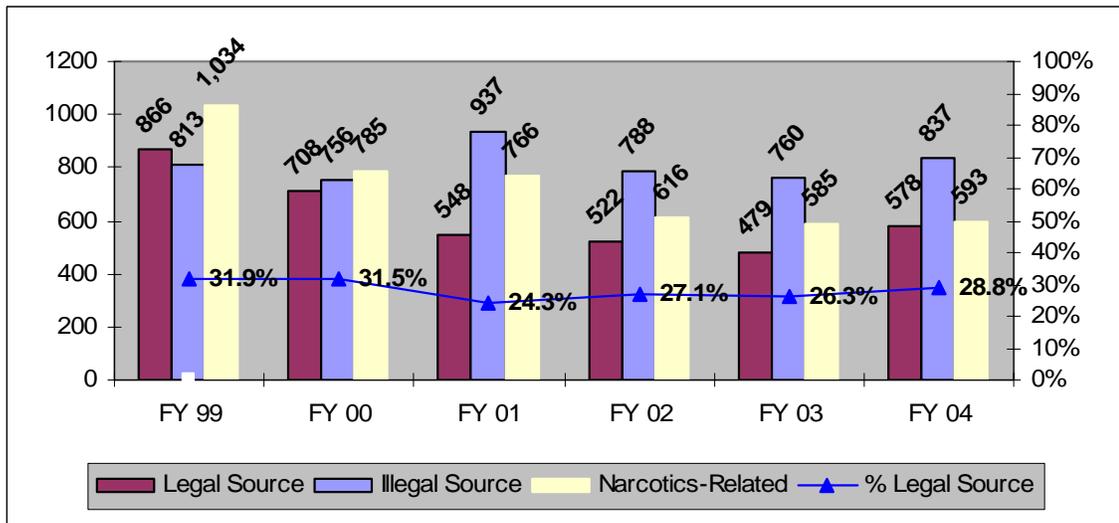
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 23: Number of Subjects Convicted of and Sentenced for a Crime Each Fiscal Year.



Source: IRS Data Book, Publication 55B.

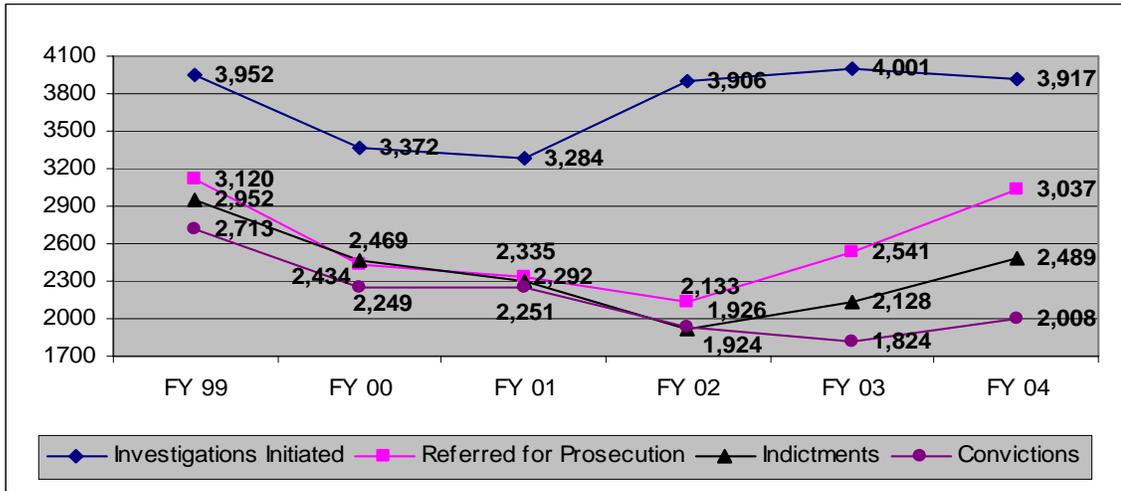
Figure 24: Number of Subjects Convicted of a Crime Each Fiscal Year by Compliance Strategy Program and the Percentage That Is Legal Source Tax Crimes.



Source: IRS Data Books, Publication 55B, for FYs 2000 through 2004. The numbers of Illegal Source Financial Crimes and Legal Source Tax Crimes were not published for FY 1999. FY 1999 numbers were obtained from the CI function based on its analysis of the CIMIS.

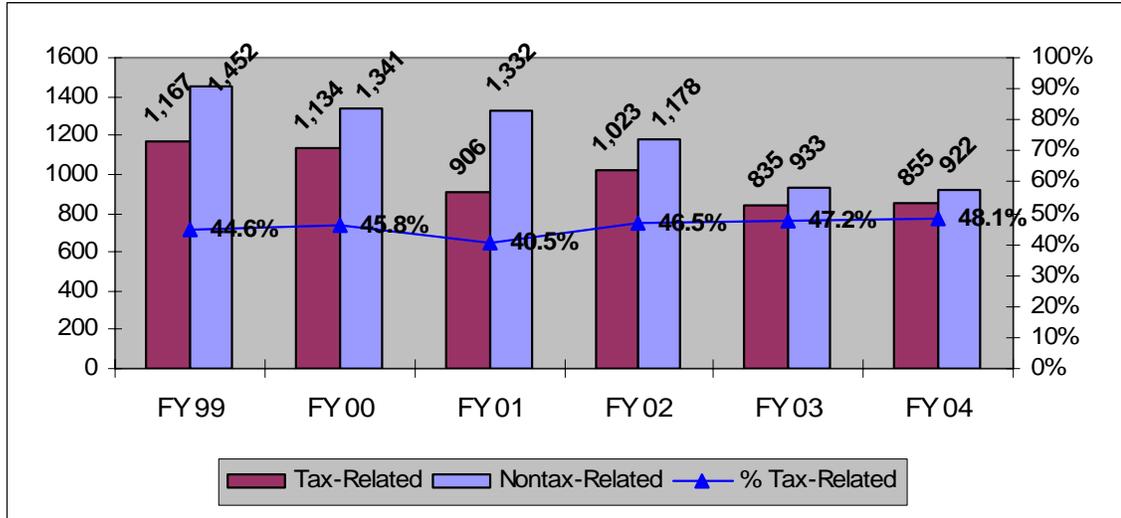
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 25: Number of Subject Investigations Initiated, Referred for Prosecution, Indicted, and Convicted Each Fiscal Year. Since actions on a specific case may cross fiscal years, the data shown in investigations initiated may not always represent the same universe of cases shown in other actions within the same fiscal year.



Source: IRS Data Book, Publication 55B.

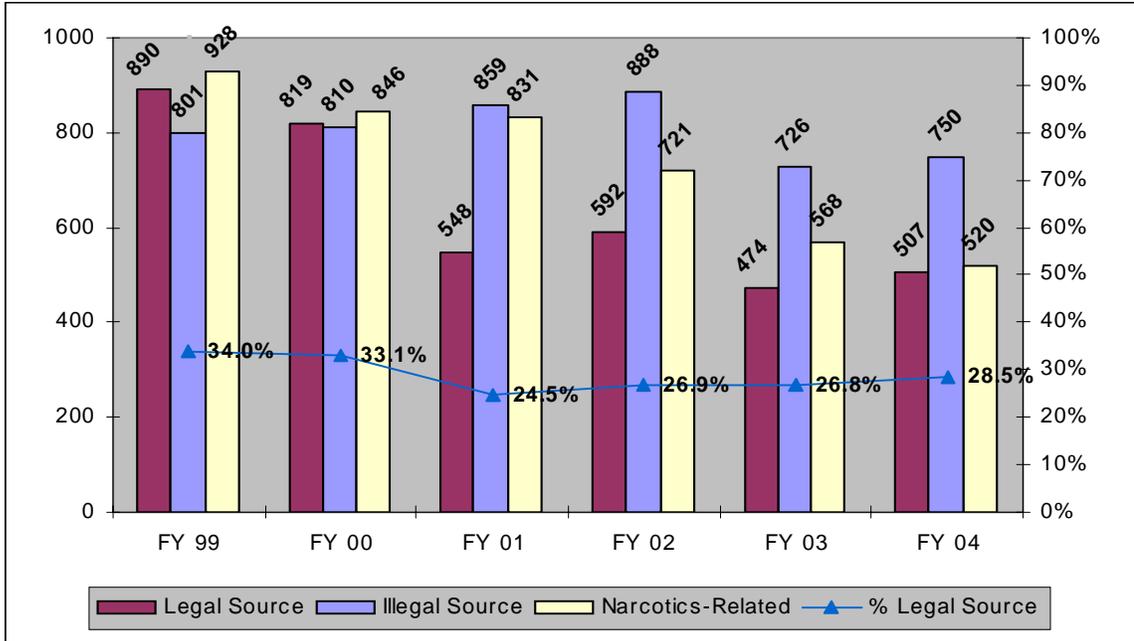
Figure 26: Number of Subjects Sentenced for a Crime Each Fiscal Year for a Tax-Related or Nontax-Related Violation and the Percentage That Is Tax-Related.



Source: CI function enforcement statistics derived from the IRS Internet web site.

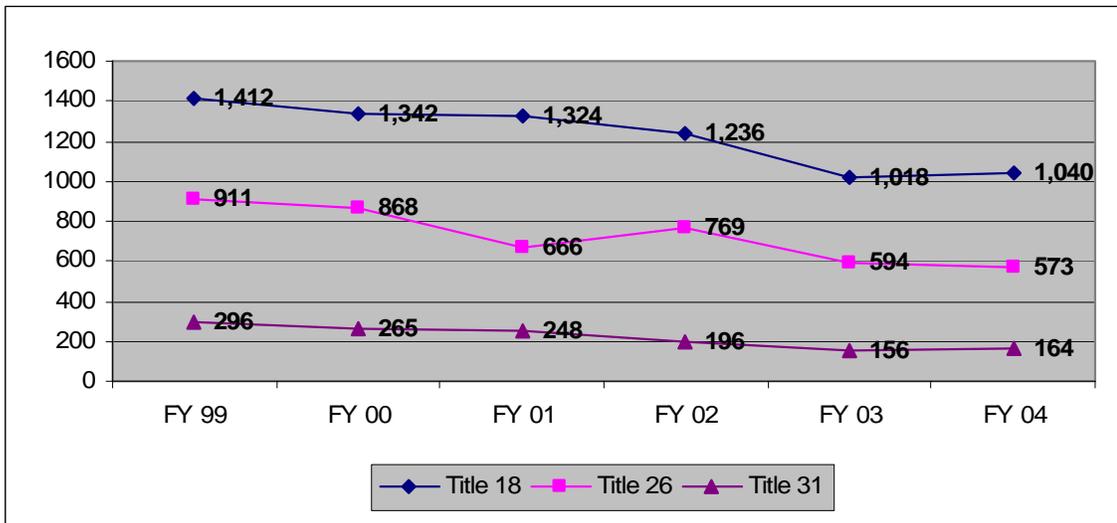
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 27: Number of Subjects Sentenced for a Crime Each Fiscal Year by Compliance Strategy Program and the Percentage That Is Legal Source Tax Crimes.



Source: IRS Data Books, Publication 55B, for FYs 2000 through 2004. The numbers of Illegal Source Financial Crimes and Legal Source Tax Crimes were not published for FY 1999. FY 1999 numbers were obtained from the CI function based on its analysis of the CIMIS.

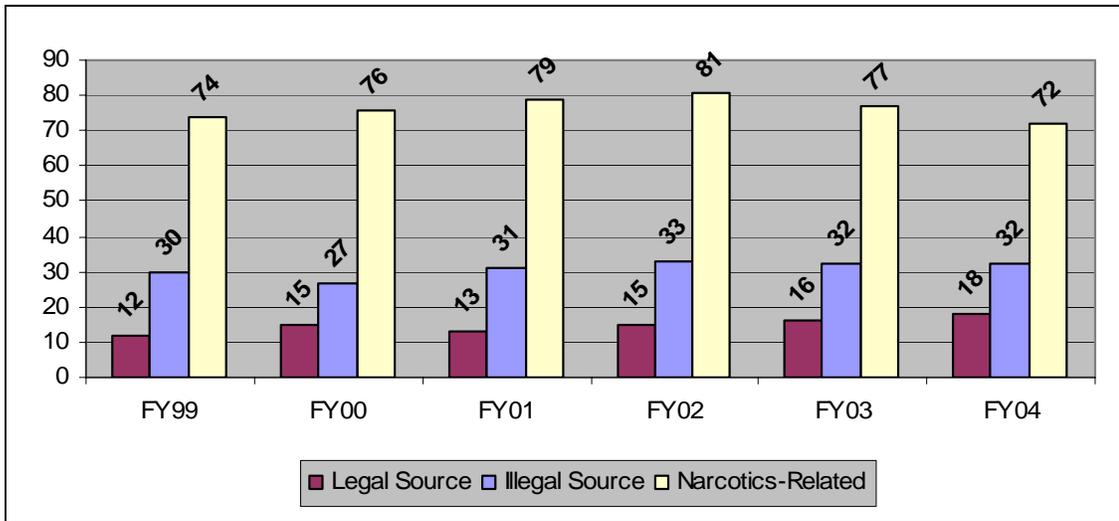
Figure 28: Number of Subjects Sentenced for a Crime Each Fiscal Year by Principle United States Code Title.



Source: CIMIS Report 11, Program Summary Analysis. Title 31 also includes other statutes.

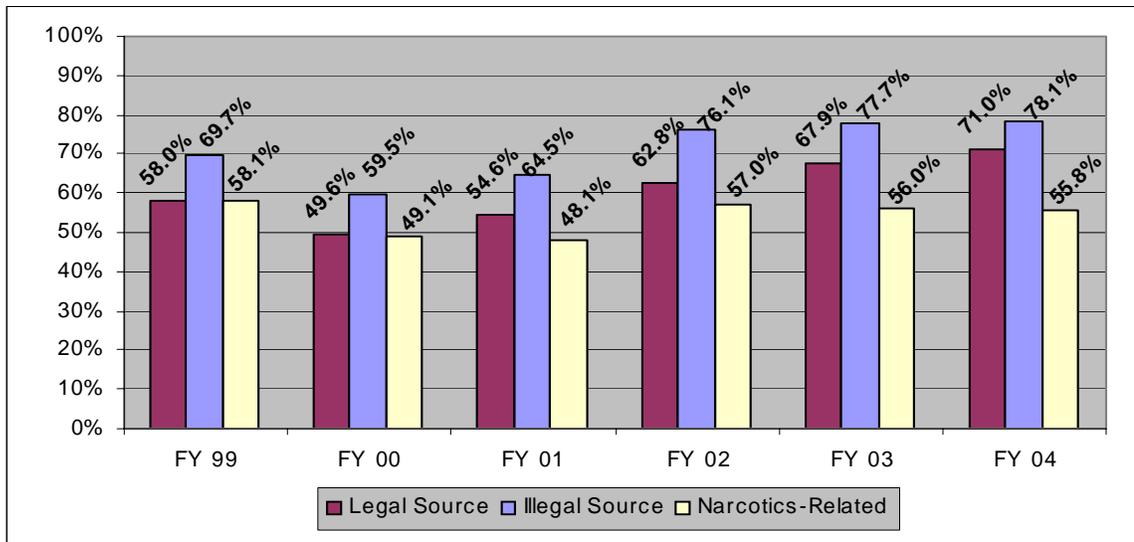
Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

Figure 29: Average Number of Months a Subject Is Incarcerated Each Fiscal Year by Compliance Strategy Program. Incarcerated may include prison time, home confinement, electronic monitoring, or a combination thereof.



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

Figure 30: Percentage of Investigations That Received Publicity Each Fiscal Year by Compliance Strategy Program.



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

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities
From Fiscal Year 1999 Through Fiscal Year 2004

Appendix VI

Management's Response to the Discussion Draft Report



Criminal Investigation

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

RECEIVED
APR 28 2005

April 28, 2005

MEMORANDUM FOR DANIEL R. DEVLIN
ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: Nancy J. Jardini 
Chief, Criminal Investigation

SUBJECT: Response To Draft Audit Report: Statistical Portrayal of the
Criminal Investigation Function's Enforcement Activities From
Fiscal Year 1999 Through Fiscal Year 2004
(Audit #200510011)

Thank you for the opportunity to respond to the draft report. Criminal Investigation (CI) has attained significant milestones the past several fiscal years. While we celebrate our achievements, we continually look for ways to refine and improve our operations. Criminal Investigation's management team spends a great deal of time analyzing various statistical indicators. However, we appreciate the additional input provided by the Treasury Inspector General for Tax Administration (TIGTA) via the annual audit of CI enforcement statistics. After a careful review of the discussion draft report, there is additional and/or clarifying information that we want to bring to your attention before the final report is issued.

- **Cover memo, page 2, first full paragraph and Draft Report, page 5, last paragraph**

"In addition, the FY 2005 budget contains almost a \$20 million decrease in funding for the Organized Crime and Drug Enforcement Task Force (OCDETF) program. As a result, the CI function will reduce the amount of direct investigative time spent on narcotics investigations and will shift some resources to tax-related investigations. The proposed budget for FY 2006 contains a 12.5 percent increase in overall enforcement funding, which includes the transfer of almost \$56 million in OCDETF funding from the Department of Justice (DOJ) to the Department of Treasury."

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

"The FY 2006 budget proposes an \$85 million (12.5 percent) increase to the CI function's overall budget, of which about \$56 million represents a transfer from the DOJ's appropriation to the Department of the Treasury's appropriation for OCDEF."

The proposed budget increase for FY 2006, \$85.4 million, does not actually increase CI resources by 12.5 percent. Sixty-five percent of this increase is a \$55.6 million transfer (rounded in the draft report to \$56 million) from the Department of Justice. However, this transfer represents a change in the funding source of an existing budgetary item, not additional resources. The remaining \$29.8 million includes \$19 million to cover anticipated increases in costs of labor, etc. and \$10.8 million to fund 22 new positions and provide additional database research capabilities to investigate additional fraudulent refund claims. Therefore, the resource increase provided for CI programs by the FY 2006 budget proposal is 1.5 percent (\$10.8 million).

- **Cover Memo Page 2, last paragraph (continuing on page 3)**

"Further, the total number of tax and tax-related investigations initiated during FY 2004 declined by 12.3 percent. This occurred primarily because there was an 11.8 percent decline in legal source investigations initiated, while illegal source investigations initiated remained the same."

Criminal Investigation's case initiation rate trended downward in FY 2004, largely due to an increased focus on completing open investigations and reducing cycle time.¹ Criminal Investigation reduced cycle time by 9.8 percent, from FY 2002 to FY 2004, while completing 37.1 percent more investigations.

The increased focus on reducing cycle time resulted in a growing pipeline inventory.² Tax and tax related investigations³ in the pipeline inventory increased by approximately 38.2 percent during FYs 2002 through 2004 from 1,486 to 2,054. The percentage of direct investigative time (DIT) expended on pipeline investigations also increased from 14.5 percent in FY 2002 to 18.5 percent in FY 2004. At least 60 percent of the total DIT expended on pipeline investigations in FY 2004 involved tax and tax related investigations.

In conjunction with the decrease in cycle time and increase in pipeline inventory, current statistics show subject criminal investigation (SCI) initiations are on the rise. The number of total SCI initiations increased by approximately 17.8 percent for the first half of FY 2005, compared to the same FY 2004 time frame. Additionally, FY 2005 first half tax and tax related SCI initiations increased 8.7 percent over FY 2004 levels, comprising 61.7 percent of total SCI initiations.

¹ Elapsed days on completed investigations

² Referred cases awaiting prosecution

³ Investigations involving Titles 26; 33, Sections 1521 through 1533; and 18, Sections 286, 287, 514 and/or 371(k)

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

- **Draft Report Page 4, next to last paragraph**

"Between FYs 1999 and 2004, special agent staffing decreased almost 2 percent from 2,849 to 2,795. However, field office special agent staffing declined by about 6.5 percent from 2,669 to 2,495 during the same period. An analysis of the CI function's hiring and attrition data for FYs 1999 to 2004 shows that the CI function was losing special agents to attrition faster than it could replace them. Since FY 2002, budget limitations caused the CI function to limit hiring to a level at or below attrition. The CI function originally planned to hire over 500 special agents in FY 2005; it now plans to hire only about 200 special agents. Factoring anticipated attrition, the CI function estimates a net increase of about 66 special agents from FY 2004."

The FY 2005 Congressional Justification approved 350 new special agent (SA) hires and CI planned attrition hiring of 68 additional SAs. However, the final funding levels only supported 216 hires. Therefore, CI currently projects a net increase of 48 SA positions for FY 2005. Even with the slight reduction in SA levels over time, the current total inventory per SA (8.3) remains at the highest level since FY 2001.

- **Draft Report Page 5, last full paragraph**

"According to the FY 2005 budget, OCDEF funding decreased by almost \$20 million from the original appropriated amount of \$72 million. As a result, the CI function field offices reduced the DIT range to 10 – 12 percent to correspond with the funding decrease. In addition, the CI function plans to complete about 11 percent fewer investigations in FY 2005, as it shifts staff from narcotics to tax-related investigations, which generally take longer to complete."

Criminal Investigation continually monitors narcotics related funding levels and makes adjustments to the narcotics program guidance to ensure resource utilization is consistent with funding levels. As a result, CI reduced the narcotics DIT range to 9 – 11 percent in the first quarter of FY 2005, to remain aligned with the reimbursement level.

The statement that CI "plans to complete 11 percent fewer investigations in FY 2005" is based on initial projections of 3,895 completed investigations. Based on early FY 2005 results, and to create ambitious performance goals for the organization, CI increased the projection by 12.5 percent to 4,380. The revised goal is slightly below actual FY 2004 completions of 4,387, which represented a 4-year high. Criminal Investigation anticipates meeting or

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

exceeding the current projection, having already achieved over 50 percent of the revised FY 2005 goal.

- **Draft Report Page 6, first full paragraph**

"...In addition, the SFC was concerned there may be as few as two investigations per special agent, and that it takes on average 2 years to prepare and present a case to the Department of Justice for prosecution."

The numbers presented on page eight of the draft report reflect CI's average elapsed time is actually 367.5 days, not two years.

- **Draft Report Page 6, last paragraph (continuing on page 7)**

"The percentage of tax-related investigations initiated increased 6.7 percentage points during FYs 1999 through 2004. However, the percentage of legal source investigations initiated was virtually unchanged during this same period. After a significant increase in FY 2002, the number of legal source investigations initiated has decreased the last 2 years, and are down 11.8 percent in FY 2004."

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 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 fiscal year 2004. During the same time frame, overall tax and tax related case initiations increased by 16.7 percent. Additionally, historic statistical trends establish that CI's work flow is cyclical. 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, legal source initiations increased 21.5 percent from an average of 1,216 to 1,477. Looking beyond individual years to broader patterns, shows 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.

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

- **Draft Report Page 7, third full paragraph**

"Also, while the numbers of tax-related and legal source tax investigations in the pipeline are at 5-year and 4-year highs, respectively, the percentages of each type of investigation have been about the same, and in fact have declined slightly during FY 2004."

The comparison here is to the FY 2003 percentages, unlike the preceding paragraph which compared to FY 2002 levels. The fact that FY 2003 is the comparison year should be added to this paragraph, for clarification purposes.

The inclusion of the final phrase in this paragraph lends a negative connotation. It is true that a slight decline from FY 2003 to FY 2004 occurred in the noted categories. However, when looking at the last four fiscal years, CI's performance was consistent with only minor percentage changes between fiscal years in each category.

- **Draft Report Page 9, second full paragraph and Page 10, first and second full paragraph (the second paragraph below is also included in the cover memo to the draft report)**

"During FY 2004, about 58.4 percent of subject investigations initiated came from USAOs or other government agencies. This increased from 51.6 percent and 54.8 percent in FY 2002 and 2003, respectively. In contrast, during FY 2004, only 30.1 percent of subject investigations initiated originated from within the IRS. This is trending down from the 34.2 percent and 31.6 percent reported in FY 2002 and 2003, respectively. Furthermore, the percentage of subject investigations initiated from a public source has decreased 18.7 percent during the last 2 fiscal years. During FY 2004 subject investigations from a public source represented 11.5 percent of the total investigations initiated."

"Initiating more cases from sources external to the IRS concerns us... We believe the CI function must also be judicious in deciding which investigations to work with other agencies, especially in those cases where the connection to tax administration is not clear."

Criminal Investigation is committed to working the highest impact cases with the greatest deterrent effect. As a result, CI field offices consistently strive to identify and work the most significant cases possible, regardless of source. Although sources from within the IRS are significant generators of legal source investigations, the deterrent effect of illegal source and narcotics investigations should not be discounted.

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

In fact two research documents, respectively completed in 2001 and 2004, answered several important compliance questions. Collectively, they provide a useful perspective from which to evaluate past, present, and future compliance strategies. Criminal Investigation's experience since the 2000 reorganization, coupled with the conclusions contained in these reports, validate its past and present case mixes and their effect on voluntary compliance.

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 tax evasion schemes, particularly, the most ambitious and sophisticated abusive tax schemes.

Professor Jeffrey A. Dubin prepared the second report, entitled Criminal Investigation Enforcement Activities and Taxpayer Noncompliance in June 2004. Through his empirical study, Professor Dubin concluded that CI's activities have a measurable effect on voluntary compliance. He further concluded that the mix of investigations (tax versus money laundering) does not have a significant impact on voluntary compliance.

The CI FY 2005 Annual Business Plan (ABP) provides guidance "intended to assist the Area and Field Offices 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." This priority is also reflected in the performance goals of all levels of CI management for FY 2005.

- **Draft Report Page 10, last paragraph**

"Further, the total number of tax or tax-related investigations initiated from FY 2002 to FY 2004 declined by 12.3 percent from 2,468 to 2,164. Since actions on criminal investigations may span more than 1 year, the more recent decline in tax and tax-related investigations initiated may result in a decline in tax and tax-related convictions and sentences in later years."

Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004

When looking at the first two quarters of FY 2005, the legal source initiations have significantly increased. As of March 31, 2005 they were 32.3 percent higher than at the same time in FY 2004.

While cyclical deviations in the number of investigation initiations exist, tax and tax related investigations have consistently comprised the majority of all SCI initiations. Further, 74 percent or more of CI's open SCIs were tax or tax related in each of the past four fiscal years.

- **Draft Report Figure 9**

The percentage of fraud referrals accepted for FY 1999 was 45.4 percent, versus the 44.3 percent reflected in the chart.

- **Draft Report Figure 14**

The correct number of non-grand jury subject investigations open at the end of FY 2000 was 1,371, not 1,374 as depicted in the chart.

If you have any questions concerning this response, please telephone me at (202) 622-3200 or contact Director, Planning and Strategy, Steven Pregozen at (202) 622-3679.

**Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities
From Fiscal Year 1999 Through Fiscal Year 2004**

Appendix VII

Office of Audit Comments on Management's Response

Although Criminal Investigation function management generally agreed with the contents of this report, they provided additional and/or clarifying information. We have taken this information into consideration in revising the report and, where appropriate, have included portions of management's response and our related comments below to identify the revisions.

- **Cover Memo, Page 2, first full paragraph and Draft Report, page 5, last paragraph.**

Management's Response:

The proposed budget increase for FY 2006, \$85.4 million, does not actually increase CI resources by 12.5 percent. Sixty-five percent of this increase is a \$55.6 million transfer (rounded in the draft report to \$56 million) from the Department of Justice. However, this transfer represents a change in the funding source of an existing budgetary item, not additional resources. The remaining \$29.8 million includes \$19 million to cover anticipated increases in costs of labor, etc. and \$10.8 million to fund 22 new positions and provide additional database research capabilities to investigate additional fraudulent refund claims. Therefore, the resource increase provided for CI programs by the FY 2006 budget proposal is 1.5 percent (\$10.8 million).

Office of Audit Comment: Report clarified by deleting reference to percentage increase in FY 2006 budget.

- **Cover Memo Page 2, last paragraph (continuing on page 3)**

“Further, the total number of tax and tax-related investigations initiated during FY 2004 declined by 12.3 percent. This occurred primarily because there was an 11.8 percent decline in legal source investigations initiated, while illegal source investigations initiated remained the same.”

Management's Response:

Criminal Investigation's case initiation rate trended downward in FY 2004, largely due to an increased focus on completing open investigations and reducing cycle time.

Office of Audit Comment: Second statement removed from the transmittal (cover memo) to be consistent with the text in the report.

**Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities
From Fiscal Year 1999 Through Fiscal Year 2004**

- **Draft Report Page 4, next to last paragraph**

Management's Response:

The FY 2005 Congressional Justification approved 350 new special agent (SA) hires and CI planned attrition hiring of 68 additional SAs. However, the final funding levels only supported 216 hires. Therefore, CI currently projects a net increase of 48 SA positions for FY 2005. Even with the slight reduction in SA levels over time, the current total inventory per SA (8.3) remains at the highest level since FY 2001.

Office of Audit Comment: Report changed to reflect current staffing projection.

- **Draft Report Page 5, last full paragraph**

Management's Response:

Criminal Investigation continually monitors narcotics related funding levels and makes adjustments to the narcotics program guidance to ensure resource utilization is consistent with funding levels. As a result, CI reduced the narcotics DIT range to 9 – 11 percent in the first quarter of FY 2005, to remain aligned with the reimbursement level.

The statement that CI “plans to complete 11 percent fewer investigations in FY 2005” is based on initial projections of 3,895 completed investigations. Based on early FY 2005 results, and to create ambitious performance goals for the organization, CI increased the projection by 12.5 percent to 4,380. The revised goal is slightly below actual FY 2004 completions of 4,387, which represented a 4-year high. Criminal Investigation anticipates meeting or exceeding the current projection, having already achieved over 50 percent of the revised FY 2005 goal.

Office of Audit Comment: Report clarified to recognize the revised narcotics DIT range and the revised goal for completed investigations.

- **Draft Report Page 6, first full paragraph**

Management's Response:

The numbers presented on page eight of the draft report reflect CI's average elapsed time is actually 367.5 days, not two years.

Office of Audit Comment: Report clarified by adding information to footnote 18.

**Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities
From Fiscal Year 1999 Through Fiscal Year 2004**

- **Draft Report Figure 9**

Management's Response:

The percentage of fraud referrals accepted for FY 1999 was 45.4 percent, versus the 44.3 percent reflected in the chart.

Office of Audit Comment: Report revised to reflect correct percentage.

- **Draft Report Figure 14**

Management's Response:

The correct number of non-grand jury subject investigations open at the end of FY 2000 was 1,371, not 1,374 as depicted in the chart.

Office of Audit Comment: Report revised to reflect correct figure.