



Department of Justice

STATEMENT OF

CAROLINE CIRAULO

**PRINCIPAL DEPUTY ASSISTANT ATTORNEY GENERAL
TAX DIVISION
U.S. DEPARTMENT OF JUSTICE**

BEFORE THE

**SUBCOMMITTEE ON REGULATORY REFORM,
COMMERCIAL AND ANTITRUST LAW
COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES**

FOR A HEARING CONCERNING

OVERSIGHT OF THE TAX DIVISION

PRESENTED

SEPTEMBER 29, 2016

Statement of Caroline Ciraolo
Principal Deputy Assistant Attorney General
Tax Division
U.S. Department of Justice
Before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law
Committee on the Judiciary
U.S. House of Representatives
September 29, 2016

Chairman Marino, Ranking Member Johnson, and Members of the Subcommittee, thank you for inviting me here to testify about the work of the Tax Division.

The Tax Division (the Division) is a litigating component of the U.S. Department of Justice (the Department), and our mission is to enforce the nation's tax laws fully, fairly, and consistently in federal and state courts throughout the country in order to promote voluntary compliance with the tax laws, maintain public confidence in the integrity of the tax system, and promote the sound development of the law. The Division functions, broadly, as four groups. The Division's seven civil trial sections have, on average, about 6,000 cases pending in various stages, with anywhere from 2,500-4,000 being actively worked, and claims in those suits exceeding \$10 billion. In any given year, the Division's civil appellate attorneys handle about 650 civil appeals, about half of which are from decisions of the United States Tax Court. To help achieve uniformity in nationwide standards for criminal tax prosecutions, the Division's criminal prosecutors are broken into three sections and authorize almost all grand jury investigations and prosecutions involving violations of the internal revenue laws. The Division authorizes between 1,300 and 1,500 criminal tax investigations annually. These crimes are prosecuted by Division attorneys or Assistant U.S. Attorneys, either working alone or in partnership with Division attorneys, after determining that there is a reasonable probability of conviction based on the existence of sufficient admissible evidence to prove all of the elements of the offense charged. Our Criminal Appeals and Tax Enforcement Policy Section handles all appeals from cases assigned to Division prosecutors, as well as selected cases assigned to the Offices of the U.S. Attorneys.

To carry out its mission, the Division currently has approximately 350 attorneys, who are assigned either to one of sixteen sections and offices located in Washington, DC, or to the Southwestern Civil Trial Section located in Dallas, Texas. Attorneys are supported by approximately 125 administrative support employees.

The President's Budget for the 2017 fiscal year requests \$114 million in funding for the Division. This funding level will allow the Division to continue its enforcement efforts through its prosecutions, collections, and injunction actions – all areas that are critical to the full and fair enforcement of the tax laws enacted by Congress.

Civil Litigation

Civil Trial. The Division is responsible for litigating all matters arising under the internal revenue laws in all state and federal trial courts, except the United States Tax Court. The Division's civil litigators enforce the Internal Revenue Service's (IRS) requests for information in ongoing examinations, and collect and defend tax assessments when the examinations are completed. Tax cases filed *against* the United States comprise nearly 70 percent of the Division's caseload, both in the number of cases to be litigated and the number of attorney work-hours devoted to them each year. Each year, the Division's civil trial attorneys save the Treasury hundreds of millions of dollars through their representation of the government in defense of refund claims brought by taxpayers. As of August 30, 2016, the Division was defending tax refund cases worth approximately \$10 billion to the Federal Treasury.

The Division contributes significantly to closing the tax gap (the difference between the amount of taxes owed and the amount that is paid on time) through its pursuit of those taxpayers that fail to truthfully and accurately comply with their federal tax obligations. The goal of the Division's civil tax litigation is twofold: first, to enforce the tax laws and collect taxes that would otherwise go unpaid; and second, to assure honest taxpayers that those who choose not to pay their fair share will be pursued and penalized. Collection suits have a direct and positive effect on the Treasury. The Division consistently collects more each year than its entire budget. Over the past five fiscal years, the Division has collected in excess of \$1.3 billion in unpaid tax debts. Given that the IRS only refers to the Division tax debts that the IRS has been unable to collect administratively, the Division's efforts are a tremendous return on investment in collecting the most difficult debts.

The portfolio of Division attorneys includes a wide array of procedural and substantive tax matters which can affect an individual taxpayer or business, a large number of similarly-situated individual taxpayers, or an entire industry. Transactions at issue can range from the proper reporting of income and deductions on a Form 1040 to the consequences of an investment in a complex corporate tax shelter. When a matter is referred by the IRS for defense or litigation, the Division independently analyzes the facts and applicable law to ensure that the tax system is being enforced uniformly and fairly across the country. As a result, the Division's civil trial attorneys are successful in more than 95 percent of the cases that they litigate to a decision each year.

Civil Appellate. The Division civil appellate attorneys are responsible for briefing and arguing civil federal tax cases before the U.S. courts of appeal. At any given time, civil appellate attorneys are responsible for approximately 650 cases. About half of the cases involve appeals from decisions of the United States Tax Court, with the balance arising from decisions of the U.S. district courts and the United States Court of Federal Claims. Civil appellate attorneys also assist the Solicitor General of the United States in drafting pleadings and briefs filed in civil federal tax cases considered by the United States Supreme Court. These include amicus curiae briefs in suits that present issues affecting the interests of the United States, or in which the Court invites the United States to provide its views on tax-related questions. When the government receives an adverse decision from a trial court, the Appellate Section closely evaluates the legal and policy implications of the decision and provides a recommendation to the Solicitor General,

taking care to ensure that resources are spent wisely only on the most meritorious government appeals.

Criminal Investigation and Prosecution

Criminal Trial. In addition to our extensive civil practice, the Division authorizes all prosecutions arising under the federal tax laws except for excise taxes and criminal disclosure violations. The Division's criminal goals are to prosecute criminal tax violations and to promote uniform nationwide criminal tax enforcement. In many cases, the Division receives requests from the IRS to prosecute violations after the IRS has completed an administrative investigation. In other cases, the IRS asks the Division to authorize grand jury investigations to determine whether prosecutable tax crimes have occurred. Division prosecutors review, analyze, and evaluate referrals to ensure that uniform standards of prosecution are applied to taxpayers across the country. In the past few years, the Division has authorized between 1,300 and 1,500 criminal tax investigations and prosecutions each year. After tax charges are authorized, cases are handled by a U.S. Attorney's Office, by a Division prosecutor, or by a team of prosecutors from both. Division prosecutors also conduct training for IRS criminal investigators and Assistant U.S. Attorneys, and provide advice to other federal law enforcement personnel, such as the Drug Enforcement Administration and the Federal Bureau of Investigation (FBI).

The crimes investigated and prosecuted by the Division include attempts to evade tax, willful failure to file returns, and submission of false returns, as well as other conduct designed to violate federal tax laws. The crimes may be committed by individuals, business entities, or tax preparers and professionals. These cases often encompass tax crimes where the source of the individual or business income is earned through legitimate means – as examples, a restaurateur who skims cash receipts; a self-employed individual who hides taxable income or inflates deductions; or a corporation that maintains two sets of books, one reporting its true gross receipts and the other – used for tax purposes – showing lower amounts. Prosecutions in these cases often receive substantial attention in the local and national media, and convictions remind law-abiding citizens who pay their taxes that those who cheat will be punished.

It is not uncommon for tax crimes to be committed during the course of other criminal conduct, such as securities fraud, bank fraud, identity theft, bankruptcy fraud, health care fraud, organized crime, public corruption, mortgage fraud, and narcotics trafficking. Division prosecutors work closely with the U.S. Attorneys' Offices on these issues.

As tax crimes have become more complex and international in scope, so has the workload of Division prosecutors. Division prosecutors investigate and prosecute domestic tax crimes involving international conduct, such as the illegal use of offshore trusts and foreign bank accounts used to conceal taxable income and evade taxes. In addition to the traditional cases involving unreported legal source income, over the last several years a greater proportion of our cases involve high net-worth taxpayers and tax professionals who sell and implement dubious tax schemes. For the period beginning October 1, 2015 through August 31, 2016, Division prosecutors obtained 112 indictments and 121 convictions (not including the additional criminal tax prosecutions handled exclusively by U.S. Attorneys' Offices). The conviction rate for cases brought by Division prosecutors generally exceeds 95 percent.

Criminal Appeals. The Division Criminal Appeals and Tax Enforcement Policy Section (CATEPS) handles appeals in criminal tax cases prosecuted by Division prosecutors, as well as some appeals from criminal tax cases handled by U.S. Attorneys' Offices. The appellate-level review provided by CATEPS attorneys plays a vital role in promoting the fair, correct, and uniform enforcement of federal tax law. CATEPS is also charged with developing criminal tax enforcement policy, and provides technical guidance on issues, including the sentencing guidelines and restitution in tax cases. CATEPS's international team serves as a resource to Division attorneys and IRS agents on international matters arising in civil and criminal cases, and provides information and technical expertise on matters involving international tax information agreements and treaties.

It is apparent from this brief overview that Division attorneys are involved in every facet of federal tax enforcement. I would like to take a moment to highlight six areas of enforcement that are among our highest enforcement priorities – abusive tax shelters, abusive promotions, offshore tax evasion, employment tax enforcement, stolen identity refund fraud, and tax defiers.

Abusive Tax Shelters

The proliferation of abusive tax shelters remains a significant problem confronting our tax system. Tax shelter litigation is among the most sophisticated and complex litigation handled by the Division. Tax shelters are designed to generate large purported tax benefits using multiple entities and complex financial transactions that lack a real business purpose or any real economic substance. Shelter cases often involve well-disguised transactions and tax-indifferent parties located in other countries, making case development and document discovery difficult and expensive. Successfully defending in federal trial and appellate courts the IRS's disallowance of sham tax benefits is critical to the government's efforts to combat abusive tax shelters. Because tax shelters typically involve enormous sums of money and often attract significant media attention, a coordinated and effective effort is essential to prevent substantial losses to the Treasury and deter future use of such tax shelters by other taxpayers.

The Division plays a critical role in the government's efforts to combat abusive tax shelters. For example:

- During the last three years, the Division prevailed in a series of cases involving intermediary tax shelter cases, in which a taxpayer who owns a company holding property with a large built-in tax liability sells his shares in the company to an intermediary that pays the taxpayer a premium for the shares, immediately sells the corporate property, and then dissolves the company without paying the resulting tax liability on the capital gain. In *Diebold Foundation v. Commissioner*, the Second Circuit held that the taxpayers participating in such a transaction could be held liable for the unpaid tax, and remanded the case to address whether the taxpayers had constructive knowledge of the overall scheme, which would result in the transaction being recharacterized as a liquidation and distribution under state law (and would subject taxpayers to liability as transferees). In *Salus Mundi v. Commissioner*, the Ninth Circuit held that the taxpayers in another intermediary shelter case had constructive knowledge of the shelter, as necessary to establish their liability as transferees under state law. In

Feldman v. Commissioner, the Seventh Circuit became the first circuit to recognize that the purported stock sale at the heart of an intermediary tax shelter was, in substance, liquidation, making the former shareholders transferees of the corporation.

- The Division also successfully defended several significant victories relating to the Son-of-BOSS tax shelter, which generally involves the transfer of assets encumbered by significant liabilities to a partnership in an attempt to artificially inflate the partners' basis in the partnership. For example, in *Humboldt Shelby Holding Corp. v. Commissioner*, the Second Circuit held that a Son-of-BOSS tax shelter, which involved a claimed loss of \$74 million, lacked economic substance because the potential profit was insubstantial compared to the guaranteed tax loss created by the shelter.
- In October 2015, in *Kearney Partners, LLC v. United States*, the Eleventh Circuit affirmed the district court's determination that an abusive basis-inflating tax shelter, known as FOCP (Family Office Customized Partnership), marketed by KPMG to high net-worth individuals, was motivated by tax avoidance, and that there was no reasonable probability of making profits from any step of the transaction.

These are significant victories and the Division will continue to vigorously defend the IRS's disallowance of the sham benefits claimed by taxpayers who seek to elevate form over substance and undermine the tax system to avoid paying their fair share.

Abusive Promotions

The Department is actively combating those who promote the use of fraudulent schemes and promotions, including the use of domestic or foreign trusts, to evade taxes and hide assets. Promoters of these schemes often use the Internet to aggressively market these trusts to the public, and rely upon strained, if not demonstrably false, interpretations of the tax laws. Employing what they often call "asset protection trusts" (ostensibly designed to guard an individual's assets from legitimate creditors, including the IRS), these promoters are in fact assisting taxpayers to fraudulently assign income and conceal ownership of income-producing assets in order to evade paying their taxes. The Division and U.S. Attorneys' Offices are vigorously employing a range of criminal and civil tools, including injunctive relief, to target promoters and address these abusive activities. For example,

- In November 2015, a federal court in California permanently barred a former California lawyer and certified public accountant (CPA) from preparing federal tax returns for others, providing tax advice for compensation or any promise of compensation, and working for any business that provides tax advice or prepares tax returns. Following this promoter's conviction for tax evasion and other federal crimes and resulting loss of his CPA license and resignation from the bar, the promoter impersonated licensed California attorneys and used multiple aliases to recruit customers and implement his tax fraud schemes. His tax fraud schemes included falsely advising his customers, typically high earners who own profitable businesses, to establish companies in another state, usually Nevada, and to treat their California home as an out-of-state corporate office.

- In May 2015, a federal court in Utah sentenced a Utah man and a Nevada woman to serve 48 months and 36 months in prison, respectively, for conspiracy to defraud the United States through their marketing “corporations sole.” The defendants told their clients that corporations’ sole were exempt from federal income tax, had no obligation to file tax returns, and had no obligation to apply for tax-exempt status. The defendants also claimed that individuals could render their own income non-taxable by assigning it to a corporation sole, could draw a tax-free stipend from their corporation sole, and could render property immune from IRS collection activity by transferring property to the corporation sole.

The Division is also committed to combating the preparation of fraudulent tax returns, including false claims for, among other things, the American Opportunity Tax Credit, the Fuel Tax Credit, and the Earned Income Tax Credit. Preparers who falsely claim these tax credits and prepare false tax returns for their customers undermine public confidence in the integrity of our tax system, and require both the IRS and the Division to devote tremendous resources to investigating the fraudulent schemes, seeking corrective action, and collecting the resulting unpaid taxes. The Division and U.S. Attorneys’ Offices are employing a range of criminal and civil tools, including injunctive relief, to stop preparers from these abusive activities.

The Division frequently enjoins tax return preparers engaged in the preparation of fraudulent returns, with the courts requiring that the preparers notify their clients of the injunctions and disgorge fees earned with respect to their fraudulent activities. And when a preparer violates the injunction, the Division stands ready to pursue civil or criminal contempt proceedings. For example:

- In August 2016, a federal court in Maryland held a woman in contempt of court for continuing to prepare tax returns despite the court ordering her to cease return preparation in 2014. In addition to holding her in contempt, the court ordered her to return to her customers the portion of the fees she diverted to herself and imposed a monetary penalty.
- In June 2016, a federal court in Florida barred two tax return preparers from preparing tax returns and entered a \$1 million judgment against each for disgorgement of the proceeds that each received preparing tax returns.
- In April 2016, a federal court in Tennessee barred two tax preparers from preparing tax returns and ordered each individual to turn over to the United States all of the fees received from preparing federal tax returns since January 15, 2016. The court later jailed one preparer for failure to pay fees received.

Through our injunction program, the Division works closely with IRS agents and attorneys to ensure that misconduct is detected early, investigated fully, and referred for litigation quickly so that it can be stopped before it spreads further.

Offshore Tax Evasion

The Division plays a lead role in investigating and prosecuting those who use foreign tax havens to evade taxes and reporting requirements. The increased technical sophistication of financial instruments and the use of the Internet have made it all too easy to move money around the world instantly, without regard to national borders. Using tax havens facilitates evasion of U.S. taxes and related financial crimes, and fosters the perception that if people have enough money and access to unscrupulous professionals, they can get away with hiding money offshore.

When taxpayers fail to produce records related to their offshore assets and activities during a civil tax audit, Department attorneys will file petitions with federal courts seeking to enforce IRS requests for this information. In many cases, we are seeking records that exist within the United States, but the Division also can seek to compel U.S. branches of foreign banks to produce records that they control located in foreign jurisdictions, despite claims that such production would violate foreign law.

In February 2016, the Division filed suit to compel UBS AG (UBS) to produce account records held by a UBS branch in Singapore, after UBS refused to produce those records in response to an IRS administrative summons. The records related to a Singapore account held by a U.S. taxpayer, believed to be residing in China. UBS initially refused to produce the account records, arguing that doing so would be a violation of Singapore bank secrecy laws. After the suit was filed, UBS produced the records requested. In today's climate, the Department's use of such tools, referred to as a *Bank of Nova Scotia* summons, expands the IRS's ability to obtain information in the U.S. Government's continuing efforts to hold U.S. taxpayers accountable for reporting and paying their fair share of taxes.

The Department will also file petitions with federal courts seeking authorization to issue what we call "John Doe summonses" to obtain information based on a reasonable belief that a class of individuals whose identities are unknown are engaged in conduct violating the U.S. internal revenue laws. In December 2014, a federal court in New York signed an order authorizing the IRS to issue John Doe summonses requiring Federal Express Corporation, FedEx Ground Package System Inc., DHL Express, United Parcel Service Inc., Western Union Financial Services Inc., the Federal Reserve Bank of New York, Clearing House Payments Company LLC, and HSBC Bank USA, National Association, to produce information about U.S. taxpayers who might be evading or have evaded federal taxes by using the services of Sovereign Management & Legal Ltd. (Sovereign). Sovereign is a multi-jurisdictional offshore services provider that the Department alleged offered clients, among other things, the formation and administration of anonymous corporations and foundations. The IRS believed Sovereign's related services included the maintenance and operation of offshore structures, mail forwarding, the availability of virtual offices, re-invoicing and the provision of professional managers who appoint themselves directors of the client's entity while the client maintains ultimate control over the assets. Sovereign used Federal Express, UPS, and DHL to correspond with U.S. clients and Western Union to transmit funds to and from clients in the United States. In addition, wire services operated by the Federal Reserve Bank and Clearing House and the U.S. correspondent bank accounts that HSBC USA held for Sovereign's banks in Panama and Hong Kong, were believed to have records of financial transactions between Sovereign and its clients in the United

States. With these records, the IRS sought to identify and gather information about Sovereign's U.S. clients who may be avoiding or evading taxes.

Similarly, in September 2015, a federal court in Miami granted the Department's petition for an order authorizing the issuance of a John Doe summons to Bank of America and Citibank seeking information about U.S. taxpayers who may hold offshore accounts at Belize Bank International Limited (BBIL) or Belize Bank Limited (BBL). Belize Corporate Services (BCS) is incorporated and based in Belize and offers corporate services, including the purchase of "shelf" Belizean international business companies. The Department established a reasonable belief that the customers in the John Doe class failed to report income, evaded income taxes, or otherwise violated U.S. internal revenue laws. The records were sought to identify U.S. taxpayers who hold or held interests in financial accounts at BBIL and BBL, as well as other financial institutions that used the same correspondent accounts.

The Department will continue to enforce IRS administrative summonses, seek the issuance of John Doe summonses, and employ all other available and appropriate methods to obtain information regarding potential tax violations and to assist its partners within the IRS with enforcement of the U.S. tax laws.

The Department also investigates and prosecutes U.S. taxpayers who use foreign accounts or entities in an attempt to evade tax, as well as bankers, account managers, professional service providers, and other facilitators, including foreign entities, assisting or conspiring with U.S. persons in evading their tax obligations. Since 2008, the Department has charged criminally more than 160 accountholders and over 50 facilitators, many of whom reside outside the United States.

For example, on August 1, 2016, a California businessman who owns a company that makes and sells clothing, was charged with conspiring to defraud the United States and corruptly endeavoring to impair and impede the due administration of the internal revenue laws. The defendant maintained several undeclared bank accounts at Bank Leumi and two other Israeli banks, both in his name and in the names of entities that he created. For decades, with the assistance of at least two bank employees, the defendant diverted tens of millions of dollars in untaxed gross business income to these accounts in an effort to conceal income and obstruct the IRS. The bankers frequently visited the defendant in Los Angeles and, at his request, delivered account information in person, rather than send account statements by mail. For example, one banker loaded account statements on a USB drive, which she concealed in a necklace worn during her trips to the United States. At the suggestion of the bankers, the defendant also used "back-to-back" loans to access his funds offshore without actually withdrawing the funds or creating a paper trail that would reveal the existence of the secret foreign accounts. The bankers also directed the defendant to obtain Israeli and Iranian passports in an effort to avoid being flagged as a U.S. citizen by the compliance departments at both banks and later facilitated the transfer of the defendant's remaining funds to yet another Israeli bank.

The defendant has agreed to plead guilty and pay more than \$8.3 million in restitution to the IRS. If the court accepts the plea agreement, he will be sentenced to 24 months in prison and

pay a civil penalty in the amount of 50 percent of the high balance of his undeclared accounts to resolve his civil liability for not disclosing the existence of his Israeli bank accounts.

As reflected in this prosecution, U.S. accountholders who use foreign accounts to conceal assets and income and to evade their U.S. tax obligations rely on the assistance of third parties – foreign financial institutions, bankers, accountants, and lawyers, just to name a few. Many of these third parties are unwitting participants. Others, like the bankers who assisted the defendant, play an active role in the criminal conduct.

For example, on June 22, 2016, an Italian citizen who resides in Switzerland pleaded guilty to conspiring to defraud the United States by assisting U.S. taxpayers to conceal foreign accounts and evade U.S. taxes during his employment as a banker working for Credit Suisse. The defendant admitted that from 2002 to 2009, while working as a relationship manager for Credit Suisse in Switzerland, he participated in a wide-ranging conspiracy to aid and assist U.S. taxpayers in evading their income taxes by concealing assets and income in secret Swiss bank accounts. He oversaw a portfolio of accounts, largely owned by U.S. taxpayers residing on the West Coast of the United States, which grew to approximately \$700 million of assets under management.

The defendant had been a fugitive since 2011, unable to travel outside of Switzerland without risking arrest. He is the third fugitive to come to the United States and plead guilty to charges in this case. Two of his co-defendants pleaded guilty in 2014 and were sentenced on March 27, 2015.

These cases demonstrate that tax evasion knows no geographic bounds and that the Department will pursue these cases wherever the money travels. Not only will those individuals involved be held responsible, but also the entities that support and facilitate their conduct. The Department remains committed to holding foreign financial institutions, corporate service providers, legal and financial professional firms, insurance companies, and other entities accountable for their role in assisting U.S. taxpayers in concealing accounts and evading U.S. tax obligations. For example,

- In May 2014, Credit Suisse pleaded guilty to conspiring to aid and assist U.S. taxpayers in filing false returns and was sentenced in November 2014 to pay \$2.6 billion in fines and restitution.
- In December 2014, Bank Leumi entered into a deferred prosecution agreement after the bank admitted to conspiring from at least 2000 until early 2011 to aid and assist U.S. taxpayers to prepare and present false tax returns by hiding income and assets in offshore bank accounts in Israel and other locations around the world. Bank Leumi admitted to helping U.S. clients conceal assets by, among other things, using assumed names or numbered accounts, providing hold mail service, sending private bankers to the United States to meet secretly with clients at hotels, parks, and coffee shops to discuss the clients' foreign account activity and assisting U.S. clients in using nominee corporations created in the British Virgin Islands, Panama, Belize, and other foreign jurisdictions to hide their foreign accounts by concealing the U.S. client as the true beneficial owner.

Under the terms of the deferred prosecution agreement, Bank Leumi paid the United States a total of \$270 million (in U.S. currency) and continues to cooperate with respect to civil and criminal tax investigations.

- In February 2016, the Department entered into a deferred prosecution agreement with Bank Julius Baer, which admitted to conspiring with and knowingly assisting U.S. accountholders to hide billions of dollars in offshore accounts and evade U.S. taxes. Julius Baer admitted that it identified certain U.S. taxpayers only by code name or number and opened accounts for U.S. taxpayer-clients in the name of non-U.S. corporations, foundations, trusts, or other legal entities or non-U.S. relatives. As part of the agreement, Julius Baer agreed to pay \$547 million (in U.S. currency), including restitution for tax loss arising from the undeclared U.S. related accounts, disgorgement of gross fees paid with respect to these accounts, and a fine for its illegal conduct. In addition, two Julius Baer bankers, both of whom had been fugitives since 2011, pleaded guilty to their role in the conspiracy.

In addition to our ongoing criminal tax investigations, in August 2013, the Department announced the Swiss Bank Program, which provided a path for Swiss banks to resolve potential criminal liabilities in the United States. Banks already under criminal investigation related to their Swiss-banking activities, identified as Category 1 banks, and all individuals were expressly excluded from the program. Under the program, Swiss banks about which we had little or no information came forward and self-identified as having helped U.S. taxpayers to hide foreign accounts and evade their U.S. tax obligations. In exchange for a non-prosecution agreement, these institutions, identified as Category 2 banks, made a complete disclosure of their cross-border activities, provided detailed information on accounts in which U.S. taxpayers had or have a direct or indirect interest, are cooperating in treaty requests for account information, are providing detailed information as to other banks that transferred funds into secret accounts or that accepted funds when secret accounts were closed, and must cooperate in any related criminal and civil proceedings for the life of those proceedings. The banks were also required to pay appropriate penalties.

From March 30, 2015, through January 27, 2016, the Department executed 78 agreements with 80 Category 2 banks and imposed more than \$1.3 billion in penalties. The Department also signed a non-prosecution agreement with Finacor, a Swiss asset management firm, reflecting the Department's willingness to reach fair and appropriate resolutions with entities that come forward in a timely manner, disclose all relevant information regarding their illegal activities, and cooperate fully and completely, including naming the individuals engaged in criminal conduct.

The banks participating in the program have revealed the names of thousands of U.S. accountholders, a substantial number of whom have voluntarily disclosed their accounts to the IRS and are providing information for treaty requests to obtain the names and account records of those individuals who have refused to waive Swiss bank secrecy. The program has driven thousands of taxpayers into the IRS voluntary disclosure programs. In October 2015, the IRS reported more than 54,000 voluntary offshore disclosures and the collection of more than \$8 billion in taxes, penalties, and interest. These figures have substantially increased since the

program was announced in August 2013, due in part to the pressure applied by the Swiss banks on their accountholders to come into compliance. In addition, according to the IRS, the number of Reports of Foreign Bank and Financial Accounts filed by U.S. taxpayers increased from just over 332,000 for calendar year 2007 to more than 1.1 million for calendar year 2015.

Division attorneys and IRS agents are reviewing the tremendous volume of information received from banks participating in the Swiss Bank Program and those cooperating pursuant to the terms of other resolutions, as well as information received in response to our treaty requests and from whistleblowers, to pursue ongoing and new criminal tax investigations and to support civil enforcement efforts.

Employment Tax Enforcement

Civil and criminal employment tax enforcement is among the Division's highest priorities. Employers have a legal responsibility to collect and pay over taxes withheld from their employees' wages. These employment taxes include withheld federal income tax, as well as the employees' share of social security and Medicare taxes (collectively known as FICA taxes). Employers also have an independent responsibility to pay the employer's share of FICA taxes.

When employers willfully fail to collect, account for, and deposit employment tax due, they are stealing from their employees and, ultimately, the U.S. Treasury. In addition, employers who willfully fail to comply with their obligations and unlawfully line their own pockets with amounts withheld are gaining an unfair advantage over their honest competitors.

Unpaid employment taxes are a substantial problem. Amounts withheld from employee wages represent 70 percent of all revenue collected by the IRS, and as of June 30, 2016, more than \$59.4 billion of tax reported on quarterly Forms 941 remained unpaid. Additional amounts are owed with respect to periods for which no returns or inaccurate returns are filed. When last measured, employment tax violations represented more than \$91 billion of the overall tax gap in this country.

Since 2014, the Division has obtained over 55 permanent injunctions compelling employers to pay over employment taxes, including:

- In May 2016, a federal court in Tennessee entered a permanent injunction against a business owner, ordering that he deposit employee income taxes and FICA taxes in a federal depository bank, deliver monthly receipts of deposits to the IRS, timely file employment-tax returns, and pay all outstanding liabilities due upon filing, bars the defendant from assigning property until withholding taxes are paid, and submit regular certifications of compliance. The court also entered a judgment in the amount of the business's unpaid liabilities.
- In April 2016, a federal court in Virginia entered a permanent injunction against a business owner, ordering him to timely withhold and pay federal income and FICA taxes from his employees' wages, make timely employment tax deposits, provide proof of his

employment tax deposits to the IRS, timely file tax returns, and notify the IRS if he becomes involved with any new company. The injunction also bars him from assigning property or making any disbursements until all employment taxes required to be paid are paid to the IRS.

- In March 2016, a federal court in Texas entered a permanent injunction against a married couple, ordering them to timely file employment tax returns and to pay employment taxes and penalties, and barring them from paying other creditors, themselves, or any third-party before paying their employment tax liabilities. The district court also ordered the sale of two parcels of property with the net sale proceeds to be applied to their unpaid income taxes and other employment tax liabilities.
- Also in March 2016, a federal court in California entered a permanent injunction against a restaurant and its owner, ordering them to timely withhold and deposit federal income and FICA taxes from employee wages, provide proof of their deposits to the IRS, and notify the IRS if the owner becomes involved with any new company. The injunction also bars the company and owner from assigning property or making any disbursements until all employment taxes are paid.
- In February 2016, a federal court in Washington entered a permanent injunction against a dentist and his wife, ordering them to timely file employment tax returns and pay employment taxes. The couple frustrated attempts to enforce employment tax laws by continually abandoning old business entities and creating a new one. The district court further barred the couple and their business entities from transferring property or making any disbursement until their employment tax liabilities are satisfied, and required that the couple notify the IRS before they begin operating a new business enterprise, which will also be bound by the terms of the injunction.

The Department also pursues criminal investigations and prosecutions against those individuals and entities who willfully fail to comply with their employment tax responsibilities, as well as those who aid and assist them in failing to meet those responsibilities. Examples include:

- In September 2016, a tax attorney who co-owned and operated a recreational sports facility located in Pennsylvania was convicted of multiple counts of failing to collect, account for, and pay over employment taxes for his respective businesses. The jury found that from 2012 through 2015, the defendant failed to timely pay more than \$790,000 in taxes withheld from the wages of his employees.
- In September 2016, the former owner of a trucking company in Kansas was sentenced to 3 years in prison for tax evasion, having pleaded guilty to failing to pay more than \$900,000 in employment taxes. When the IRS began collection efforts, the defendant filed a false statement to the IRS concealing his ownership interest in assets, including livestock, life insurance, farm equipment, and a limited liability company.

- In August 2016, a Tennessee business owner was sentenced to one year in prison for failing to collect, account for, and pay over employment taxes to the IRS. He was the majority owner, president, and Chief Executive Officer (CEO) of a company that produced and installed check processing, and the owner and CEO of a company that provided merchant services for credit card processing. From 2007 through 2011, he collected more than \$6.8 million in employment taxes from these two companies which he failed to pay. During the same timeframe, he spent more than \$6.2 million from the business bank accounts on personal expenses such as house and condominium payments, vehicle, yacht and motorcycle loan payments, and travel.
- In May 2016, a Virginia business owner was sentenced to 18 months in prison for failing to collect, account for, and pay over employment taxes. He was the president of two construction companies, controlled their finances, and was responsible for paying over the employment taxes for the two businesses. He failed to pay over more than \$700,000 in employment taxes in the last two quarters of 2014, and concealed his personal use of more than \$500,000 in corporate funds, to include paying off a lien on his lake property.
- In October 2015, a Texas resident and former CEO of a trucking company was sentenced to seven and a half years in prison for conspiracy to defraud the United States, tax evasion, and bank fraud. The defendant used funds from the company to pay personal expenses while failing to pay over employment tax withheld from his employees. The conspiracy caused a loss to the United States of more than \$9.5 million. The former Chief Financial Officer (CFO) of the trucking company, a co-conspirator, was sentenced to 35 months in prison.

These cases are sending the clear message that willful violations of employment tax obligations will not be tolerated, and the Department remains committed to addressing this serious issue.

Stolen Identity Refund Fraud

Investigating, stopping, and prosecuting individuals who engage in tax refund fraud have always been top priorities for the Division. Using a variety of civil and criminal enforcement tools, the Division, along with our partners at the IRS and in the U.S. Attorneys' Offices, has successfully shut down hundreds of unscrupulous preparers and individuals who viewed the Federal Treasury as a personal bank account. Their schemes have included filing returns containing inflated, false deductions or false W-2 income statements, or preparing returns and failing to remit the refund to the taxpayer. In the past decade, an even more aggressive scheme has raged across the country at an alarming rate – stolen identity refund fraud (SIRF).

SIRF schemes involve the theft of social security numbers and other personal identifying information, filing fictitious tax returns claiming refunds, and having the refunds sent to an address where the offender can access the refund checks or electronically deposited into an account or onto a debit card which is then accessed by the offender. A more recent scheme involves stealing a taxpayer's personal identifying information and using that information to access IRS databases that allow the perpetrators to file fictitious returns that include accurate

taxpayer information – number and names of dependents, financial institutions, etc. – in order to fraudulently obtain tax refunds. In many cases, the taxpayer whose social security number has been compromised will later face difficulties when he or she files a tax return. In other cases, the fictitious returns are filed using social security numbers of deceased taxpayers or others from whom no federal tax return may be due for filing.

These schemes are often implemented in early January, before the proper taxpayer is expected to file his or her return, with the goal of taking advantage of the IRS's efforts to pay out refunds quickly. In many cases, the most vulnerable in our society are the victims. Names and social security numbers have been stolen from medical firms, schools, prisons, and hospitals by dishonest employees who are often paid for the information.

For taxpayers whose identities are stolen, the economic and personal consequences can be severe and often long-term. While the IRS has invested substantial efforts and resources to address identity theft concerns, those victimized face months, if not years, of overwhelming paperwork, credit problems, and inconvenience. And when a stolen identity is used to commit tax refund fraud, all taxpayers are victims, and all Americans are impacted by the loss to the Treasury. In recognition of the severity of the problem, the Department and the IRS have devoted significant resources to the successful prosecution of individuals engaged in SIRF crimes. Individuals engaged in this criminal conduct face a variety of charges, including aggravated identity theft, theft of government property, false claims for refund, false returns, and tax conspiracy.

In the last several years, the Department has successfully prosecuted and received significant sentences in cases in which a stolen identity was used to commit tax refund fraud. For example:

- In August 2016, two residents of Kentucky were sentenced to 60 and 82 months in prison, respectively, for stealing identities and filing false returns. The defendants stole the personal identifying information of customers of a pawn shop, and obtained stolen identities from a co-conspirator, and used this stolen information to file false returns.
- In July 2016, a Georgia husband and wife were sentenced to 80 and 21 months in prison, respectively, for their role in a conspiracy that involved stealing identities and using this information to access the IRS's "Get Transcript" database. As part of the scheme, participants purchased prepaid debit cards from stores located in multiple states, registered the cards in the names of the stolen identities, and directed the IRS to deposit the tax refunds from the fraudulently filed returns onto these cards. The participants then used these cards to purchase money orders, which the defendants deposited into bank accounts and structured the deposits to prevent the bank from filing Currency Transaction Reports.
- In May 2016, a Maryland man and former employee of the District of Columbia's Department of Youth Rehabilitation Services (DYRS) was sentenced to four years in prison for his role in a far-reaching identity theft and tax fraud scheme. The defendant accessed his agency's database to obtain personal identifying information of current and

former DYRS youth, and provided this information to a co-conspirator who used the stolen identities to file at least 1,160 false income tax returns. The defendant is among a large number of individuals who have pleaded guilty in one of the largest prosecutions to date involving the use of stolen identities with at least 12,000 fraudulent returns seeking more than \$42 million in refunds.

- In February 2016, an Alabama woman, a former U.S. Postal Service employee, was sentenced to 51 months in prison for her role in a SIRF scheme. The defendant provided co-conspirators with addresses along her mail delivery route to use in filing false returns, retrieved the fraudulent refund checks from the mail, and delivered the checks to her co-conspirators. The scheme resulted in the filing of more than 700 fraudulent returns and more than \$1.5 million in fraudulently obtained refunds. Two co-conspirators pleaded guilty and were sentenced in August and September 2015 to 159 months and 180 months in prison.
- In January 2016, two Florida men were each sentenced to 42 months in prison for their role in a SIRF scheme, in which they formed two companies with the intended purpose of filing fraudulent tax returns and recruited co-conspirators to obtain electronic filing identification numbers through which they filed the fraudulent returns. The defendants obtained and used stolen personal identifying information belonging to prisoners and deceased individuals to file more than 860 fraudulent returns claiming more than \$1 million in refunds.
- In September 2015, a Georgia woman was sentenced to fifteen years in prison for her role in a \$24 million SIRF conspiracy involving the filing of more than 9,000 false returns that claimed more than \$24 million in fraudulent refunds. Other co-defendants were sentenced to serve between 12 and 159 months in prison.

SIRF crimes differ from traditional tax prosecutions in that SIRF crimes generally involve garden-variety theft and fraud, and often require a quick response by law enforcement. The Division continues to work closely with the IRS and U.S. Attorneys' Offices across the country to ensure effective information sharing and investigative cooperation as permitted by law. From October 2012 through August 31, 2016, the Department has authorized more than 1,300 SIRF investigations involving more than 2,000 subjects, and authorized more than 1,000 prosecutions involving more than 1,900 individuals.

The prosecution of SIRF crimes is a national priority and, together with our law enforcement partners, we will continue to look for the most effective ways to bring this conduct to an end and to punish these wrongdoers. While the goal is to stop fraudulent refunds before they are issued, the Division will continue to work with its colleagues in the U.S. Attorneys' Offices to prosecute these cases and, in so doing, send a clear message to those who engage in this conduct that they will be held accountable for their actions.

Tax Defier Initiative

Tax defiers have long been a focus of the Division's investigative and prosecution efforts. For decades, tax defiers have advanced frivolous arguments and developed numerous schemes to evade their income taxes, assist others in evading their taxes, and frustrate the IRS under the guise of constitutional and other meritless objections to the tax laws. Frivolous arguments used by tax defiers include, for example, spurious claims that an individual is a "sovereign citizen" not subject to the laws of the United States, that the federal income tax is unconstitutional, and that wages are not income. Schemes utilized include the use of fictitious financial instruments in purported payment of tax bills and other debts, as well as the filing of false liens and IRS reporting forms, such as Forms 1099, designed to harass and retaliate against government employees and judges. In the most extreme circumstances, tax defiers have resorted to threats and violence to advance their anti-government agenda.

Tax defiers are identified by the schemes in which they participate and the tactics they utilize. It is important to note that those who merely express dissatisfaction with the tax laws should not be, and are not, prosecuted. The Department cherishes the right to free speech, but recognizes that it does not extend to acts that violate or incite the imminent and likely violation of the tax laws.

Because a segment of the tax defier community may resort, and has resorted, to violence to advance its cause, it is essential that law enforcement be prepared to respond rapidly to threats against agents, prosecutors, and judges. The Division has implemented a comprehensive strategy using both civil and criminal enforcement tools to address the serious and corrosive effect of tax defier and sovereign citizen activity. Led by a National Director, the Division's Tax Defier Initiative facilitates coordination among nationwide law enforcement efforts. Increased coordination allows new and recycled tax defier and related schemes and arguments to be identified quickly, and a coordinated strategy to be developed.

Through the Tax Defier Initiative, the Division leveraged its expertise to develop a government-wide approach to monitoring and combating these crimes. As a result, the National Director for the Tax Defier Initiative, working with representatives of IRS Criminal Investigations, Treasury Inspector General for Tax Administration, the FBI, Domestic Terrorism Operations Unit, and the Department's National Security Division, developed and implemented a national training program for prosecutors and investigators. The close working relationships fostered by the Tax Defier Initiative have enabled us to identify and respond more quickly and efficiently to trends in the tax defier community.

Recent cases demonstrate the scope and seriousness of tax defier misconduct:

- In August 2016, a North Carolina man pleaded guilty to setting up straw companies to evade income. He owned a holistic medicine business, which he operated out of his residence in North Carolina. He admitted that, with the help of others, he set up straw companies and opened bank accounts in the name of the straw companies to hide his income and assets from the IRS. He also admitted to dealing extensively in cash to evade the payment of income tax. He earned more than \$2.7 million in gross receipts from his

holistic medicine business, but failed to file income tax returns for those years and evaded approximately \$740,000 in income taxes due and owing.

- In June 2016, a Maryland man was sentenced to serve 97 months in prison for conspiring to file false federal income tax returns and filing false tax returns. The defendant recruited clients for a co-conspirator, who prepared tax returns falsely reporting the amount of taxes withheld and purportedly paid to the IRS. The defendant collected financial information from clients and provided the information to his co-conspirator for the preparation of the false tax returns, causing the filing of 14 false tax returns that fraudulently claimed \$7,753,940 in tax refunds.
- In May 2016, two Maryland men were sentenced to serve 132 months and 48 months in prison, respectively, after pleading guilty to perpetrating a scheme in which they filed 46 fraudulent income tax returns seeking refunds in excess of \$224 million. The defendants established trusts and business entities, with addresses at numerous private commercial postal carrier stores in Maryland and North Carolina, and mailed fraudulent tax returns to the IRS in the names of the trusts and businesses requesting refunds. After receiving the refund checks, the defendants deposited the funds into bank accounts they controlled and used cashier's checks and other financial instruments to transfer a portion of the money to third parties and other bank accounts.

Those who engage in tax defier activity risk criminal prosecution resulting in conviction, substantial penalties and time in prison, as well as the collection of taxes, interest, and penalties. Prosecution of tax defiers also reassures the vast majority of taxpayers that their voluntary compliance with the tax laws is justified and that everyone will be held accountable under the law.

Thank you again, Mr. Chairman, for the opportunity to appear this morning to discuss the important work of the Division. I am happy to answer any questions that you or the other Members of the Subcommittee may have.