Department of Justice

STATEMENT OF

DAVID A. HUBBERT
ACTING 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

JUNE 8, 2017

Statement of David A. Hubbert
Acting 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
June 8, 2017

Chairman Marino, Ranking Member Cicilline, 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: civil trial sections, civil appeals, criminal enforcement sections, and criminal appeals. The Division's seven civil trial sections have, on average, about 6,000 cases pending in various stages of litigation, with anywhere from 2,500 to 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 geographic sections and authorize almost all grand jury investigations and prosecutions involving violations of the internal revenue laws nationwide. The Division authorizes between 1,300 and 1,600 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 145 administrative support employees.

The Tax Division's appropriation for the 2017 fiscal year was approximately $107 million. The President's FY2018 budget request for the Tax Division seeks $107 million for 499 direct positions. This funding level allows 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 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. Tax cases filed *against* the United States comprise nearly 60 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 U.S. Government hundreds of millions of dollars through their representation of the government in defense of refund claims brought by taxpayers. As of September 30, 2016, the Division was defending tax refund cases worth approximately $12 billion.

The Division also 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 who fail to truthfully and accurately comply with their federal tax obligations. Collection suits have a direct and positive effect on Federal revenue. The Division consistently collects more each year than its entire budget. Over the past five fiscal years, the Division has collected in excess of $2.1 billion in unpaid tax debts. Given that the Internal Revenue Service (IRS) only refers to the Division those 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 Division's civil litigators also seek to enforce the IRS's requests for information in ongoing examinations and collect and defend tax assessments when the examinations are completed.

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 600 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 enforcement 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 1,600 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 offices. 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.

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 also 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, heath 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 FY16, Division prosecutors obtained 131 indictments and 145 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 has succeeded in litigation involving Structured Trust Advantaged Repackaged Securities (STARS) tax shelters. The STARS transaction was designed and promoted to subvert the foreign tax credit rules and generate illicit tax benefits to be shared among the transaction's participants. In *Salem Financial, Inc. v. United States*, the Court of Appeals for the Federal Circuit ruled that a STARS transaction engaged in by a subsidiary of the BB&T Corporation was not a genuine business transaction, but "simply a money machine." The Second Circuit and First Circuit have similarly held that the STARS transactions at issue in *Bank of New York v. United States* and *Santander Holding v. United States*, respectively, lacked economic substance and had no objective non-tax economic benefit. The Division also received a favorable jury verdict regarding Wells Fargo's participation in a STARS tax shelter, in

which the jury found that the Wells Fargo STARS transaction consisted of two economically distinct and independent transactions: a loan and a trust, and found that the trust structure had no reasonable potential for pretax profit, and that Wells Fargo entered into the trust structure solely for tax reasons. We are currently awaiting final judgment in the case.

- The Division has also prevailed in a series of cases involving intermediary tax shelters, 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 *Salus Mundi v. Commissioner*, the Ninth Circuit held that the taxpayers participating in such a transaction 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. In *Cullifer v. Commissioner*, the Eleventh Circuit held that the transfers at issue were fraudulent under the Texas Uniform Fraudulent Transfer Act and that the taxpayer was liable to the extent of the transfers.

- 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 *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.

- In *Chemtech Royalty Associates v. United States*, the Fifth Circuit upheld a district court's penalty determinations in a tax shelter case involving the Dow Chemical Company and its creation of a partnership with several foreign banks. Through the shelter scheme, Dow claimed more than $1 billion in improper tax deductions over a 13-year period.

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 to evade taxes and hide assets. Promoters of these schemes often use the Internet to aggressively market these fraudulent schemes and scams, and rely upon strained, if not demonstrably false, interpretations of the tax laws. 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 March 2017, a federal court in Montana permanently barred a California man from preparing any property appraisal that will be used in connection with federal taxes, amongst other relief. The court found that this person assisted in the organization of a timeshare donation scheme that resulted in timeshare owners claiming improper federal tax deductions for donating their timeshares. The court also found that this person prepared at least 5,000 timeshare appraisals that contained false or fraudulent statements about the allowability of tax deductions. In 2016, the court enjoined other alleged promoters of this scheme, also named as defendants in this suit, from organizing any plan or arrangement regarding charitable contribution deductions claimed on federal tax returns, amongst other relief.

- 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 of "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 returns containing 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 courts requiring that the preparers notify their clients of the injunctions and disgorge fees earned with respect to their fraudulent activities. For example,

- In March 2017, a federal court in Florida barred a man from preparing tax returns or owning a tax return preparation business and ordered him to pay the government nearly $950,000 in funds he received from improper and fraudulent tax return preparation. The court found that this person owned a tax return preparation business with stores located in Alabama, Florida, Georgia, and North Carolina, and these stores targeted

"underprivileged, undereducated poor people and earned income credit claims." The court found that these stores not only prepared false tax returns but charged customers in excess of $600 to prepare a single return, even as much as $999, sometimes without telling the customer.

When a preparer violates the injunction, the Division stands ready to pursue civil or criminal contempt proceedings. For example:

- This month, a federal court in Maryland found that a man previously enjoined from preparing tax returns violated that court order and ordered him to pay the government nearly $30,000 for its costs in investigating him. According to the government's investigation, this return preparer continued to prepare tax returns in the Washington, D.C. area despite a court order requiring him to stop.

- 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.

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. 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 January 2017, a federal court in Montana granted the Department's petition for an order authorizing the issuance of a John Doe summons to a Montana man seeking information about U.S. taxpayers who may hold offshore accounts established by Sovereign. Specifically, the IRS sought records of U.S. taxpayers who, during the years 2005 to 2016, had been issued a "Sovereign Gold Card" debit card that could be used to access the funds in those accounts in such a manner as to evade their obligations under the internal revenue laws. In its petition, the United States alleged that Sovereign advertises various "packages" to allow taxpayers to hide their assets offshore. These packages include corporations owned by other entities (to include fake charitable foundations), all held in the name of nominee officers provided by Sovereign. Sovereign then opens bank accounts for these entities and provides debit cards in the name of the nominee to the taxpayer. By using such cards, taxpayers seek to access their offshore funds without revealing their identities.

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 130 accountholders and 40 facilitators, many of whom reside outside the United States.

For example, in March 2017, a California businessman who owns a company that makes and sells clothing, was sentenced to 24 months in prison for 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 was also ordered to pay more than $8.3 million in restitution to the IRS and to pay a civil penalty of more than $18.2 million.

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 February 2016, a Swiss citizen and a dual Swiss and Italian citizen, both bankers who worked as client advisors at Bank Julius Baer, pleaded guilty to conspiring with U.S. taxpayers-clients to help them hide their assets in offshore accounts and to evade U.S. taxes on the income earned in those accounts. They aided U.S. taxpayers in maintaining undeclared accounts at the bank and advised the taxpayers that their accounts would not be disclosed to the IRS.

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 so will 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 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, 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 ("the 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 the Department had little or no information came forward and self-identified as having helped U.S. taxpayers 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. These 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 $1.36 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 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 also driven thousands of taxpayers into the IRS voluntary disclosure programs. In October 2016, the IRS reported more than 55,800 taxpayers had made voluntary offshore disclosures and the IRS had collected nearly $10 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 the calendar year 2007 to more than 1.1 million for the 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, according to the IRS, 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 October 1, 2014, the Division has obtained over 70 permanent injunctions compelling employers to pay over employment taxes. In addition to granting this injunctive relief, federal courts throughout the United States will often bar the employer from paying other expenses before first paying the employment taxes. In the past year, federal courts in California, Florida, Illinois, Pennsylvania, and Texas, among other states, have entered injunctions with these prohibitions against businesses and their alleged owners. For example,

- In January 2017, a federal court in California found that the owner of rain gutter businesses directed the businesses to pay himself and his wife a salary and other expenses before meeting their employment tax obligations. The court found that the owner "frustrated the IRS's effort to collect" unpaid employment taxes by engaging in a "pattern to form new entities through which to conduct business" and "promptly withdrawing cash deposited to the account for non-tax purposes." The court entered a permanent injunction against the owner and his businesses, ordering them to timely file employment tax returns, to pay the amounts due on these returns, and barred them from making any other payments before first paying their employment tax liabilities.

The Division, in collaboration with the IRS, monitors employers' compliance with these court orders and has alerted courts to employers that fail to follow the court's order to timely file returns and pay the employment tax due. For example,

- In March 2017, a federal court in Washington held a dentist and his wife in contempt of court after they "demonstrated a consistent pattern of disregarding their tax obligations by making incomplete payments, making dishonored payments, and missing deadlines." The court previously ordered the two to timely file employment tax returns and pay employment taxes. In addition to holding the two in contempt of court, the court ordered them to, no later than June 8, 2017, close their dental care businesses and cease operating as employers, and barred them from opening any new businesses where the two would serve as employers.

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 March 2017, a Texas business owner of an industrial staffing company, pleaded guilty to failing to pay more than $18 million in employment taxes. The defendant filed false employment tax returns that did not report the majority of his employees and did not pay the taxes he withheld from his employees' paychecks. Instead, he used the money for luxury travel and to make payments on his ranch. He was also ordered to pay restitution to the IRS.

- In January 2017, two West Virginia business owners were sentenced to serve 21 and 27 months in prison, respectively, for failing to pay over more than $1.4 million in employment taxes. The defendants owned a construction business that transported steel and sold gravel and concrete. They changed the name of their business several times, though the operations of the business remained the same. Both were responsible for collecting, accounting for and paying over the employment taxes withheld from their employees' wages. Instead of paying over the taxes that they collected, the defendants used the funds to purchase property and finance their horse farm. They were also ordered to pay restitution to the IRS.

- In January 2017, a North Carolina businessman who ran an audio company was sentenced to serve 15 months in prison for failing to pay over employment taxes. From 2008 through 2011, the defendant used company funds for personal expenses while failing to pay over the employment taxes withheld from his employees' wages. He was also ordered to pay restitution to the IRS.

- In December 2016, a Maryland surgeon and entrepreneur pleaded guilty to failing to pay over $7.5 million in employment taxes and to shareholder fraud. The defendant founded a corporation that provided data analysis and services related to health care expenditures. Instead of paying the employment taxes due, the defendant spent millions on personal expenses including transferring funds to himself and others, travel, car service and the publication of a book.

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 and/or 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 which criminals use to file fictitious tax returns claiming refunds, and then have 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 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 actual 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 obtained significant sentences in cases in which a stolen identity was used to commit tax refund fraud. For example:

- In May 2017, a former resident of Illinois was sentenced to 87 months in prison for filing tax returns using stolen identities. The defendant directed the IRS to send the refunds in the form of prepaid debit cards and checks mailed to addresses that she controlled. The defendant admitted to an intended tax loss of $1,026,284.

- In February 2017, an Oregon woman was sentenced to 72 months in prison for conspiring to file false tax returns that claimed more than $1.2 million in fraudulent refunds. The defendant conspired to file at least 224 individual income tax returns using names and social security numbers of individuals that she directly obtained or acquired with the assistance of a co-conspirator.

- In February 2017, a California man was sentenced to serve 144 months in prison for filing tax returns in the name of deceased individuals and stealing social security and refund checks. The defendant was convicted of aggravated identity theft and other crimes when he and his co-conspirators took names and personal identification information of deceased individuals from California death records and used them to file income tax returns seeking refunds.

- In December 2016, a Maryland man was sentenced to 135 months in prison for a sophisticated scheme that used stolen identifying information to fraudulently seek more than $20 million in tax refunds. The defendant participated in a massive and sophisticated scheme with an extensive network of more than 130 other people, many of whom were receiving public assistance.

- 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, a former U.S. Postal Service employee and Alabama resident were 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, respectively.

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 March 31, 2017, the Department authorized more than 1,400 SIRF investigations involving more than 2,400 subjects, and authorized more than 1,100 SIRF prosecutions involving more than 2,200 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 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 by tax defiers 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 is 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 arguments, 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, the 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 April 2017, a California woman, who owned a tax return preparation business, was sentenced to serve 120 months in prison for conspiring to file fraudulent tax returns with the IRS claiming more than $60 million in refunds. She recruited clients by falsely representing that they could legally receive large refunds by filing tax returns using IRS Forms 1099-OID. She prepared false Forms 1099-OID that reported her clients' debts as income and the same amount as income tax withheld. The scheme included clients from 26 states and caused the IRS to pay out over $9 million in fraudulent refunds. In addition, the defendant assisted two clients in filing fraudulent multi-million dollar liens against government officials, including three IRS employees involved in the collection of the taxes the clients owed as a result of the scheme. The defendant also filed an $84 million lien against the then Acting U.S. Attorney for the Eastern District of California and hired a collection agency to enforce a false $500,000 lien that her client filed against an IRS revenue officer.

- In April 2017, a prominent tax-defier promoter was convicted following a jury trial of making, passing and submitting fictitious financial instruments to a financial institution and the U.S. Treasury and failing to file tax returns. The defendant was highly influential in the sovereign citizen movement and has a significant following across the country and abroad. From approximately 2008 through 2015, he created and submitted more than 1,000 bogus financial instruments with the intent of defrauding financial institutions and the U.S. Treasury. He held worldwide seminars and private meetings to promote and market the use of these fake financial instruments to pay off debts, including federal taxes. The defendant sold recordings of his seminars, templates for fake financial instruments and other materials through his website. Despite earning $562,224 in income from his seminars, licensing fees from his products, and pension payments, the defendant failed to file his 2009 through 2014 tax returns.

- 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. He 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 more than $7.7 million in tax refunds.

- In May 2016, a Maryland man and a North Carolina man were respectively sentenced to serve 132 months and 48 months in prison, after pleading guilty to perpetrating a scheme in which they filed fraudulent 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 prison sentences, 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.