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TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Office of Inspections and Evaluations



*A More Focused Strategy Is Needed  
to Effectively Address Egregious  
Employment Tax Crimes*

**March 21, 2017**

**Reference Number: 2017-IE-R004**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 21, 2017

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION  
CHIEF, CRIMINAL INVESTIGATION

**FROM:** Gregory D. Kutz  
Acting Deputy Inspector General for Inspections and Evaluations

**SUBJECT:** Final Evaluation Report – A More Focused Strategy Is Needed to  
Effectively Address Egregious Employment Tax Crimes  
(# IE-14-032)

This report presents the results of our evaluation to determine the levels of payroll tax noncompliance identified by the Internal Revenue Service (IRS) and the extent of civil and criminal enforcement actions taken by IRS. This evaluation was included in our Treasury Inspector General for Tax Administration (TIGTA) Fiscal Year (FY) 2016 Program Plan. This review addresses the major management challenge of Tax Compliance Initiatives.

### **Synopsis**

Employment tax noncompliance is a serious crime. Employment taxes finance Federal Government operations plus Social Security and Medicare. When employers willfully fail to account for and deposit employment taxes, which they are holding in trust on behalf of the Federal Government, they are in effect stealing from the Government. As of December 2015, 1.4 million employers owed approximately \$45.6 billion in unpaid employment taxes, interest, and penalties. The TFRP is a civil enforcement tool the Collection function can use to discourage employers from continuing egregious employment tax noncompliance and provides an additional source of collection for unpaid employment taxes. In FY 2015, the IRS assessed the TFRP against approximately 27,000 responsible persons—38 percent fewer than just five years before as a result of diminished revenue officer resources. In contrast, the number of employers with egregious employment tax noncompliance (20 or more quarters of delinquent employment taxes) is steadily growing—more than tripling in a 17-year period. For some tax



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debtors, assessing the TFRP does not stop the abuse. Although the willful failure to remit employment taxes is a felony, there are fewer than 100 criminal convictions per year. In addition, since the number of actual convictions is so miniscule, in our opinion, there is likely little deterrent effect.

### **Recommendation**

The TIGTA recommended that the Commissioner, Small Business/Self-Employed Division and the Chief, CI, should consider a focused strategy to enhance the effectiveness of the IRS's efforts to address egregious employment tax cases. This strategy should include use of data analytics to better target egregious employment tax noncompliance, including identification of high-dollar cases and individuals with multiple companies that are noncompliant. In addition, the Collection function should expand the criteria used to refer potentially criminal employment tax cases to CI to include any egregious cases (not only those where a firm indication of fraud is present).

### **Response**

The IRS partially agreed with our recommendation. The IRS agreed with the portion of our recommendation describing a focused strategy to enhance effectiveness of the IRS's efforts to address egregious employment tax cases by citing various initiatives in process and completed. However, the IRS did not specifically address our recommendation to enhance the use of data analytics. The IRS disagreed with the portion of our recommendation that the Collection function should expand the criteria used to refer potentially criminal employment tax cases to CI to include any egregious cases (not only those where a firm indication of fraud is present) citing the need to balance several factors by a number of stakeholders and limited government resources including limitations on the number of criminal tax cases the United States Attorneys and the US Courts can accommodate. Management's response to the draft report is included as Appendix IX.

**Office of Inspections and Evaluations Comment:** The Treasury Inspector General for Tax Administration disagrees with the IRS position that criminal conduct beyond willfully not reporting and paying employment taxes is necessary for criminal investigation and referral to the Department of Justice (DOJ). We believe the position allows egregiously noncompliant taxpayers—including those involved in cases of over \$1 million or involved in 10 or more companies that fail to remit payroll taxes to IRS—to escape criminal prosecution contrary to the statute. The IRS insistence that fraud is a prerequisite for applying I.R.C. § 7202 is not in agreement with stated DOJ guidelines:

“To establish a violation of section 7202, the following elements must be proved beyond a reasonable doubt: 1. Duty to collect, account for, and pay over a tax; 2. Failure to collect, truthfully account for, or pay over the tax; and 3. Willfulness. Cases prosecuted under this statute usually involve social security taxes (FICA) and withholding tax.”



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We fully understand there are limited resources available to pursue employment tax noncompliance. Our purpose in the recommendation is to clarify that deceit is not required for a conviction under I.R.C. § 7202. For example, the statute does not require that a taxpayer convert withheld trust fund taxes for personal use. In addition, there are numerous egregious cases available that should be considered for investigation that are not even referred to CI or considered. This includes cases with over \$1 million and individuals involved with 10 or more companies that failed to provide the money to IRS that was being held “in trust” for the Federal government.

If you have any questions about this report, you may contact me or Phil Shropshire, Director, Office of Inspections and Evaluations.



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*Abbreviations*

CI	Criminal Investigation
DOJ	Department of Justice
FICA	Federal Insurance Contribution Act
FY	Fiscal Year
GAO	Government Accountability Office
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
TFRP	Trust Fund Recovery Penalty



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## *Background*

The United States Federal income tax is a “pay-as-you-go tax” because individuals pay taxes as they earn or receive income during the year. For most taxpayers, this means their employer<sup>1</sup> withholds income taxes from their pay. Employers also withhold employee Federal Insurance Contribution Act (FICA) taxes, which include Social Security and hospital insurance (Medicare) taxes. Employers are required to match the amounts withheld from the employee’s salary for FICA taxes. Employers also must report and pay Federal unemployment tax from their own funds. Combined, the amounts withheld from the employee’s salary for the Federal individual income tax and the employee share of FICA taxes and amounts contributed by the employer for the employer share of FICA taxes and unemployment taxes are referred to as employment taxes.<sup>2</sup>

In Fiscal Year (FY) 2015, the Internal Revenue Service (IRS) collected \$3.3 trillion in taxes (gross receipts before tax refunds), which accounted for 93 percent of total Federal Government receipts. Employment taxes amounted to almost \$2.3 trillion (69 percent) of the \$3.3 trillion collected by the IRS. Employers are required to deposit withheld taxes on a regularly scheduled basis. However, sometimes employers fail to timely file employment tax returns and make late payments but do subsequently comply. In fact, as of December 2015, approximately \$45.6 billion of tax, interest, and penalties from Forms 941, *Employer’s QUARTERLY Federal Tax Return*, remained unpaid. Unfortunately, a small number of employers attempt to evade paying the withheld employment taxes altogether.

Employment tax noncompliance occurs for many reasons. Sometimes, employers experiencing economic strain “borrow the money for a short while” to use the withheld taxes to fund the employer’s operations. Other employers willfully divert the withheld taxes for their own personal benefit, such as for the purchase of luxury items, vacations, and real estate.

Finally, employers may be the victim of an unscrupulous third-party payroll service provider. Regrettably, sometimes third-party payroll service providers fail to pay over the collected employment taxes to the IRS; however, the employer remains liable for the unpaid taxes. This can be a significant cost for employers who may be required to pay the employment taxes twice, first to the payroll service provider and again to the IRS, along with interest and penalties.

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<sup>1</sup> An employer is any entity with a requirement to report income and employment taxes withheld from their employees. An employer can be any type of for-profit or nonprofit entity such as a corporation, partnership, sole proprietorship, government entity, or Professional Employer Organization.

<sup>2</sup> The Internal Revenue Service classifies the payroll taxes reported on Form 941, *Employer’s QUARTERLY Federal Tax Return*, as employment taxes. However, there are other taxes such as the unemployment tax that are also employment taxes but are not the focus of this review.



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Noncompliant employers or payroll service providers are subject to civil and criminal sanctions for willfully failing to remit employment taxes. The Small Business/Self-Employed (SB/SE) Division performs the related tax collection efforts. In general, a delinquent taxpayer will receive a series of notices demanding payment. If the IRS does not receive payment, a collection employee assigned to the case will then attempt to collect the taxes due using various and escalating enforcement tools. These tools include assessing penalties, filing Notices of Federal Tax Lien, and serving Notices of Levy.

In addition, Internal Revenue Code (I.R.C.)<sup>3</sup> Section (§) 6672, *Failure to Collect and Pay Over Tax, or Attempt to Evade or Defeat Tax*, provides that any person required to collect, account for, and pay over taxes held in trust who willfully<sup>4</sup> fails to perform any of these activities or willfully attempts to evade or defeat any such tax or its payment can be assessed a Trust Fund Recovery Penalty (TFRP). The revenue officer<sup>5</sup> can assess the TFRP against any person who is determined to be willful and responsible for the employer's failure to pay over employment taxes, making the individual or individuals the liable party. The TFRP applies to the employee's portion of employment tax, namely, the withheld income tax and employee's portion of FICA. It does not apply to the employer's portion of employment taxes. Generally speaking, the IRS has 10 years to collect a TFRP assessment before the Government's right to pursue the assessment expires.

If the collection case meets certain criteria, the SB/SE Division may refer it to Criminal Investigation (CI). CI conducts a criminal investigation and, if appropriate, refers the case to the U.S. Department of Justice (DOJ). If accepted, the DOJ prosecutes the case in a Federal District Court where a conviction can lead to fines, imprisonment, or both. I.R.C. § 7202, *Willful Failure to Collect or Pay Over Tax*, stipulates that any person required to collect, account for, and pay over tax who willfully<sup>6</sup> fails to do so shall, in addition to other penalties provided by law, be guilty of a felony punishable by a fine of up to \$10,000,<sup>7</sup> up to five years in prison, or both. Incarceration is the ultimate sanction provided by Congress for tax noncompliance. For

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<sup>3</sup> The I.R.C. is also referred to as Title 26 of the United States Code (U.S.C.).

<sup>4</sup> With respect I.R.C. § 6672, willful refers to "voluntary, conscious and intentional – as opposed to accidental – decisions not to remit funds properly withheld to the Government."

<sup>5</sup> Revenue officers are employees in the SB/SE Division Collection function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by IRS campuses (formerly known as service centers) or the Automated Collection System. All references to the Collection function in this report are to the SB/SE Division's Collection function.

<sup>6</sup> With respect to I.R.C. § 7202, willful refers to a "voluntary, intentional violation of a known legal duty."

<sup>7</sup> For offenses committed after December 31, 1984, the Criminal Fine Enforcement Act of 1984 (P.L. 98-596) enacted as 18 U.S.C. § 3623, which increased the maximum permissible fines for misdemeanors and felonies. Where 18 U.S.C. § 3623 is applicable, the maximum fine under § 7202 for offenses committed after December 31, 1984, would be at least \$250,000 for individuals and \$500,000 for corporations. Note: 18 U.S.C. § 3623 changed to 18 U.S.C. § 3571 commencing November 1, 1986.





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examples of employment tax criminal cases, see Appendix VII. For additional information about I.R.C. §§ 6672 and 7202, see Appendix VIII.<sup>8</sup>

Voluntary compliance remains the cornerstone of the tax system. Voluntary compliance means taxpayers are responsible for the timely filing of required tax returns and paying the correct amount of tax. When taxpayers are noncompliant, the IRS has progressively severe enforcement tools to achieve compliance. Employment tax embezzlement is an especially egregious crime because the employer or payroll service provider violates their fiduciary responsibility to remit the taxes on behalf of their employees. Furthermore, the programs funded by employment taxes, such as Social Security and Medicare, provide essential benefits to many citizens.

For example, Social Security taxes pay 65.4 million individuals who receive various benefits such as retired worker, disabled worker, and survivor benefits. Similarly, Medicare taxes pay for medical benefits for over 55.5 million individuals. In addition, Federal income taxes finance a wide range of Federal Government services, including national defense, health protection, education funding, housing assistance, transportation infrastructure, natural disaster assistance, food and drug safety, and payments on the national debt. When employers willfully fail to account for and deposit employment taxes due, they are stealing from their employees and ultimately, the U.S. Department of the Treasury.

More specifically, when an employer does not remit FICA taxes, the General Fund<sup>9</sup> subsidizes the Social Security and Medicare trust funds to the extent that FICA taxes owed are not collected. In addition, the employee's wages often go unreported to both the Social Security Administration and to the IRS. Missing wage information can adversely lower Social Security benefits. A taxpayer may petition the Social Security Administration to correct his or her earnings record for the missing years of work credits. However, the related trust fund taxes may never be paid. As a result, all taxpayers incur additional costs when employers fail to report and remit withheld Federal income taxes.

This review was performed at the IRS National Headquarters in Washington, D.C., in the offices of Criminal Investigation and the SB/SE Division Collection function during the period April 2015 through July 2016. We conducted this evaluation in accordance with the Council of the Inspectors General for Integrity and Efficiency Quality Standards for Inspection and Evaluation. Detailed information on our objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>8</sup> In addition, 26 U.S.C. § 7215, *Offenses with Respect to Collected Taxes*, makes it a misdemeanor to fail to comply with a requirement for employers to collect employment taxes and deposit the withheld taxes in a special bank account held in trust for the United States. If convicted, this crime carries a fine of not more than \$5,000, or imprisonment for not more than one year, or both. None of the cases we reviewed involved the misdemeanor charge under 26 U.S.C. § 7215.

<sup>9</sup> The tax money the Federal Government collects is placed into the General Fund of the Treasury to pay for essential Government services.



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## *Results of Review*

As of December 2015, 1.4 million employers owed approximately \$45.6 billion in unpaid employment taxes, interest, and penalties. Employment tax noncompliance is a serious crime. Employment taxes finance Federal Government operations plus Social Security and Medicare. When employers willfully fail to account for and deposit employment taxes, which they are holding in trust on behalf of the Federal Government, they are in effect stealing from the Government. The TFRP is a civil enforcement tool the Collection function can use to discourage employers from continuing egregious employment tax noncompliance and provides an additional source of collection for unpaid employment taxes. In FY 2015, the IRS assessed the TFRP against approximately 27,000 responsible persons—38 percent fewer than just five years before as a result of diminished revenue officer resources. In contrast, the number of employers with egregious employment tax noncompliance (20 or more quarters of delinquent employment taxes) is steadily growing—more than tripling in a 17-year period. For some tax debtors, assessing the TFRP does not stop the abuse. Although the willful failure to remit employment taxes is a felony, there are fewer than 100 criminal convictions per year. In addition, since the number of actual convictions is so miniscule, in our opinion, there is likely little deterrent effect.

### ***Egregious Employment Tax Noncompliance Is Growing***

A July 2008 Government Accountability Office (GAO) report<sup>10</sup> described that the vast majority of employers timely remit withheld employment taxes to the IRS. However, according to IRS records as of December 2015, over 1.4 million employers owed approximately \$45.6 billion in delinquent employment taxes, including penalties and interest. Furthermore, almost 75 percent of all unpaid employment taxes were owed by employers with more than a year (five or more tax quarters) of unpaid employment taxes, and almost a third of unpaid employment taxes are owed by employers that have tax debt for more than three years (13 or more tax quarters). The Internal Revenue Manual<sup>11</sup> states that revenue officers must stop employers from accumulating employment tax debt and instructs revenue officers to use all appropriate remedies to bring the taxpayer into compliance and to immediately stop any further accumulation of unpaid taxes.

In the aforementioned report, the GAO addressed egregious employment tax noncompliance. The GAO made six recommendations in its report, including a recommendation to develop

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<sup>10</sup> GAO, GAO-08-617, *Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes* (July 2008).

<sup>11</sup> Internal Revenue Manual 5.7.8.4, *Working Repeater Trust Fund Taxpayers to Address Pyramiding*. The Internal Revenue Manual is the primary, official source of IRS “instructions to staff” related to the organization, administration, and operation of the IRS. It details the policies, delegations of authorities, procedures, instructions, and guidelines for daily operations for all divisions and functions of the IRS.



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processes and performance measures to monitor collection actions against egregious payroll tax offenders and a recommendation to develop procedures to timely assess TFRPs to hold responsible parties personally liable for not remitting withheld payroll taxes. According to the GAO, the IRS has implemented all six recommendations. However, additional actions may be necessary to address egregious noncompliance. Figure 1 shows a FY 2015 summary of employment tax accounts receivable by the number of unpaid quarters:

**Figure 1: Summary of Employment Tax Accounts Receivable (FY 2015)**

Number of Quarters Delinquent	Taxpayer Accounts	Accounts Receivable (in millions)	Average Taxpayer Account <sup>12</sup> Balance
1 Quarter	680,682	\$3,129	\$4,596
2 Quarters	218,102	\$2,618	\$12,002
3 Quarters	127,723	\$2,784	\$21,798
4 – 7 Quarters	251,480	\$11,995	\$47,698
8 – 11 Quarters	96,869	\$9,415	\$97,189
12 – 15 Quarters	37,763	\$6,202	\$164,233
16 – 19 Quarters	16,376	\$3,555	\$217,080
20 Quarters or More	16,861	\$6,102	\$361,905
<b>Totals</b>	<b>1,445,856</b>	<b>\$45,800</b>	<b>\$31,676</b>

*Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of IRS data as of December 2015.*

Of particular concern is the steady growth of the number of employers with 20 or more quarters of delinquent employment taxes. According to the GAO in its report, at the end of FY 1998, about 5,000 employers had 20 or more quarters of employment tax debt; by FY 2007, the number had grown to over 10,000. By December 2015, according to IRS records, there were almost 17,000 employers with 20 or more quarters of employment tax debt— thereby more than tripling in the 17-year period.

The IRS attempts to collect Federal taxes due in many ways, including sending notices, making telephone calls, and meeting face-to-face. The IRS also recently piloted, and plans to make permanent, an Early Interaction Initiative to identify noncompliance with payroll tax requirements and take action through intervention and education to deter and change noncompliant behavior. However, collection actions are not always successful, and as a consequence, IRS employees may close cases as “currently not collectible” in certain

<sup>12</sup> An IRS tax module contains records of tax liability and accounting information pertaining to the tax for one tax period.



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circumstances. In order to close a case as currently not collectible, the IRS must first take all the necessary steps in the collection process and determine that there is not any income or assets available to resolve the outstanding taxes owed. A case can also be closed as currently not collectible if the IRS is unable to contact or unable to locate the taxpayer. When the IRS determines that a taxpayer's account is currently not collectible, IRS personnel stop actively working the case and suspend collection activity until the taxpayer's ability to pay improves.

Of the over 1.4 million employers described in Figure 1, the IRS has determined that over 423,000 employers (29 percent) are in a currently not collectible status. Currently not collectible statuses for business accounts include unable to locate or contact, defunct, bankrupt, hardship, and in-business closures.<sup>13</sup> Internal Revenue Manual guidance requires the TFRP to be addressed on all applicable cases prior to closing them as currently not collectible. Over 40 percent of the employers with eight or more quarters of unpaid payroll taxes are considered by the IRS to be currently not collectible. According to IRS records, as of December 2015, the IRS had placed in currently not collectible status almost \$21 billion (46 percent) of the \$46 billion in delinquent employment taxes on its books. We understand that the IRS removes these cases from its collection inventory either because the employer closed or because the IRS has determined that there is little or no likelihood of collecting the taxes due; however, whether collectible or not, this does not change the fact that the money was supposed to be held in trust and that trust was broken or that these taxes are still owed. Furthermore, the status of a case deemed by the IRS as currently not collectible should not preclude the Collection function from referring the case for criminal investigation if egregious (*e.g.*, substantial dollars or multiple offenders).

Employers that do not comply with employment tax laws are subject to civil and criminal sanctions. For both the civil and criminal statutes, the Government must prove that an individual willfully failed in his or her fiduciary duty to collect, account for, and pay over taxes to the Government. However, although willful failure to collect, account for, and pay over taxes to the

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<sup>13</sup> If neither the taxpayer nor assets can be located, the case may be closed as unable to locate. When the taxpayer's ability to pay cannot be determined because he or she cannot be contacted and income and assets cannot be identified, the case can be closed as unable to contact. The currently not collectible status on cases closed as unable to locate or contact may be reversed if the IRS obtains information from a subsequently filed tax return or if a third party reports a new levy source or address to the IRS. Cases closed as bankrupt or defunct relate to businesses that are no longer operating and for which the IRS has determined that there are no other assets to collect from. According to the IRS, defunct and bankrupt closures are often the result of successful IRS actions to stop a taxpayer from accumulating additional debt. In cases closed as hardship, the IRS has determined that the taxpayer is unable to pay and enforcement action would create a hardship. The currently not collectible status on cases closed as hardship may be reversed if the IRS obtains information from subsequently filed tax returns that reflects a change in the taxpayer's income that may enable him/her to pay. All "in-business" currently not collectible cases involve businesses that IRS has determined can pay their current tax liabilities but are unable to pay back taxes and have no equity in assets to collect from. These cases are monitored for compliance and periodic financial review to reassess ability to pay.



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Government is a felony offense, referrals to the DOJ are relatively infrequent. In virtually every case, the IRS does not pursue criminal prosecution and instead relies on collection and penalty assessment authority to encourage compliance. In virtually every case of repeated failures to pay employment taxes, the IRS relies primarily on civil enforcement actions, such as filing Notices of Federal Tax Lien, serving Notices of Levy, and assessing the TFRP rather than pursuing a felony or misdemeanor case. The TFRP is distinct from the employer entity’s liability for employment taxes. The TFRP may be assessed against any person who is both:

- Responsible for collecting or paying withheld income and employment taxes.
- Willfully fails to collect or pay them.

While there are 1.4 million employers who have at least one quarter of delinquent employment taxes as of December 2015, the IRS had only assessed TFRPs against individuals responsible for approximately 154,000 (11 percent) delinquent employer accounts.<sup>14</sup> Figure 2 shows the number of taxpayer accounts and the corresponding percentage of accounts that have an associated TFRP.

**Figure 2: Percent of Delinquent Employment Tax Accounts With a TFRP (FY 2015)**

<b>Number of Quarters Delinquent</b>	<b>Taxpayer Accounts</b>	<b>Percent of Accounts With a TFRP</b>
1 Quarter	680,682	1
2 Quarters	218,102	5
3 Quarters	127,723	10
4– 7 Quarters	251,480	22
8 – 11 Quarters	96,869	35
12 – 15 Quarters	37,763	44
16 – 19 Quarters	16,376	48
20 Quarters or More	16,861	52

*Source: TIGTA analysis of IRS data as of December 2015.*

Figure 2 shows that nearly 52 percent of employers with more than five years of delinquent employment taxes have an associated TFRP. On the other hand, this means that almost half

<sup>14</sup> The IRS can determine that more than one party is responsible for unpaid employment taxes for any given employer.

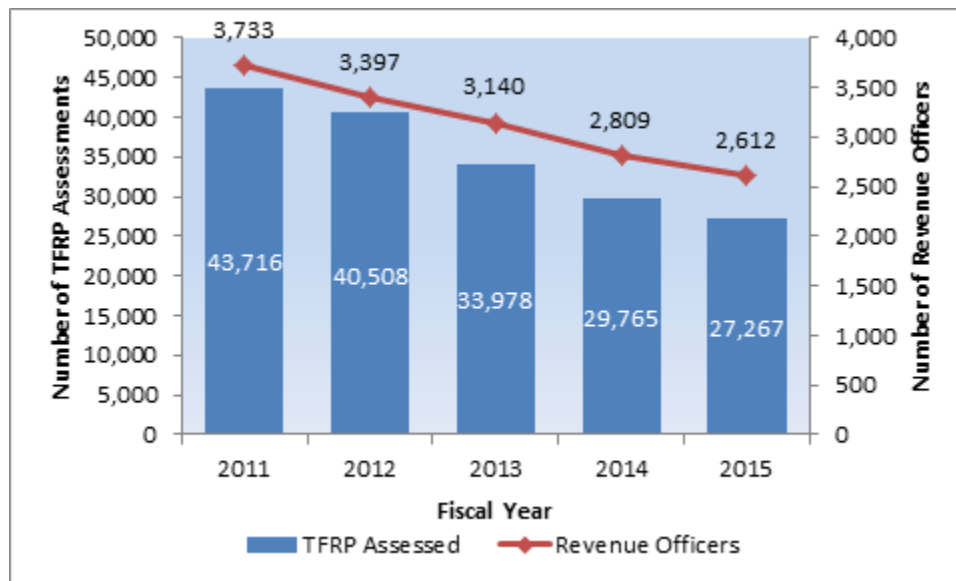


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(48 percent) of all employers with five years or more of unpaid employment taxes do not have a responsible person who has been assessed a TFRP. Additionally, the IRS had assessed a total of \$15 billion in TFRP penalties against responsible persons connected to approximately 154,000 employers. In FY 2015, the IRS conducted a study<sup>15</sup> on the collection success rate of TFRP assessments. It determined that approximately 28 percent of assessed TFRPs were collected over a nine-year period. In addition, the IRS found that its collection success decreases proportionately with an increase in the assessed TFRP amount. For example, the study found that for FY 2010 assessments below \$10,000, 65 percent of the total value of these assessments was collected by May 2015. However, for assessments greater than \$100,000, only 15 percent of the total value of these assessments was collected by May 2015.

Furthermore, due to diminished revenue officer resources, the IRS has assessed fewer TFRPs each year since FY 2011. In FY 2011, the IRS assessed the TFRP against approximately 44,000 individuals, but by FY 2015, the number of TFRPs dropped to 27,000 (38 percent fewer than in FY 2011). Figure 3 shows the number of taxpayer accounts assessed a TFRP and the number of revenue officers for each of the last five fiscal years.

**Figure 3: Number of TFRPs Assessed and Revenue Officers by Fiscal Year**



Source: TIGTA analysis of the Individual Master File<sup>16</sup> as of December 2015 and IRS Collection function information on revenue officer staffing.

<sup>15</sup> IRS, *Collection Success Rate of TFRP Assessment* (Sept 2015). The study includes TFRP assessments originating from both employment tax and excise tax sources.

<sup>16</sup> The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.



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There has been a significant decrease in the Collection function’s staffing in recent years. The number of revenue officers declined over 40 percent, from 4,068 at the end of FY 2010 to 2,425 as of June 2016. According to the IRS, despite the decline in resources, the number of TFRP recommendations made per revenue officer increased over 17 percent.

Most individuals who are assessed a TFRP are assessed the penalty because they have been found to be a responsible person for only one employer. However, some individuals are assessed TFRPs on more than one employer with unpaid employment taxes. Figure 4 provides information on the number of individuals who received a TFRP and for how many employers they were determined to be a responsible party.

**Figure 4: Number of Employer Entities Associated with Taxpayer Accounts Assessed a TFRP by Fiscal Year**

Employer Entities	Number of Taxpayer Accounts				
	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
1	40,958	37,910	31,335	27,973	25,881
2	2,211	2,094	1,641	1,426	1,109
3 – 9	529	487	424	355	268
10+	17	17	11	6	8

*Source: TIGTA analysis of Individual Master File as of December 2015.*

We reviewed the 59 individual taxpayer accounts for which an individual was assessed a TFRP for unpaid employment taxes for 10 or more employers and found that only five (8.5 percent) of the 59 individuals had been investigated by CI for potential criminal prosecution.

Both Congress and the GAO have long expressed concerns over egregious employment tax abuse by employers and their owners or principals.<sup>17</sup> However, based on resource limitations, the IRS is assessing fewer TFRPs overall. When this trend is combined with the declining number of employment tax cases referred to CI for investigation, there is very little opportunity of significant punishment for individuals who do not pay over the funds they are holding in trust for the Federal Government.

<sup>17</sup> GAO, GAO/AIMD/GGD-99-211, *Unpaid Payroll Taxes: Billions in Delinquent Taxes and Penalty Assessments Are Owed* (Aug. 1999); GAO, GAO-08-617, *Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes* (July 2008).

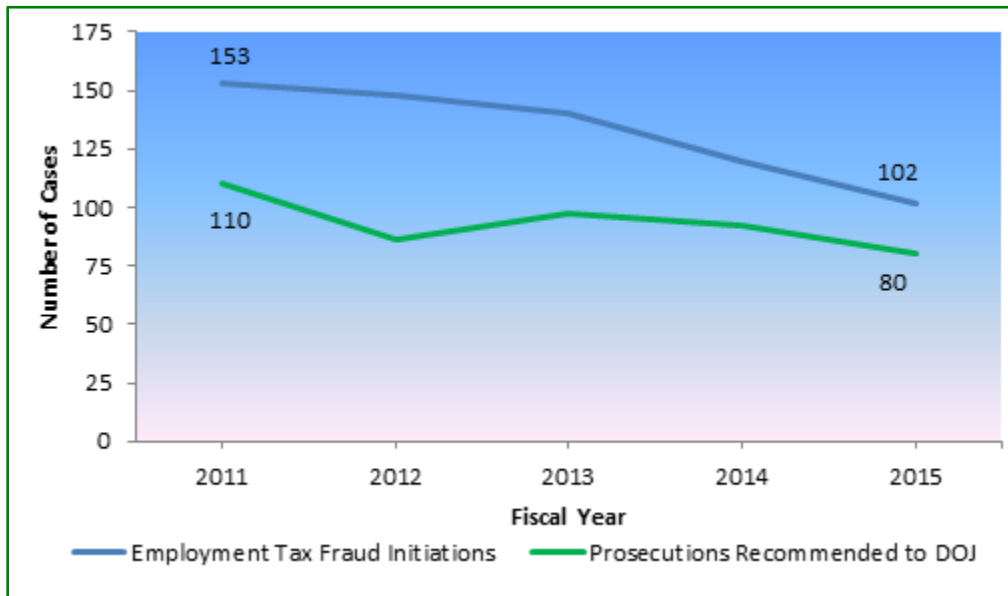


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**Criminal Investigation Receives Relatively Few Employment Tax Case Referrals From the Collection Function**

Employment tax investigations represent a small portion CI casework. For example, in FY 2015, CI initiated 102 employment tax investigations, which is less than 3 percent of all initiated cases. In comparison, the top two priorities—identity theft and abusive return preparer fraud and questionable refund fraud—resulted in almost 1,800 new investigations and accounted for 47 percent of new initiations in FY 2015. Figure 5 shows the number of employment tax cases initiated and referred for prosecution from FYs 2011 through 2015.

**Figure 5: Employment Tax Fraud Initiations and Referrals to DOJ**



Source: TIGTA analysis of CI data.<sup>18</sup>

Criminal investigations are initiated in a number of ways. First, the IRS initiates investigations from referrals when a compliance employee such as a revenue officer or revenue agent detects indicators of fraud, also known as “Badges of Fraud.” For additional information on the Badges of Fraud, see Appendix IV. However, not all referrals result in an investigation. Additionally, CI receives information from U.S. Attorney’s offices, other law enforcement agencies, the public, Bank Secrecy Act reports, and whistleblower claims. Figure 6 provides detailed information about the sources of CI employment tax initiations from FYs 2011 through 2015.

<sup>18</sup> Since actions on a specific investigation may cross fiscal years, the data shown in cases initiated may not always represent the same universe of cases shown in other actions within the same fiscal year.





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**Figure 6: Sources of CI Employment Tax Initiations**

	FYs 2011 – 2015	
SB/SE Division Referral (collection)	260	
SB/SE Division Referral (examination)	28	
SB/SE Division Referral (other)	5	
Combined Annual Wage Reporting <sup>19</sup>	40	
Other IRS	22	
Fraudulent Intent Referral Memo—SB/SE and Bank Secrecy Act	4	
<b>Total IRS Source</b>	<b>359</b>	<b>54%</b>
U.S. Attorney's Office	99	
Other Federal Agency	113	
General Public or Media	41	
Not Listed	31	
State/Local Government	20	
<b>Total Non-IRS Source</b>	<b>304</b>	<b>46%</b>
<b>Total Initiated Investigations</b>	<b>663</b>	

Source: TIGTA analysis of CI data.

Figure 6 indicates that over the last five fiscal years, IRS sources referred just over half of all employment tax initiated investigations. During this time, the Collection function was responsible for 39 percent of all the employment tax cases initiated. This is despite the nearly 175,000 TFRP assessments made in the same period. Since the statutes for the TFRP and the criminal counterpart I.R.C. § 7202 are similar, there is a high likelihood that some portion of the egregious noncompliance is the result of willful criminal acts.

In order to refer a case to CI, Collection function procedures require that firm indications<sup>20</sup> of fraud must be present. These firm indications of fraud must establish that a particular action was deliberately done for the purpose of deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events, or to make things seem other than what they are. However, I.R.C. § 7202 clearly indicates that the statute applies to any person required to collect, account for, and pay over tax who willfully fails to do so. A felony conviction under I.R.C. § 7202 does not require an attempt at concealment, deception, or false or fraudulent statements.

The DOJ Criminal Tax Manual section specific to I.R.C. § 7202 also confirms that in order to prosecute persons who willfully fail to comply with their obligation to collect, account for, and

<sup>19</sup> The Combined Annual Wage Reporting is a document matching program that compares the Federal income tax withheld, Medicare wages, Social Security wages, and Social Security tips reported to the IRS against the amounts reported to the Social Security Administration. When this reconciliation results in an apparent underpayment of taxes or over-withholding of Federal income tax, an IRS-Combined Annual Wage Reporting case is created.

<sup>20</sup> Commonly referred to by the IRS as badges of fraud.



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pay over taxes, an element of fraud need not be proven. According to the DOJ, to establish a violation of I.R.C § 7202, the prosecutor must prove three elements beyond a reasonable doubt:

1. A duty to collect, account for, and pay over a tax.
2. Failure to collect, truthfully account for, or pay over the tax.
3. Willfulness.

The DOJ Criminal Tax Manual states:

*The element of willfulness under § 7202 is the same as in other criminal offenses under Title 26.... The government must show that a defendant voluntarily and intentionally violated a known legal duty.... Evil motive or bad purpose is not necessary to establish willfulness under the criminal tax statutes.*<sup>21</sup>

There is considerable similarity between the elements that must be proven in order to assess a TFRP (I.R.C. § 6672) and those required to prosecute someone under I.R.C. § 7202, yet the Collection function refers very few cases to CI. In the five year period between FY 2011 and FY 2015, the Collection function assessed nearly 175,000 new TFRPs but referred fewer than 1,000 cases to CI. During that time period, CI initiated investigations based on the Collection function referrals in 260 cases, or less than one quarter of one percent of the employers connected to the TFRP penalties assessed during that time period. Even fewer are eventually referred by CI to the DOJ. We are concerned that the Collection function requirement that I.R.C. § 7202 cases only be referred when an element of fraud is present is overly restrictive and may affect the quality and quantity of referrals that are made to CI.

In fact, when we reviewed the top five percent of TFRP cases (based on total TFRP dollars assessed) each year from FYs 2010 through 2015, our analysis showed that few of the cases had any indication of previous or current CI activity. Figure 7 provides detailed information about the top five percent of cases with TFRPs and the level of associated CI activity from FYs 2011 through 2015.

***Figure 7: Top Five Percent of Taxpayer Accounts (Based on Assessment Amount) Assessed a TFRP and Investigated by CI***

<b>Fiscal Year</b>	<b>FY 2011</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>	<b>FY 2015</b>
TFRP Accounts in Top 5%	2,186	2,025	1,699	1,488	1,363
Accounts With CI Activity	57	48	36	22	8
Percent	2.61%	2.37%	2.12%	1.48%	.59%

*Source: TIGTA analysis of Individual Master File as of December 2015.*

<sup>21</sup> DOJ Criminal Tax Manual, pages 11-12 (2012).



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In addition, we reviewed taxpayer accounts with over \$1 million in TFRP assessments from FYs 2010 through 2015. There were approximately 700 individuals who were assessed in excess of \$1 million each of TFRP during this time period, yet CI had opened investigations on fewer than 50 of the individuals.

During an investigation, special agents determine if there is sufficient evidence of criminal acts (see Appendix VI for additional information about the phases of a criminal investigation). In FY 2013, CI initiated 140 employment tax investigations. CI considers a number of factors when it decides whether or not to initiate an employment tax investigation. According to CI, these factors include deterrence, willfulness, and jury appeal.

We reviewed the supporting documents for 71 non–grand jury<sup>22</sup> criminal employment tax investigations (administrative cases) completed in FY 2013. Our analysis determined that CI discontinued 37 (52 percent) of the 71 administrative cases. The reasons why CI discontinued these investigations included insufficient tax losses for prosecution, insufficient evidence or witnesses to prove all criminal elements, and the inability to prove intent. The average number of calendar days a discontinued investigation was open was 496 days (1.4 years). Thus, the investigative resources expended on discontinued cases are significant.

CI recommended prosecution on 34 cases (48 percent) of the 71 administrative cases we reviewed. In 30 (88 percent) of the 34 cases referred, the DOJ accepted the case for prosecution. Of the 30 administrative cases that the DOJ accepted for prosecution, no case went to trial. The DOJ filed a motion to dismiss one case and accepted a plea bargain in the other 29 cases. The cases that were accepted for prosecution took two years, on average, for CI to investigate. As previously stated, once the DOJ accepts a case for prosecution, CI continues providing investigative support.

### ***The Deterrent Effect of Employment Tax Case Prosecutions Is Unknown***

Once accepted for prosecution, it took the DOJ an additional 1.7 years on average to complete the case for those non–grand jury cases closed in FY 2013. This means that it takes close to four years, on average, from the time CI initiates an employment tax investigation to the time that sentencing is complete. In the past five fiscal years, fewer than 100 individuals a year have been convicted for willfully failing to pay over employment taxes when grand jury and non–grand jury cases are combined. The length of incarceration in FY 2013 averaged around 24 months for grand jury and non–grand jury cases. For the 29 non–grand jury cases closed in FY 2013 that we reviewed, eight convicted individuals received no prison time. For the

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<sup>22</sup> Access to grand jury case information is highly restricted. Because of this, we reviewed only administrative cases completed in FY 2013. We reviewed 100 percent of the administrative cases identified by the IRS as being closed in FY 2013.



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remaining 21 individuals, the average incarceration sentence was 27 months, with a low of six months and a high of 60 months, or 5 years. Examples of the types of cases investigated by CI and prosecuted by the DOJ are in Appendix VII.

According to CI, one of the most effective methods to encourage compliance is from the deterrence effect achieved through publicity. Although CI highlights criminal convictions on the IRS website, penetrating hundreds of local media markets throughout the country remains a challenge. For example, when we reviewed court records for all employment tax prosecutions completed in FY 2013, we found that generally one or two employment tax cases were prosecuted per State and some States had no employment tax prosecutions that year. While the prosecutions we reviewed often received some media attention, it is unknown what deterrent effect such a small number of infrequently prosecuted cases might have. However, TIGTA concludes that the limited number of convictions each year (fewer than 100 per year on average) results in only a limited deterrence effect because the likelihood of criminal punishment for egregious employment tax embezzlement is very low.

Although TIGTA found declining civil and criminal enforcement, according to the DOJ, since January 2015 the Tax Division has increased its focus on civil and criminal employment tax enforcement. We met with DOJ Tax Division staff to understand their perspective on employment tax noncompliance. The DOJ's increased efforts include developing a centralized database of criminal employment tax resources for prosecutors and educating employers, through a public campaign, about the serious nature of employment tax violations. In addition, the DOJ and IRS worked collaboratively to provide training to IRS personnel and to update the employment tax chapter of the DOJ Criminal Tax Manual. The DOJ also noted that although the IRS and DOJ are in frequent contact, there is no formalized process for priority setting between the two agencies.

According to the IRS, Since May 2015, CI has been working with the Collection function, the DOJ, and the IRS Criminal Tax Counsel to promote the employment tax program within the IRS. CI collaborated with the Collection function, DOJ, IRS Criminal Tax Counsel, and IRS National Fraud Program throughout FYs 2015 and 2016 in efforts to promote the cross-agency focus on employee tax fraud compliance and deterrence. The effort has included promotion of the program to senior and frontline leadership, internal and external presentations, prosecutorial assistance from the DOJ, and training for both civil and criminal agents. As a result of this collaboration, CI's direct investigative time has increased in this area. It has gone up from 3.7 percent in FY 2015 to 4.2 percent in FY 2016.

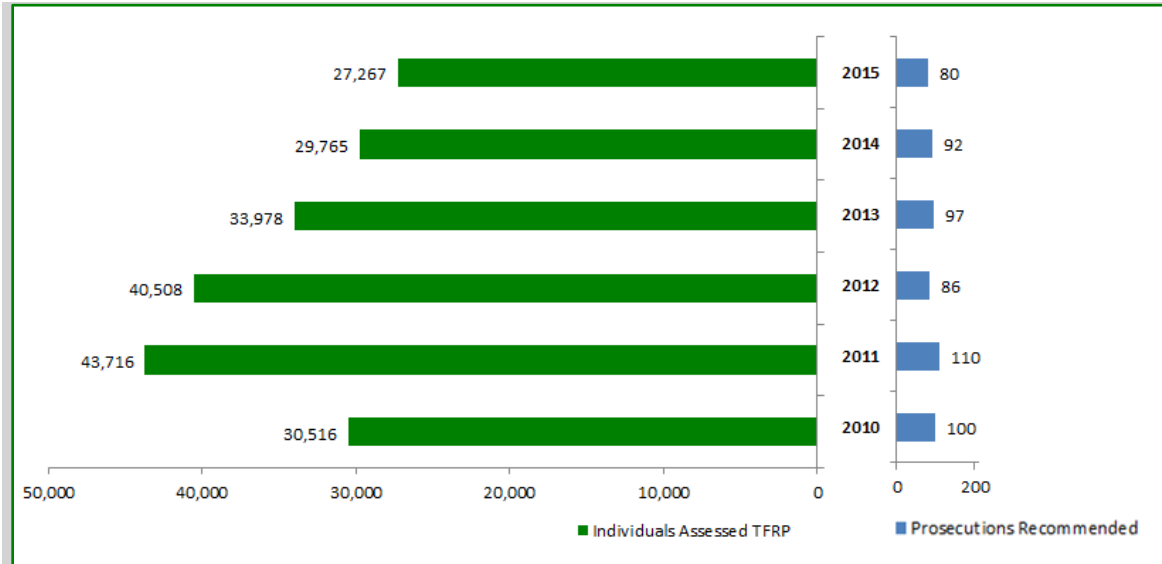
Given the dramatic increase in the number of egregious employment tax cases with 20 or more quarters of noncompliance since FY 1998 and the lack of investigation of individuals responsible for 10 or more employers' noncompliance or individuals assessed in excess of \$1 million in TFRPs from FYs 2011 through 2015, a more focused approach could result in a more effective deterrent to egregious noncompliance. We believe this is especially important in light of declining IRS collection and law enforcement resources. Figure 8 provides information on the



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number of prosecution recommendations for each of the past five fiscal years in comparison to the number of TFRPs assessed in the same year.

**Figure 8: TFRPs Assessed and Prosecution Recommendations by Fiscal Year**



Source: TIGTA analysis of the Individual Master File as of December 2015 and CI data.

The three primary entities involved in employment tax compliance are the SB/SE Division, CI, and the DOJ. In our discussion with the DOJ Tax Division, we learned that there is not a cross-agency strategy to address employment tax noncompliance. The Government Performance and Results Act Modernization Act of 2010<sup>23</sup> provides a framework for cross-agency priority goals. While there is some cross-agency collaboration being performed, a more focused effort on priority goals between the IRS and DOJ could help deter future employment tax fraud and abuse.

### Recommendation

**Recommendation:** The Commissioner, SB/SE Division, and the Chief, CI, should consider a focused strategy to enhance the effectiveness of the IRS's efforts to address egregious employment tax cases. This strategy should include use of data analytics to better target egregious employment tax noncompliance, including identification of high-dollar cases and individuals with multiple companies that are noncompliant. In addition, the Collection function should expand the criteria used to refer potentially criminal employment tax cases to CI to include any egregious cases (not only those where a firm indication of fraud is present).

<sup>23</sup> Government Performance and Results Act Modernization Act of 2010, Pub. L. 111-352.



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**Management’s Response:** The IRS partially agreed with our recommendation. The IRS agreed with the portion of our recommendation describing a focused strategy to enhance effectiveness of the IRS’s efforts to address egregious employment tax cases by citing various initiatives in process and completed. However, the IRS did not specifically address our recommendation to enhance the use of data analytics. The IRS disagreed with the portion of our recommendation that the Collection function should expand the criteria used to refer potentially criminal employment tax cases to CI to include any egregious cases (not only those where a firm indication of fraud is present) citing the need to balance several factors by a number of stakeholders and limited government resources including limitations on the number of criminal tax cases the United States Attorneys and the US Courts can accommodate. Management’s response to the draft report is included as Appendix IX.

**Office of Inspections and Evaluations Comment:** The TIGTA disagrees with the IRS position that criminal conduct beyond willfully not reporting and paying employment taxes is necessary for criminal investigation and referral to the Department of Justice (DOJ). We believe the position allows egregiously noncompliant taxpayers—including those involved in cases of over \$1 million or involved in 10 or more companies that fail to remit payroll taxes to IRS—to escape criminal prosecution contrary to the statute. The IRS insistence that fraud is a prerequisite for applying I.R.C. § 7202 is not in agreement with stated DOJ guidelines:

“To establish a violation of section 7202, the following elements must be proved beyond a reasonable doubt: 1. Duty to collect, account for, and pay over a tax; 2. Failure to collect, truthfully account for, or pay over the tax; and 3. Willfulness. Cases prosecuted under this statute usually involve social security taxes (FICA) and withholding tax.”

We fully understand there are limited resources available to pursue employment tax noncompliance. Our purpose in the recommendation is to clarify that deceit is not required for a conviction under I.R.C. § 7202. For example, the statute does not require that a taxpayer convert withheld trust fund taxes for personal use. In addition, there are numerous egregious cases available that could be considered for investigations that are not even referred to CI or considered. This includes cases with over \$1 million and individuals involved with 10 or more companies that failed to provide the money to IRS that was being held “in trust” for the Federal government.



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## **Appendix I**

### *Detailed Objectives, Scope, and Methodology*

The overall objectives of this review were to determine the levels of payroll tax noncompliance identified by the IRS and determine the extent of civil and criminal payroll tax enforcement actions taken by the IRS. To accomplish these objectives, TIGTA:

- I. Determined the levels of payroll tax noncompliance identified by the IRS.
  - A. Determine the amount of payroll taxes the IRS has assessed but not collected by collection status for FYs 2012 through 2015.
  - B. Determine the number and amount of TFRP assessed annually.
- II. Determined the number and characteristics of payroll tax evasion investigations conducted by the IRS.
  - A. Determine the number of payroll tax evasion investigations that were (a) initiated, (b) opened, (c) in pipeline, (d) closed, and (e) referred for prosecution for FYs 2012 through 2015.
  - B. Determined how this compares to the total number of investigations that were (a) initiated, (b) opened, (c) in pipeline, (d) closed, and (e) referred for prosecution during this time period.
  - C. Determined the source of payroll tax investigations initiated from FYs 2011 through 2015.
  - D. Determined the source of total investigations and how this compares to payroll tax investigations initiated during this time period.
  - E. Determined the DOJ and U.S. Attorney case acceptance rate for payroll tax evasion cases that were referred for prosecution during FYs 2011 through 2015.
  - F. Determined the total number of hours or days applied to each payroll tax investigation by CI for FY 2013.
  - G. Examined investigations that were closed in FY 2013 but were not referred for prosecution to explore the reasons why these cases were not referred for prosecution.
  - H. Examined payroll tax investigations that were referred for prosecution in FY 2013 but did not ultimately lead to either an indictment or guilty plea to identify potential prosecution challenges.



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- III. Determined the outstanding amount of the accounts receivable as of December 2015 for accounts and the number of quarterly payroll tax returns outstanding, along with characteristics that include modules with criminal investigations, number and amount of modules with TFRP assessments based on information from the Business Master File<sup>24</sup> and the Individual Master File<sup>25</sup> as of December 2015.
- IV. Determined the number employer entities that a responsible person controls and the amount of TFRP assessment for FYs 2011 through 2015 using Individual Master File data as of December 2015.
- V. Determined the portion of currently collectible and currently not collectible assessed module balance/accounts receivable as of December 2015 for employer entities/accounts and the number of quarterly module/payroll tax returns outstanding and the assessed module balance/accounts receivable amount.
- VI. Determined the criminal investigative activity on the Top Five Percent of TFRP assessments for FYs 2010 through 2015 and determined the criminal investigative activity related to FYs 2010 through 2015 for all TFRP assessments on the Individual Master File as of December 2015.
- VII. Determine the number of employer entities/payroll tax entities that a responsible person controls, the amount of TFRP assessments, and the number of criminal investigations for FYs 2011 through 2015 as shown in December 2015 on the Individual Master File.

### **Data Validation Methodology**

We assessed the reliability of Form 941, *Employer's QUARTERLY Federal Tax Return*, data from the Business Master File and TFRP assessment data from the Individual Master File as of December 2015 obtained from the TIGTA Data Center Warehouse<sup>26</sup>. We assessed the reliability of the data by (1) performing electronic testing of required data elements that included selecting a sample of transactions and matching them back to the originating transactions on the Integrated Data Retrieval System<sup>27</sup> and (2) reviewing existing information including the Internal Revenue Manual and Document 6209, *IRS Processing Codes and Information*, about the data and the system that produced them. We determined that the data were sufficiently reliable for the purposes of this report.

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<sup>24</sup> The Business Master File is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

<sup>25</sup> The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.

<sup>26</sup> The TIGTA Data Center Warehouse is a secured centralized storage of IRS database files used to maintain critical historical data that have been extracted from operational data storage and transformed into formats accessible to TIGTA employees.

<sup>27</sup> The Integrated Data Retrieval System is the IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.





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**Appendix II**

*Major Contributors to This Report*

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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Director, Collection, Small Business/Self-Employed Division SE:S:C  
Director, Office of Audit Coordination OS:PPAC



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## Appendix IV

### *Indicators of Fraud*

Internal Revenue Manual 25.1.2.3, *Indicators of Fraud*, describes indicators of fraud, commonly referred to as badges of fraud. We are concerned that the SB/SE Division Collection function requirement that I.R.C. § 7202 cases only be referred when an element of fraud is present is overly restrictive and may affect the quality and quantity of referrals that are made. The list below describes categories of fraud indicators as described in the Internal Revenue Manual. The list is not all-inclusive but instead cites examples of actions taxpayers may take to deceive or defraud:

#### **Income**

- a. Omitting specific items where similar items are included.
- b. Omitting entire sources of income.
- c. Failing to report or explain substantial amounts of income identified as received.
- d. Inability to explain substantial increases in net worth, especially over a period of years.
- e. Substantial personal expenditures exceeding reported resources.
- f. Inability to explain sources of bank deposits substantially exceeding reported income.
- g. Concealing bank accounts, brokerage accounts, and other property.
- h. Inadequately explaining dealings in large sums of currency, or the unexplained expenditure of currency.
- i. Consistent concealment of unexplained currency, especially in a business not routinely requiring large cash transactions.
- j. Failing to deposit receipts in a business account, contrary to established practice.
- k. Failing to file a tax return, especially for a period of several years, despite evidence of receipt of substantial amounts of taxable income.
- l. Cashing checks, representing income, at check cashing services and at banks where the taxpayer does not maintain an account.
- m. Concealing sources of receipts by false description of the source(s) of disclosed income, and/or nontaxable receipts.



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**Expense or Deductions**

- a. Claiming fictitious or substantially overstated deductions.
- b. Claiming substantial business expense deductions for personal expenditures.
- c. Claiming dependency exemptions for nonexistent, deceased, or self-supporting persons. Providing false or altered documents, such as birth certificates, lease documents, school/medical records, for the purpose of claiming the education credit, additional child tax credit, earned income tax credit, or other refundable credits.
- d. Disguising trust fund loans as expenses deductions.

**Books and Records**

- a. Multiple sets of books or no records.
- b. Failure to keep adequate records, concealment of records, or refusal to make records available.
- c. False entries or alterations made on the books and records; back-dated or post-dated documents; false invoices, false applications, false statements, or other false documents or applications.
- d. Invoices are irregularly numbered, unnumbered, or altered.
- e. Checks made payable to third parties that are endorsed back to the taxpayer. Checks made payable to vendors and other business payees that are cashed by the taxpayer.
- f. Variances between treatment of questionable items as reflected on the tax return and representation within the books.
- g. Intentional under- or over-footing of columns in journal or ledgers.
- h. Amounts on tax return not in agreement with amounts in books.
- i. Amounts posted to ledger accounts not in agreement with source books or records.
- j. Journalizing questionable items out of correct account.
- k. Recording income items in suspense or asset accounts.
- l. False receipts to donors by exempt organizations.

**Allocations of Income**

- a. Distribution of profits to fictitious partners.
- b. Inclusion of income or deductions in the tax return of a related taxpayer when tax rate differences are a factor.



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**Conduct of Taxpayer**

- a. False statement about a material fact pertaining to the examination.
- b. Attempt to hinder or obstruct the examination. For example, failure to answer questions; repeated cancelled or reschedule appointments; refusal to provide records; threatening potential witnesses, including the examiner; or assaulting the examiner.
- c. Failure to follow the advice of accountant, attorney, or return preparer.
- d. Failure to make full disclosure of relevant facts to the accountant, attorney, or return preparer.
- e. The taxpayer's knowledge of taxes and business practices where numerous questionable items appear on the tax returns.
- f. Testimony of employees concerning irregular business practices by the taxpayer.
- g. Destruction of books and records, especially if just after examination was started.
- h. Transfer of assets for purposes of concealment, or diversion of funds and/or assets by officials or trustees.
- i. Pattern of consistent failure over several years to report income fully.
- j. Proof that the tax return was incorrect to such an extent and in respect to items of such magnitude and character as to compel the conclusion that the falsity was known and deliberate.
- k. Payment of improper expenses by or for officials or trustees.
- l. Willful and intentional failure to execute pension plan amendments.
- m. Backdated applications and related documents.
- n. False statements on Tax Exempt/Government Entity determination letter applications.
- o. Use of false Social Security Numbers.
- p. Submission of a false Form W-4, *Employee's Withholding Allowance Certificate*.
- q. Submission of a false affidavit.
- r. Attempt to bribe the examiner.
- s. Submission of tax returns with false claims of withholding (Form 1099-OID, *Original Issue Discount*; Form W-2, *Wage and Tax Statement*) or refundable credits (Form 4136, *Credit for Federal Tax Paid on Fuels*; Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gains*) resulting in a substantial refund.
- t. Intentional submission of a bad check resulting in erroneous refunds and releases of liens.



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- u. Submission of false Form W-7, *Application for IRS Individual Taxpayer Identification Number*, information to secure an Individual Taxpayer Identification Number for self and dependents.

**Methods of Concealment**

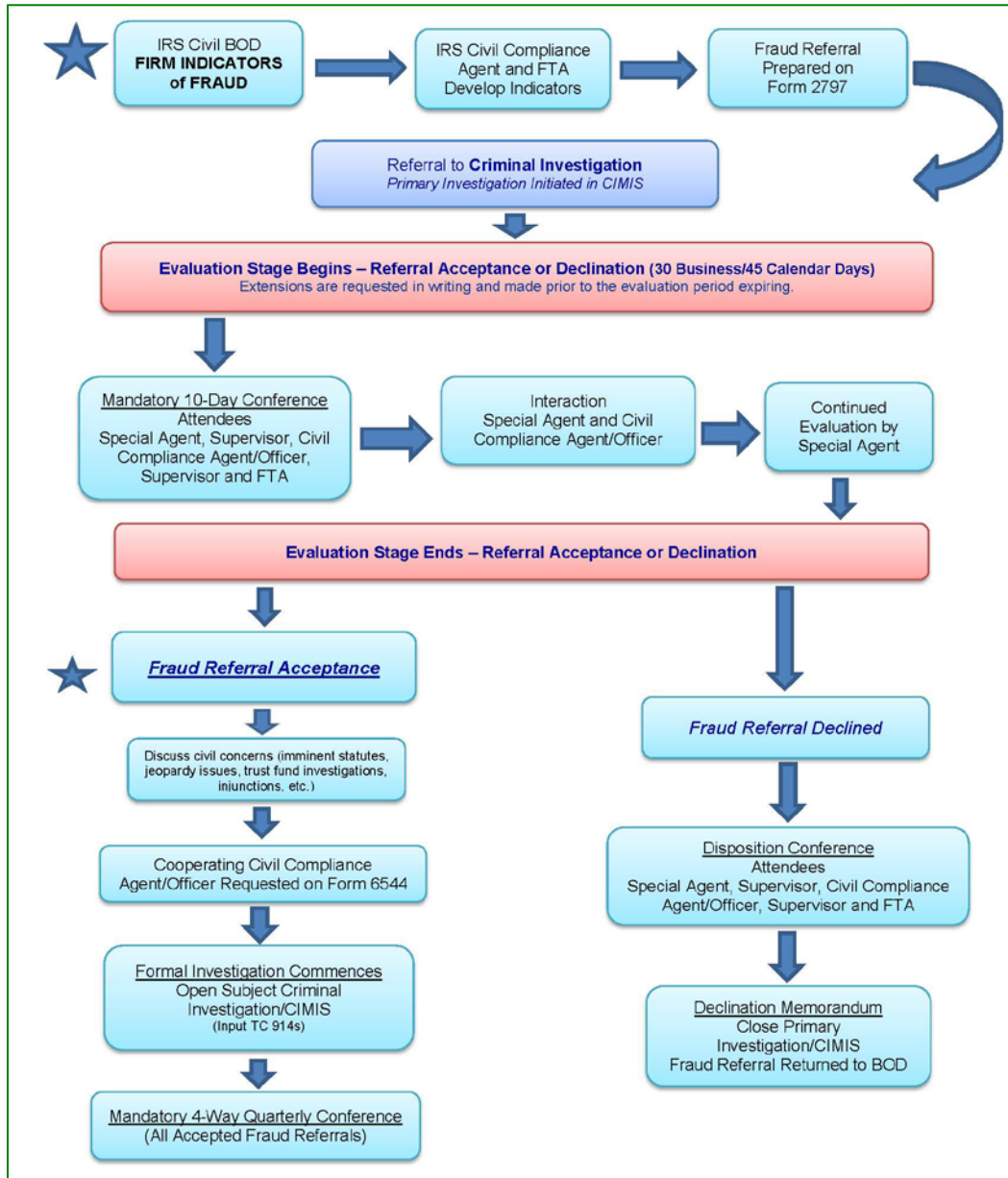
- a. Inadequacy of consideration.
- b. Insolvency of transferor.
- c. Asset ownership placed in other names.
- d. Transfer of all or nearly all of a debtor's property.
- e. Close relationship between parties to the transfer.
- f. Transfer made in anticipation of a tax assessment or while the investigation of deficiency is pending.
- g. Reservation of any interest in the property transferred.
- h. Transaction not in the usual course of business.
- i. Retention of possession or continued use of asset.
- j. Transactions surrounded by secrecy.
- k. False entries in books of transferor or transferee.
- l. Unusual disposition of the consideration received for the property.
- m. Use of secret bank accounts for income.
- n. Deposits into bank accounts under nominee names.
- o. Conduct of business transaction in false names.



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**Appendix V**

*Fraud Referral Process*



Source: IRS SB/SE Division Collection function. Note: BOD = Business Operating Division. CIMIS = Criminal Investigation Management Information System. FTA = Fraud Technical Advisor. TC = Transaction Code. Form 2797, (Referral Report of Potential Criminal Fraud Cases). Form 6544, (Request for Cooperating Examiner/Revenue Officer).



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## Appendix VI

### *Steps in Subject<sup>1</sup> Criminal Investigation to Prosecution Recommendation*

**Conducting a Criminal Investigation:** Once an investigation is opened, the special agent obtains the facts and evidence needed to establish the elements of criminal activity. Various investigative techniques are used to obtain evidence, including interviews of third party witnesses, conducting surveillance, executing search warrants, subpoenaing bank records, and reviewing financial data.

The special agent works closely with IRS Chief Counsel criminal tax attorneys during the course of the criminal investigation. This process ensures that all legal aspects of the investigation and prosecution recommendation are correctly addressed.

**Prosecution Recommendations by the Special Agent:** After all the evidence is gathered and analyzed, the special agent and his or her supervisor either make the determination that the evidence does not substantiate criminal activity, in which case the investigation is “discontinued”, or that the evidence is sufficient to support the recommendation of prosecution, in which case the agent proceeds with the preparation of a written report detailing the findings of violation of the law and recommending prosecution. This report is called a ‘special agent report’ and it is reviewed by numerous officials, including:

1. The agent’s frontline supervisor, called the supervisory special agent.
2. A criminal investigation quality review team, Centralized Case Review.
3. CI assistant special agent in charge.
4. CI special agent in charge.

Each level of review may determine that evidence does not substantiate criminal charges and the investigation should not be prosecuted.

If CI determines that the investigation should be criminally prosecuted, a prosecution recommendation is forwarded to the DOJ Tax Division.

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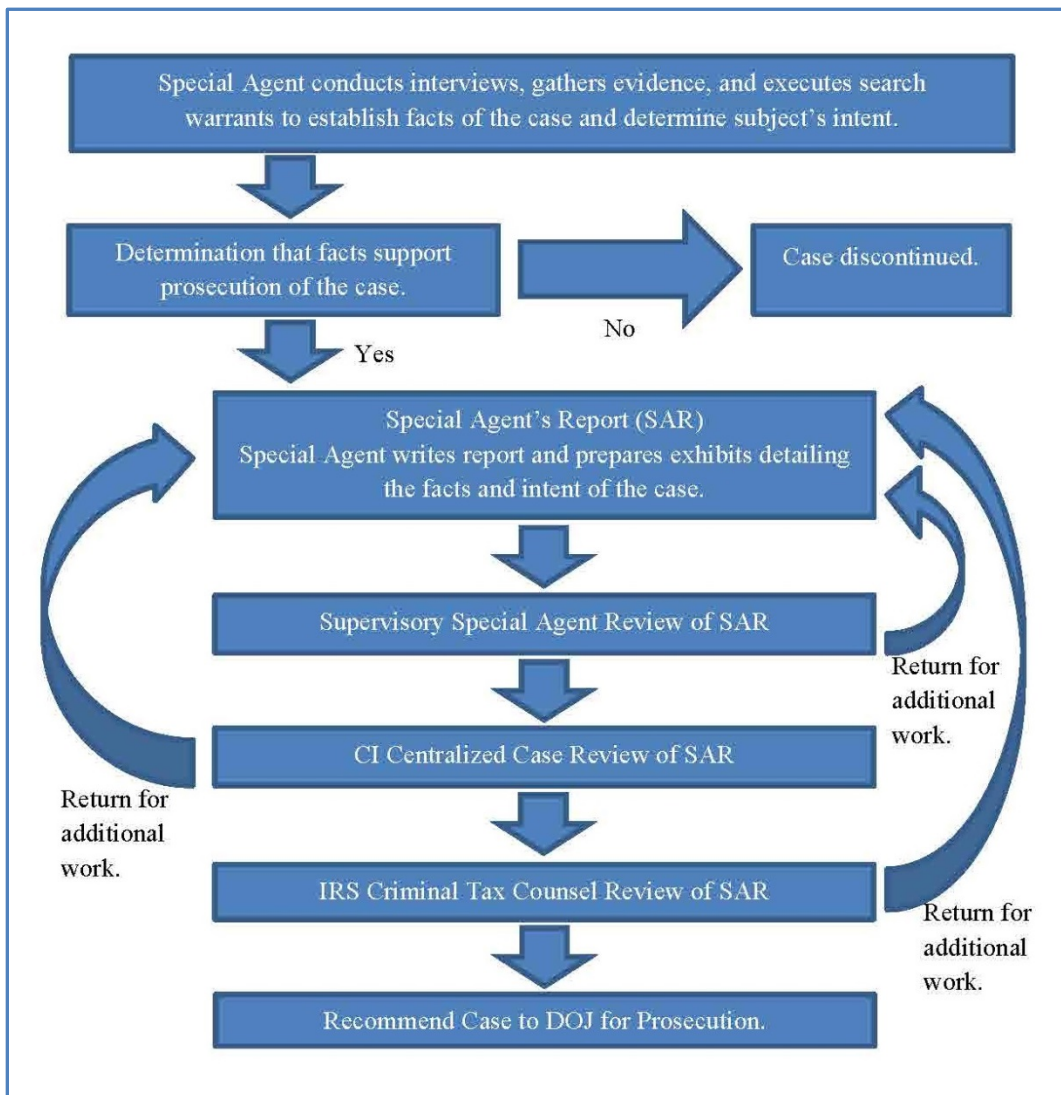
<sup>1</sup> A subject criminal investigation is an investigation developed when an individual or entity is alleged to be in noncompliance with tax laws and there is prosecution potential. The objective of a subject criminal investigation is to gather evidence to prove or disprove the existence of a violation of the laws enforced by the IRS.





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**Prosecution:** If the DOJ or the U.S. Attorney’s Office accepts the investigation for prosecution, the IRS special agent will be asked by the prosecutors to assist in preparation for trial. However, once a special agent report is referred to for prosecution, the investigation is managed by the U.S. Attorney’s Office.



Source: TIGTA depiction of CI procedures.



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## Appendix VII

### *Examples of Employment Tax Criminal Cases*

Below are examples of the types of employment tax cases investigated by CI and prosecuted by the DOJ:

**United States v. Zakarian:** Richard Zakarian was sentenced to 210 months (17.5 years) imprisonment<sup>1</sup> and three years supervised release and ordered to pay restitution of over \$4.4 million. Zakarian pleaded guilty to two counts each of wire fraud and mail fraud and one count of making and subscribing false income tax returns. Zakarian, a certified financial planner and self-employed tax preparer, operated two schemes. One scheme was to defraud clients whose payroll taxes he handled through a company known as Ben Franklin Payroll Service, and another was to defraud investment clients, many of whom were also clients of his tax preparation business. From September 2002 through August 2012, Zakarian devised a scheme to defraud investment clients by inducing them to invest their retirement funds and other savings through him as their account representative through false and fraudulent misrepresentations. He misled clients to believe their funds would be placed in safe, guaranteed-return investments when, in fact, he diverted the funds to pay personal and business expenses and invest in risky investments for which he had a consistent history of incurring large losses. He primarily targeted clients from his tax preparation business. While some clients received a return on part or all of their investment, 23 clients incurred combined out-of-pocket losses of more than \$1 million.

Zakarian began his separate payroll tax scheme in Calendar Year 2010 that continued through August 2012. He induced clients to retain Ben Franklin Payroll Service, which he owned and operated, leading them to believe the company would and did file the client's required employment tax returns and reports and pay the clients' Federal, State, and local tax obligations. The funds should have been forwarded to various taxing authorities to pay the income taxes of his clients' employees. In reality, he failed to file many of the returns and diverted substantial portions of the clients' funds to pay his own personal and business expenses and invest in highly leveraged, risky investments with a consistent history of sustaining large losses. Zakarian devised the scheme in hopes of raising money to be able to pay victims of his investment fraud scheme described above. He attempted to solicit for-profit clients by offering services well below market rates and below his own operating costs. Later in Calendar Year 2010, after this failed to generate as many clients as envisioned, he developed a new plan to solicit churches, charities, and other nonprofits through a purported "grant" program. Many of the payroll tax victims were churches, charities, and other nonprofit organizations that Zakarian lured as clients.

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<sup>1</sup> In some instances, the DOJ may prosecute an individual for other crimes in addition to the employment tax embezzlement.



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In total, Ben Franklin had at least 72 clients that incurred combined losses of more than \$3.4 million from Zakarian's fraudulent diversion of their employment tax funds. Just over half the losses were incurred by at least 29 nonprofit organizations.

**United States v. Weiss:** Arthur Sanford Weiss was sentenced to 185 months (15.4 years) imprisonment and five years supervised release and ordered to pay restitution of over \$7 million to numerous victims including the IRS, the North Carolina Department of Revenue, and former clients. Weiss pleaded guilty in a plea bargain to charges of wire fraud, bank fraud, money laundering, and tax obstruction.

Weiss operated professional employer organizations, which provided payroll-related services to client companies. For his client companies, Weiss agreed to pay the employees, withhold and remit Federal and State taxes, prepare and file the Federal and State employment tax returns, and provide workers' compensation insurance. Weiss did pay the employees and withhold the employment taxes, but he failed to remit the employment taxes, keeping them for his personal use. Weiss failed to file employment tax returns and failed to pay over to the IRS employment taxes in excess of \$4 million. In addition, Weiss collected workers' compensation insurance premiums from his clients but failed to obtain adequate workers' compensation insurance protection and diverted premiums for his personal use.

Weiss used a portion of his fraud proceeds to fund a lavish lifestyle, purchasing expensive jewelry and exotic cars such as Ferraris, Lamborghinis, and Porsches. During a trip to Europe, Weiss fraudulently reported four pieces of jewelry lost or stolen and received \$177,480 from his insurance company. The jewelry was later seized during a search at his former residence in Marion, North Carolina.

**United States v. Tillman:** Alphonso Tillman was sentenced to 24 months (2 years) imprisonment and three years supervised release and ordered to pay over \$2.2 million in restitution for failure to account for and pay over employment taxes. Tillman was president and sole owner of Remote Surveillance Technology Solutions Inc. and its successor, Remote Surveillance Technology Services LLC. The companies provided security guards for commercial and residential properties in the District of Columbia, Maryland, Pennsylvania, and Virginia.

Both companies withheld taxes from their employees' paychecks, including Federal income taxes and Medicare and Social Security taxes (payroll taxes). Tillman failed to file the required forms or pay the payroll taxes, resulting in total tax loss of over \$2.2 million. Tillman made hundreds of thousands of dollars of expenditures from both businesses' accounts for his personal benefit while at the same time failing to pay over to the IRS payroll taxes withheld from his employees' paychecks.

**United States v. Sacco:** Robert R. Sacco, the owner and chairman of the board of Paysource, was sentenced to 78 months (6.5 years) imprisonment and three years supervised release and ordered to pay restitution of more than \$26.7 million in a conspiracy and financial crimes scheme



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involving withholding money to pay Federal employment taxes from employees' paychecks and keeping the money instead of paying the IRS. Sacco was convicted of one count each of conspiracy to defraud the United States by impeding the IRS, money laundering, and tax evasion.

Sacco and others conspired to avoid the payment of Federal employment taxes owed by Payscale and concealed from the IRS legitimate tax liabilities the company owed. Sacco directed co-conspirators to prepare fraudulent IRS forms claiming that the wages paid by the company and the resulting tax liabilities were significantly lower than the wages the company actually paid.

**United States v. Dawson:** Carolyn Dawson was sentenced to 24 months imprisonment and three years supervised release and ordered to pay over \$1.8 million in restitution consisting of nearly \$1.2 million to her former employer, American Plant Products, and \$649,000 to the IRS. Dawson pleaded guilty to one count each of fraud by wire, radio, or television and attempt to evade or defeat tax.

Dawson worked as the bookkeeper for American Plant Products, an Oklahoma City wholesaler of greenhouse and garden supplies. Her duties included maintaining payroll, preparing payroll tax returns, and paying withheld taxes to the IRS. According to the criminal information filed, Dawson defrauded the business by using interstate wire communications to pay personal credit card expenses from a business bank account without the knowledge of the business or its owners. The information also alleged that Dawson willfully evaded Federal payroll taxes by failing to file a Tax Year 2010 payroll tax return for the company, failing to make payroll withholding payments to the IRS, and altering the books and records of American Plant Products to conceal her failure to make withholding payments.

**United States v. Cipoletti et al:** Kerry Seaman, controller of the payroll company Ingentra HR Services Inc., was sentenced to 44 months (3.7 years) imprisonment and three years supervised release and ordered to pay restitution of more than \$19.1 million for defrauding SanDisk Corp., Stanley Solutions Inc., and the County of Sacramento. Ingentra provided payroll services to employers throughout the country. The services included the calculation and transmission of tax payments on behalf of its clients and its clients' employees to State and Federal taxing agencies.

The DOJ charged Albert Cipoletti, Ingentra Chief Executive Officer, and Kerry Seaman, Ingentra Comptroller, with wire fraud for diverting tens of millions of dollars from the County of Sacramento, SanDisk Corp., and Stanley Solutions Inc. after underreporting the amount the companies owed to the IRS. Ingentra sent funding letters for each pay period to clients informing them of the amount of money that clients needed to send Ingentra to fund the clients' payroll and various taxes. Ingentra was then responsible for paying the income withheld from employees' pay to the IRS. The company was also responsible for filing its clients' quarterly Federal tax forms with the IRS. But starting no later than Calendar Year 2005, and continuing through April 2010, Cipoletti and Seaman submitted false forms to the IRS indicating that



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Ingentra's clients owed less in taxes than they actually did and pocketed the rest of the funds collected from the companies.

The IRS provides information on certain criminal cases on its public website. For additional examples of criminal cases, see:

<https://www.irs.gov/uac/examples-of-employment-tax-fraud-investigations-fiscal-year-2016>

<https://www.irs.gov/uac/examples-of-employment-tax-fraud-investigations-fiscal-year-2015>



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**Appendix VIII**

*Comparison of Internal Revenue  
Code Sections 6672<sup>1</sup> and 7202<sup>2</sup>*

Statute	I.R.C. § 6672	I.R.C. § 7202
<b>Type</b>	Civil	Criminal
<b>Statutory Language</b>	Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.	Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$10,000, or imprisoned not more than five years, or both, together with the costs of prosecution
<b>Who Assesses/Charges</b>	IRS SB/SE Division	IRS CI/DOJ
<b>Target</b>	Responsible person	Responsible person
<b>Court Venue</b>	U.S. District Court or U.S. Court of Federal Claims	U.S. District Court
<b>Evidence Elements</b>	The person is “responsible”—had a duty to account for, collect, and pay over the trust fund taxes to the Government; and the person “willfully” failed to collect or pay over trust fund taxes to the Government.	The person is “responsible”—had a duty to account for, collect, and pay over the trust fund taxes to the Government; and the person “willfully” failed to collect or pay over trust fund taxes to the Government.

<sup>1</sup> 26 U.S.C. § 6672, *Failure to collect and pay over tax, or attempt to evade or defeat tax.*

<sup>2</sup> 26 U.S.C. § 7202, *Willful failure to collect or pay over tax.*



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Statute	I.R.C. § 6672	I.R.C. § 7202
<b>Standard for Assessment/Charge</b>	<p>The TFRP is summarily assessed; however, the IRS will in most circumstances grant a preassessment administrative appeal. A responsible person can take the following action: agree to the assessment, provide no response, or appeal the TFRP. A responsible person who pays the TFRP may file a claim for refund on Form 843, <i>Claim for Refund and Request for Abatement</i>. This can be done after an unsuccessful appeal or in lieu of an appeal. Following a denial of the refund claim or the elapse of six months, whichever is shorter, the responsible person can file a refund action in the U.S. Court of Claims or appropriate U.S. District Court.</p>	<p>The defendant can be charged through information<sup>3</sup> or by a grand jury indictment. Conviction of the defendant can be obtained by the defendant agreeing to the charges at the arraignment, by the defendant agreeing to a plea bargain with the prosecutor prior to or during trial, or by the defendant being found guilty at the completion of a trial. The defendant can also be found innocent of the charges.</p>
<b>Legislative Purpose of Statute</b>	<p>Encourages prompt payment of income and employment taxes withheld from employees and other collected taxes.</p> <p>Makes the responsible person liable for 100 percent of the unpaid trust fund taxes.</p> <p>Facilitates the collection of trust fund taxes from secondary sources.</p>	<p>Punishment and deterrence.</p>
<b>Burden of Proof</b>	<p>Preponderance of evidence on the debtor/taxpayer in a civil tax refund litigation.</p>	<p>Beyond a reasonable doubt on the Government in a Federal criminal trial.</p>

<sup>3</sup> “Information” is an accusation brought by a Federal prosecutor without the requirement of a grand jury.



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**Appendix IX**

*Management's Response to the Draft Report*



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

February 3, 2017

MEMORANDUM FOR GREGORY D. KUTZ  
ACTING DEPUTY INSPECTOR GENERAL FOR  
INSPECTIONS AND EVALUATIONS

FROM: Richard Weber  
Chief, Criminal Investigation 

SUBJECT: Response to Draft Audit Report — A More Focused Strategy Is  
Needed to Effectively Address Egregious Employment Tax  
Crimes (Audit # IE-14-032)

Thank you for the opportunity to review and comment on the subject draft report. Employment taxes comprise nearly two-thirds of the taxes collected by the Federal Government, and are used to fund several Government programs (such as Social Security and Medicare) that provide essential benefits to many citizens. Promoting payroll tax compliance has been, and will always continue to be, a top priority for the IRS. Indeed, one of the IRS' first Future State initiatives was on employment tax compliance.

Employment tax noncompliance occurs in a variety of contexts, including employers who withhold the taxes from the employees' paychecks and use it (impermissibly) to, for example, improve their cash flow with the hope of eventually remitting the amounts to the Government; employers who withhold the money from the employees with no intent of remitting it to the Government; and employers who use a third-party payer to handle their employment tax obligations but the third-party absconds with the funds and does not remit it them to the Government, leaving the employer liable for these amounts that they previously remitted to third-party payer.

The IRS' comprehensive strategy around employment tax compliance and enforcement utilizes a multi-pronged, tailored and data-driven approach, so as to apply the appropriate civil and/or criminal enforcement tools to effectively address the different strains and degrees of employment tax noncompliance. One of our first Future State initiatives, and a keystone of our civil compliance activities around employment taxes, is to improve voluntary compliance and protect the Government's interest in these amounts. To that end, we recently launched an "Early Interaction" initiative, whereby we tested the effectiveness of earlier interaction with employers, as well as a new taxpayer selection methodology on employment tax depositors by making contact earlier in the quarter and via personal and/or mailed contacts. We conducted the study to determine if the selection criteria could accurately identify as early in the quarter as possible, employers who were at risk of becoming delinquent





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and to positively impact filing and payment compliance through personal and mail contacts (i.e., to intervene early before the employment tax obligations became insurmountable and to change the taxpayer's behavior around timely remittances of these amounts).

Utilizing this information, from December 2015 to December 2016, we made personal contact in the field with approximately 15,000 more taxpayers than in previous years. The results of these contacts showed that following a Revenue Officer (RO) visit, net payment during the treated quarter increased by up to 12%. The positive impact of the RO visit continued in the subsequent quarters with an increase in payments of up to 17.3% for some of the tested segments. Field contacts were also successful in reducing penalties and interest; and even alternative low cost treatments, such as letters and notices, also had a positive impact on increasing payment and reducing penalty and interest. We will continue to refine and expand on this initiative to maximize its compliance impact.

We've also streamlined the trust fund recovery penalty and injunctive relief procedures, as these remain important tools for resolving cases involving egregious employment tax pyramiding. To address the employment tax noncompliance perpetuated by third-party payers, we've undertaken a targeted outreach and education effort to make employers aware of the potential risks with certain types of these arrangements. Also, in December of 2014, Congress enacted legislation that required the IRS to establish a voluntary certification program for professional employer organizations that meet certain requirements, and if approved, they would become liable for the employment taxes that they collect from their customers' employees. The IRS began accepting applications under this voluntary program in July of 2016; and this will provide employers with an informed process for selecting their third-party payers.

These civil enforcement tools are useful and effective for taxpayers who are generally trying to comply. But for taxpayers who engage in egregious employment tax crimes, these are violations that the IRS' Criminal Investigation function (CI) takes very seriously. For a number of years, Employment Tax Fraud has been one of CI's annual priorities; even in light of increased demands for CI's limited Special Agents (SA) resources to deal with a host of emerging and continuing threats to tax administration, including cybercrime, identity theft, fraudulent tax preparers. Employment tax fraud has also been a priority for the Department of Justice, with whom CI works very closely on these matters. CI's commitment and emphasis on tackling employment tax crimes has resulted in significant prosecutions, incarcerations and restitution. For example, a recent successful prosecution resulted in a sentencing of 41 months in federal prison and order to pay more than \$2.9 million in restitution for evading taxes and failing to turn over employee's withholding taxes.

CI and SBSE Collection and SBSE Fraud work closely together to foster a robust fraud referral process to ensure quality fraud referrals of the most egregious employment tax violators. The processes for recognizing and referring potential fraud cases to CI are effective; specifically the number of SBSE criminal fraud referrals CI accepted in FY16 increased nearly 17% over the prior year, despite declines in SBSE Collection staffing. The fraud component of Revenue Officer Recruit Training was



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recently updated, and fraud technical advisors make regular presentations to revenue officer groups to coach them on recognizing indicators of fraud. However, the biggest challenge facing both our civil and criminal enforcement of employment tax fraud is the significant and sustained decline in IRS resources, both on the civil and criminal side. This is a reality that no strategy can fully overcome, as the work of ROs and SAs requires manpower and resources that are in critical shortage at this time.

Attached is our detailed response to your recommendation. While we agree with you on the importance of a focused strategy, which is precisely what we have developed and continue to refine, we do not agree with the recommendation to expand the criteria to refer employment tax cases to CI to include any egregious case (not only those with a firm indication of fraud). CI has always put an emphasis on case selection which includes a number of factors, one of which is a firm indication of fraud. The selection of criminal tax cases, including which criminal statute(s) to charge in a given case, involves a careful balancing of several factors by a number of stakeholders. Given the reality of limited government resources including limitations on the number of criminal tax cases the United States Attorneys and US Courts can accommodate and the fact that the same conduct may violate more than one criminal statute, each case we undertake should have significant potential for incarceration, publicity and broad impact in furtherance of our mission to deter would-be criminals and demonstrate to the law abiding public that we are applying their tax dollars purposefully and responsibly.

If you have any questions, please contact me, or a member of your staff may contact Teri Alexander, Acting Director, Operations Policy & Support, at (202) 317-3614.



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Our comments on the specific recommendation in this report are as follows:

### **RECOMMENDATION**

The Commissioner, SB/SE Division, and the Chief, CI, should consider a focused strategy to enhance the effectiveness of the IRS's efforts to address egregious employment tax cases. This strategy should include use of data analytics to better target egregious employment tax noncompliance, including identification of high-dollar cases and individuals with multiple companies that are noncompliant. In addition, the Collection function should expand the criteria used to refer potentially criminal employment tax cases to CI to include any egregious cases (not only those where a firm indication of fraud is present).

### **CORRECTIVE ACTION (S)**

SBSE and CI have a focused strategy in place to enhance the effectiveness of the IRS's efforts to address egregious employment tax cases. The strategy includes the following steps which have taken place in 2016. This strategy will continue and is supported by IRM Section 25.1.2.7 as well as the IRS CI 2017 Investigative Priorities and Annual Business Plan.

- CI Special Agent Employment Tax Coordinators will continue to focus on employment tax fraud and case development. They received training in August/September 2016 which included using data analytics tools to assist in identifying egregious employment tax investigations.
- SBSE Fraud Technical Advisors and CI jointly administer annual formal and informal fraud training workshops directed to CI and Compliance employees and their managers, to increase fraud awareness and keep up to date on changes in procedures, tax law, and recent cases. Most recently, a presentation given on November 16, 2016 focused on the importance of building a strong partnership between Collection and CI in the area of employment tax fraud referrals. Topics of discussion included similarities in employment tax cases between Collection and CI and the Trust Fund Recovery Penalty (TFRP).
- Regular collaboration occurs between SBSE Fraud Technical Advisors and CI in discussing issues impacting current investigations and coordinating joint presentations to front-line SBSE and CI employees. This has included a presentation in 2016 on Employment Tax Interviewing, presented by CI and SBSE Fraud to SBSE Collection and Exam employees.
- SBSE Fraud Technical Advisors and CI collaborate to develop, strengthen and maintain coalitions and relationships with strategic internal and external partners, including IRS Chief Counsel and U.S. Attorneys' offices. For example, Acting Assistant Attorney General Caroline Ciruolo spoke at the Federal Bar Association Tax Law Conference in March 2016. Her remarks noted that the DOJ Tax Division has sharpened its focus on civil and criminal employment tax enforcement and focused on the joint efforts taken between



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DOJ, IRS Field Collection, IRS CI, and IRS Criminal Tax Counsel to address employment tax pyramiding as well as DOJ actions to more effectively address criminal employment tax cases.

- In February 2016, CI hosted a meeting focused on employment tax enforcement focusing on civil and criminal remedies. This meeting was attended by DOJ Tax Division and IRS Director of Field Collection.
- On December 16, 2016, DOJ Tax Division held a conference focused on Employment Tax Enforcement. In attendance were principals from the DOJ Tax Division, Deputy Chief CI, Director Financial Crime CI, Director Field Collection and other relevant IRS attendees. The primary focus of the conference was to collaborate on civil and criminal enforcement of employment tax violations.
- SBSE Fraud Technical Advisors and CI jointly administer annual formal and informal fraud training workshops directed at CI and Compliance employees and their managers, to increase fraud awareness and keep up to date on changes in procedures, tax law, and recent cases. These presentations provided a definition of employment tax fraud, discussed employment tax fraud schemes and indicators, explained the similarities of the civil and criminal statutes on employment taxes, and reviewed tools for developing employment tax fraud.
- SBSE Field Collection, DOJ Tax Division, CI, and IRS Chief Counsel have partnered to develop strategies to address egregious non-compliance by employers with both civil and criminal remedies and are continuing this effort in 2017.
- SBSE Field Collection and DOJ Tax Division developed a civil and criminal training course for use by personnel in both Field Collection and CI.
- SBSE Field Collection and Criminal Investigation have agreed to explore the possibility of piloting the concept of revenue officers and special agents conducting joint field visitations. The focus of such efforts would be to enhance the potential for future compliance of some of the most egregious employment tax violations.

We do not agree with the second part of your recommendation dealing with expanding the criteria to refer employment tax cases to CI to include any egregious case (not only those with a firm indication of fraud). CI has always put an emphasis on case selection which includes a number of factors, one of which is a firm indication of fraud. The selection of criminal tax cases, including which criminal statute(s) to charge in a given case, involves a careful balancing of several factors by a number of stakeholders. Given the reality of limited government resources including limitations on the number of criminal tax cases the United States Attorneys and US Courts can accommodate and the fact that the same conduct may violate more than one criminal statute, each case we undertake should have significant potential for incarceration, publicity and broad impact in furtherance of our mission to deter would-be criminals



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and demonstrate to the law abiding public that we are applying their tax dollars purposefully and responsibly.

The Collection function refers cases when firm indications of fraud/willfulness are present and they meet criminal criteria. IRC § 7202 is considered and referred to as a tax fraud statute, and therefore the criteria used to criminally prosecute employment tax cases to CI under §7202 require the Service to prove the willfulness standard that the taxpayer committed "a voluntary, intentional violation of a known legal duty". That level of fraud/willfulness (known as "mens rea") is the key differentiation between civil and criminal cases. Cases that do not meet this standard should continue to be pursued under applicable civil remedies.

Implementation Date: Implemented.

Responsible Official: N/A



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**[www.treasury.gov/tigta/](http://www.treasury.gov/tigta/)**

**Or Write:**

Treasury Inspector General for Tax Administration  
P.O. Box 589  
Ben Franklin Station  
Washington, D.C. 20044-0589

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