
REPORT BY THE
Comptroller General
OF THE UNITED STATES

Improved Planning For Developing And Selecting IRS Criminal Tax Cases Can Strengthen Enforcement Of Federal Tax Laws

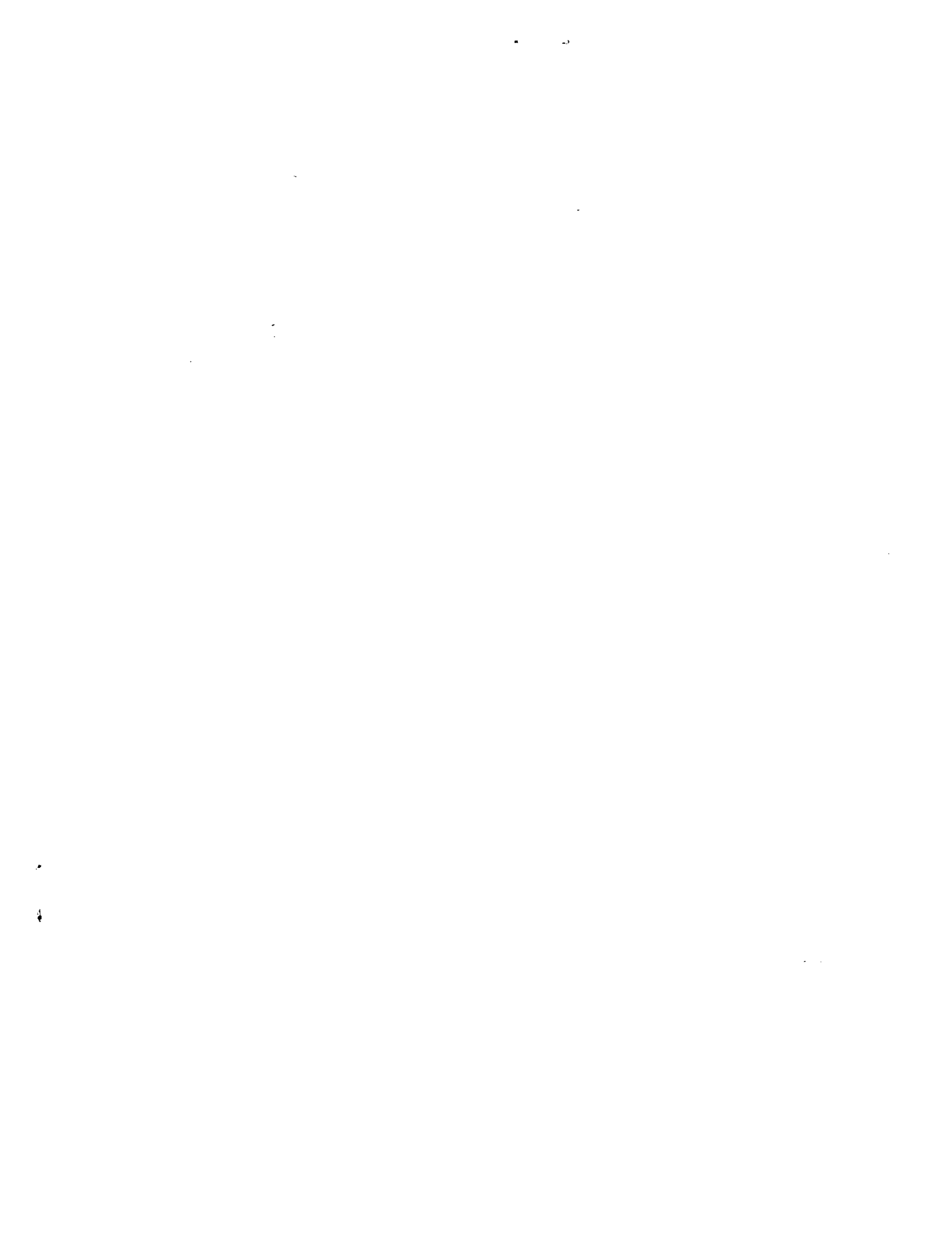
IRS' Criminal Investigation Division recognizes inadequacies in its long- and short-range planning for detecting and deterring tax fraud. It has made improvements in the planning process and is testing others. More needs to be done.

The Division needs more guidance from Department of Justice attorneys because they review and prosecute criminal tax cases. It also needs to improve the way it develops and selects possible tax fraud cases. Better planning will facilitate those improvements.

GAO made this review at the request of the Joint Committee on Taxation.

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OFFICE





COMPTROLLER GENERAL OF THE UNITED STATES
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To the Chairman and Vice Chairman
Joint Committee on Taxation
Congress of the United States

ACQUISITIONS

This report, in response to your Committee's request, discusses the need for better planning to enhance the productivity of the Internal Revenue Service's criminal tax case development and selection activities. Both the Attorney General and the Commissioner of Internal Revenue generally agreed with our recommendations for improving those activities.

As arranged with your Committee, unless you publicly announce its contents earlier, we plan no further distribution of the report until 30 days from its date. At that time, we will send copies to interested parties and make copies available to others upon request.

A handwritten signature in black ink that reads "Thomas B. Steats".

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT
TO THE JOINT COMMITTEE ON
TAXATION
CONGRESS OF THE UNITED STATES

IMPROVED PLANNING FOR
DEVELOPING AND SELECTING
IRS CRIMINAL TAX CASES CAN
STRENGTHEN ENFORCEMENT OF
FEDERAL TAX LAWS

D I G E S T

Taxpayers who truthfully report their income and pay the taxes required expect the Internal Revenue Service (IRS) to do all it can to make sure that everyone pays his or her fair share. IRS tries to do so through audits, collection actions, and criminal investigations.

Each year, IRS' Criminal Investigation Division recommends prosecution of more than 3,000 people who try to evade paying taxes. About 1,400 are convicted, fined, and/or jailed.

IRS has 2,800 agents to specifically work on tax fraud problems. It must use these agents as effectively as possible. Careful planning is essential if the Criminal Investigation Division is to carry out a balanced and effective enforcement program. The Division attempts to balance its cases among all types of violations in many income tax brackets, occupations, and geographical locations to promote voluntary compliance with tax laws.

However, the Division's long- and short-range plans need improvement. The national office needs to clearly define its national strategy and needs to establish additional, more specific goals for detecting and deterring tax fraud. Improved plans would

- help IRS to better ensure that its criminal investigation agents are used as productively as possible (see pp. 5 to 11),
- provide additional criteria to measure how well the Criminal Investigation Division is achieving its mission (see pp. 9 to 11), and
- improve case development activities which produce the information that Criminal

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Investigation Division managers use in selecting cases (see pp. 26 to 46).

BETTER PLANNING NEEDED

The Criminal Investigation Division's present long-range plan is general and does not clearly define a national strategy. Its short-range plans specify various pockets of noncompliance requiring national attention. But the short-range plans include only a limited number of specific, measurable goals; as a result, 58 district chiefs have overall program direction responsibility. Each District Criminal Investigation Division chief is responsible for directing a tax fraud program within the context of broad, general guidelines. (See pp. 5 to 9.)

In 1975, the Division recognized the deficiencies in these plans and began to improve them. Assisted by the National Academy of Public Administration, the Division conducted a planning model study during fiscal years 1977 and 1978. In fiscal year 1980, it will test a more rigorous long-range planning process. (See pp. 11 to 13.)

However, the Division's revised planning process lacks one vital component--more information on a regular basis from the Department of Justice's Tax Division and from U.S. attorneys. IRS recommends prosecution of alleged tax evaders, but it is Justice's Tax Division which reviews IRS recommendations and decides whether to prosecute. Similarly, U.S. attorneys prosecute most criminal tax cases. Thus, Justice plays a key role in administering the criminal provisions of the tax laws; this is why Justice officials' views must be considered in the Criminal Investigation Division's planning process. (See pp. 13 to 20.)

The Attorney General and the Commissioner of Internal Revenue need to develop a system whereby Justice provides the Criminal Investigation Division with useable input to program plans and with better guidance on case requirements. (See pp. 20 and 21.)

CASE DEVELOPMENT AND SELECTION
ACTIVITIES NEED IMPROVEMENT

The basic data that Criminal Investigation Division managers use in deciding which cases warrant detailed investigation is generated by referrals from the Examination and Collection Divisions, information gathering efforts by special agents, and information item evaluations (referred to collectively as case development activities). Selection decisions are important because they determine the focus of the Division's program. Cases selected for detailed investigation require substantial resource expenditures; however, many cases selected do not lead to prosecution recommendations, let alone convictions. (See pp. 24 to 26.)

Improved planning would provide Division managers with better guidance for conducting case development activities and making case selection decisions. IRS can further strengthen case development and selection activities by

- providing its employees better and more consistent training on referrals (see pp. 26 to 34),
- affording managers better guidance for initiating and conducting information gathering efforts (see pp. 34 to 43), and
- developing criteria against which the Criminal Investigation Division can measure the potential value of information items (see pp. 43 to 46).

The Criminal Investigation Division can also further improve its case selection process by requiring that each district use the "case pool" approach. Under that system, Division managers need not consider whether staff is available before initiating a case. Rather, a "pool" of unassigned cases results, and managers can select the best case from that pool as staff becomes available. Besides affording Division

managers alternative cases to select from, the case pool approach serves as a management control over staff resource allocations. (See pp. 46 and 47.)

RECOMMENDATIONS

To improve the Criminal Investigation Division's planning process, GAO recommends that the:

- Attorney General and the Commissioner of Internal Revenue develop specific methods through which Justice and IRS can better coordinate their efforts to combat tax fraud. (See p. 21.)
- Commissioner further refine the Criminal Investigation Division's short-range program plans in light of data developed through its long-range planning process. (See p. 21.)

To improve case development activities, the Commissioner should:

- Clarify the guidance provided to referring agents by developing guidelines for referral training applicable to each district office. (See p. 48.)
- Develop guidelines which district directors and higher level IRS officials can use to evaluate the appropriateness of Division-proposed information gathering projects. (See p. 49.)
- Revise guidelines pertaining to individual information gathering activities so that files on such efforts contain clear documentation describing investigative steps performed and results leading to disposition decisions. (See p. 49.)
- Revise IRS' information item form as appropriate to ensure the future availability of data needed to analyze and improve information item evaluations. (See p. 49.)

The Commissioner should also require that each district Criminal Investigation Division chief use the case pool approach in selecting cases. (See p. 49.)

AGENCY COMMENTS

Both IRS and Justice generally agreed with GAO's recommendations. Ongoing or planned actions, described in their official comments, were generally responsive to those recommendations. (See pp. 22, 23, 49 and 50.)

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ABBREVIATIONS

CID	Criminal Investigation Division
GAO	General Accounting Office
IRS	Internal Revenue Service

CHAPTER 1

INTRODUCTION

Our voluntary compliance tax system is successful largely because most citizens believe that taxpayers should pay their fair share and that those who do not will be detected and dealt with accordingly. To maintain and further that belief, the Internal Revenue Service (IRS) must seek out and prosecute persons who willfully violate the tax laws. The growing complexity and diversity of our economic system, however, has increased the opportunities for and incidence of tax fraud. Thus, the media often carries reports about tax protesters, corporate slush funds, the use of illegal tax havens, multiple false claims for refunds, and other tax evasion schemes.

IRS' Criminal Investigation Division (CID) is responsible for enforcing the criminal provisions of the tax laws. The most frequently prosecuted tax law violations are willful attempts to evade tax and failure to file returns. CID has a force of 2,800 special agents to deal with the tax fraud problem. Its fiscal year 1979 appropriation was \$128 million. Like IRS in general, CID's organization is highly decentralized among 7 regions, 58 districts, and 10 service centers.

At the request of the Joint Committee on Taxation, we reviewed IRS' criminal investigation activities. This report, the third in a series, discusses IRS' development and selection of criminal cases. 1/

DEVELOPING CRIMINAL TAX CASES

CID receives information on potential tax fraud from three basic sources--referrals from IRS' Examination and Collection Divisions, information gathering efforts, and information items.

1/"Disclosure and Summons Provisions of 1976 Tax Reform Act--Privacy Gains With Unknown Law Enforcement Effects" (GGD-78-110, Mar. 12, 1979) and "Better Use of Currency and Foreign Account Reports by Treasury and IRS Needed for Law Enforcement Purposes" (GGD-79-24, Apr. 6, 1979).

<u>Case source</u>	<u>Percentage of cases initiated</u>		
	<u>Fiscal year</u> <u>1977</u>	<u>Fiscal year</u> <u>1978</u>	<u>Fiscal year</u> <u>1979</u> (note a)
Referrals	52.4	48.4	44.3
Information gathering	26.0	28.9	32.3
Information items	9.2	9.2	7.4
Other	<u>12.4</u>	<u>13.5</u>	<u>16.0</u>
Total	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

a/October 1, 1978, through March 31, 1979.

Referrals from IRS' Examination
and Collection Divisions

IRS employees are required to be alert to indications of tax fraud. Because they deal directly with taxpayers, employees assigned to IRS' Examination and Collection Divisions often spot indications of possible tax fraud. Indications of fraud prompt Examination and Collection personnel to suspend their civil activities and refer the subject case to CID for evaluation. CID analyzes referrals for criminal tax potential and accepts or rejects them based on that analysis. Those accepted by CID become criminal tax investigations.

Information gathering

To successfully carry out its mission, CID must actively seek out and identify pockets of noncompliance with the tax laws. To this end, special agents may be authorized to initiate efforts designed to determine whether a particular individual, business, or group has violated those laws. Such efforts are referred to as "individual information gatherings" and "information gathering projects."

The chief of CID at the district must approve individual information gathering efforts. Each effort is directed toward gathering information on a specific taxpayer who is or appears to be involved in possible tax fraud.

District directors or higher level IRS officials must approve information gathering projects. Projects are directed toward gathering information on a number of taxpayers within such categories as an occupation, an industry or a geographical area. Some projects, such as those directed at narcotics traffickers and filers of multiple false tax returns, are nationwide in scope. Other projects are regionwide; most, though, are initiated and carried out at the district level.

Information items

IRS often receives unsolicited communications from the general public alleging that a particular individual or business has violated the tax laws. It also receives such communications from Federal, State, and local law enforcement agencies and from financial institutions who are required to report certain types of currency transactions to IRS. In addition, IRS employees generate such communications as a result of their everyday work efforts. All fraud allegations are directed to CID, which documents them on a specially designed form. These documented allegations are referred to as "information items."

CASE SELECTION

Case development activities--evaluations of referrals, information gathering efforts, and information item evaluations--enable special agents to develop information that CID managers can use in deciding whether detailed investigations are warranted. The decision to conduct a detailed investigation is important because it involves committing special agent resources to a particular case. Special agents can conduct only a limited number of detailed investigations each year.

Case selection decisions also are important because they determine the extent to which CID achieves its balanced enforcement program goal. In this regard, CID strives to develop prosecution cases involving all types of tax violations in different geographical locations. Balanced enforcement also includes seeking cases in various income brackets spread over as many occupations and businesses as possible to deter other would-be violators.

Case selection decisions, therefore, have a strong impact on CID's effectiveness. Each selected case is expected to complement CID's mission--achieving a balanced

enforcement program to foster voluntary compliance with the tax laws. The effectiveness of the case selection process, in turn, greatly depends on the type and quality of information that emanates from case development efforts.

CHAPTER 2

CID NEEDS TO FURTHER IMPROVE

ITS PLANNING PROCESS

Effective long- and short-range program plans are necessary if CID is to achieve its mission. Presently, however, CID's plans need improvement. CID has not developed a long-range national strategy containing specific goals for detecting and deterring tax fraud. Its short-range plans, on the other hand, specify various pockets of non-compliance requiring national attention. But the plans do not contain many specific, measurable goals. Improved long-and short-range plans would

- enable IRS to better assure that its resources are used as efficiently and effectively as possible to combat tax fraud,
- provide IRS with additional criteria against which to measure the extent to which CID is achieving its mission, and
- facilitate improvements in case development activities which produce the information that CID managers use in making case selection decisions.

CID has recognized the deficiencies in its long- and short-range plans and has taken action to improve them. It conducted a planning model study and is testing a rigorous long-range planning process. These actions should facilitate CID efforts to improve short-range plans which need additional, more specific goals. Such goals would provide the impetus for CID managers to improve case development and selection activities. However, the revised planning process has one key omission: inadequate input from the Department of Justice. In developing its long- and short-range plans, CID needs such input.

INADEQUATE PLANS LIMIT CID'S ABILITY TO EFFECTIVELY ALLOCATE RESOURCES AND MEASURE PROGRAM RESULTS

CID's long- and short-range program plans provide little specific guidance to field office managers. Thus, the CID chief in each of IRS' 58 district offices directs a tax fraud program within the context of very broad, general guidelines. As a result, IRS does not know whether it is effectively deploying its

resources to combat tax fraud, and it has little criteria for evaluating CID's effectiveness.

Long-range planning: CID's national strategy is not well defined

CID needs to develop and implement an effective long-range plan to afford CID managers, both at the national office and in the field, a frame of reference for decisionmaking. A rigorous long-range planning process in turn would force CID to formulate a well-defined strategy against tax fraud. Without that strategy, CID managers have to make decisions based on their personal concept of the tax fraud problem.

In our opinion, to develop an effective long-range plan, CID needs to

- formulate tax fraud profiles with respect to occupations, geographical areas, and income levels;
- identify significant pockets or potential pockets of noncompliance with the tax laws;
- obtain better input from Department of Justice officials, including Tax Division officials and U.S. attorneys, who review and prosecute criminal tax cases and who, as a result, have expertise in dealing with tax fraud;
- obtain input on the tax fraud problem from IRS field offices; and
- discuss the tax fraud problem with other concerned parties, such as the Drug Enforcement Administration, the Customs Service and Strike Force attorneys.

Analyzing the information obtained through the above process would enable CID to formulate a national strategy with well-defined goals. This strategy would provide a basis for allocating resources. Well-defined goals would also enable IRS to measure how well CID is achieving its mission.

CID's long-range plan for fiscal years 1979 through 1982 did not set forth a specific national strategy. Rather, it was very general and contained no specific goals. The process through which the plan was developed did not entail all the steps described above. Instead, the planning

process was directed at preparing a justification for CID's portion of IRS' annual budget submission.

Because the long-range plan did not set forth a specific national strategy with well-defined goals, CID could not use it to make resource allocation decisions. Instead, resources were deployed on the basis of a mathematical formula. The number of special agents apportioned to each region was based on that region's percentage of total civilian employment adjusted for per capita income and its percentage of Examination Division technical staff members. Thus, CID resources were not deployed on the basis of solid information on potential tax fraud--such as those occupations, geographical areas, income levels, and specific pockets of noncompliance which are characterized by higher-than-average fraud tendencies.

The lack of specific goals also limited CID's ability to assess the extent to which it achieves its mission. In this regard, the long-range plan set forth objectives such as:

- Identify cases representing serious non-compliance situations.
- Select cases involving major issues or significant dollars.
- Select a mix of cases which assures geographic and occupational coverage.

These objectives leave a great deal of room for interpretation. What is a major issue? What is a serious noncompliance situation? What constitutes occupational coverage? Individual district CID chiefs were left to answer these questions. The national and regional offices had no specific grounds on which to question chiefs' decisions and, therefore, no way to accurately assess how well CID was achieving its mission.

Short-range planning needs
to be more specific

Each year, CID develops a program plan for the next fiscal year's activities. CID's program plan is incorporated into IRS' annual compliance program plan, along with plans submitted by other IRS divisions, including Examination and Collection. Before fiscal year 1978, CID's short-range plan was similar to its long-range plan in that it provided field office managers little specific

guidance. For example, the fiscal year 1977 plan contained the following generalized guidance:

- Use information gathering projects to explore and resolve complex tax law abuses.
- Conduct appropriate criminal investigations of individuals who appear to have violated the Internal Revenue laws and who have been identified by the Drug Enforcement Administration as major drug law violators.
- Continue to intensify investigations of fraudulent practices in large corporations.
- Emphasize the identification and investigation of significant cases to achieve the broadest possible geographical and occupational coverage.
- Cooperate with the Collection Division to identify significant prosecutable trust fund and employment tax cases.

In fiscal year 1978, however, CID changed its approach to short-range planning. The national office inserted some specific goals into the plan. The plan specified goals for (1) the percentage of cases to be obtained from information gathering activities, (2) completing investigations in a timely manner, (3) time applied to cases which result in prosecution recommendations, (4) case complexity, (5) types of violations to be prosecuted, and (6) case declinations by legal reviewers.

Inserting specific goals into the short-range plans constituted an important step forward. In taking that step, national office officials began providing some centralized direction to IRS efforts to combat tax fraud. In addition, the specific goals set forth in the plan afforded IRS a partial means for measuring the effectiveness of CID's operations. For example, CID set forth 90 percent as a benchmark for the percentage of prosecution cases which ought to be approved by IRS attorneys. During fiscal year 1978, then, a region achieving only a 70-percent case approval rate from IRS attorneys would have alerted the national office to a potential problem. Similar specific goals also were included in the fiscal year 1979 short-range plan.

Although CID's fiscal year 1978 and 1979 short-range plans contained some specific goals, individual district CID chiefs were still responsible for the major portion of

program direction. That situation resulted in part because the specific goals included in the plan were limited in number. Moreover, the few specific goals included in short-range plans were quantified on the basis of CID's historical experience rather than its future expectations. For example, in fiscal year 1979, Western Regional CID offices collectively were required to apply from 25 to 30 percent of their investigative time to cases directed at individuals who derive income from illegal activities, such as arson and drug trafficking. That specific goal was set up not because CID had solid information on the extent of illegal activities and tax evasion in the region but because the region always had spent about that much investigative time on such cases.

In addition, each district CID chief within a region is free to apply the investigative time to cases involving illegal activities he or she deems appropriate. This situation exists because the specific goals set forth in CID short-range plans apply to regions rather than individual districts. Thus, each CID chief determines the extent of his district's involvement in such cases, and the region has no specific means for ensuring that it achieves specific goals.

Long- and short-range plans
do not provide sufficient basis
for fully measuring CID's effectiveness

CID has four key methods through which it seeks to measure program effectiveness and correct deficiencies-- the national office review program, regional office evaluation teams, quarterly narrative reports, and the CID management information system. The CID director's immediate staff conducts national office reviews. Each of IRS' seven regions is evaluated during a 21-month cycle. Formal reports on the results of each evaluation are prepared. Regional office evaluation teams seek to measure each district CID office's effectiveness annually with larger districts often evaluated semiannually.

District chiefs submit quarterly narrative reports to their regional offices, describing program accomplishments and problems. Similarly, regional CID officials submit quarterly narratives to the CID director at the national office. A computerized management information system also provides CID managers with numerous reports on an immediate access basis.

Thus, CID has several means through which it seeks to measure how well it achieves its mission. But CID plans

do not provide much specific criteria against which to measure program effectiveness. This is especially true with respect to case development activities. Concerning information items, for example, the long-range plan for fiscal years 1979 through 1982 stated that their volume had almost doubled between fiscal years 1970 and 1977. As a result, the plan noted that CID would require additional staff years to keep pace with increasing evidence of tax fraud. The long-range plan contained no other reference to information items.

Similarly, IRS' fiscal year 1979 short-range compliance program plan contained little referral program guidance, although it singled out referrals as an area requiring special management emphasis. Specifically, the plan stated that managers should:

- "Emphasize detection and referral to Criminal Investigation of all cases involving potential criminal violations of tax law."
- "Emphasize the identification and development of quality referrals through involvement of all managers and examiners."

CID's portion of the compliance program plan did not mention referrals. As a result, CID had no specific criteria against which to measure referral program effectiveness. In the absence of specific goals, CID managers use varying criteria for measuring program effectiveness. Some district CID chiefs told us that the volume of referrals generated is a key program measure. Other CID chiefs disagreed, however, pointing out that a more important measure is the number of cases initiated from referrals. Still others argue that actual prosecution cases resulting from referrals is the key measure.

Recent national office review reports exemplify the difficulties involved in evaluating the referral program without specific criteria. One recent national office review report stated that the subject region had a strong referral program. The reviewer reached that conclusion by analyzing statistics which showed that "referrals have increased in each of the last five fiscal years, and the acceptance rate is one of the highest in the nation." On the other hand, another report pertaining to a different region highlighted the referral program under "achievements and significant accomplishments," although it noted that the region "has been below the national average on the percentage of referrals accepted." The report pointed out that the regional CID office "believes that the true indicator of

a good referral program is the "bottom line"--prosecutions and fraud penalties."

Still another report failed to mention the referral program at all even though CID selects most of its cases from that program. A fourth report noted that a region had received 762 referrals during the first 6 months of the year compared to 981 referrals received during the same period the year before. The report referred to the decline as an "apparent problem."

Similar evaluation problems result from a lack of specific program goals for information gathering efforts and information item processing. The fiscal year 1978 long-range plan prescribed no goals for either type of case development activity. The short-range plan did not mention information items but provided the following guidance for information gathering efforts:

--"As part of a balanced enforcement program, develop cases and identify areas of noncompliance that would not be detected by normal Examination and Collection activities. To this end, emphasize the development of cases by special agents and the initiation of projects. Accordingly, cases initiated from special agents and projects should be at least 25% of all cases initiated."

--"Information Gathering-Conduct information gathering to aid in the identification of noncompliance and development of TPG [Taxpayer in General] and SEP [Special Enforcement Program] impact cases that will ensure effective and proper tax administration through a balanced enforcement program."

The short-range plan also identified a few specific groups which required national attention from various IRS divisions including CID, such as multiple filers and drug traffickers. However, the plan did not specify the extent to which each region and district needed to apply its resources to those groups. With the exception of the few groups identified, the program plan fell short of identifying targets and setting priorities for information gathering activities.

CID EFFORTS TO IMPROVE LONG- AND SHORT-RANGE PLANNING

CID has recognized the weaknesses in its long- and short-range plans. Since 1975, CID has sought to upgrade its plans and the planning process. With assistance from the National Academy of Public Administration, it conducted

a planning model study of its activities. The study demonstrated the need for a better long-range plan; as a result, CID will test a more rigorous long-range planning process during fiscal year 1980. That process should provide the basis for developing additional, more specific goals needed to further improve short-range plans.

In September 1976, IRS contracted with the National Academy of Public Administration for assistance in conducting a planning model study. The study objectives were to

- measure the extent of criminal tax fraud;
- measure the cost effectiveness of investigations and prosecutions, and their impact on compliance;
- review the adequacy of sources of tax fraud investigations and the effectiveness of case selection and evaluation systems;
- define rules and priorities for management of CID programs to develop a more effective, better coordinated national compliance strategy; and
- establish a more objective basis for allocating resources to the regions by program and subprogram.

While the planning model study did not achieve all of its objectives, it did serve to focus IRS and CID management attention on the planning process. As a result of the study, CID has established a permanent research group which will develop and analyze data using sophisticated statistical and quantitative methods. The research group will provide CID managers with some of the data needed to identify trends which affect the planning process.

The planning model study also affected other CID efforts to improve its planning process. Data from this study was used, for example, to quantify short-range program goals which previously had been expressed in general terms.

The planning model study also underscored the need to improve CID's long-range planning process. To that end, CID has initiated and plans to test, during fiscal year 1980, a rigorous process. This process will involve

- formulating issues and program initiatives, planning assumptions, and program objectives;

- analyzing demographic statistics at the district level;
- comparing historical CID investigative coverage statistics with demographic statistics to define more clearly the nature of a balanced enforcement program;
- developing estimates of workload to forecast future resource needs in terms of fixed and discretionary resources;
- developing program objectives and performance measures on a national level;
- gathering input from top CID managers throughout the country, with a view toward adjusting regional and district plans to reflect geographical differences; and
- developing a methodology for further improving annual program plans as they pertain to regional offices and individual district offices.

Although CID's long-range planning initiative cannot be expected to produce results for several years, it constitutes an important step forward. CID's long-range planning initiative and data developed by its research group should assist CID in further refining its short-range plans. Other specific goals should emanate from efforts to refine short-range plans. Such goals should include the (1) number of Strike Force cases to be worked, (2) number and type of occupations from which to select cases, and (3) number of cases involving particular income levels.

Similarly, involving district CID managers in the long-range planning process should facilitate development of short-range plans for each individual district office. Those plans can take into account local peculiarities surfaced by district CID chiefs and data developed by CID's research group. If the planning process develops along these lines, it will provide an impetus for CID to resolve problems we noted in case development and selection activities.

CID NEEDS SYSTEMATIC INPUT FROM JUSTICE TO DEVELOP EFFECTIVE PLANS

Although CID has initiated important revisions to its planning process, more needs to be done. CID's planning

process should provide a systematic means for obtaining input from the Department of Justice's Tax Division and U.S. attorneys. In this regard, IRS is authorized to recommend prosecution in criminal tax cases. But IRS depends on the Criminal Section of Justice's Tax Division to review and approve recommended prosecutions and depends on U.S. attorneys to handle the prosecutions. Despite this, CID's planning process lacks systematic input from the Department of Justice.

The Criminal Section of Justice's Tax Division and U.S. attorneys are authorized to recommend that the Assistant Attorney General, Tax Division, decline prosecution of criminal tax cases. The following statistics show that Department of Justice decisions have a substantial impact on CID's overall effectiveness.

<u>Fiscal year</u>	<u>IRS prosecution recommendations</u>	<u>Tax Division declinations</u>	<u>U.S. attorney declinations</u>	<u>Total declinations</u>	<u>Percent of CID prosecution recommendations declined by Justice</u>
1976	2,850	289	260	549	19
1977	3,144	221	274	495	16
1978	<u>3,178</u>	<u>336</u>	<u>269</u>	<u>605</u>	19
Total	<u>9,172</u>	<u>846</u>	<u>803</u>	<u>1,649</u>	18

The Tax Division and U.S. attorneys decline some cases for reasons beyond CID's control. For example, taxpayers can die, gain immunity in exchange for testimony in other cases, or go to jail for other violations. The CID director estimated that as many as 700 of the 1,649 cases Justice declined during fiscal years 1976 through 1978 may have resulted from factors beyond CID's control. On the other hand, many cases that Justice declined represent inefficient use of IRS resources from a criminal tax standpoint. Each such case represents a substantial expenditure of special agent investigative resources. Nationwide, each special agent conducts an average of about 3 investigations per year. In addition, each declined case represents resource expenditures by IRS attorneys who conduct detailed legal reviews of CID prosecution recommendations. Thus, each case IRS forwards to Justice is deemed appropriate for prosecution by CID managers and IRS attorneys.

Despite the resources IRS expends on each prosecution recommendation, Justice consistently deems many of them defective for various reasons. Although Justice declines to prosecute some cases for reasons which are beyond IRS' control, it declines other cases for reasons relating to basic policies which should be subject to advance planning and coordination. For example:

<u>Reasons for Justice's declination</u>	<u>Number of declinations fiscal years 1976 - 1978</u>	<u>Percent of total declinations</u>
Insufficient evidence	169	10.2
Amount of additional tax due too small	136	8.2
IRS failed to prove willful intent	107	6.5
Lack of jury appeal	82	5.0
Key witness unavailable or unreliable	73	4.4
IRS could not clearly show who was responsible	52	3.2
Taxpayer's ill health	40	2.4

While there is always room for variance in legal opinions concerning evidence and willful intent, the frequency of case declinations indicates that IRS needs to better understand the criteria Justice uses in evaluating the merits of cases.

Besides matters involving evidence and jury appeal, Justice and IRS often disagree on how and to what extent certain tax law violations should be dealt with. For example:

--Employers who withhold income and social security taxes from employees' wages are required to file quarterly tax returns and periodically remit the funds to the Government. When an employer fails to do so, IRS requires that such deposits be made timely into a special bank account which it monitors. Employers who continue to violate the law may become CID targets. Because IRS considers the employer tax deposit system essential to the tax system as a whole, CID vigorously pursues many such cases each year. Justice, however, dislikes the small amounts often involved in such cases. It questions the probability of gaining convictions in the many instances in which IRS "condones" employers' delinquent payment habits for years before seeking criminal prosecutions. According to the CID director, during fiscal years 1976 through 1978, Justice declined prosecution on at least 86 such cases.

--Individuals who win large sums at race tracks are required to sign a withholding tax form before cashing their tickets. Some winners seek out other persons, referred to as "ten percenters," to cash the tickets and sign the form for them in an effort to evade taxes. During fiscal years 1976 through 1978, IRS sought to crack down on that practice. Some U.S. attorneys felt that IRS went too far in terms of the volume of such cases and, as a result, the attorneys declined many of them. In the U.S. attorneys' view, a few good cases would do as much for voluntary compliance as many, lower quality cases.

We reviewed all 27 cases which were submitted by four IRS district offices and declined by the Criminal Section of Justice's Tax Division during the 18 months ended March 31, 1978. Based on detailed analyses of the 27 cases and discussions with Justice attorneys involved in declining each case, we concluded that 21, or 78 percent, resulted

in part from a lack of coordination between and advanced planning by IRS and Justice. Two of the 21 cases involved employers' abuse of the tax deposit system. In each case, Justice felt that IRS had condoned the employer's actions for too long a period of time before seeking criminal prosecution. Another case involved the cashing of a race track ticket by a ten percenter. The following are examples of other cases Justice declined:

- A taxpayer failed to file timely income tax returns for 4 consecutive years. But, in Justice's view, the taxpayer's age, poor health, and low economic status suggested a low probability of conviction. In documenting his reasons for declining the case, the Chief of the Criminal Section of Justice's Tax Division stated, "This case strikes me as a sure loser." If IRS clearly understood the factors that made this case a "sure loser," it would have applied its resources to another case with better prosecution potential.
- A narcotics trafficker understated his income by \$127,000 during a 3-year period. Justice declined prosecution on this case because the taxpayer already was serving a 9- to 10-year jail sentence on narcotics charges. This case illustrates that IRS does not fully understand Justice's "dual prosecution" policy. That policy provides that all offenses arising out of a single transaction, such as drug trafficking and evading taxes on the resultant profits, should be tried together.
- A lawyer understated his income for 2 consecutive years. Justice declined to prosecute the taxpayer, however, because he had made some voluntary disclosures to IRS and paid the taxes due. Justice also cited the nominal amount of the tax deficiency for 1 year as an additional reason for its declination. This case illustrates the need for IRS to better understand, before committing resources to a detailed investigation, Justice's views on the effects of voluntary disclosures, payments of tax due, and the amount of additional tax that a criminal case ought to involve.

A lack of coordination between CID and Justice during the CID planning process results in unnecessary staff-day expenditures which produce little in the way of prosecutions, let alone convictions. Both the Chief and the former Chief of the Criminal Section of Justice's Tax Division told us that Justice is interested in providing input

to CID plans but noted that IRS does not consistently solicit that type of assistance. The present Chief stated that, given such an opportunity, he would advise CID that it is producing too many cases, some of rather dubious quality, when a lesser number of high impact cases would suffice.

The CID director, on the other hand, told us that IRS has consistently sought Justice input. He noted, for example, that CID frequently invites Tax Division officials to attend and speak at various meetings involving national, regional, and district CID managers. He said that during such meetings, however, Justice provides CID with little in the way of overall guidance, preferring instead to discuss a few, isolated cases. The director further stated that Justice's consistent inability to provide specific guidance prompted CID to initiate action aimed at developing that guidance. In this regard, CID sought and obtained access to Justice's files on declined criminal tax cases. CID is presently analyzing those files to determine whether Justice's policies can be more clearly communicated to regional and district office managers.

While CID seeks input from the Tax Division, it has no systematic means for obtaining and evaluating input from U.S. attorneys. Because they prosecute criminal tax cases, U.S. attorneys are in a unique position to evaluate the strengths and weaknesses of those cases. Also, because they handle many different types of criminal cases besides tax cases, the attorneys have some knowledge of crime trends. District CID chiefs need to know what the people who prosecute their cases consider important. Perhaps of even more value is knowing what the local U.S. attorney considers unimportant. Otherwise, CID can waste resources investigating cases which the attorney has little interest in prosecuting.

Despite the coordination problems described above, the CID director told us that, in recent years, Justice and IRS effectively planned and coordinated approaches to handling some new problems such as illegal tax protesters and wagering tax cases. Both CID and Justice recognized, for example, that criminal tax cases involving certain types of illegal tax protesters would raise sensitive constitutional issues. Before initiating investigations in that area, CID consulted Justice and worked out a joint strategy for handling the sensitive cases. Basically, CID agreed to perform several high quality investigations in an effort to develop good test cases. Justice agreed to provide general legal guidance on the approach to such cases and high quality prosecutorial support.

CID and Justice also worked out a special arrangement for handling wagering tax cases. In 1977, CID assumed responsibility for enforcing the wagering tax laws. Historically, U.S. attorneys gave little priority to those cases and, in many instances, declined to prosecute them due to their lack of "jury appeal." CID initiated and Justice agreed to a procedure whereby IRS would identify potential targets and discuss them with U.S. attorneys before expending a significant number of staff days on investigations. Since then, IRS has worked only a small number of wagering tax cases but has experienced a relatively high level of success in terms of convictions.

In each of the above situations, IRS adjusted its plans for handling a particular pocket of noncompliance with the tax laws. As a result, both IRS and Justice resources were used more efficiently and effectively. CID worked fewer cases than it might have without Justice's input, thus reducing its resource expenditures on those areas. Similarly, Justice received fewer cases related to these matters than it reasonably might have expected. On the other hand, it seems reasonable to conclude that, despite the reduced resource expenditures in these areas, higher quality cases were the end result.

CONCLUSIONS

CID's long- and short-range program plans afford little specific guidance to CID managers at all levels. CID has not established a long-range national strategy containing specific goals for IRS efforts to detect and deter tax fraud. Similarly, its short-range plan contains few specific objectives. IRS needs to better assure that its resources are being used as effectively and efficiently as possible. It also needs to develop additional criteria against which to measure how well CID is achieving its overall mission.

In fiscal year 1978, based in part on the results of a planning model study, CID improved its short-range plans. In fiscal year 1980, CID will test major changes to its long-range planning process. While CID has taken significant action to try to upgrade its planning process, the results of those efforts will be difficult to assess in the immediate future. A well-planned program, however, should certainly produce better results than one which, for years, was not subject to a rigorous planning process.

One vital omission from CID's current planning initiative is a lack of input from Justice. Tax Division officials and U.S. attorneys play an important role in the legal processing of criminal tax cases. IRS, however, has no systematic

means for obtaining input from U.S. attorneys. Also, its efforts to obtain specific guidance from Tax Division officials have met with little success. On the other hand, Tax Division officials claim that CID does not consistently solicit input from them. Whatever, a need exists for better coordination between the two agencies. The Attorney General and the Commissioner of Internal Revenue need to jointly develop a system whereby Justice provides IRS with better guidance for conducting its tax fraud program. Neither agency can handle the tax fraud problem alone. With better coordination, however, each agency's resources would be better applied against tax fraud.

CID also needs to further refine its short-range plans. Additional specific goals need to be inserted into the national plan and complementary district level short-range plans should be developed. These refinements should help CID resolve problems we noted in case development activities, described in chapter 3.

RECOMMENDATIONS TO THE ATTORNEY GENERAL AND THE COMMISSIONER OF INTERNAL REVENUE

We recommend that the Attorney General and the Commissioner of Internal Revenue jointly develop specific methods for coordinating Justice and IRS efforts to combat tax fraud. Specifically, the Attorney General should direct the Assistant Attorney General, Tax Division to provide better input to CID's planning process and more specific guidance on case requirements. The Commissioner ~~should direct the Assistant Commissioner for Compliance and the CID Director to~~

- coordinate CID's planning process with the Assistant Attorney General, Tax Division, and
- coordinate with Justice's Executive Office for U.S. attorneys to develop a systematic means for obtaining U.S. attorneys' input to CID's planning process at the local level.

We also recommend that the Commissioner further refine CID's annual program plans in light of data developed through its long-range planning process. Specific national, regional, and district level case development goals need to be developed, documented, and used as a means for measuring the effectiveness of referrals, information gathering and information items.

AGENCY COMMENTS
AND OUR EVALUATION

In letters dated September 17 and 19, 1979, the Commissioner of Internal Revenue and the Assistant Attorney General for Administration, respectively, generally agreed with our conclusions and recommendations.

IRS said that it is working with Justice to develop specific methods for better coordinating efforts to combat tax fraud. IRS further stated that it planned to establish a system of regularly scheduled meetings between key Justice and IRS officials, including representatives from the Service's Office of the Chief Counsel. IRS emphasized Chief Counsel's role as the coordinator of criminal investigative issues with Justice. IRS deems that role appropriate because the Chief Counsel's Office ultimately decides whether CID prosecution recommendations will be forwarded to Justice.

Chief Counsel plays an important role with respect to IRS' criminal tax cases, but its role basically centers on legal reviews of cases CID already has investigated. Our recommendation, on the other hand, is directed at front-end program planning and coordination. Those functions are best carried out by program managers. Thus, while the Chief Counsel should provide legal advice as part of the planning process, a program manager--the Assistant Commissioner for Compliance, a member of his immediate staff, or the CID director or deputy director--should serve as IRS' key coordinator during planning meetings with Justice.

In commenting on the draft report, IRS also said it would explore ways to obtain systematic input from U.S. attorneys. Justice, however, saw little to be gained from such efforts. It pointed out that attorneys assigned to the Criminal Section of the Tax Division deal exclusively with criminal tax cases and noted that those attorneys often are called on to prosecute such cases. As a result, Justice concluded that its input to CID plans should emanate largely from the Criminal Section of the Tax Division, rather than U.S. attorneys.

We agree that the Tax Division possesses substantial expertise in these matters and that it should take the lead in coordinating with CID and providing Departmental input to CID program plans. However, U.S. attorneys still prosecute the vast majority of criminal tax cases. As a result, they, as well as Criminal Section attorneys, have some expertise in

criminal tax matters. To develop effective program plans, CID needs to tap the knowledge of individuals who have expertise in criminal tax matters. Thus, while CID should rely primarily on the Tax Division's input in developing long- and short-range plans, it also could benefit from U.S. attorneys' input.

Provided U.S. attorneys' input to the planning process at the district level, CID chiefs could consider adjusting their plans. For example, if a particular U.S. attorney refuses to prosecute trust fund cases, the CID chief can limit the number of such investigations. On the other hand, the chief could inform the Tax Division that CID will need the Criminal Section's prosecutorial assistance on a number of trust fund cases in the near future. The Tax Division would then be able to better plan its workload, knowing that a particular district CID chief will need such assistance in the future.

CHAPTER 3

BETTER GUIDANCE WOULD STRENGTHEN CID CASE

DEVELOPMENT AND SELECTION ACTIVITIES

Referrals from the Examination and Collection Divisions, information gathering efforts by special agents, and information item evaluations (referred to collectively as case development activities) provide the basic data that CID managers use in deciding which cases warrant detailed investigation. Those decisions are important because they determine the focus of CID's program and because cases selected for detailed investigation require substantial resource expenditures. CID cases often lead to high impact convictions, recovery of taxes due, heavy fines, and jail terms. However, many cases CID managers select for detailed investigation do not lead to prosecution recommendations let alone convictions.

Improved planning will provide CID managers better guidance for conducting case development activities and making case selection decisions. However, IRS can further strengthen case development activities by

- providing its employees better, more consistent training on referrals;
- affording its managers better guidance for initiating and conducting information gathering efforts; and
- developing criteria against which CID can measure the potential value of information items.

With better guidance on case development activities, IRS employees can produce better information which CID managers can use, in conjunction with more specific plans, to improve the case selection process. That process can also be improved through adopting the case pool approach nationwide.

CID INVESTIGATIONS OFTEN LEAD TO HIGH-IMPACT CONVICTIONS BUT IMPROVEMENTS ARE NEEDED

Each year, CID investigates thousands of alleged violations of the tax laws and ultimately obtains about 1,400 convictions. Convicted tax evaders are required to pay overdue taxes and heavy fines and they often are sentenced to jail. Of more importance than the penalties levied on individual taxpayers, however, is the effect of convictions on other taxpayers. While not quantifiable, IRS believes

that the ripple effect--many taxpayers voluntarily complying with the tax laws for fear of criminal prosecution--is substantial. Although CID investigations often lead to high-impact convictions, improvements are needed. Many cases CID managers select for detailed investigation do not result in prosecution recommendations let alone convictions.

In deciding to select a case for detailed investigation, CID managers weigh numerous factors. Besides evaluating each case in light of CID's balanced enforcement goal, CID managers must consider factors which affect prosecution potential such as taxpayer attitude, legal issues, the availability and reliability of witnesses, case complexity, and the availability and quality of evidence. No matter what his or her specific reason, a manager is guided by one overriding factor in the case selection process--he wants to work cases that will result in prosecution and conviction. In the past 3 years, however, few criminal tax cases have resulted in prosecution recommendations let alone convictions.

Nationwide CID statistics (note a)

	<u>Fiscal</u> <u>year</u> <u>1976</u>	<u>Fiscal</u> <u>year</u> <u>1977</u>	<u>Fiscal</u> <u>year</u> <u>1978</u>
Cases selected for detailed investigation (note b)	8,371	8,425	8,786
Cases closed--prosecution not recommended (note b)	4,986	4,983	5,274
Cases closed--prosecution recommended	3,147	3,408	3,439
Cases declined for prose- cution by IRS or Department of Justice attorneys	805	760	866
Cases prosecuted with resultant convictions	1,193	1,476	1,414

a/These statistics must be viewed from the standpoint of an overall trend because opening and closing inventories vary from year to year and because investigations initiated one year often remain active in subsequent years.

b/Excludes cases initiated and later closed due to lack of staff.

Each year, special agents spend over 100,000 staff days investigating cases which do not lead to prosecution recommendations. In many instances, these resource expenditures are appropriate in that special agents often determine, through their investigations, that apparent tax law violations cannot be proven, are not committed willfully, or otherwise do not merit further investigation or prosecution. Moreover, CID investigations often produce leads or evidence which the Examination and Collection Divisions follow up on from a civil tax standpoint.

More cases would result in prosecution recommendations and convictions if CID, in concert with better plans as discussed in chapter 2, improved its case development and selection activities. This would afford CID managers better information on which to base case selection decisions. The CID director agreed that further improvements are needed. He also noted, however, that substantial improvements have been made during the past decade. For example, he told us that in fiscal year 1970, only 1,118, or 14 percent, of CID's 7,965 cases resulted in prosecution recommendations. For fiscal year 1978, on the other hand, 3,439, or 39 percent, of CID's 8,713 cases resulted in prosecution recommendations.

SPECIFIC GUIDANCE NEEDED TO ENHANCE THE PRODUCTIVITY OF CASE DEVELOPMENT ACTIVITIES

More specific guidance is needed with respect to referrals, information gathering efforts, and information items. Case selection decisions are made on the basis of information obtained through case development activities. Those activities, however, often produce (1) information which does not lead to criminal tax cases or (2) information which leads to cases that do not result in prosecution recommendations or convictions.

IRS needs to strengthen its referral program

IRS can strengthen the referral program by affording referring agents better, more consistent training. Most CID cases are generated by referrals from Examination and Collection Division employees who rely on subjective criteria in deciding when a referral is appropriate. As a result, CID receives many incomplete referrals which require some time to handle and thus waste resources.

Referrals are the key
source of CID cases

During the course of their everyday activities, IRS employees are expected to remain alert to indications of fraud. Because Examination and Collection Division employees are involved in auditing tax returns, securing unfiled returns, and securing delinquent payments, they are in a unique position to spot indications of fraud. IRS guidelines provide that an indication of fraud should prompt Examination and Collection Divisions employees to suspend their activities and refer the case to CID for evaluation. IRS guidelines and training materials seek to clarify what constitutes an indication of fraud but, in the final analysis, it involves employee judgment.

Referrals generally are evaluated based solely on the information provided by the Examination and Collection Divisions. CID usually performs no additional investigative work before deciding whether to initiate a detailed investigation. The decision to accept or reject is made on the basis of the individual merits of each referral. Accepted referrals become detailed criminal tax cases. Rejected referrals are returned to the initiating division for follow up from a civil tax standpoint.

As shown below, during fiscal year 1977, the eight district CID offices we visited derived almost half their cases from referrals.

<u>District office</u>	<u>Cases derived from Examination Division referrals</u>	<u>Cases derived from Collection Division referrals</u>	<u>Total cases derived from referrals</u>	<u>Total cases derived from sources other than referrals</u>	<u>Percentage of cases derived from referrals</u>
Boston	82	25	107	45	70
Chicago	103	30	133	246	35
Dallas	102	29	131	132	50
Hartford	29	16	45	45	50
Los Angeles	232	48	280	234	54
Milwaukee	51	25	76	78	49
New Orleans	46	25	71	50	59
Phoenix	<u>46</u>	<u>13</u>	<u>59</u>	<u>156</u>	27
Total	<u><u>691</u></u>	<u><u>211</u></u>	<u><u>902</u></u>	<u><u>986</u></u>	48

Nationwide, referrals--3,239 from Examination and 1,425 from Collection--accounted for 4,664, or 52 percent, of CID's 8,901 fiscal year 1977 detailed investigations. Thus, referrals are the major source of CID cases in terms of quantity.

Better, more consistent training
would improve referrals

To improve its referral program, IRS needs to provide better, more consistent training to referring agents. Because referrals are such an important source of CID cases, IRS needs to do all it can to ensure their effectiveness. But CID receives many incomplete referrals and IRS requires that CID managers make case selection decisions based on the information they receive from the Examination and Collection Divisions. Incomplete referrals lead to case selection decisions which waste scarce investigative resources.

Examination and Collection Divisions employees often forward incomplete referral reports to CID because IRS guidelines conflict. The guidelines specify that, upon detecting an indication of fraud, IRS employees should suspend their civil tax activities and, at the earliest opportunity, refer the matter to CID. This guidance is aimed at ensuring that civil tax activities do not violate taxpayers' constitutional rights. However, the same guidelines also specify that reports referring fraud allegations to CID should contain certain information. For example, Examination Division referrals should contain the following:

- Alleged violation such as failure to file, failure to collect and pay tax, and failure to report all income.
- Taxpayer's age, health, marital status, education, and number of exemptions.
- Sources of income.
- Types of records and accounting methods.
- Estimated amount of unreported income.
- Estimated taxes due.
- Statements made by the taxpayer to the referring agent.

--Narrative explanation of the alleged tax evasion scheme.

Similarly, Collection Division referrals should contain the alleged violation, the taxpayer's age and occupation, taxable income, the tax liability, the taxpayer's explanation, and certain other information.

CID managers weigh numerous factors in deciding whether to accept or reject referral. Thus, it is important that each referral be complete to facilitate CID evaluations and decisions. To determine the type and extent of information provided CID by referring agents, we reviewed a randomly selected sample of 240 of the 2,677 referrals eight district offices generated during the 14 months ended August 31, 1977. Of the 240 referrals, CID accepted 103, or 43 percent, and rejected 137, or 57 percent.

We analyzed the 137 rejected referrals to determine why CID deemed them inappropriate. In total, CID cited 262 reasons for rejecting the 137 referrals. Eighty, or 58 percent, of the 137 referrals were rejected in part because the additional amount of taxes due was too small. For example:

--An Examination Division referral alleged unreported income of \$2,000. But the taxpayer, a corporation, reported and paid taxes on an income of \$17.9 million.

--A Collection Division referral alleged that a taxpayer failed to file for 6 consecutive years. The referral report, however, contained no indication that the individual had any taxable income.

Another 30 referrals, or 22 percent, were rejected in part because they involved a single tax year. CID generally needs to develop evidence showing a pattern of willful tax evasion over several years to obtain a conviction. The fact that CID received many referrals involving small amounts and/or a single tax year indicates that referring agents do not clearly understand what constitutes an indication of tax fraud.

We analyzed 201 of the 240 referrals to determine the extent of information provided CID by referring agents. Some reports lacked key information while others did not contain information which is helpful to CID managers responsible for selecting cases. The 201 referrals included 157 Examination Division referrals and 44 Collection Division referrals. Thirty-nine referral reports were unavailable during our analysis.

Examination Division referral information <u>element</u>	Information provided <u>CID</u>	Information not provided <u>CID</u>	Percent of referrals in which information was not <u>provided</u>	Information not <u>applicable</u>
Alleged tax law violation	156	1	0.6	0
Taxpayer's:				
Age	113	25	18.1	19
Health	115	23	16.7	19
Marital status	131	7	5.1	19
Education	69	69	50.0	19
Exemptions	126	12	8.7	19
Sources of income	138	5	3.5	14
Type, quality, and location of taxpayer's records	127	30	19.1	0
Estimated amount of unreported income	129	28	17.8	0
Taxpayer's explanation of discrepancies	125	32	20.4	0
Narrative explanation of alleged tax evasion scheme	152	5	3.2	0

With the exception of one key information element, Collection Division referrals generally were more complete than Examination Division referrals. But 34, or 77 percent, of the 44 Collection Division referrals did not contain specific information on the taxpayer's income or the estimated tax liability. From CID's standpoint, that is an extremely important information element because criminal tax cases involving relatively small dollar amounts often lack jury appeal.

We also analyzed the 103 referrals CID accepted to determine whether they led to prosecution recommendations. Fifty-five, or 53 percent, already had been closed without a prosecution recommendation when we completed our review. One reason why many cases did not result in prosecution recommendations centered on referring agents being hesitant to contact taxpayers, apparently due to their concern about violating taxpayers' constitutional rights. In the following instances, for example, referrals would have been avoided had the referring agent contacted the taxpayer:

- A Collection Division referral alleged that a taxpayer failed to file. CID initiated a case and immediately determined, through the initial interview, that the taxpayer had filed a return under a different name.
- An Examination Division referral alleged tax evasion. CID initiated a case and determined during the initial interview that the taxpayer had heart disease and was under psychiatric care. CID discontinued the case due to potential jury appeal problems.
- An Examination Division referral asserted unreported interest income. CID initiated a case and determined that the information document the bank provided IRS contained a slipped decimal point.

The above examples exemplify the key weakness in IRS' referral program--the difficulty involved in defining an indication of fraud. That, of course, will always be a subjective decision. But subjectivity can be minimized through improved referral training.

CID receives many incomplete referrals because Examination and Collection Division employees often are not sure when a referral is warranted. That situation could improve if referring agents were provided more

uniform training on a more consistent basis. Presently, Examination and Collection Division personnel receive several hours of basic referral training as part of their initial IRS training. IRS, however, has no minimum requirements for further referral training. Instead, each district determines the type and extent, if any, of referral training afforded employees.

The Boston district office, for example, had not established a formal referral training program. However, CID managers discuss the referral program during Examination and Collection Division group meetings and training programs. Examination and Collection Division managers in Boston noted that they also discuss the program during their group meetings. IRS managers in Hartford established a formal fraud awareness program in July 1977 to increase the number of referrals and to improve their quality. The program consisted of publicizing the elements and results of innovative referrals. Also, CID managers, accompanied by Examination and Collection personnel, began conducting referral training seminars.

The CID chief in Los Angeles operates an ongoing fraud awareness program. During fiscal year 1978, for example, the CID chief and assistant chief formally briefed Examination and Collection Division branch chiefs. According to the assistant chief, the briefings were aimed at increasing fraud awareness in an effort to improve the district's referral program. As a result of these briefings, the CID chief hoped that Examination and Collection Divisions managers would invite lower level CID managers and special agents to conduct fraud awareness training sessions.

The CID chief in Dallas relied on the district's training branch to develop and conduct referral training. According to the training branch chief, however, no referral training had been conducted in Dallas since 1975. Similarly, the New Orleans CID chief had no referral training program. However, the district's Collection Division chief has a referral training program in which the CID chief participates.

IRS managers in Phoenix set up a program whereby they jointly develop and present specialized referral training sessions on a quarterly basis to each Examination and Collection Divisions group. In Chicago, certain CID group managers were designated as points of contact for referral-related discussions with Examination Division managers. In addition, the managers discussed the referral program at Examination Division group meetings and training classes. Milwaukee did not conduct a formal fraud awareness program.

IRS recognizes that its fraud referral program can be strengthened and has initiated a coordinated compliance referral study. The study group, which is composed of CID, Examination, Collection, and other IRS personnel, is seeking to

- evaluate the present program from the standpoint of criteria used to accept or reject referrals;
- evaluate the management information system for referrals in terms of its adequacy and effectiveness;
- identify at the national, regional, and district levels, an optimal referral program and the components contributing to that program; and
- identify each IRS division's areas of concern and the actions necessary to improve the referral program.

The study group also plans to evaluate the need for additional training for Examination and Collection Division employees. To avoid duplication, the study group is reviewing the data we developed while analyzing IRS' referral program.

Better management controls
would improve the productivity
of information gathering activities

Despite their importance, information gathering activities have not consistently led to criminal tax cases. The reasons include the following:

- The purposes of some projects were not well defined and their scopes were overly broad.
- Some projects were directed at groups which demonstrate no clear tax evasion tendencies.
- District directors approved projects although CID chiefs had not sufficiently justified them.
- Inadequate management controls reduced the productivity of individual information gathering efforts.

Compliance with the tax laws cannot be determined solely by reference to information on returns and other documents filed with IRS. Thus, to fulfill its mission, CID must obtain information from outside sources. Information gathering is the investigative tool CID uses to ferret out suspected pockets of noncompliance with the tax laws.

IRS needs to ensure CID
compliance with information
gathering guidelines

Some alleged and other actual abuses of IRS' investigative authority during the early 1970s led to additional management controls over information gathering activities. In June 1975, IRS began overhauling its controls over information gathering activities by issuing revised guidelines which distinguished between (1) information gathering projects directed at a group of taxpayers within such categories as an occupation, an industry, a geographic area, or a specific economic activity and (2) an information gathering effort directed at a specifically identified taxpayer. In connection with this distinction, the guidelines require that district directors approve projects, while district CID chiefs can approve information gathering on specific taxpayers. The regional commissioner or Assistant Commissioner for Compliance must approve information gathering efforts to be conducted by the regional or national offices.

The guidelines require a timely evaluation of information and provide clear and specific procedures for processing the information. The guidelines also (1) state that only "directly tax-related information" may be gathered, (2) define "directly tax related," and (3) provide examples.

A request for authorization to conduct a project must state the purposes, define the scope, and specify the estimated life of the effort and the type of information to be gathered. In authorizing information gathering on individuals, a CID chief must specify the known or assumed name of the taxpayer and the reason information gathering has been authorized.

IRS designed its revised information gathering guidelines with a view toward affording top managers the opportunity to weigh the risks against the potential benefits before deciding whether to authorize them. With minor modifications, those guidelines have remained in effect since June 23, 1975. IRS places substantial controls over information gathering efforts because they usually are conducted without the knowledge of the subject taxpayer or group of taxpayers and because they can involve very sensitive investigative techniques, such as the use of informants and surveillances.

To evaluate the extent to which CID complies with the information gathering guidelines, we reviewed 244 project

authorization requests approved by eight district directors during June 23, 1975, through March 31, 1979. The information gathering guidelines do not specify a format for such requests, nor do they describe the type of information CID chiefs must include in them. As a result, some CID chiefs provide district directors with enough information on which they can make informed risk/reward decisions while others do not. Without specific criteria, we were unable to determine how often CID chiefs provided inadequate information on proposed projects. However, the following are examples of inadequate project justifications which district directors approved:

--According to the CID chief's proposal, this project "would relate to violations of public integrity in the state." To describe the scope of the proposed project, the chief stated that "Groups which will be considered include but are not limited to: public officials/employees of Federal, state, and local governments; regulatory boards; labor unions; lobbyists and government contractors." The district director approved the project, thus authorizing CID to gather information on all government employees in the State, other large groups and individuals, as well as any other groups or individuals CID determined appropriate to its investigation. Before approving this project, the district director should have required that the CID chief document the specific groups and individuals targeted under the project and the specific investigative steps anticipated. Otherwise, the district director could not weigh the risks associated with the project against potential benefits.

--CID proposed a project whose specified purpose was "to identify potential areas of tax abuse in international investments and financing." The scope of the project included "those entities and individuals in the district." The area covered by the district is one of IRS' largest in terms of population. Therefore, the chief essentially had requested that the district director authorize CID to gather information on any corporation, business, group, or individual residing in or doing business within the area covered by the district. The only limitation on the project would be a need to ensure that each target had some connection with international investments and financing. Thus, the project

could be directed at bankers, stockbrokers, real estate salespersons, importers, exporters, managers of international corporations, currency speculators, etc. The district director approved the project. Before doing so, he should have required that the CID chief further justify the project's purpose and better define its scope.

--According to the CID chief, a proposed project would be aimed at determining "the extent of compliance with United States tax laws with regard to foreign investments." The chief described the scope as including, "All foreign investments made in the State or in companies doing business in [the State]." Despite the broad purpose and scope of the proposed project, the district director approved it. In doing so, he authorized CID to gather information on any company, group, or individual who had any connection with foreign investments. Again, this encompasses individuals in numerous occupations, small businesses, and corporations. The district director needed more specific information to make an informed risk/reward decision, but he did not require that CID provide that information.

--CID proposed a project whose purpose was to "examine compliance with IRS laws by agencies, officials, contractors, politicians, and other persons associated with governmentally funded programs." The CID chief stated that the scope of the project was "nationwide due to the need to trace such funds to the federal level, although the actual programs will be located in [a densely populated county]." The Government funds many programs--such as welfare, scientific research, education grants, health programs, and employment programs--and CID essentially requested permission to gather information on them as it saw fit. The district director approved CID's request. Again, to properly carry out his responsibilities, the district director needed much more specific information.

--A CID chief proposed a project whose purpose was "to identify persons and organizations receiving income from illegal activities and to gather tax-related information to be used

in evaluating the tax potential of these entities." The project's scope was "limited" to individuals, groups, and businesses who derive income from illegal activities. The district director approved the project thereby authorizing CID to gather information on drug traffickers, organized crime figures, gamblers, pimps, loan sharks, murderers, arsonists, and any other individual or group that might be involved in those or other illegal activities. The district director did not know where CID planned to start nor what investigative steps it planned to take. He, therefore, was not in a position to make an informed decision on the risks and merits of the project.

In each of the above examples, the district director had little information on which to base an evaluation of potential risks and rewards. In approving such projects, district directors grant CID chiefs permission to gather information within very broad segments of the population.

Other projects were approved despite the questionable nature of the targets selected. For example:

- A district director approved a project directed at taxpayers purchasing "large motor vehicles" in other States. According to the CID chief, "There is a high probability that people who spend substantial amounts of cash outside the State * * * have some reason other than just a bargain purchase." The chief's justification contained no information backing his contention concerning that "high probability."
- A district director approved an information gathering project based on the following statement in the CID chief's justification: "I believe it would be worthwhile to prepare a listing of persons acquiring highly expensive automobiles (Mercedes Benz, BMW, etc.) and check this against the income tax reported."
- Similar to the above project, the same district director approved a project directed at persons owning private airplanes. According to the chief "approximately 500 private airplanes are registered in the State * * *."

The fact that an individual owns an expensive car or a private airplane indicates neither compliance nor noncompliance with the tax laws. The above projects were directed at segments

of the population which have no clear tax evasion tendencies. CID's resources could better be used to develop cases against drug traffickers, return preparers, corporations who evade taxes, or other recognized groups which IRS has singled out as requiring national attention. The CID director told us that such projects are conducted by many district offices, often with limited or no results in terms of cases. The director further stated that CID is considering revising its guidelines to eliminate such projects.

Many information gathering projects led to few or no criminal tax cases

As discussed in chapter 2, CID has no clear criteria for measuring the effectiveness of information gathering projects. CID, however, initiates projects with a view toward developing criminal tax cases. Therefore, the number of cases emanating from projects is a key measure of their effectiveness. On the other hand, projects often produce leads which Examination and Collection personnel pursue from a civil tax standpoint. Benefits in the form of increased revenues thus may accrue to IRS even when CID projects lead to few or no criminal tax cases. Some districts have tracked this information and used it to provide a broader measure of projects' effectiveness. Until recently, however, there were no uniform project monitoring procedures.

We evaluated the effectiveness of CID projects from the standpoint of their criminal tax case productivity. Our review of a randomly selected sample of 53 of the 184 projects initiated by eight district offices between June 23, 1975, and August 31, 1977, disclosed that many projects led to few or no criminal tax cases. For example, 17 completed projects or 32 percent of the 53 projects we reviewed led to no criminal tax cases. Two other completed projects led to one case each, while another project led to nine cases which were closed without prosecution recommendation. Moreover, we also noted that the few nationally directed projects, set forth in CID's short-range plans, were more productive than many of the local projects approved by district directors.

In Boston, for example, 6 projects led to 22 cases but 14 of the 22 cases resulted from a single, nationally directed project aimed at drug traffickers. The other five projects resulted in a total of eight cases by the end of calendar year 1977. In Hartford, four projects led to four cases but two of the four cases emanated from a nationally directed project aimed at tax refund schemes.

In Chicago and Milwaukee, we sought to review files relating to 13 projects but CID officials told us that project records had been destroyed. CID officials in Chicago and Milwaukee did provide us with some summary reports on projects and with the following overall statistics for projects initiated during the period June 1, 1975, through August 31, 1977.

	<u>Chicago</u>	<u>Milwaukee</u>
Projects initiated	34	26
Staff days applied	2,245	457
Cases initiated from projects	105	19
Discontinued cases	<u>54</u>	<u>14</u>
Potential prosecution cases	<u>51</u>	<u>5</u>

Sixty projects led to 124 criminal tax cases as of August 31, 1977, at a cost of 2,702 investigative staff days, but 68 of those cases already had been closed without prosecution recommendations when we completed our review.

Three projects in Dallas and New Orleans led to three cases by the end of calendar year 1978. In Los Angeles, we reviewed records on 18 projects which led to 77 cases. Seventy of the 77 cases, however, resulted from 5 projects, while 13 other projects resulted in only 7 cases. Moreover, 34 of the 77 cases resulted from a single project aimed at drug traffickers, which was tied in to CID's nationally directed drug traffickers project. Another 14 cases emanated from the nationally directed project aimed at tax refund schemes.

In Phoenix, nine sample projects led to eight cases through August 31, 1977. But one nationally directed project--tax refund schemes--was the source for six of the eight cases. The other eight projects led to only two cases.

The CID director told us that he certainly would like to see increased productivity from projects in terms of additional criminal tax cases. However, he also said that historically, cases resulting from projects have been CID's most productive cases in terms of prosecution recommendations. He noted, for example, that during fiscal years 1974 through 1978, 1,695 or 47 percent of the 3,626 cases CID initiated from projects resulted in prosecution recommendations. He compared these figures to a 31 percent rate for the 7,439 prosecution recommendation that resulted from 23,667 cases initiated from referrals. However the CID director further stated that, in an effort to improve the productivity of

projects, CID chiefs soon will be required to submit copies of project justification and project closing reports to the national office for review--an additional management control over those activities.

More management control needed to enhance the productivity of individual information gathering efforts

Individual information gathering efforts could be more productive if CID managers exercised more control over such investigations. Unlike projects, individual information gathering efforts generally are not overly broad in purpose and scope because they are directed at individual taxpayers. On the other hand, justifications approved by CID chiefs often did not indicate what investigative steps the special agent planned to take, while final reports often did not discuss what the special agent had done. Thus, CID managers were not always managing and controlling special agent individual information gathering efforts as effectively as possible, and results from those efforts were not impressive.

We sampled 139 of the 901 individual information gathering efforts initiated by 8 district offices between June 1, 1975, and August 31, 1977. As shown below, only 43, or 31 percent of the 139 individual information gathering efforts, led to criminal tax cases. Moreover, 21 of those 43 cases already had been closed without prosecution recommendations when we completed our review.

<u>District office</u>	Completed individual information gathering efforts	<u>Criminal tax cases</u>		
		<u>Initiated</u>	<u>Discontinued</u>	<u>Open</u>
Boston	6	2	1	1
Chicago	32	8	0	8
Dallas	23	4	2	2
Hartford	4	1	1	0
Los Angeles	39	10	2	8
Milwaukee	10	2	1	1
New Orleans	10	1	0	1
Phoenix	<u>15</u>	<u>15</u>	<u>14</u>	<u>1</u>
Total	<u>139</u>	<u>43</u>	<u>21</u>	<u>22</u>

In Dallas, 14 of 23 such efforts contained requests to conduct surveillances of a continuing and secretive nature. But in 12 of the 14 efforts, the file contained no evidence

that surveillances were conducted and no specifics on their results. Other files contained approved requests for contacts with law enforcement agencies but no indications in the final reports that those contacts were made.

In both Dallas and New Orleans, CID managers did not ensure timely completion of individual information gathering efforts. In Dallas, 23 such efforts remained open for an average of 137 calendar days each, with an average of 3 expended investigative staff days applied. In New Orleans, 10 efforts remained open for an average of 134 days, with an average of slightly more than 3 investigative staff days applied. One Dallas effort was initiated on November 11, 1976, and subsequently transferred to other special agents on July 18, 1977, and September 13, 1977, respectively. As of January 23, 1978, no investigative time had been applied. If CID targets a particular taxpayer for information gathering--a serious step--it should conduct the investigation quickly.

Another effort included in our sample exemplified the need for controls over information gathering. A special agent's spouse informed him that her ophthalmologist charged more for office visits and contact lenses than his competitors, directed patients to a particular contact lens retailer, and unnecessarily replaced good lenses. These seemingly non-tax-related allegations prompted the special agent to request the physician's 1973, 1974, and 1975 tax returns for review. Based on information on the returns, the special agent requested and was authorized to conduct information gathering on the physician. The effort did not lead to a CID case.

In Boston, two of the six individual information gathering files we reviewed contained no evidence of the investigative work performed. Three of the six justifications simply stated that information gathering was needed to determine whether a full scale investigation was warranted.

In Chicago, justifications for and final reports on information gathering were vague. For example, the narcotics group's justification often contained standardized descriptions of planned investigative activities. A final report for one effort closed as having no CID potential noted that "facts and circumstances did not indicate adequate potential for a future criminal investigation." On the other hand, another effort resulted in a case because the special agent "suspected potentially unreported wagering income."

Neither report contained any further justification for the actions taken.

In Los Angeles, 17 of the 39 individual information gathering justifications described no planned investigative steps for which such an authorization was needed. A CID manager noted that agents sometimes request information gathering authorizations to avoid the 30 days investigative time limit CID imposes on district information item evaluations. Also, 19 of the 39 files contained no documentation concerning the specifics of the alleged tax violation, while 22 files lacked documentation as to investigative steps performed.

Better criteria needed to
enhance the usefulness
of information items

IRS receives more than 200,000 information items each year. Very few items lead to criminal tax cases, however, in part because CID uses subjective criteria to evaluate their potential and in part because many items are trivial, incomplete, or otherwise lacking in merit.

Information items constitute, among other things, an important link between IRS and the general public. IRS needs to maintain a system for handling items. However, in light of their limited value to CID, IRS needs to critically assess the cost effectiveness of its current system for handling them. CID, in particular, needs to explore ways to streamline the system in an effort to increase its productivity.

How information items are
processed and evaluated

An information item is a tax-related communication received by IRS alleging or indicating that a particular individual or business may have violated the tax laws. IRS receives many of these communications from varied sources, such as Federal agencies, the general public, informants, and IRS employees. IRS processed 248,475 information items during fiscal year 1978.

The Criminal Investigation Branches at IRS' 10 service centers evaluate information items to determine their potential for criminal tax investigations. Those items having such potential are forwarded to the affected taxpayer's district office for special agents to further evaluate. Information items having no potential for criminal tax

investigation are made available to representatives of IRS' Examination and Collection Divisions located at the service center. Items that the representatives believe have audit or collection potential are forwarded to the affected taxpayer's district office for further evaluation and followup, if warranted.

Besides evaluating information items for their criminal tax implications, the service centers enter certain data from each item into CID's computerized information item storage and retrieval system. That system is decentralized with each service center's data base maintained independently. Data entered into the system includes the taxpayer's name, address, occupation, and social security number and a description of the alleged tax law violation when applicable. Data is retained in the system from 1 to 10 years depending on its source and potential value.

CID staffs each service center with two special agents and several tax examiners. Their primary duties center on processing and evaluating information items. CID also operates the computerized information item storage and retrieval system. While IRS does not maintain specific cost data applicable to information items, we estimate direct staffing and computer costs associated with their processing to be at least \$1 million. Our estimate is based on an analysis of CID service center staffing patterns combined with the costs associated with the computer system CID operates.

Information items produce relatively few criminal tax cases

The Criminal Investigation Branch at IRS' 10 service centers receives and evaluates all information items for their criminal tax potential. Only those items with criminal tax potential are referred to district CID personnel for further review and follow up, if warranted. This service center evaluation substantially reduces the number of items that district CID personnel must consider. During fiscal year 1977, for example, IRS' 10 service centers evaluated 214,621 information items and referred only 14,992, or 7 percent, of them to district CID personnel.

To determine how district CID personnel disposed of information items referred to them by the service centers, we reviewed randomly selected samples of items referred to four IRS district offices by different service centers between June 1, 1977, and August 31, 1977.

District office	Number of information items referred to district	Sample size	Disposition		
			CID case	CID rejection	Other
Boston	47	47	4	39	4
Chicago	183	100	9	71	20
Dallas	291	97	9	86	2
Los Angeles	<u>250</u>	<u>97</u>	<u>24</u>	<u>44</u>	<u>29</u>
Total	<u>771</u>	<u>341</u>	<u>46</u>	<u>240</u>	<u>55</u>

Of the 341 information items included in our sample, only 46, or 13 percent, led to criminal tax cases.

Subjective evaluation criteria limits the usefulness of information items

IRS guidelines specify how to process an information item, but they afford evaluators little criteria for measuring their criminal or civil tax potential. The subjective criteria special agents use in lieu of specific criteria does little to enhance the value of information items.

Our discussions with the chiefs of the Criminal Investigation Branches at four IRS service center--Andover, Austin, Fresno, and Kansas City--disclosed that criteria used to evaluate information items was extremely subjective. The chiefs were unable to supply us with any written evaluation criteria. Generally, they agreed that items with potential are characterized by indications that the additional tax due exceeds \$1,000 and that more than 1 tax year is involved, since CID usually must establish a pattern of willfulness to prove the criminal nature of a tax law violation.

Because service center CID personnel were unable to clearly describe the criteria they use to evaluate information items, we sought to analyze our sample of items to determine whether any particular characteristics seemed to affect evaluators' decisions. With one exception, we were unable to detect any pattern in the selection process.

For example, only 29 of the 97 items included in our Los Angeles sample contained any indication of the taxpayers' income level. Moreover, 34 of the 97 items concerned a single tax year despite the chiefs' consensus that a criminal tax case generally involves more than 1 tax year.

Only 23 of the 97 items included in our Dallas district sample indicated the taxpayer's occupation. Also, 61 items concerned an allegation involving only 1 tax year. Several items involved tax years going as far back as the late 1960s and early 1970s, despite the 6-year statute of limitations generally applicable to tax fraud cases. Fourteen of the 47 items included in our Boston district sample involved a single tax year; taxpayers' income levels were unknown in 40 of the 47 instances.

CID does not adequately document
information item evaluations

District office CID personnel do not adequately document the results of their evaluations of information items. As a result, data that could be used to develop better criteria for information item evaluations is unavailable. While procedures varied with respect to the items included in our sample, most items rejected by the district office were labeled simply "no CID potential."

If district office CID personnel were required to document their reasons for selecting or rejecting each item, CID would have data from which to develop criteria for information item evaluations. To collect that data, IRS would have to revise its information item form to include a list of factors which special agents could check off as they apply to accept/reject decisions. CID could then use that data, along with other data already on the form, such as the alleged offense, occupation, and income, in an effort to identify characteristics that separate items with potential from those without potential. Also, service center CID personnel would get some feedback on reasons why districts reject items they select.

UNIFORM USE OF CASE POOLS WOULD
IMPROVE THE SELECTION PROCESS

Using the case pool approach, CID would better be able to achieve the case selection goals in its short range plans. Under that approach, CID managers evaluate referrals, information items, and the results of information gathering efforts without considering the availability of staff resources. Each indication of tax fraud, regardless of source, is evaluated solely on its potential from a criminal tax standpoint. Cases selected are then pooled together, and as special agents become available, the case with the highest potential is assigned. After a specified period of time, often 90 days, cases not assigned are closed due to lack of staff.

The case pool approach offers several advantages to CID managers compared to a system in which irrevocable selection/rejection decisions are made at one point in time. Under the latter process, a high potential case can be rejected due to lack of staff. Thirty days later, as staff might become available, a case with less potential can be investigated. The case pool, on the other hand, provides a range of alternatives from which CID can select cases. Alternatives are important because the case selection process involves so many variables such as balanced enforcement program needs and the special agent's experience level.

From the standpoint of balanced enforcement, the case pool is an especially useful management tool. At a particular point in time, for example, CID might decide that it needs to work five cases involving accountants in a specific county. The case pool inventory can then be checked for that type of case. As CID plans become more specific--thus more clearly defining balanced enforcement--case pools will become even more important. Case pools also serve as a management control mechanism over CID's district office staffing levels. At any point in time, national or regional CID managers can evaluate the quality of cases in a district's pool. If one district consistently has higher quality cases in its pool than does another district, CID can consider moving some special agents from one district to another.

The CID director told us that case pools are an extremely useful management tool. Despite case pools' usefulness, however, district CID chiefs are not required to use them. In light of the difficulties that CID managers face in making case selection decisions and the fact that many cases do not result in convictions, it seems inappropriate that certain CID chiefs do not use the case pool approach.

CONCLUSIONS

Case development activities are designed to enable special agents to develop the information CID managers need to make informed case selection decisions. Many cases selected for detailed investigation by CID managers do not lead to prosecution recommendations let alone convictions, however. Inadequate planning, as discussed in chapter 2, limits the effectiveness of CID case development activities since they are conducted without the benefit of a well-defined national strategy and specific program goals. But there are other deficiencies in case development processes which need correction.

Referrals are the most important source of CID cases in terms of quantity. But Examination and Collection Division personnel forward many incomplete referrals to CID. Conflicting IRS guidance makes the referral decision process highly subjective from referring agents' standpoint. That decision process always will involve judgment. IRS, however, can reduce the subjectivity involved by affording referring agents better, more consistent training.

Information gathering guidelines IRS issued in 1975 have improved its controls over those activities. But more needs to be done to improve the focus, productivity, and controls over information gathering. Many projects were overly broad in scope and/or directed at inappropriate targets. Also, many projects led to few or no criminal tax cases. Similarly, individual information gathering efforts led to relatively few cases, in part because management controls over them were inadequate.

Despite their high volume, information items produce relatively few criminal tax cases. This is partly due to the fact that many items are incomplete, inconsequential, or otherwise of little or no value to IRS. On the other hand, IRS necessarily maintains a system for handling items and it therefore needs to do all it can to enhance the system's value. Presently, information item evaluators have no clear criteria on which to base their decisions to accept or reject them. Moreover, IRS is not collecting the data it needs to develop such criteria.

Finally, CID can improve the case selection process by requiring that each district use the case pool approach. Besides affording CID managers alternative cases from which to make selection decisions, the case pool approach also serves as a management control over staff resource allocations.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

To improve CID's case development activities, we recommend that the Commissioner

- Develop guidelines, applicable to each district office, for referral training. The guidelines should specify the minimum level of effort each district must apply to referral training annually and the methodology for that training. Such training should help clarify the conflicting guidance IRS now provides referring agents.

- Develop guidelines which district directors and higher level IRS officials can use to evaluate the appropriateness of CID-proposed information gathering projects. Among other things, the guidelines should list the factors that ought to enter into the decision process, such as the (1) purpose and scope of the proposed effort, (2) methodology CID plans to follow, (3) risks involved, and (4) relationship of the project to national, regional, and district CID program goals. Specific examples of proper and improper project justifications also should be included in the guidelines.
- Revise CID's guidelines pertaining to individual information gathering activities so that files contain clear documentation describing investigative steps performed and results leading to disposition decisions.
- Revise CID's information item form to ensure the future availability of data needed to analyze and improve information item evaluations. At a minimum, the reasons why particular items are accepted or rejected by district CID personnel should be documented. Documentation should help CID develop criteria against which to evaluate information items and would provide specific feedback on rejected items to service center information item evaluators.

We also recommend that the Commissioner require that each district CID chief use the case pool approach in making case selection decisions.

AGENCY COMMENTS
AND OUR EVALUATION

IRS agreed with our recommendations and is

- implementing a minimum requirement for annual referral training for district Examination personnel,
- evaluating the need for additional referral training for both Examination and Collection personnel,
- revising its information gathering guidelines to (1) require that CID chiefs specify the relationship of proposed projects to existing program goals and (2) ensure that special agents document the investigative steps involved

in and the results of individual information gathering efforts,

--improving its documentation of information item evaluations, and

--requiring that case pools be used in districts where sufficient workload exists.

These ongoing and planned actions are responsive to our recommendations. With respect to the last point, however, we want to emphasize that case pools can serve as a useful management control over CID staffing levels at district offices. Thus, over the long term, if IRS sees little need to use the case pool approach in particular districts, it can consider shifting some staff resources from those districts to districts which have consistently heavy workloads. Ultimately, by making such analyses and taking appropriate staffing actions, IRS may be in a position to implement the case pool approach nationwide.

CHAPTER 4

SCOPE OF REVIEW

We reviewed the laws, plans, policies, and procedures IRS follows in developing and selecting criminal tax cases. We did our work at IRS headquarters in Washington, D.C.; its regional offices in Chicago, Dallas, New York, and San Francisco; its service centers in Andover, Massachusetts; Austin, Texas; Fresno, California; and Kansas City, Missouri; and its district offices in Boston, Chicago, Dallas, Hartford, Los Angeles, Milwaukee, New Orleans, and Phoenix.

We interviewed IRS and Department of Justice officials and reviewed IRS records pertaining to samples of information items, information gathering efforts, referrals, and detailed criminal tax investigations. We also coordinated our audit work with IRS' Internal Audit Division and its fraud referral study group to avoid duplicative analyses of CID operations.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

SEP 17 1979

Mr. Allen R. Voss
Director, General Government Division
U. S. General Accounting Office
Washington, DC 20548

Dear Mr. Voss:

Thank you for giving us the opportunity to review your draft report entitled, "Improved Planning and Better Guidance Needed to Enhance the Productivity of IRS' Criminal Tax Case Development and Selection Activities."

The Service is in general agreement with the substance of your recommendations and is well on its way in implementing them. We have initiated efforts to improve the Criminal Investigation Division's long-range and short-range planning process, including systematic coordination with the Department of Justice. We are continuing our efforts to improve our case development activities and case selection process. We agree that the CID planning process needs further improvement and refinement within the framework of our overall compliance strategy.

As you point out, we have made progress toward improved planning by conducting a planning model study during fiscal years 1977 and 1978 and will continue to move ahead by testing a more rigorous long-range planning process during fiscal year 1980. You also refer to our current efforts to analyze cases in which prosecution was declined by the Department of Justice to determine how guidance about the Department's policies can be more clearly communicated to our managers.

We will always investigate many criminal tax cases which do not result in prosecutions. To protect the rights of those investigated, we advise them of their legal rights at the early stage of a case. Therefore, we must select cases for criminal investigation before the facts are fully developed. This will necessarily result in dropping cases where prosecution is inappropriate upon complete review of the matters.

- 2 -

Our primary planning focus will be to emphasize the use of criminal prosecutions as an effective deterrent, not merely to improve the statistics of the percentage of cases selected for investigation which end in prosecution. Overemphasis on such statistics would run the risk of encouraging selection of the easier cases rather than the major cases, which are often the most difficult to investigate and bring to prosecution.

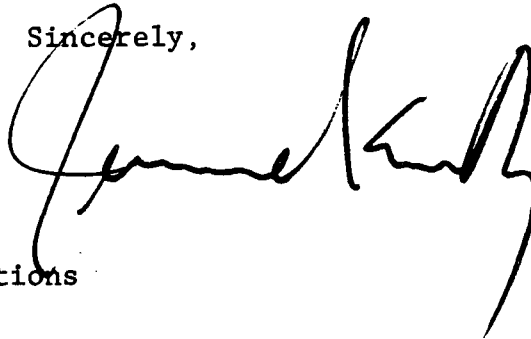
We share the goal to improve the efficiency of allocating our scarce criminal investigation resources to those cases most likely to result in prosecutions by the government. We will continue our efforts for the purpose of improving planning and guidance to enhance the productivity of criminal tax case selection and development.

Our responses to your specific recommendations are enclosed, and are referenced to the applicable page number in the draft report.

I appreciate the work you and your staff have done in this area and we will take your comments and observations into account in our continuing efforts to improve our criminal tax investigation activities.

With kind regards,

Sincerely,

A handwritten signature in black ink, appearing to be "James K. ...", written in a cursive style.

Enclosure
Responses to Recommendations

GAO note: Some page references in the following enclosure have been changed to conform with the final report.

Page 21-1

We recommend that the Attorney General and the Commissioner of Internal Revenue jointly develop specific methods for coordinating Justice and IRS efforts to combat tax fraud. Specifically, the Attorney General should direct the Assistant Attorney General, Tax Division, to provide better input to CID's planning process and more specific guidance on case requirements. The Commissioner should direct the Assistant Commissioner for Compliance and the CID Director to coordinate CID's planning process with the Assistant Attorney General, Tax Division, and coordinate with the Director of Justice's Executive Office of U. S. Attorneys to develop a systematic means for obtaining U. S. Attorneys' input to CID's planning process at the local level.

Response

We are in general agreement with the recommendation. We are working with the Department of Justice to develop specific methods to better coordinate Justice and IRS efforts to combat tax fraud. We plan to establish a system of regularly scheduled meetings between key Justice, IRS and Chief Counsel officials at the headquarters level to better coordinate CID's planning process and, to the extent possible, develop more specific guidance on case requirements. We will explore with the Tax Division and the Executive Office for U. S. Attorneys ways to obtain systematic input from U. S. Attorneys, and whether this may best be accomplished at the local level or through Justice headquarters.

In recent years, the Internal Revenue Service, through its Chief Counsel, has coordinated numerous criminal investigative issues with the Department of Justice. This is appropriate since the Chief Counsel's Office has the responsibility for making the final institutional determination on behalf of the Internal Revenue Service with respect to recommending cases for prosecution. In fulfilling this role, the Chief Counsel's Office maintains close contact with CID. As issues arise, it is typical that proposed plans and instructions to Service personnel are reviewed by Chief Counsel attorneys and coordinated directly with the Tax Division of the Department of Justice. The Department of Justice representatives are also invited to express their views at the regular meetings held for the Deputies Regional Counsel-Criminal Tax and the Assistant Regional Commissioners-CID.

As you note in the draft report, CID is currently analyzing the reasons for Department of Justice declinations in order to discern trends or problems which can be corrected.

Page 21-2

We also recommend that the Commissioner further refine CID's annual program plans in light of data developed through its long-range planning process. Specific national, regional, and district level case development goals need to be developed, documented, and used as a means for measuring the effectiveness of referrals, information gathering and information items.

Response

We agree that further refinement of CID's annual program plans should develop from CID's long-range planning effort. CID's revised long-range planning process is being piloted in two regions in FY 1980. A key feature of this revised process is joint goal setting in establishing a yearly plan involving all three levels of IRS management -- from the National Office through the regional office down to the district level.

As experience with this revised process is gained, further refinements to annual plans will undoubtedly follow. However, we believe that annual plans must contain sufficient flexibility to allow district management to factor in local conditions which have a direct bearing on voluntary compliance.

Page 48-1

To improve CID's case development activities, we recommend that the Commissioner clarify the conflicting guidance provided referring agents by developing guidelines for referral training applicable to each district office. The guidelines should specify the minimum level of effort each district must apply to referral training annually and the methodology for that training.

Response

We agree. Earlier this year, IRS developed a new basic training course on fraud referrals for Examination Division personnel. In the near future, the Examination Division plans to implement a minimum requirement for annual referral training at the district level. In addition, as you point out in your

report, IRS has a coordinated compliance fraud referral study under way. The study group will attempt to identify the components of an optimal fraud referral program and actions necessary to improve the present fraud referral program to the optimal level for each IRS function. The study will include an evaluation of the fraud referral criteria for consistency and completeness in concept and practice and an evaluation of the need for additional training for Examination and Collection personnel.

Page 49-1

To improve CID's case development activities, we recommend that the Commissioner develop guidelines which district directors and higher level IRS officials can use to evaluate the appropriateness of CID proposed information gathering projects. Among other things, the guidelines should list the factors that ought to enter into the decision process, such as the purpose and scope of the proposed effort, the methodology CID plans to follow, the risks involved, and the relationship of the project to national, regional, and district CID program goals. Specific examples of proper and improper project justifications also should be included in the guidelines.

Response

We agree. Our existing Internal Revenue Manual guidelines require that requests for authorization to conduct information gathering projects must state the purpose, define the scope, and specify the anticipated contacts, the estimated life of the project and the type of information to be gathered and indexed. However, we will revise our guidelines to require that the relationship of the project to existing program goals be specified, and provide examples of proper and improper project justification.

Page 49-2

To improve CID's case development activities, we recommend that the Commissioner revise its guidelines pertaining to individual information gathering activities so that files pertaining to such efforts contain clear documentation describing investigative steps performed and results leading to disposition decisions.

Response

We agree. CID's Internal Revenue Manual guidelines pertaining to individual information gathering were recently revised, and now require that a closing report be prepared. The closing report will summarize the investigative steps performed and results leading to disposition decisions.

Page 49-3

To improve CID's case development activities, we recommend that the Commissioner revise its information item form as appropriate to ensure the future availability of data needed to analyze and improve information item evaluations. At a minimum, documentation of the reasons why particular items are accepted or rejected by district CID personnel should be required. This should help IRS develop criteria against which CID can evaluate information items and will provide specific feedback on rejected items to service center information item evaluators.

Response

We agree that better handling of information items is a necessary part of improving CID's case development activities.

CID is beginning work to improve district documentation on information items selected at the service centers for district evaluation. As an interim measure, CID will capture data concerning reasons for acceptance or rejection on a simple checksheet, which will be prepared by the district evaluator and fed back to the service centers. As data processing resources become available, similar data will be captured on the information item form itself and processed by computer. Ultimately, the data from both efforts, along with findings from CID's planning model study, will be used to develop more objective criteria to guide information item evaluators.

Page 49-4

We also recommend that the Commissioner require that each district CID chief use the case pool approach in making case selection decisions.

Response

CID's case pool procedures in the Internal Revenue Manual were recently revised, and now require that case pools be used in each district where sufficient workload exists. This requirement will also be emphasized in the compliance program guidelines for FY 1980.



UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

Address Reply to the
Division Indicated
and Refer to Initials and Number

SEP 19 1979

Mr. Allen R. Voss
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

This letter is in response to your request for comments on the draft report entitled "Improved Planning And Better Guidance Needed To Enhance The Productivity Of IRS' Criminal Tax Case Development And Selection Activities."

We have reviewed the General Accounting Office (GAO) draft report and find that our areas of disagreement with the findings and recommendations are rather narrow. We agree that the case selection process at the investigative level needs improvement. At the same time, however, we recognize that in the past, we may not have been providing the Internal Revenue Service (IRS) with as much guidance as possible. In recent years, however, these problems have become readily apparent and both agencies have taken remedial steps.

With respect to the types of cases being investigated, we wish to emphasize that we agree with the IRS that the greatest deterrent effect is created by a nationally consistent, balanced program of criminal tax enforcement. Given the miniscule percentage of criminal tax cases prosecuted, compared with the number of tax returns filed each year, it is not going to be the quantity of criminal tax prosecutions undertaken which will accomplish the Government's goal of creating a deterrent effect. The IRS national office has for many years established guidelines for a balanced enforcement program. Yet, the declination rate of cases referred to the Department of Justice (Department) has increased from 11 percent in fiscal year 1970 to 18 percent in fiscal year 1978. We believe this is attributable in large part to a lack of adequate coordination in enforcement planning between the Department and the IRS, as well as the failure of agents in the field to adequately implement existing guidelines.



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We would also like to comment on what appears to be a misapprehension, or at least, a misstatement, of the role of the Criminal Section of the Tax Division in prosecuting criminal tax cases. This point is important because we believe that GAO may be placing excessive reliance upon the United States attorneys' offices with respect to functions more properly placed in the hands of the Tax Division's Criminal Section. At the outset, we must take issue with the repeatedly stated inference that the Criminal Section does not prosecute cases. For example, page 14 of the draft report states, in essence, that ". . . IRS depends on the Criminal Section of Justice's Tax Division to review and approve recommended prosecutions and depends on U.S. attorneys to handle the prosecutions." On page 19, the draft report states: "Because they /U.S. attorneys' offices/ prosecute criminal tax cases, U.S. attorneys are in a unique position to evaluate the strengths and weaknesses of those cases. . . . District CID chiefs need to know what the people who prosecute their cases consider important."

The portions of the draft dealing with this issue make no mention of the fact that Criminal Section attorneys are actively involved in criminal tax litigation--and it is the only type of litigation with which they are directly involved. At the close of fiscal year 1978, Criminal Section attorneys were directly responsible for 52 trials and 52 grand jury investigations throughout the country. If anyone is in the "unique position to evaluate the strengths and weaknesses of those /criminal tax/ cases," it is the Criminal Section attorneys, who deal exclusively with such cases. Moreover, the Criminal Section holds bi-weekly litigation meetings that are attended by all attorneys not on travel status to specifically discuss actual trial problems encountered throughout the country. We know of no U.S. attorney's office which is able to focus a comparable amount of experience and expertise on criminal tax issues. Although a recommendation appears on page 21 of the draft report that the Executive Office for United States Attorneys should become involved in providing input into the IRS Criminal Investigation Division's (CID) planning process at the local level, we believe they are not as well equipped to perform the function as the Criminal Section, which has dealt with the various U.S. attorneys' offices for years. Indeed, the Tax Division's policies have surely been partially shaped over the years by the reactions of numerous U.S. attorneys' offices.

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Perhaps the greatest danger in overemphasizing the value of direct input from each U.S. attorney's office is that nationally consistent treatment of criminal tax cases will be destroyed. Some U.S. attorneys want to prosecute no criminal tax cases; others want to prosecute cases against only organized crime figures; others want to pursue only specific kinds of cases; and so forth. With the diverse nature, composition, and standards of those offices, their direct input into the CID planning process will be of slight value if nationally consistent policies are to be preserved. CID is trying to establish long-range goals, and since U.S. attorneys are Presidential appointees who change with each new administration, or even during the term of a particular administration, the belief of one U.S. attorney may not be the belief of his successor. On the other hand, the Criminal Section possesses many years of career-oriented experience, is keenly aware of issues affecting the criminal tax area, and is directly exposed to the viewpoint of U.S. attorneys throughout the country.

We would like to point out, however, that the viewpoint of the U.S. attorneys' offices is in fact brought to the attention of the IRS. In the first place, when a case that will be tried by an assistant U.S. attorney is being prepared, a tremendous amount of formal and informal contact takes place between individual investigative agents and the assistant U.S. attorneys prosecuting the case. As a result of such contact, a learning experience generally occurs wherein CID learns prosecutorial guidelines, standards, and requirements on a firsthand basis. If the U.S. attorney desires that a case referred to him be declined, and if the Tax Division agrees, the Criminal Section gives the views of both offices to the Chief Counsel and the District Counsel. Also, the Tax Division has just instituted a procedure whereby, in cases which have resulted in an acquittal, its attorneys will ask the prosecuting assistant U.S. attorney the reasons for the acquittal. These reasons and any further comments are given to District Counsel and Chief Counsel.

Thus, we fully agree that prosecutorial input into the case selection process is indeed valuable, but we believe that such input is most appropriately and effectively provided by and through the Tax Division, rather than individual U.S. attorneys' offices. We are counting on IRS permitting us to have increased participation in this area.

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Finally, we disagree with certain of the comments on page 19 attributed to the CID director with respect to the Tax Division's "inability" to provide specific guidance to CID. The Tax Division is willing to provide more direct guidance to IRS, including the CID. When we decline to prosecute cases, we prepare a letter detailing our reasons for declining to prosecute to the IRS District Counsel and Chief Counsel. Prior to October 1, 1978, those letters tended to be of a rather general nature. However, since October 1978, we have attempted to be as specific as possible in discussing the factors which led to the declination. We now also provide the Chief Counsel with a copy of the internal declination memorandum prepared by our line attorney. Although we do not directly inform CID of our reasons for declining cases, we are prepared to discuss procedures for doing so.

Also, we have yet to refuse to provide Tax Division speakers to appear at IRS training sessions or other meetings to which we are invited to appear. We would welcome an opportunity to discuss the details of further participation in such sessions. In addition, we would welcome an opportunity to more fully participate in the establishment of long- and short-range goals promulgated by IRS. Although the CID director states that our staff prefers to discuss "a few, isolated cases," in preference to providing overall guidance, our speakers have indicated that they attempt to avoid discussing specific cases since such discussions are less helpful than those involving broad principles and policies. Finally, we would point out that certain IRS personnel have attended sessions of our Criminal Tax Institute, as well as other meetings, where Departmental policies in criminal tax cases are discussed. However, our viewpoint as expressed on such occasions is not always effectively disseminated to agents in the field. For example, as the draft report points out, during fiscal years 1976 through 1978, the Department declined prosecution on at least 86 employment tax cases. Yet, the difficulties encountered in such cases were fully discussed at a meeting of the Tax and White-Collar Crimes Seminar, held in the Department on May 13, 1975. High-level IRS officials, including the Chief Counsel, were in attendance, but we continued to receive a large volume of defective cases in this area.

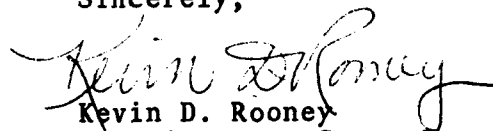
We are hopeful that the above comments will provide a better insight as to the interrelationships between the IRS' CID, the Department's Tax Division, and the U.S. attorneys in the review and prosecution of criminal tax cases

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and the Department's coordinative role with IRS. Nevertheless, we share GAO's concern, and as we have pointed out, are making sizeable efforts to improve coordination and communication between IRS and Departmental officials.

We appreciate the opportunity to comment on the report. Should you desire any additional information, please feel free to contact us.

Sincerely,



Kevin D. Rooney
Assistant Attorney General
for Administration

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