



*Statistical Portrayal of the
Criminal Investigation Function's
Enforcement Activities From
Fiscal Year 2000 Through Fiscal Year 2005*

May 2006

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 12, 2006

MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION

FROM:

Michael R. Phillips

Michael R. Phillips

Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Statistical Portrayal of the Criminal Investigation Function’s Enforcement Activities From Fiscal Year 2000 Through Fiscal Year 2005 (Audit # 200610006)

This report presents the results of our review of statistical information that reflects activities of the Criminal Investigation (CI) function. The overall objective of this review was to provide statistical information on the CI function’s enforcement activities and trend analyses of that information.

Synopsis

The CI function performance measures and business results showed improvements from Fiscal Year (FY) 2003. Specifically, the total number of subject investigations¹ completed and prosecution referrals increased; the number of indictments, convictions, and sentences increased; and the number of investigations in the Department of Justice pipeline increased. Several indicators continued to show improvements from FY 2004. While the number of subject investigations completed decreased slightly, FY 2005 showed gains in the total numbers of subject investigations initiated, Department of Justice pipeline investigations, convictions, and sentences and in the percentage of direct investigative time.

The CI function reported an increase in total special agent staffing² from FYs 2000 through 2005; however, field office special agent staffing declined during this time. Increasing special agent staffing remains a challenge as the CI function continues to lose experienced special agents

¹ A Glossary of Terms is included in Appendix IV.

² Includes new recruits, part-time special agents, field and Headquarters office managers and program analysts, and Lead Development Center and Fraud Detection Center special agents.



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to attrition faster than it can replace them. We are concerned this trend may adversely affect the current levels of and improvements in productivity the CI function has recently experienced.

About 2 years ago, the Senate Finance Committee expressed concerns about the CI function's ability to increase legal source income tax investigations, the length of time it takes to refer a case for prosecution, and the number of investigations per special agent. Criminal enforcement indicators in the legal source and tax-related program areas showed improvements in FYs 2004 and 2005. Further, the total inventory per special agent increased to 8.53 in FY 2005, the highest level since FY 2001. In addition, the elapsed time to recommend a case for prosecution remained at nearly the same level since FY 2003, and the length of time to discontinue a case slightly increased since FY 2003. The CI function continues to emphasize cycle-time improvements and has established a benchmark range for the completion of legal and illegal source investigations.

Refund fraud, and how the Internal Revenue Service (IRS) combats it, is another concern of Congress and the National Taxpayer Advocate. Since Processing Year 2003, the number of fraudulent returns detected by the CI function's Questionable Refund Program increased 36.2 percent, and the total amount of fraudulent refunds stopped increased 53.8 percent. Further, our limited-scope review of refund fraud committed by Federal and State prisoners, which has grown significantly in recent years, showed inaccurate and missing information prevented the IRS from detecting all fraudulent refund returns filed by prisoners.³ The IRS Commissioner has initiated an internal review of the Questionable Refund Program to address, among other things, concerns that taxpayers whose refunds are frozen are not always notified. We are also conducting a review of this Program.⁴

The CI function initiates investigations from many different sources, both from within and outside the IRS. During FY 2005, about 53.1 percent of subject investigations initiated came from the United States Attorneys' Offices or other Government agencies, a percentage that is trending downward from prior years. In contrast, about 36.2 percent of subject investigations initiated came from within the IRS, a percentage that is trending upward from prior years. Historically, internal IRS programs have been the primary sources of investigations involving pure tax violations. Between FYs 2000 and 2005, almost 64.2 percent of legal source investigations came from within the IRS. During FY 2005, 71.0 percent of legal source investigations and 50.9 percent of tax-related investigations came from internal IRS sources. On the other hand, more than one-half of the

Criminal enforcement indicators in the legal source and tax-related program areas show improvement; however, refund fraud remains a concern.

³ *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (Reference Number 2005-10-164, dated September 2005).

⁴ *Review of the Criminal Investigation Function's Questionable Refund Program* (Audit # 200610003).



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cases initiated from the United States Attorneys' Offices and other Government agencies were nontax-related, which continues to create a challenge for the CI function in maintaining a proper balance with its stated priorities of legal source and tax-related investigations.

Recommendations

We made no recommendations in this report. However, key CI function management officials reviewed the report and provided written comments to add perspective on areas such as the Questionable Refund Program to make it more informative to the reader. In addition, we considered the CI function's comments and made corrections to the figures where appropriate. Management's complete response to the discussion draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report information. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations), at (202) 622-5800.



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Background

In recent years, the Internal Revenue Service (IRS) has made tremendous efforts to improve customer service and make it easier for taxpayers to comply with their tax obligations. However, in 1999, overall enforcement activities began to erode, and a survey conducted in 2003 indicated that 17 percent of the population believed it was acceptable to cheat on their taxes. Since then, the IRS Commissioner has emphasized the role and importance of tax enforcement in overall tax compliance by recognizing the need to enhance levels of enforcement activity to provide a proper balance between service and enforcement.

The IRS Strategic Plan for Fiscal Years (FY) 2005 to 2009 provides that enforcing tax compliance is critical to maintaining the American taxpayers' expectation that the tax system is fair. It also outlines several objectives to meet the goal of enhanced enforcement, including discouraging and deterring noncompliance with emphasis on corrosive activity by corporations, high-income individual taxpayers, and other contributors to the tax gap (the difference between taxes owed and paid).

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

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

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

The CI function addressed many of the Webster Report concerns by creating a revised mission statement, developing a compliance strategy designed to guide the CI function to develop and investigate cases that foster confidence in the tax system, reducing the resources placed on

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

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



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narcotics investigations, publicizing the results of its investigations, and conducting an empirical study to determine the effect investigations have on voluntary compliance. CI function executives continue to emphasize the importance of developing and investigating those cases that have the greatest effect on tax administration, regardless of whether the sources of income in those investigations are derived from legal or illegal industries.

We initiated this review as part of the Treasury Inspector General for Tax Administration's (TIGTA) FY 2006 Annual Audit Plan. While our trend analyses covered FYs 2000 through 2005, our report concentrates on providing a perspective for the 2 most current fiscal years.

Our data analyses were conducted in the TIGTA Chicago, Illinois, office during the period December 2005 through February 2006 using data accumulated by the CI function. The audit was conducted in accordance with *Government Auditing Standards*. However, because we relied on information accumulated by the CI function in established reports, we did not verify the accuracy of the data. Much of the data in this report were updated from the prior TIGTA report on the CI function's enforcement activity trends.³ Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II. A Glossary of Terms is included in Appendix IV. Detailed charts and tables referred to in the body of the report are included in Appendix V.

³ *Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through Fiscal Year 2004* (Reference Number 2005-10-081, dated May 2005).



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Results of Review

Several Performance Indicators Continued to Show Improvements in Fiscal Years 2004 and 2005

We previously reported⁴ that many of the performance indicators showed improvements from FY 2003. For example, in FY 2004, the total number of subject investigations completed and prosecution referrals increased; the number of indictments, convictions, and sentences increased; and the number of investigations in the Department of Justice (DOJ) pipeline increased.⁵

Although the number of subject investigations completed decreased by 6.5 percent between FYs 2004 and 2005,⁶ several of the trends showed improvements from FY 2004. For example, the number of subject investigations initiated increased 9.0 percent, the percentage of direct investigative time (DIT) increased slightly, the number of subjects convicted of a crime increased 7.1 percent, and the number of subjects sentenced for a crime increased 17.9 percent.⁷ In addition, the number of investigations in the DOJ pipeline increased 5.9 percent and is at a 6-year high.⁸ The CI function Office of Strategy recently completed a review of the aging of pipeline inventory and selected those judicial districts with the largest increases in pipeline investigations to identify a cause. The study concluded that the United States Attorneys' Offices (USAO) operational priorities are not optimally aligned with the CI function's priorities. The CI function indicated the timely resolution of these pipeline investigations will remain a challenge. We also are concerned that a continuing expansion of the pipeline inventory will result in more DIT being spent preparing these investigations for trial or adjudication, which may result in fewer new investigations and thus affect future productivity levels.

Also, while the average number of calendar days to discontinue an investigation improved from FY 2004 to FY 2005 (down 5.1 percent), the average number of calendar days to refer an investigation for prosecution increased 5.2 percent during the same period.⁹ This increase may be attributed to the CI function working more investigations directly relating to tax administration, which generally take longer to complete than nontax-related narcotics investigations.

⁴ *Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 1999 Through 2004* (Reference Number 2005-10-081, dated May 2005).

⁵ See Appendix V, Figures 15, 25, 23, and 22.

⁶ See Appendix V, Figure 15.

⁷ See Appendix V, Figures 4, 2, and 23.

⁸ See Appendix V, Figure 21.

⁹ See Appendix V, Figure 16.



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Collectively, these indicators demonstrate that the CI function is effectively improving the discharge of its investigative responsibilities and mission. We believe this is attributable to the Commissioner's and CI function management's continued emphasis on improving productivity and enforcing the tax laws.

Introduction of new performance measures

During FY 2005, the Office of Management and Budget (OMB) reviewed the CI function's program. The Program Assessment Rating Tool is used to evaluate a program's effectiveness, and ratings can be used as a basis for future funding. The CI function received a rating of moderately effective and indicated it is among the highest ratings achieved by any Federal Government law enforcement agency.

During this review, the Department of the Treasury, the OMB, and the CI function jointly determined that the measure of completed investigations was insufficient to measure program effectiveness. The Department of the Treasury and the OMB requested the development of new measures to reflect efficiency and a return on investment. As a result, the CI function introduced three new annual performance measures: the number of convictions (a measure of impact on compliance), the conviction rate (a measure of the quality of investigations), and conviction efficiency (a measure of cost efficiency).

The CI function's goal is to increase the number of convictions by at least 2.0 percent each year. The CI function actually reported a 7.1 percent increase in convictions over FY 2004. According to the FY 2005 Business Performance Review document, the CI function projected a total of 2,260 convictions in FY 2006, about a 5.0 percent increase over FY 2005. In addition, the CI function's long-term goal is to maintain or increase the conviction rate through FY 2009. The conviction rate in FY 2005 was 91.2 percent and is projected to be 92.0 percent in FY 2006.

We previously reported¹⁰ that the CI function's performance measure of cases initiated, later changed to cases completed, was not outcome oriented and did little to quantify program results. We are encouraged by the introduction of the new measures and believe these measures and the CI function's diagnostic tools (open inventory, acceptance rates, etc.) provide a more balanced picture of the CI function's overall performance. We also believe the CI function should continue to consider additional measures that would demonstrate its effectiveness and impact on tax compliance, possibly expressed in monetary terms or rates of future compliance with tax laws.

¹⁰ *GPRA: Criminal Investigation Can Improve Its Performance Measures to Better Account for Its Results* (Reference Number 2002-10-009, dated January 2002). Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.). This Act requires Federal Government agencies to establish standards for measuring performance and effectiveness.



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Challenges Remain to Increase Special Agent Staffing

Between FYs 2000 and 2005, total special agent staffing¹¹ increased 3.3 percent, from 2,734 to 2,823, although staffing levels remained nearly the same from FYs 2003 to 2005. Meanwhile, field office special agent staffing declined 3.9 percent, from 2,513 to 2,416 between FYs 2000 and 2005.¹² The decrease in field office special agent staffing was more noticeable in recent years, with a 5.0 percent decline from FYs 2003 to 2005. Despite this more recent decline, since FY 2003, the CI function has reported an increase in the number of subject investigations initiated and total inventory per field agent.¹³

While these statistics represent an increase in productivity, increasing special agent staffing remains a challenge as the CI function continues to lose experienced special agents to attrition faster than it can replace them. According to its most recent estimates, the CI function expects to lose about 160 special agents and 170 special agents in FYs 2006 and 2007, respectively, while hiring only about 48 special agents during each of those years. We are concerned this trend may adversely affect the current levels of and improvements in productivity the CI function has recently experienced. We were advised by CI function management that they recently received assistance that will allow them to increase the anticipated FY 2006 special agent hiring to about 120. In addition, the CI function projects hiring about 120 special agents in FY 2007.

Congressional Interest in Criminal Investigation Activities

About 2 years ago, the Senate Finance Committee expressed concerns about the CI function's productivity and its ability to increase the number of legal source income tax investigations. In addition, the Senate Finance Committee was concerned that there may be as few as 2 investigations per special agent and that it takes on average 2 years to prepare and present a case to the DOJ for prosecution. In April 2005, the House Ways and Means Subcommittee on Oversight expressed concerns about the increase in refund fraud committed by individuals who are incarcerated in Federal and State prisons.

Trends related to legal source income tax investigations

The CI function's Annual Business Plans have consistently described legal source tax cases as a top investigative priority, and we believe these cases are an important component of all tax-related investigations. We previously challenged the CI function's efforts to show progress towards increasing the level of legal source investigations over the years, despite articulating a

¹¹ Includes new recruits, part-time special agents, field and Headquarters office managers and program analysts, and Lead Development Center and Fraud Detection Center special agents.

¹² See Appendix V, Figure 1.

¹³ See Appendix V, Figures 4 and 10.



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focus on these types of investigations in its strategic documents.¹⁴ Although we could not conclusively determine during that review whether the CI function was conducting enough legal source income investigations, or to what extent it can or should increase the number, we identified several areas in which the CI function could make improvements to the legal source investigative program and more effectively measure the program's impact on tax compliance.

Criminal enforcement indicators in the legal source and tax-related program areas showed improvements in FYs 2004 and 2005. For example:

- The numbers of legal source and tax-related subject investigations initiated are at 6-year highs and have increased 12.4 percent and 7.3 percent, respectively, since FY 2003.¹⁵
- The amount of DIT spent on legal source and tax-related subject investigations are at 6-year highs and have increased 2.4 percentage points and 1.7 percentage points, respectively, since FY 2003.¹⁶
- The total number of legal source investigations referred for prosecution is at a 6-year high and has increased 15.6 percent since FY 2003. The number of tax-related investigations referred for prosecution decreased slightly from its 5-year peak reached in FY 2004.¹⁷
- The percentage of legal source investigations accepted by the DOJ continued to show improvement, increasing from 95.0 percent in FY 2003 to 96.3 percent in FY 2005.
- The numbers of legal source and tax-related investigations in the pipeline are at 6-year highs and have increased 25.1 percent and 25.8 percent, respectively, since FY 2003.¹⁸
- The numbers of subjects convicted of and sentenced for a crime in the legal source category have steadily increased since FY 2003.¹⁹

The results listed above demonstrate the CI function's progress towards investigating those cases that have the greatest impact on tax compliance. We believe this is attributable to CI management's continued emphasis on the core mission and investigative priorities of legal source and tax-related investigations.

¹⁴ *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (Reference Number 2005-10-054, dated March 2005).

¹⁵ See Appendix V, Figures 6 and 5.

¹⁶ See Appendix V, Figure 3. Also, the CI function reduced the narcotics program DIT from 15.1 percent in FY 2003 to 12.1 percent in FY 2005, to more closely align with funding received from the Organized Crime Drug Enforcement Task Force program. Thus, the CI function could redirect these resources into legal source and tax-related cases.

¹⁷ See Appendix V, Figures 18 and 17.

¹⁸ See Appendix V, Figures 22 and 21.

¹⁹ See Appendix V, Figures 24 and 27.



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Trends related to the number of investigations per special agent

The CI function uses the average inventory of subject investigations per special agent and the average total inventory per special agent as business results measures. The average inventory calculation includes only open subject investigations, whereas the total inventory calculation includes primary investigations, open and pipeline subject investigations, and subject seizure investigations.

In FY 2003, the average inventory of subject investigations per special agent was 2.00. This decreased to 1.84 in FY 2004, and then increased to 1.94 in FY 2005. On the other hand, the total inventory per special agent, which we believe is a better indicator of a special agent's workload, increased from 7.86 in FY 2003 to 8.53 in FY 2005, the highest level since FY 2001.²⁰

Trends related to the time it takes to prepare and present a case to the DOJ for prosecution

The elapsed time to recommend a case for prosecution remained nearly the same since FY 2003. The elapsed time to discontinue a case increased 2.2 percent during the same period to 437.1 calendar days.²¹

In 2003, the Commissioner raised concerns about the length of time it takes to recommend a case for prosecution. Since then, the CI function has emphasized reduction of cycle time. The CI function Office of Planning and Strategy recently conducted a study to determine the desired cycle-time range and whether additional reductions were feasible. The CI function established a benchmark figure for the completion of legal and illegal source investigations (415 calendar days to 425 calendar days) because these investigations closely align with the CI function's mission and measure investigative efficiency. CI function management believes they can achieve this goal with proper oversight.

Trends related to the Questionable Refund Program (QRP)

Refund fraud continues to grow. Since Processing Year 2003, the number of fraudulent or potentially fraudulent returns detected by the QRP increased 36.2 percent, and the total amount of fraudulent refunds stopped increased 53.8 percent.²² As part of its continuing efforts to increase enforcement and combat refund fraud, the CI function has increased staffing dedicated to refund fraud by 35.8 percent since FY 2003.

²⁰ See Appendix V, Figure 10.

²¹ See Appendix V, Figure 16.

²² See Appendix V, Figures 31 and 32.



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In April 2005, at the request of the House Ways and Means Subcommittee on Oversight, we conducted a limited-scope review²³ concerning refund fraud committed by individuals who are incarcerated in Federal and State prisons, which has grown significantly in recent years. We reported that inaccurate and missing information from the prisoner data file prevented the IRS from detecting all fraudulent refund returns filed by prisoners. In addition, Internal Revenue Code § 6103²⁴ generally prohibits the IRS from sharing Federal tax information with other agencies such as State prison authorities, except under limited circumstances. We made no recommendations in that report; however, we committed to conducting a follow-on review to determine the effectiveness of the IRS' processes for detecting and preventing fraudulent refund returns.²⁵

In January 2006, the National Taxpayer Advocate issued her 2005 Annual Report to Congress reporting significant problems with the QRP as currently designed and administered. Shortly thereafter, the Senate Finance Committee and the House Ways and Means Oversight Subcommittee sent letters to the Secretary of the Treasury and the IRS Commissioner expressing concern that taxpayers whose refunds were frozen were not always notified. Congress requested a review of the QRP, and on January 24, 2006, the IRS Commissioner announced he had initiated an internal review to improve the QRP process. We are also conducting a review of the CI function's QRP to determine the effectiveness of procedures for detecting fraudulent and potentially fraudulent refund returns.²⁶

Investigations Initiated From External Sources

The CI function initiates investigations from many different sources, both from within and outside the IRS. The primary sources from within include fraud referrals from the IRS compliance functions and investigations developed by the CI function from the QRP and Return Preparer Program. The primary sources of investigations from outside the IRS include the USAOs and other Government agencies, both Federal and State. In addition, the CI function initiates investigations based on information received from public sources, including the media and informants.

During FY 2005, about 53.1 percent of subject investigations initiated came from the USAOs or other Government agencies. This decreased from 54.8 percent and 58.4 percent in FYs 2003 and 2004, respectively.

In contrast, during FY 2005, about 36.2 percent of subject investigations initiated originated from within the IRS. This is trending upward from 31.6 percent and 30.1 percent reported in

²³ *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (Reference Number 2005-10-164, dated September 2005).

²⁴ Internal Revenue Code § 6103 (2006).

²⁵ *Review of the Criminal Investigation Function's Questionable Refund Program* (Audit # 200610003).

²⁶ *Review of the Criminal Investigation Function's Questionable Refund Program* (Audit # 200610003).



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FYs 2003 and 2004, respectively. Further, the number of subject investigations initiated from a public source has decreased 16.4 percent during the last 2 fiscal years. During FY 2005, subject investigations from a public source represented 10.7 percent of the total investigations initiated.

Historically, internal IRS programs have been the primary sources of investigations involving pure tax violations. Between FYs 2000 and 2005, almost 64.2 percent of legal source investigations came from within the IRS. During FY 2005, 71.0 percent of legal source investigations and 50.9 percent of tax-related investigations came from internal IRS sources. On the other hand, more than one-half (57.2 percent) of the cases initiated from USAOs and other Government agencies were nontax-related investigations.

We continue to believe the CI function should remain vigilant when evaluating whether the level of cases initiated from sources external to the IRS maintains a proper balance with its stated priorities of legal source and tax-related investigations. We previously reported that the tax enforcement process works most effectively if the CI function and the various USAOs have the same priorities.²⁷ While we understand the CI function needs to maintain an effective working relationship with the USAOs, we also believe the CI function must be judicious in deciding which investigations to work with other agencies (especially if the connection to tax administration is not clear). In response to our prior report, the Chief, CI, reemphasized the CI function's commitment to working the highest impact cases with the strongest deterrent effect, as evidenced by the following language from the FY 2006 Annual Business Plan: "The CI function will continue to emphasize investigations, both legal and illegal source, that adversely affect tax administration through two major compliance strategies that address our investigative priorities with other divisions and law enforcement partners."

Fraud referral program successes

In response to our prior report on the legal source program,²⁸ the CI function committed to taking several steps to enhance the fraud referral program such as establishing fraud referral coordinator positions in each field office, fostering relationships with other IRS operating divisions, and incorporating language into the managers' commitments. As a result of these changes, the CI function received 17.9 percent more fraud referrals during FY 2005 than during FY 2004.²⁹ Further, the CI function received and accepted (numbered a subject investigation) 418 fraud referrals during FY 2005, an increase of 34 percent over FY 2004, and rejected (closed with no subject investigation) 15.9 percent fewer referrals during FY 2005 than during FY 2004.

²⁷ *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (Reference Number 2005-10-054, dated March 2005).

²⁸ *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (Reference Number 2005-10-054, dated March 2005).

²⁹ See Appendix V, Figure 9.



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In addition, the performance results presented in Figure 1 illustrate recent improvements in the fraud referral program.

Figure 1: FYs 2004 and 2005 Fraud Referral Program Performance Results

	FY 2004	FY 2005	Percentage Change
Number of Subject Investigations Initiated	419	569	35.8%
Number of Investigations Recommended for Prosecution	245 ³⁰	325	32.7%
Number of Subjects Convicted	185	184	-0.5%
Number of Subjects Sentenced	149	185	24.2%
Average Months to Serve	18	23	27.8%

Source: CI function Business Performance Review, dated September 30, 2005 and analysis by the CI function Office of Research.

Because fraud referrals remain a viable and important source of legal source income tax investigations, we are encouraged by the recent results demonstrated by the fraud referral program. We believe the CI and Compliance functions should continue to emphasize the importance of these types of investigations as they relate to tax administration and the IRS' efforts to improve voluntary compliance.

³⁰ In its response, the CI function advised us of the accurate numbers for the FY 2004 categories of Number of Investigations Recommended for Prosecution and Number of Subjects Convicted. Our report reflects these corrections.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to provide statistical information and trend analyses of the Criminal Investigation (CI) function's enforcement activities from Fiscal Years 2000 through 2005. To accomplish our objective, we reviewed Internal Revenue Service data publications and CI function management information to analyze data and identify trends. We relied on information accumulated by the Internal Revenue Service in established reports and the CI function's management information system and did not verify its accuracy. The major issues we focused on included:

- Special Agent Staffing.¹
- Investigation Initiations.
- Open Investigations.
- Pipeline Investigations.
- Investigation Closures.
- Investigations Referred for Prosecution.
- Subsequent Legal Actions.
- Compliance Strategy Programs.

Where appropriate, we also referenced previously issued Treasury Inspector General for Tax Administration audit reports to provide additional perspective.

¹ A Glossary of Terms is included in Appendix IV.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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Appendix IV

Glossary of Terms

Business Performance Review – A quarterly review conducted by the Criminal Investigation (CI) function of its performance measures, business results, employee and customer satisfaction, and other items of importance to the CI function.

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

Conviction Efficiency – A measure of cost efficiency. The measure quantifies the average dollar cost of convictions and is computed by dividing the CI function's financial plan by the number of convictions.

Conviction Rate – A measure of the quality of investigations. It is the total number of cases with investigation status codes of guilty plea, nolo contendere, judge guilty, or jury guilty divided by the total number of cases with these same status codes plus nolle prosequi, judge dismissed, judge acquitted, and jury acquitted.

Cycle Time – Elapsed calendar days on completed investigations.

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

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

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

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

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

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

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



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

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

Lead Development Center – The primary function of a Lead Development Center is to identify and develop quality investigations to meet the CI function's business plan. The Lead Development Centers assist CI field offices by conducting research and analysis on alleged noncompliance.

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

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

National Taxpayer Advocate – The Taxpayer Advocate helps taxpayers resolve problems with the Internal Revenue Service and recommends changes to prevent the problems.

Nolle Prosequi – A declaration that the plaintiff in a civil case or the prosecutor in a criminal case will drop prosecution of all or part of a suit or indictment.

Nolo Contendere – A plea made by the defendant in a criminal action that is substantially, but not technically, an admission of guilt and subjects the defendant to punishment but permits denial of the alleged facts in other proceedings.

Organized Crime Drug Enforcement Task Force Program – A multi-agency enforcement initiative that jointly handles drug investigations using investigative grand juries.

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

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

Processing Year – Refers to the year in which taxpayers file their tax returns at the Submission Processing sites. Generally, returns for Tax Year 2004 were processed during 2005, although returns for older years were also processed in 2005.

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



*Statistical Portrayal of the Criminal Investigation Function's
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Referred for Prosecution – A subject investigation that resulted in the determination of prosecution potential referred to the Department of Justice or a United States Attorney Office.

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

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

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

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

Submission Processing Sites – The Submission Processing sites are the data processing arm of the Internal Revenue Service. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Tax-Related Violation – A violation involving Title 26, Title 33 sections, or one of the following Title 18 sections: § 286, § 287, § 371 or § 514 associated with a Title 26 violation, or § 371 associated with a Title 26 and a Title 31 violation.

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

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

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

Title 33 – U.S.C. Title 33, Taxation and Finance – Virgin Islands. Several sections of Title 33 apply to violations that are within the jurisdiction of the CI function. Examples include § 1521, Attempt to Evade or Defeat Tax; § 1522, Conspiracy to Evade or Defeat Tax; and § 1523, Willful Failure to Collect or Pay Over Tax.



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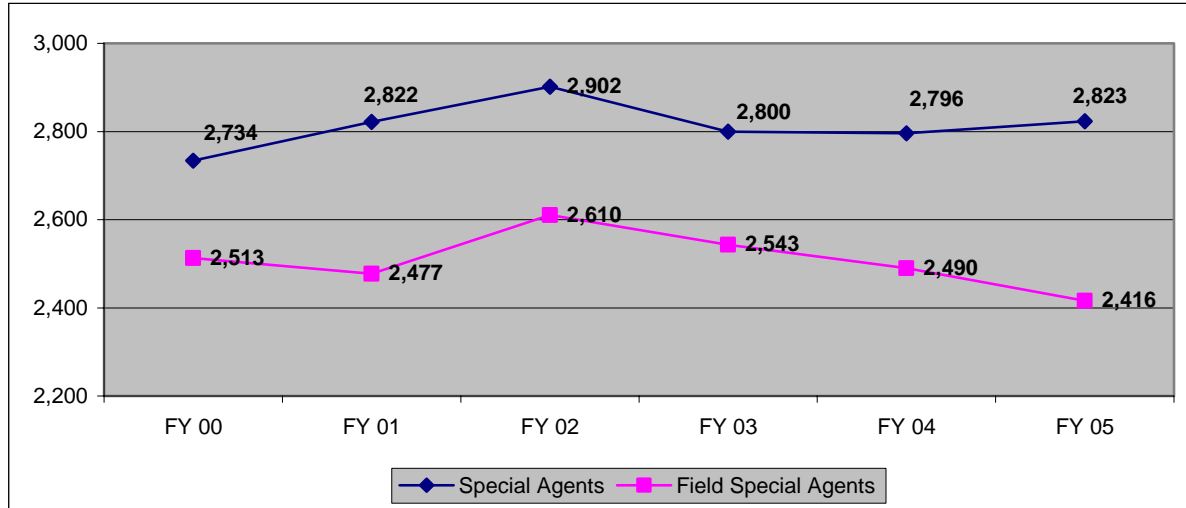
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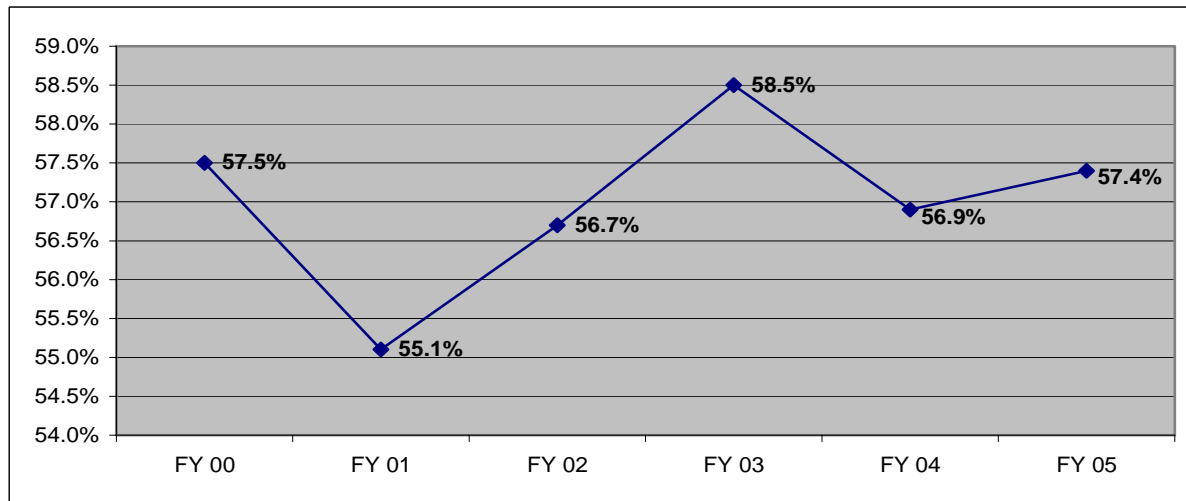
*Statistical Portrayal of the Criminal Investigation Function's
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Figure 1: Special Agent and Field Special Agent Staffing at the End of Each Fiscal Year.¹



Source: *The Criminal Investigation (CI) function's analysis of staffing information.*

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



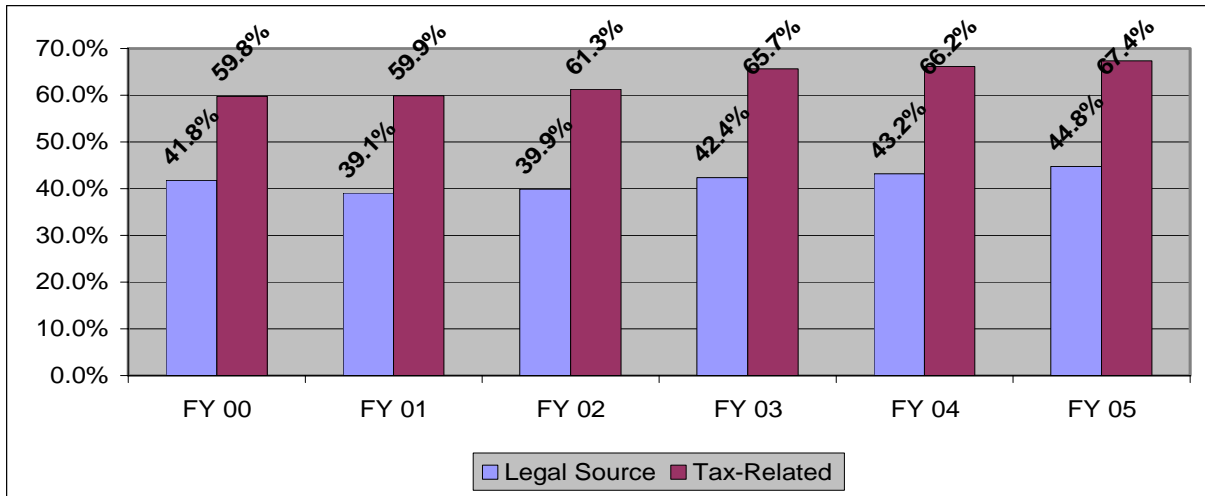
Source: *The Criminal Investigation Management Information System (CIMIS) Report 2, Total Time by Criminal Investigation Program and Activity.*

¹ In Fiscal Year (FY) 2005, the CI function revised its calculation formula to include case reviewers and updated the special agent numbers for FYs 2000 to 2004; therefore, the numbers may not agree with those in prior reports.



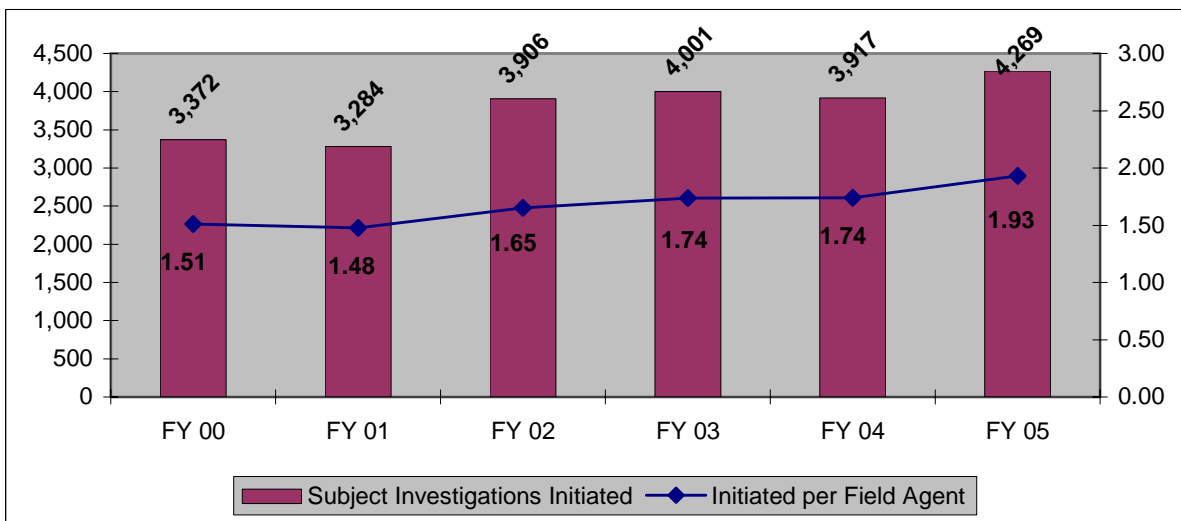
*Statistical Portrayal of the Criminal Investigation Function's
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Figure 3: Percentage of Direct Investigative Time Spent on Legal Source and Tax-Related Investigations Each Fiscal Year.



Source: The CI function's Business Performance Review (BPR) reports and analysis of the CIMIS.

Figure 4: Number of Subject Investigations Initiated and Number Initiated per Field Special Agent Each Fiscal Year.²



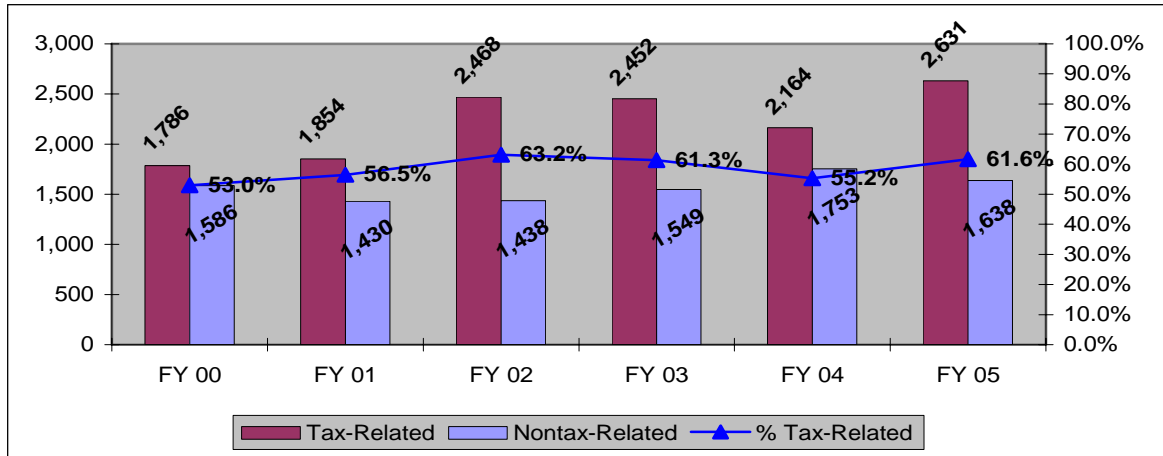
Source: Internal Revenue Service (IRS) Data Book, Publication 55B for FYs 2000 through 2004 investigations initiated; the CI function BPR for FY 2005 data; and Treasury Inspector General for Tax Administration (TIGTA) analysis based on the number of field agents provided by the CI function.

² In FY 2005, the CI function revised its calculation formula to include case reviewers and updated the special agent numbers for FYs 2000 to 2004; therefore, the numbers may not agree with those in prior reports.



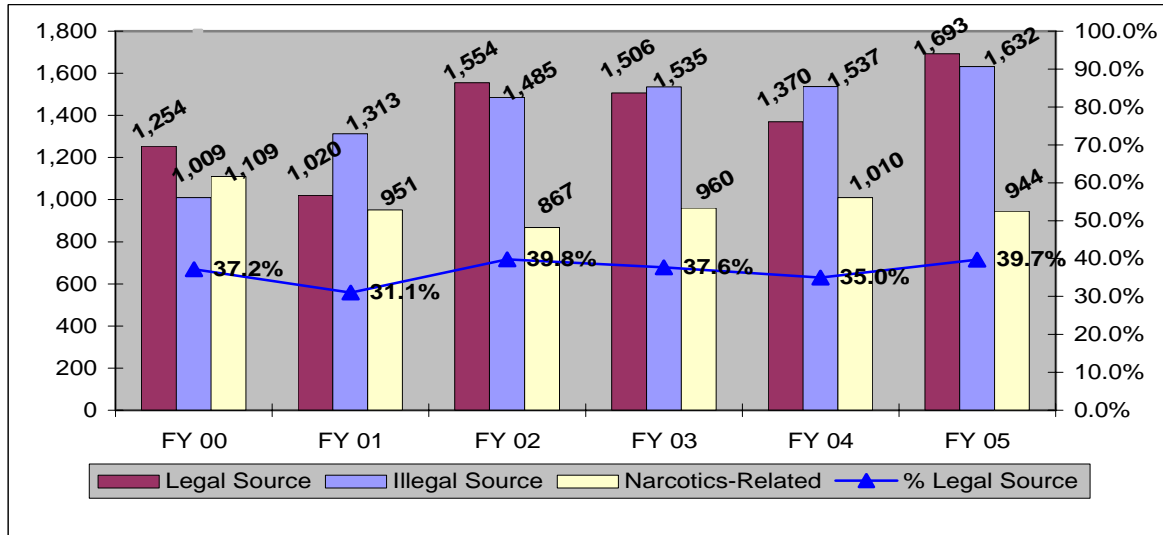
*Statistical Portrayal of the Criminal Investigation Function's
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Figure 5: Number of Subject Investigations Initiated Each Fiscal Year for a Tax-Related or Nontax-Related Violation and Percentage That Is Tax-Related.



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

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

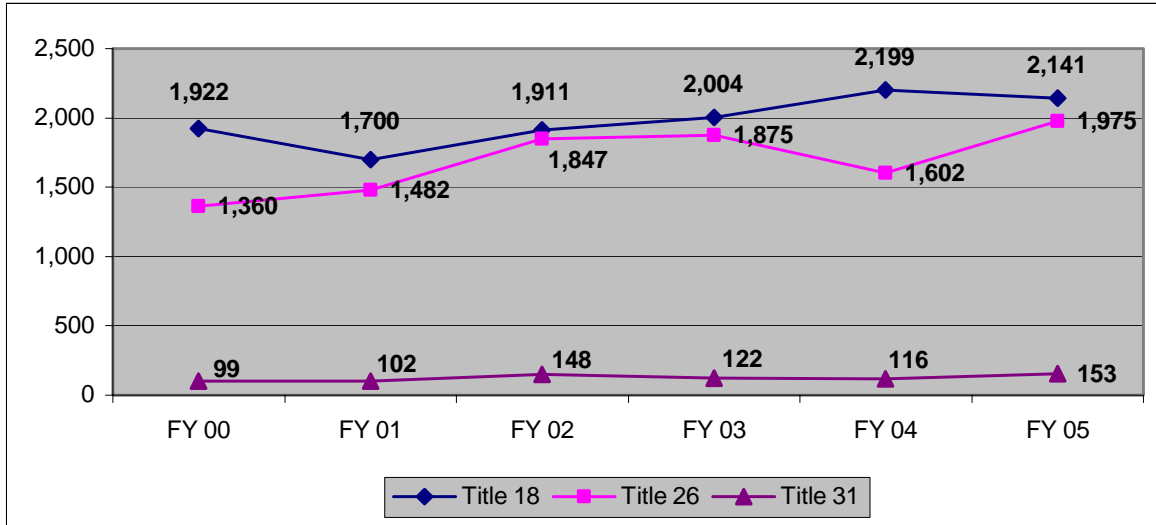


Source: IRS Data Book, Publication 55B for FYs 2000 to 2004, and the CI function's BPR report for FY 2005.



Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 2000 Through Fiscal Year 2005

Figure 7: Number of Subject Investigations Initiated Each Fiscal Year by Principle United States Code Title. The number of subject investigations initiated during FY 2005 as Title 31 includes one investigation that was categorized as “other” on the CIMIS Report 11. This did not occur in the prior fiscal years. See Glossary of Terms in Appendix IV for definitions.

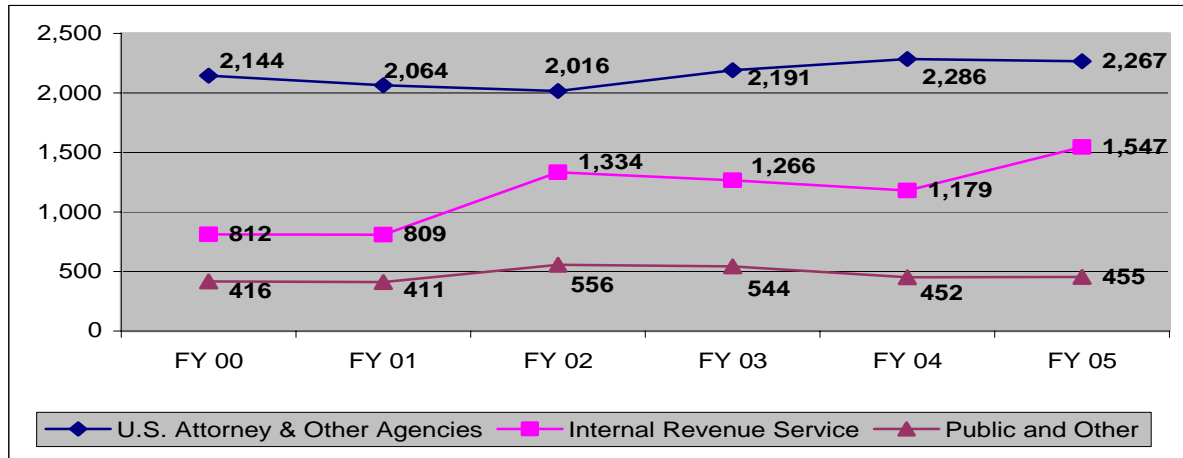


Source: CIMIS Report 11, Program Summary Analysis.



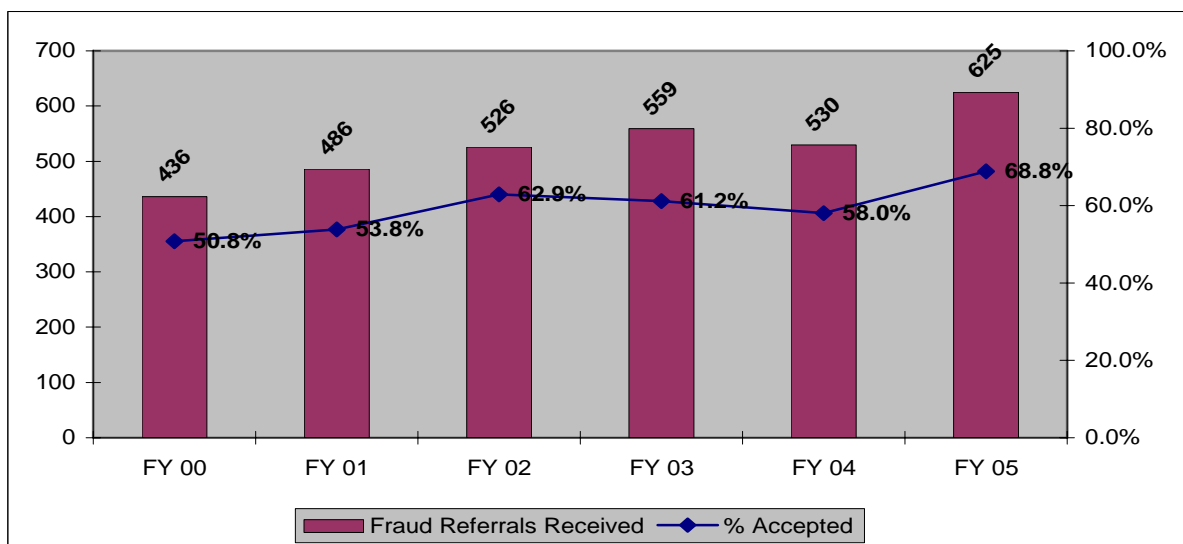
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Figure 8: Number of Subject Investigations Initiated Each Fiscal Year by Source of the Allegation or Information. IRS sources include fraud referrals from the Compliance functions, investigations developed by the Fraud Detection Centers and Lead Development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



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

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

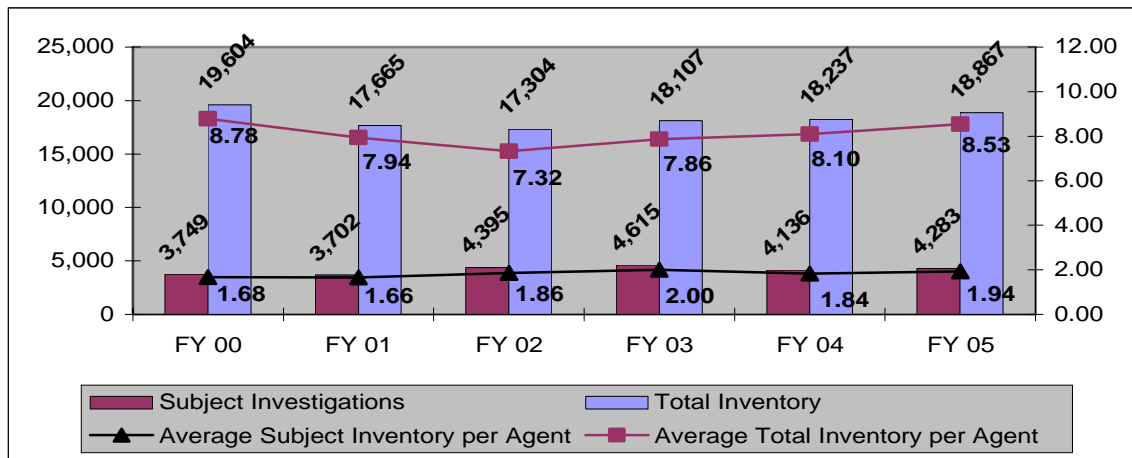


Source: The CI function's BPR reports.



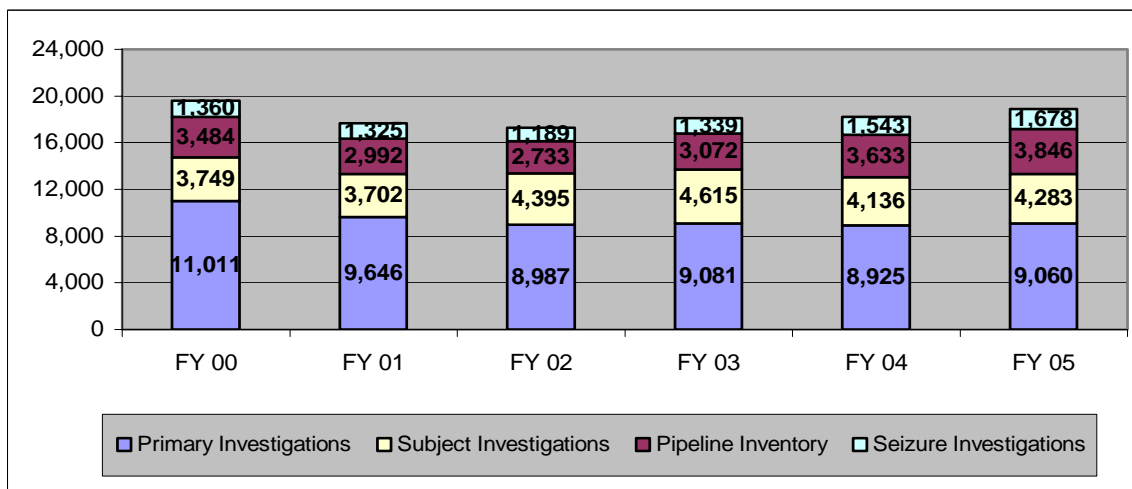
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Figure 10: Number of Open Subject Investigations, Total of All Investigations at the End of Each Fiscal Year, and Number per Nonsupervisory Special Agent in Field Offices.³ The total inventory includes open subject investigations as well as other investigations agents may have been assigned concurrently with open subject investigations, such as primary investigations, subject seizure investigations, and subject investigations that have been referred for prosecution (pipeline).



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

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



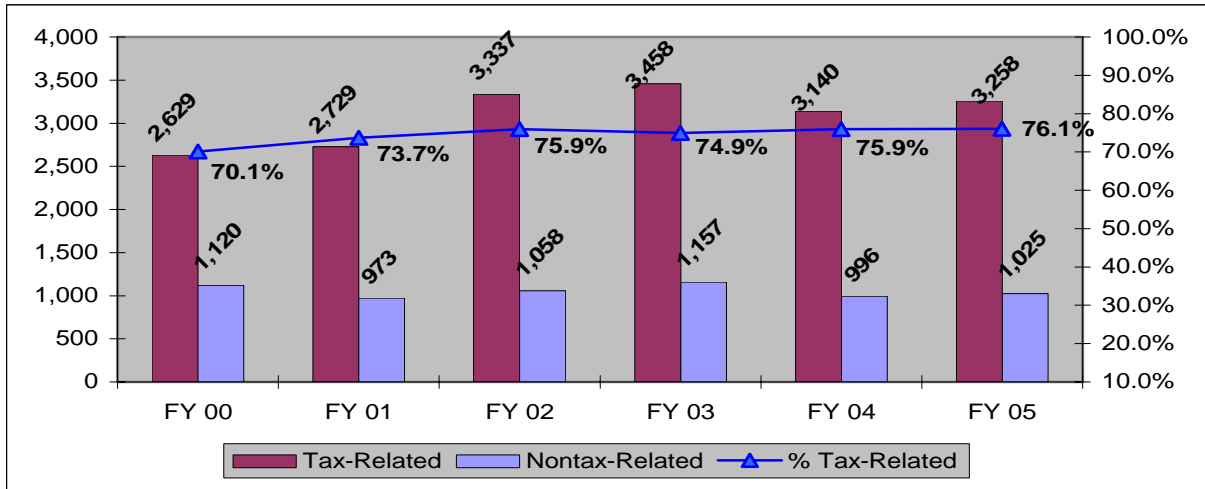
Source: The CI function's analysis of the CIMIS and National Criminal Investigation Statistics.

³ The CI function revised its calculation formula in FY 2005 to allow it to capture inventory numbers at fiscal yearend. As a result, the inventory numbers reported in Figures 10 and 11 for the prior fiscal years changed and may not agree with those in prior reports.



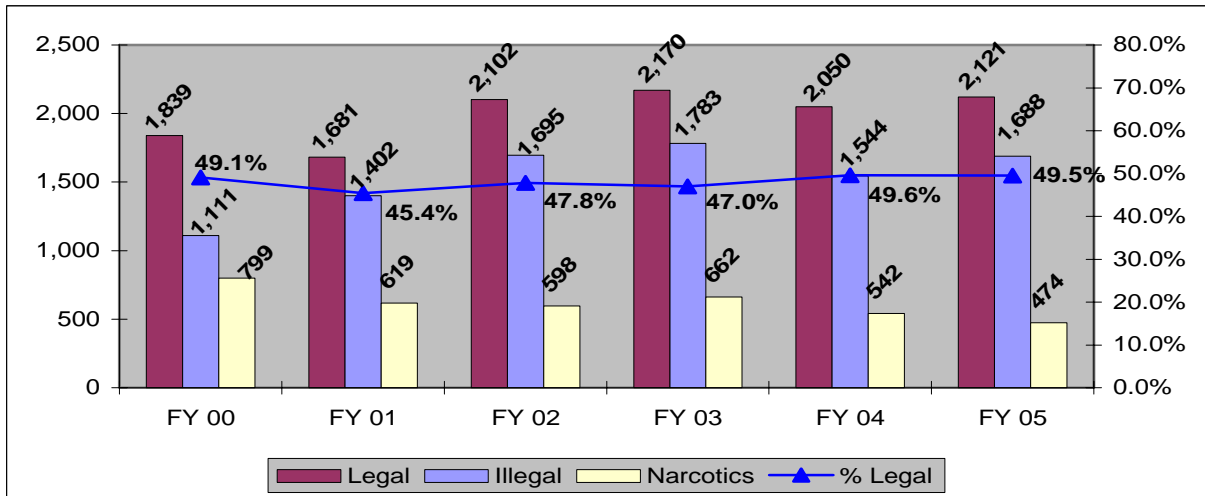
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Figure 12: Number of Open Subject Investigations Each Fiscal Year for a Tax-Related or Nontax-Related Violation and Percentage That Is Tax-Related.



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

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

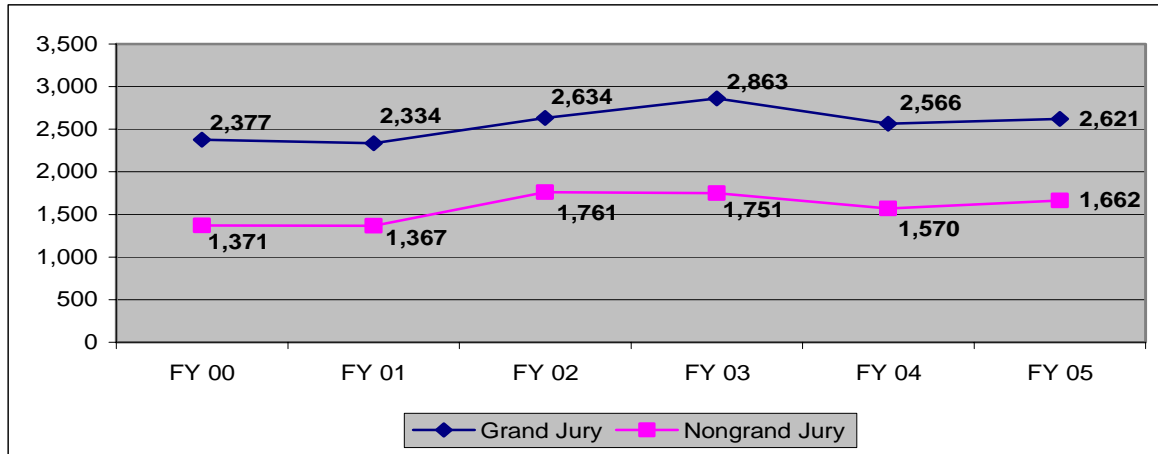


Source: The CI function's National Criminal Investigation Statistics and analysis of the CIMIS.



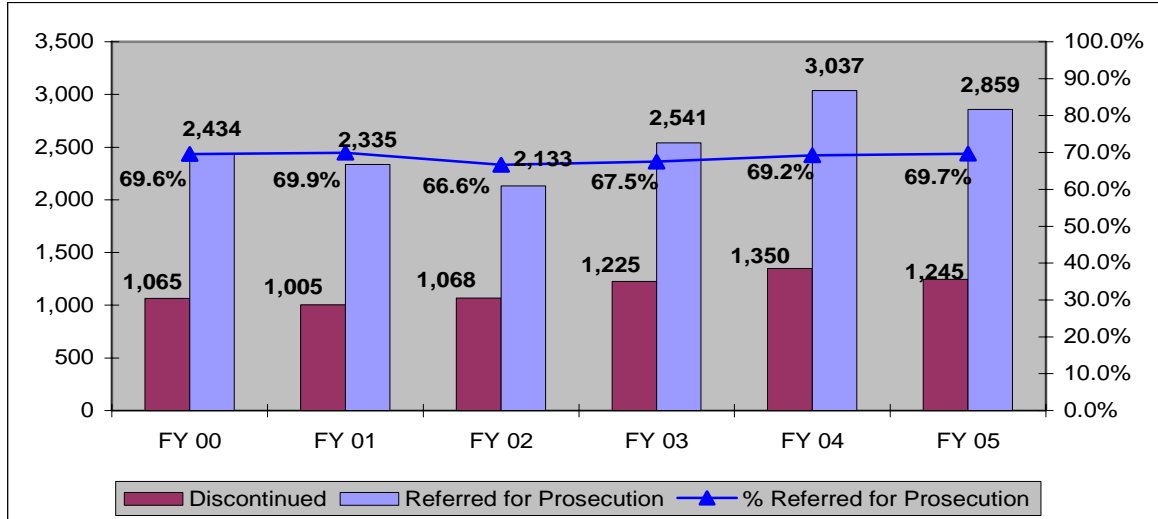
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Figure 14: Number of Open Subject Investigations at the End of Each Fiscal Year by Type of Investigation: Grand Jury or Nongrand Jury Investigation.



Source: CIMIS Report 11, Program Summary Analysis.

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

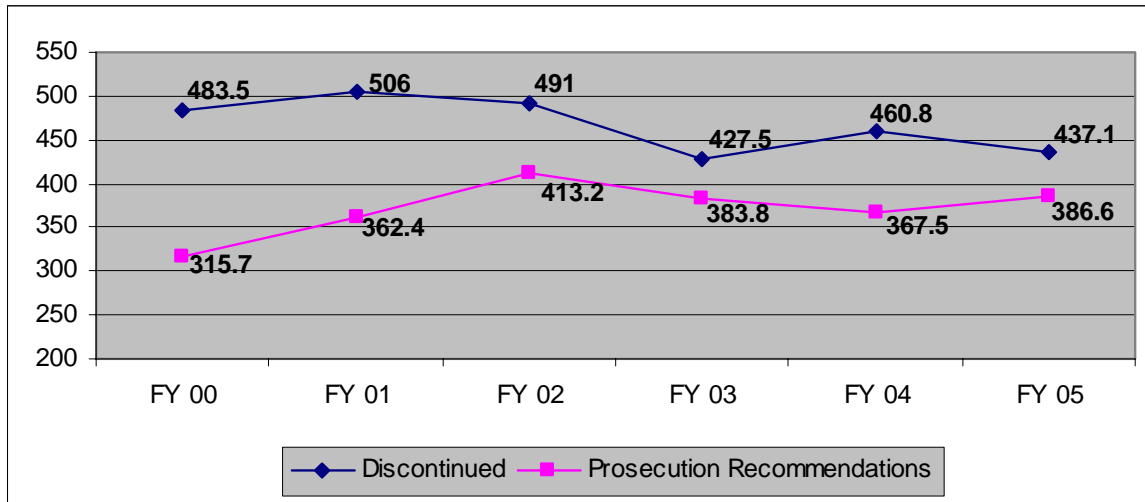


Source: IRS Data Book, Publication 55B for FYs 2000 through 2004 data, and CIMIS Report 11, Program Summary Analysis for FY 2005.



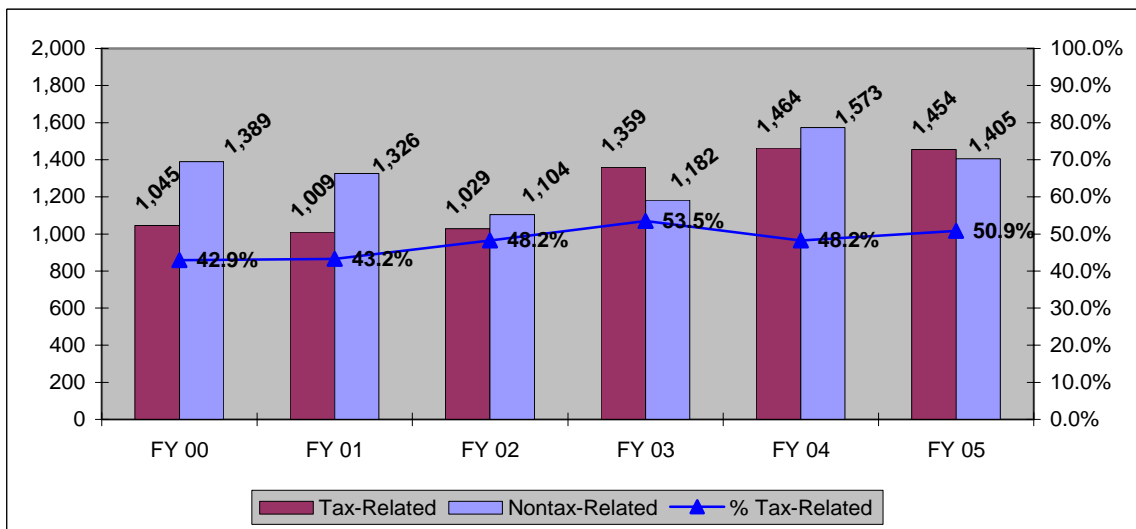
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Figure 16: Average Elapsed Days for Subject Investigations Discontinued and Referred for Prosecution Each Fiscal Year.



Source: CIMIS Report 11, Program Summary Analysis.

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

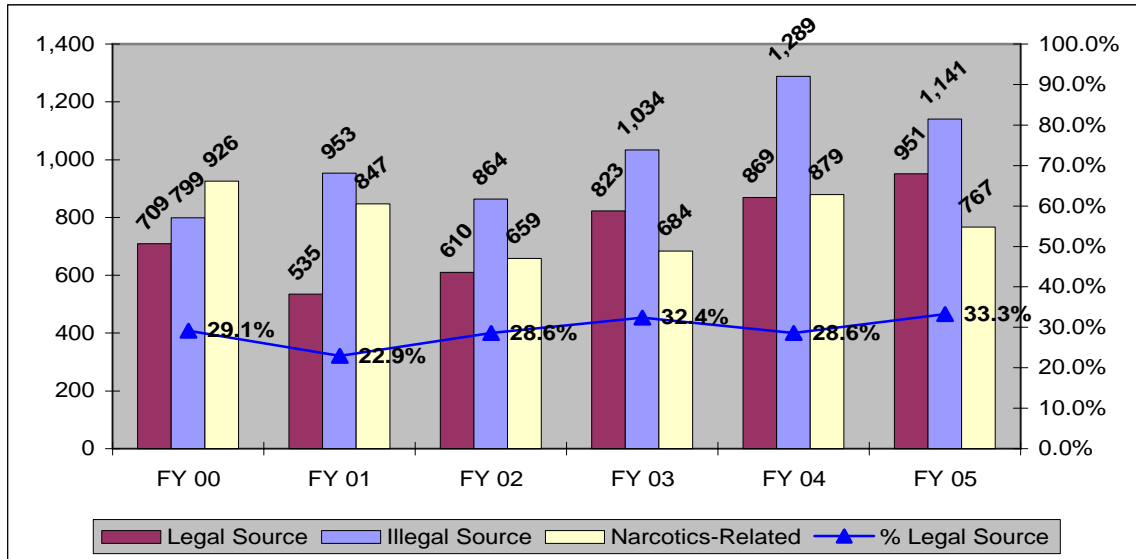


Source: The CI function's BPR reports and analysis of the CIMIS.



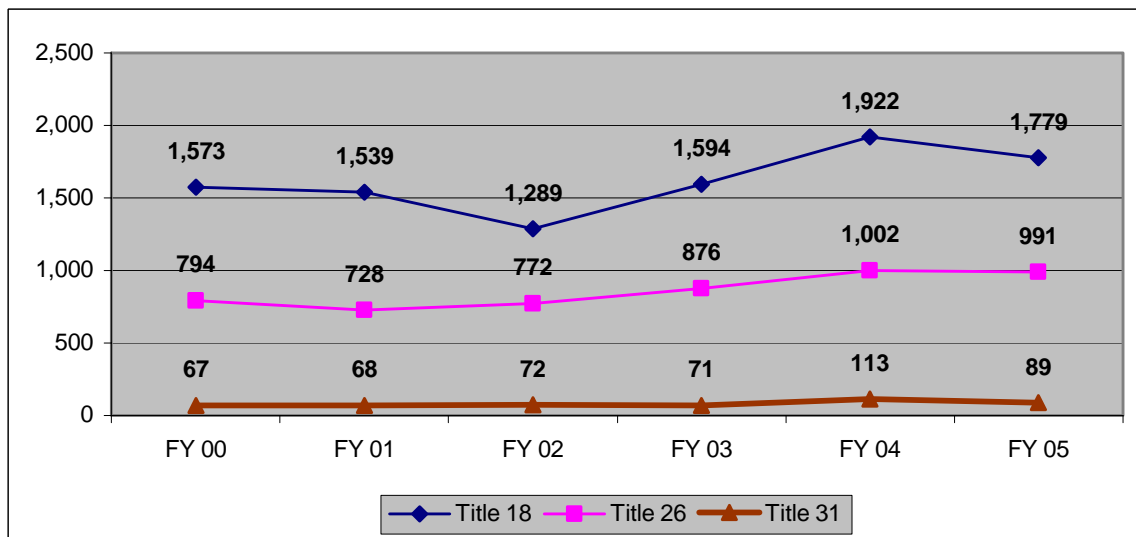
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Figure 18: Number of Subject Investigations Referred for Prosecution Each Fiscal Year by Compliance Strategy Program and Percentage That Is Legal Source Tax Crimes.



Source: IRS Data Book, Publication 55B for FYs 2000 through 2004, and the CI function's analysis of the CIMIS for FY 2005.

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

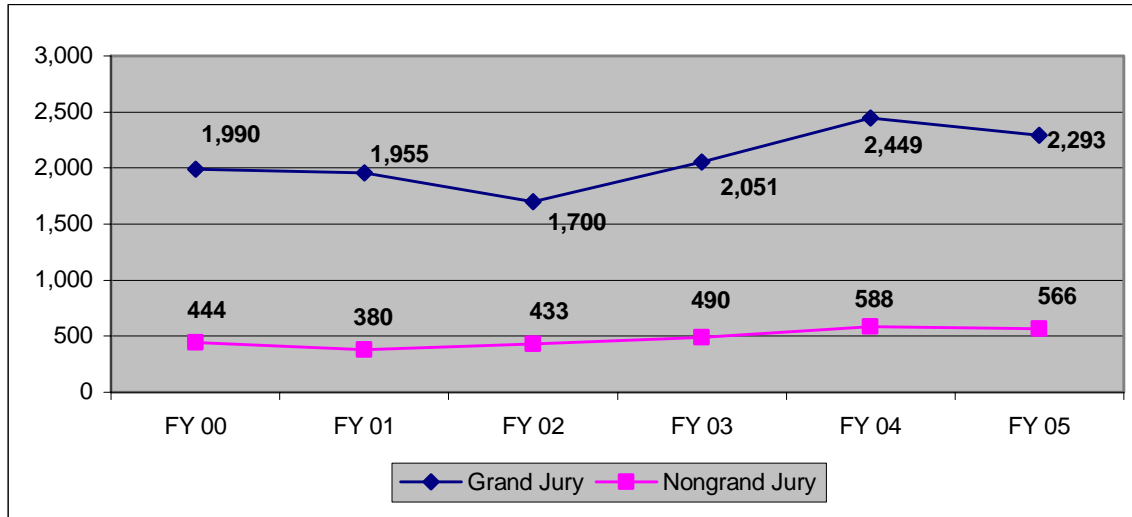


Source: CIMIS Report 11, Program Summary Analysis.



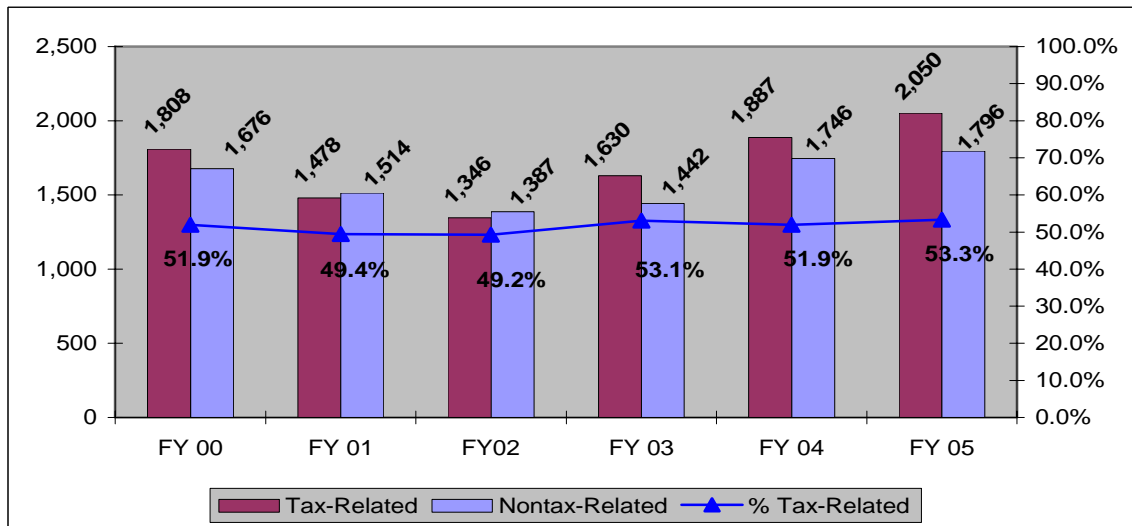
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Figure 20: Number of Subject Investigations Referred for Prosecution Each Fiscal Year by Type of Investigation: Grand Jury or Nongrand Jury Investigation.



Source: CIMIS Report 11, Program Summary Analysis.

Figure 21: Number of Tax-Related and Nontax-Related Subject Investigations in the Pipeline Each Fiscal Year and Percentage That Is Tax-Related.⁴



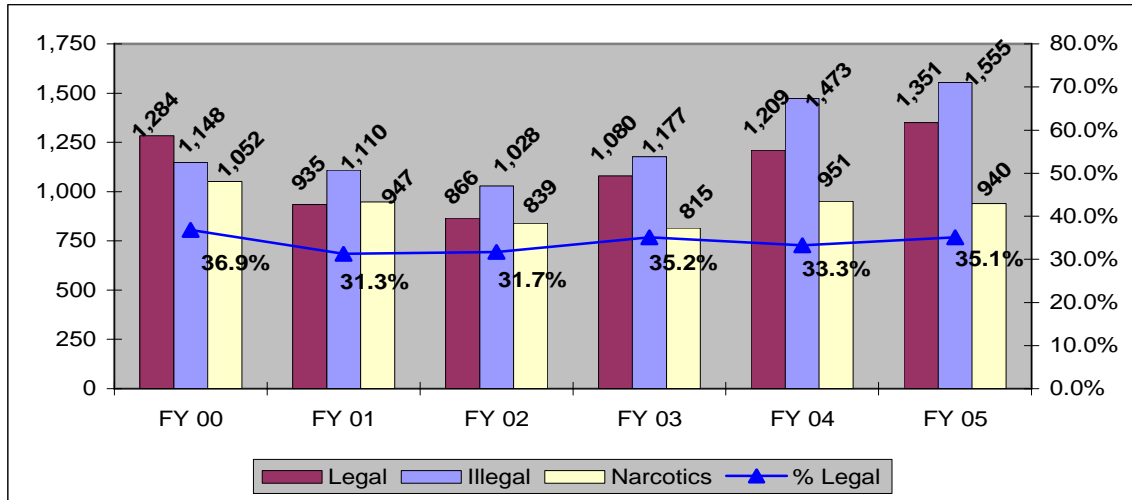
Source: The CI function's BPR reports and analysis of the CIMIS.

⁴ The CI function revised its calculation formula in FY 2005 to allow it to capture inventory numbers at fiscal yearend. As a result, the inventory numbers reported in Figures 21 and 22 for the prior fiscal years changed and may not agree with those in prior reports.



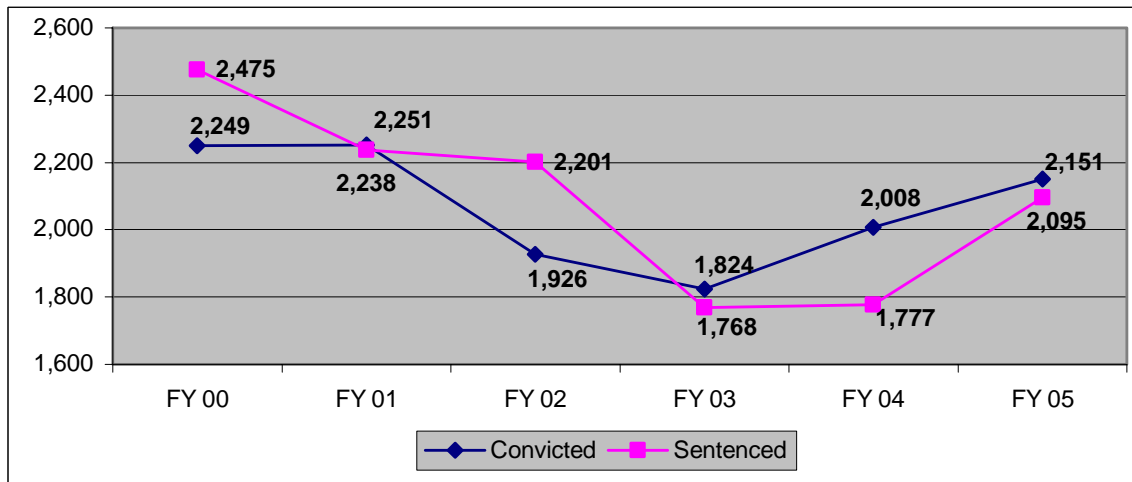
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Figure 22: Number of Subject Investigations in the Pipeline Each Fiscal Year by Compliance Strategy Program and Percentage That Is Legal Source Tax Crimes.



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

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

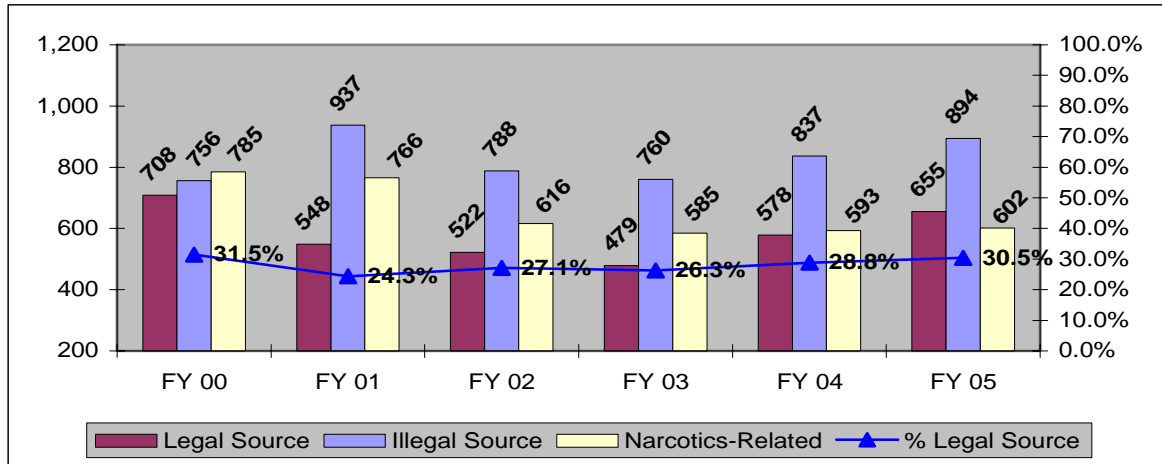


Source: IRS Data Book, Publication 55B for FYs 2000 to 2004, and the CI function's analysis of the CIMIS for FY 2005.



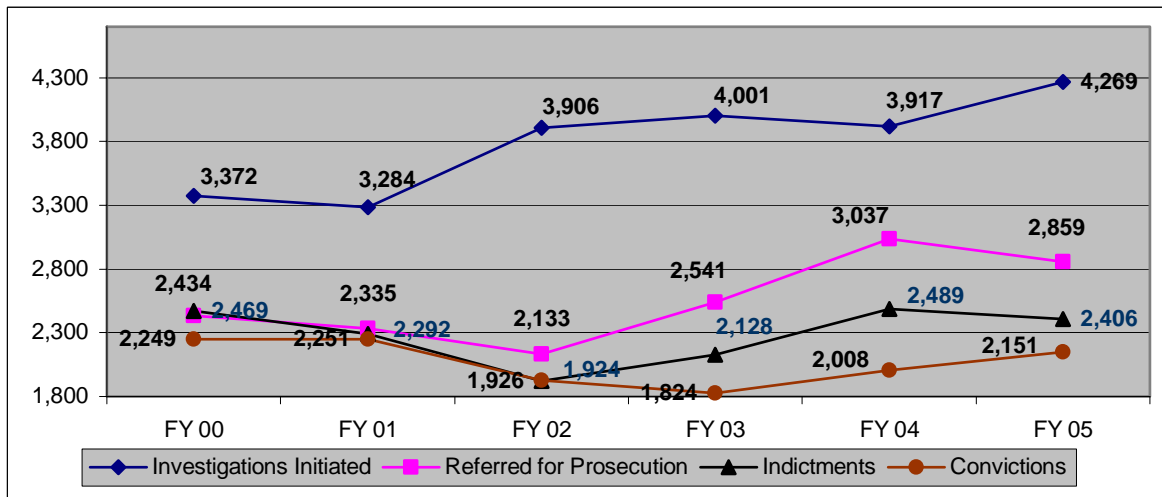
*Statistical Portrayal of the Criminal Investigation Function's
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Figure 24: Number of Subjects Convicted of a Crime Each Fiscal Year by Compliance Strategy Program and Percentage That Is Legal Source Tax Crimes.



Source: IRS Data Books, Publication 55B for FYs 2000 through 2004, and the CI function's analysis of the CIMIS for FY 2005.

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

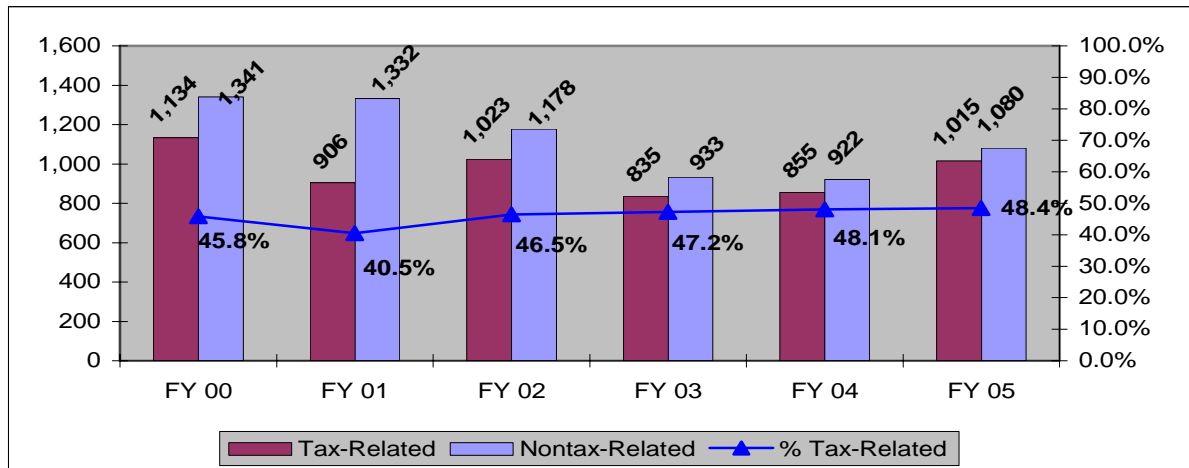


Source: IRS Data Book, Publication 55B for FYs 2000 through 2004, and the CI function's National Criminal Investigation Statistics for FY 2005.



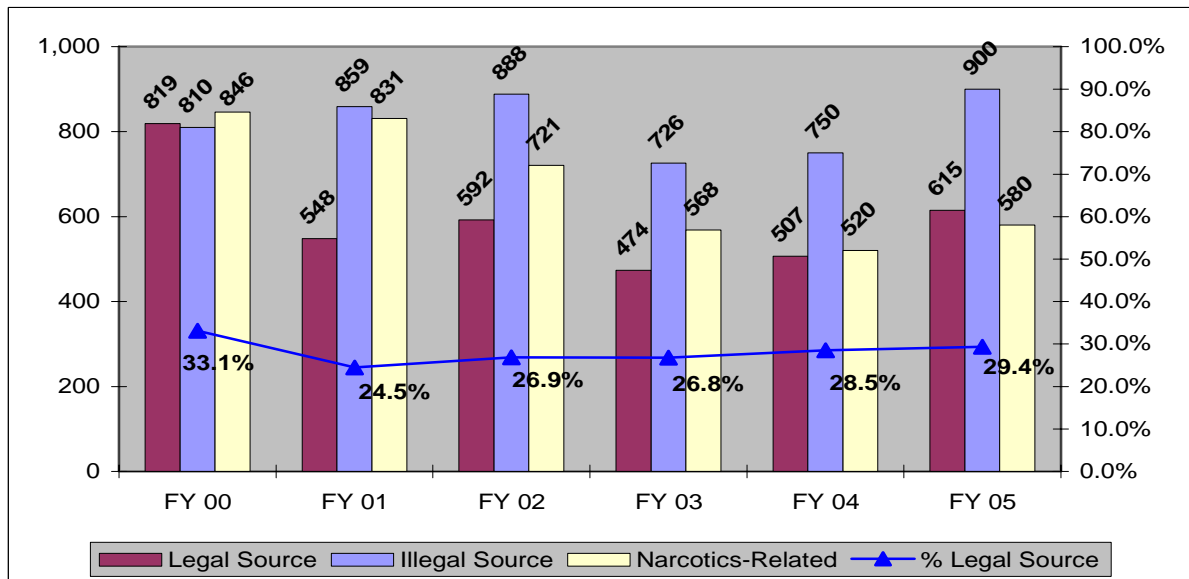
*Statistical Portrayal of the Criminal Investigation Function's
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Figure 26: Number of Subjects Sentenced for a Crime Each Fiscal Year for a Tax-Related or Nontax-Related Violation and Percentage That Is Tax-Related.



Source: CI function enforcement statistics derived from the IRS Internet web site for FYs 2000 through 2004 and the CI function's analysis of the CIMIS for FY 2005.

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

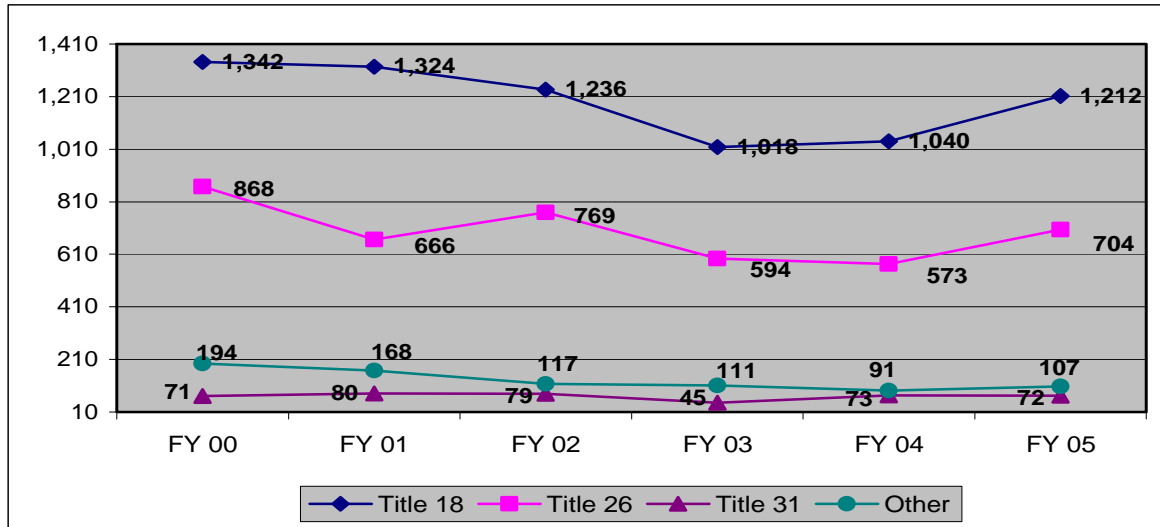


Source: IRS Data Books, Publication 55B for FYs 2000 through 2004, and the CI function's analysis of the CIMIS for FY 2005.



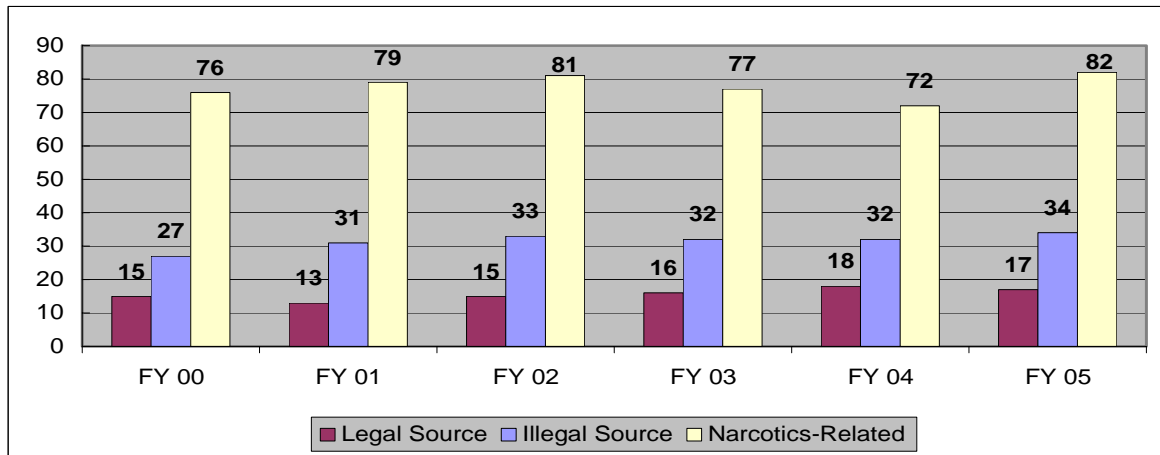
*Statistical Portrayal of the Criminal Investigation Function's
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Figure 28: Number of Subjects Sentenced for a Crime Each Fiscal Year by Principle United States Code Title.



Source: CIMIS Report 11, Program Summary Analysis.

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

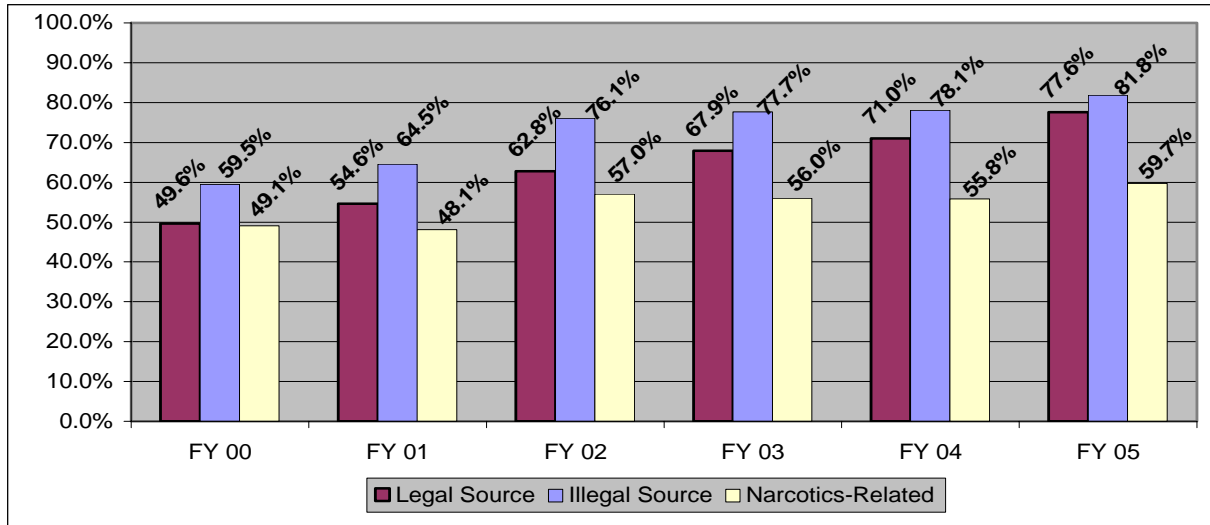


Source: The CI function's analysis of the CIMIS.



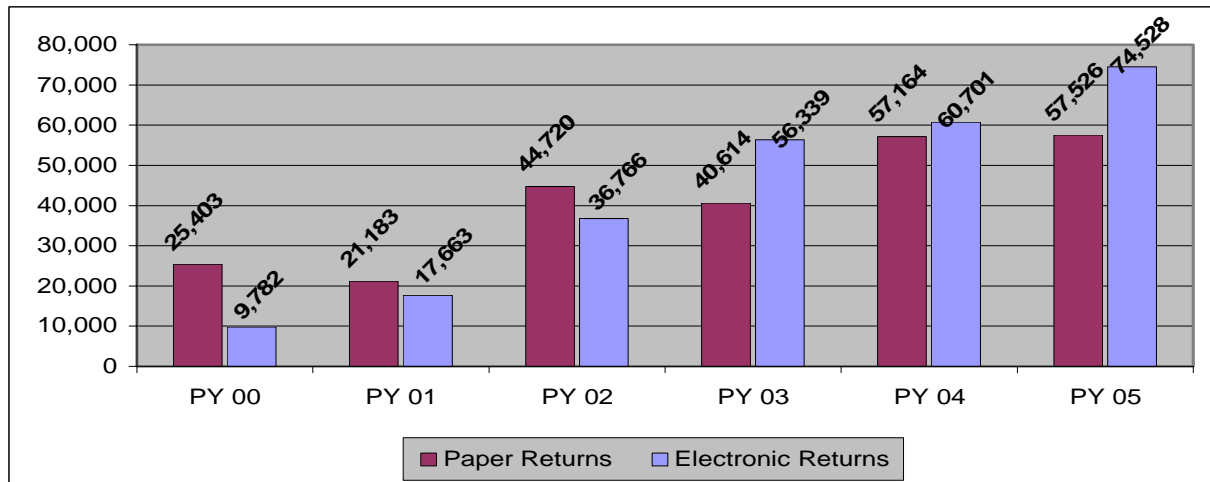
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Figure 30: Percentage of Investigations That Received Publicity Each Fiscal Year by Compliance Strategy Program.



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

Figure 31: Number of Paper and Electronic Returns Determined to Be Fraudulent or Potentially Fraudulent by the Criminal Investigation Function's Questionable Refund Program. PY refers to Processing Year.

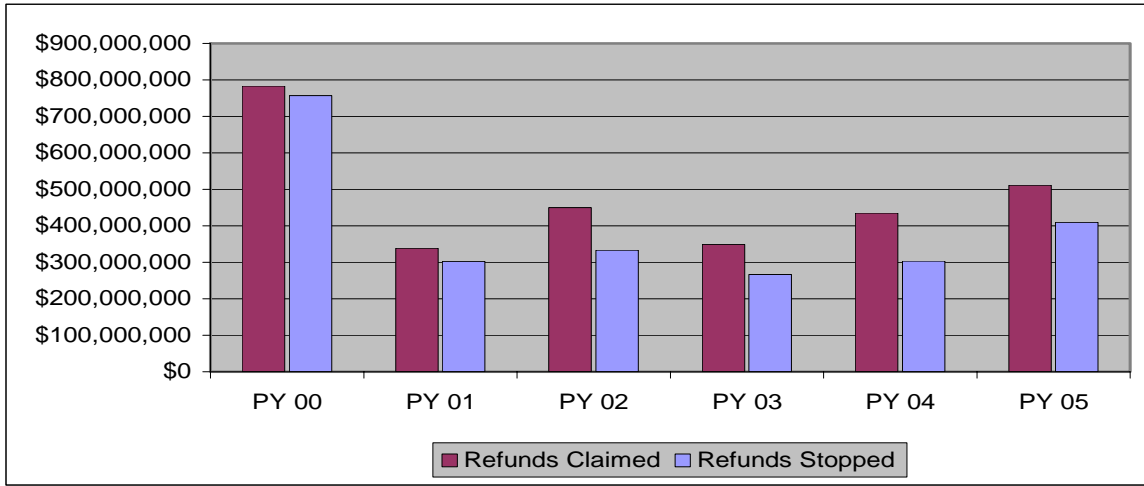


Source: The CI function's Office of Refund Crimes.



Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 2000 Through Fiscal Year 2005

Figure 32: Dollar Amounts of Fraudulent Refunds Identified and Stopped by the Criminal Investigation Function's Questionable Refund Program. PY 2000 includes a refund fraud scheme involving 1,672 tax returns with over \$215 million in false refunds claimed, over \$214 million of which were stopped. PY 2004 figures do not include 2 returns that claimed refunds of over \$1.8 billion.



Source: The CI function's Office of Refund Crimes.



*Statistical Portrayal of the Criminal Investigation Function's
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Appendix VI

*Management's Response to the Discussion Draft
Report*



Criminal Investigation

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

April 19, 2006

RECEIVED
APR 20 2006

MEMORANDUM FOR DANIEL R. DEVLIN
ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: Richard Speier, Jr. 
Acting Chief, Criminal Investigation

SUBJECT: Response To Discussion Draft Audit Report: Statistical Portrayal
of the Criminal Investigation Function's Enforcement Activities
From Fiscal Year 2000 Through Fiscal Year 2005
(Audit #200610006)

Thank you for the opportunity to respond to the discussion draft report. As your report reflects, Criminal Investigation (CI) has achieved significant results in the last several years thereby "effectively improving the discharge of its investigative responsibilities and mission." We also appreciate your report's recognition of CI's commitment to improving productivity and enforcing the tax laws, as demonstrated by the continued emphasis of CI management. However, after a careful review of the discussion draft report, we believe the following clarifications would be valuable additions to the report to make it more informative for the reader.

**Cover memo Page 2, third paragraph and Draft Report Page 8,
second paragraph**

"Further, our limited scope review of refund fraud committed by Federal and State prisoners, which has grown significantly in recent years, showed that inaccurate and missing information prevented the IRS from detecting all fraudulent refund returns filed by prisoners."

AND

¹ *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (reference number 2005-10-164, dated September 2005).

FINAL-CI Response to TIGTA Discussion Draft Enforcement Statistics Report FY 2000-2005



*Statistical Portrayal of the Criminal Investigation Function's
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Fiscal Year 2005*

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"In April 2005, at the request of the House Ways and Means Subcommittee on Oversight, we conducted a limited scope review² concerning refund fraud committed by individuals who are incarcerated in Federal and State prisons, which has grown significantly in recent years. We reported that inaccurate and missing information from the prisoner data file prevented the IRS from detecting all fraudulent refund returns filed by prisoners."

Although it is true that the quality and completeness of electronic data is a critical factor affecting CI's ability to address false refunds claimed by prisoners, it is important to note that the problem originates with the prisons supplying the data. Most states, the District of Columbia, and the Federal Bureau of Prisons strive to comply with IRS requests for a complete and accurate annual listing of all their inmates; however, gaps and irregularities in the data do exist. Criminal Investigation continues to work with prison officials to perfect both the process and the data they submit.

Draft Report Page 4, third paragraph

During this review, the Department of Treasury, OMB, and the CI function jointly determined that the measure of completed investigations was insufficient to measure program effectiveness. The Department of Treasury and the OMB requested the development of new measures to reflect efficiency and a return on investment. As a result, the CI function introduced three new annual performance measures: the number of convictions (a measure of impact on compliance); the conviction rate (a measure of quality of investigations);³ and, conviction efficiency (a measure of cost efficiency).⁴

The three new measures in concert with the old one (completed investigations) provide a suite of annual performance measures that better assist CI in evaluating its effectiveness. It is important to note that these measures are strictly utilized at the national level for planning and budgetary purposes.

² *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (reference number 2005-10-164, dated September 2005).

³ The conviction rate is defined as the total number of cases with investigation status codes of guilty plea, nolo-contendere, judge guilty or jury guilty divided by the total number of cases with these same status codes plus nolle prosequi, judge dismissed, judge acquitted, and jury acquitted.

⁴ The measure quantifies the average dollar cost of convictions and is computed by dividing the CI function's financial plan by the number of convictions.



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Draft Report Page 5, third paragraph

"While these statistics represent an increase in productivity, increasing special agent staffing remains a challenge as the CI function continues to lose experienced special agents to attrition faster than it can replace them. According to its most recent estimates, the CI function expects to lose about 160 and 170 special agents in FYs 2006 and 2007, respectively; while only hiring about 48 special agents during each of those years."

The draft report correctly identifies special agent staffing as a continuing challenge for CI. Criminal Investigation recently received assistance from Small Business/Self-Employed (SBSE) that will allow us to increase anticipated fiscal year (FY) 2006 special agent hiring to approximately 120. In addition, we currently project FY 2007 special agent hiring to be 120 as well. The CI management team continues to explore ways to maximize the efficiency and productivity of its special agent workforce.

Draft Report Page 5, last paragraph

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

Criminal Investigation tracks two different inventory statistics. One is open subject criminal investigations per special agent, which stood at 1.94 per special agent at the end of FY 2005, while the other is total inventory per special agent.⁵ We concur with your assessment that total inventory per special agent is the better indicator of a special agent's workload. As your report indicates the total inventory per special agent stood at a four year high of 8.53 at fiscal year end 2005.

As for the length of time it takes CI to complete investigations, the average cycle time for all investigations completed during FY 2005 was 401.83 days and 386.58 days for prosecution recommendations. Both of these numbers are significantly below the two year mark quoted.

⁵ Total inventory includes open subject investigations, as well as subject seizure investigations, investigations recommended for prosecution (pipeline), and investigation development activities (primary and general investigations).



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Draft Report Page 6, Bullet 2 and Page 22, Figure 3

"The amount of DIT spent on legal source and tax-related are at 6-year highs, and have increased 2.4 and 2.3 percentage points respectively since FY 2003".⁶

The percentage of Direct Investigative Time (DIT) applied to tax-related investigations was actually 65.7, 66.2, and 67.4 for fiscal years 2003, 2004, and 2005, respectively. This results in a 1.7 percent increase since 2003, versus the 2.3 percent currently noted in the report.

Draft Report Page 8, last paragraph

"In January 2006, the National Taxpayer Advocate issued the 2005 Annual Report to the Congress reporting significant problems with the Questionable Refund Program (QRP) as currently designed and administered. Shortly thereafter, the Senate Finance Committee and the House Ways and Means Oversight Subcommittee sent letters to the Secretary of the Treasury and the IRS Commissioner expressing concern that taxpayers, whose refunds were frozen, were not always notified. The Congress requested a review of the QRP, and on January 24, 2006, the IRS Commissioner announced he initiated an internal review to improve the QRP process. We are also conducting a review of the CI function's QRP to determine the effectiveness of procedures for detecting fraudulent and potentially fraudulent refund returns".⁷

Criminal Investigation immediately went to work on this issue. By working in conjunction with the Taxpayer Advocate Service (TAS); Wage and Investment (W&I); SB/SE; and Modernization, Information, and Technology Services (MITS), CI developed and instituted significant improvements to the Questionable Refund Program (QRP) as it relates to frozen refunds. Specifically, those individuals whose refunds are frozen due to suspected fraud are now being provided with a notice. The issuance of these notices provides the affected individuals with information regarding the status of their refunds, a timeline for action by the IRS, and the next steps to take if the IRS fails to meet the timeline. The first notices were sent to impacted individuals in March 2006. The National Taxpayer Advocate has indicated the new procedures strike the proper balance between combating suspected tax fraud and protecting taxpayer's rights. Criminal Investigation continues to explore ways to improve the QRP overall.

⁶ Appendix V, Figure 3. Also, the CI function has reduced the narcotics program DIT from 15.1 percent in FY 2003 to 12.1 percent in FY 2005, to more closely align with funding received from the Organized Crime Drug Enforcement Task Force program. Thus, the CI function could redirect these resources into legal source and tax-related cases.

⁷ *Review of the CI function's Questionable Refund Program* (Audit Number 200610003).



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Draft Report Page 9, last paragraph

"We continue to believe the CI function should remain vigilant when evaluating whether the level of cases initiated from sources external to the IRS maintains a proper balance with its stated priorities of legal source and tax-related investigations. We previously reported that the tax enforcement process works most effectively if the CI function and the various USAOs have the same priorities.⁸ While we understand the CI function needs to maintain an effective working relationship with the USAOs, we also believe the CI function must be judicious in deciding which investigations to work with other agencies (especially if the connection to tax administration is not clear)."

The CI FY 2006 Annual Business Plan (ABP) provides guidance to assist the Area and Field Offices in developing local plans and action items to support the CI Strategy and Program Plan. It specifically requires CI to maintain its focus on legal source tax investigations. It also calls for CI to effectively work with its law enforcement partners "to enforce tax laws and criminal statutes to combat corporate fraud, terrorism, and the financial aspects of other criminal activity, and to enhance Bank Secrecy Act compliance efforts." In order to assist field offices in achieving the desired results, headquarters CI released guidance materials in early FY 2006, designed to assist field management in selecting those investigations most closely aligned with the CI mission. While we agree our primary focus should be on legal source/tax related investigations, Criminal Investigation is committed to working the highest impact cases with the greatest deterrent effect.

Despite the fact that sources from within the IRS are significant generators of legal source investigations, the deterrent effect of illegal source and narcotics investigations should not be discounted. In fact, two research documents, completed in 2001 and 2004, answered several important compliance questions. Collectively, they provide a useful perspective from which to evaluate past, present, and future compliance strategies. Criminal Investigation's experience since the 2000 reorganization, coupled with the conclusions contained in these reports, validate its past and present case mixes and their effect on voluntary compliance.

The first report prepared by IRS for the Secretary of the Treasury in July 2001 was entitled Money Laundering's Role in IRS Tax Administration. This report explores the widely recognized use of money laundering by domestic and international criminal enterprises to conceal illegal, untaxed proceeds. More importantly, it brought into sharp focus the pivotal role money laundering plays in

⁸ *The Criminal Investigation Function Has Made Progress in Investigating Criminal Tax Cases; However, Challenges Remain* (reference number 2005-10-054, dated March 2005).



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many legal source income tax evasion schemes, particularly, the most ambitious and sophisticated abusive tax schemes.

In June 2004, Professor Jeffrey A. Dubin prepared the second report, entitled **Criminal Investigation Enforcement Activities and Taxpayer Noncompliance**. Through his empirical study, Professor Dubin concluded that CI's activities have a measurable effect on voluntary compliance. He further concluded that the type of investigation (tax versus money laundering) was not a factor on voluntary compliance.

Draft Report Page 10 Figure 1, 2004 and 2005 Fraud Referral Performance Results - Number of Investigations Recommended for Prosecution

The number of investigations recommended for prosecution in FY 2004 is actually 245, versus 232 as depicted in the draft report. This correction also causes the percentage change of the number of investigations recommended for prosecution to decrease from 40.1 to 32.7 percent.

Draft Report Page 10 Figure 1, 2004 and 2005 Fraud Referral Performance Results - Number of Subjects Convicted

The number of subjects convicted for fiscal year 2004 was listed as 142 in the draft report; however, 185 subjects were actually convicted. The revision results in a decrease in the percentage change of subjects convicted from 29.6 to -0.5 percent.

Draft Report Page 15, last item (continuing to page 16) and Page 16, second full item

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

AND

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

As mentioned in your draft report, investigations worked in conjunction with other law enforcement agencies are defined as illegal source. Conversely, cases involving legal industries and occupations and legally earned income are classified as legal source. However, it is important to point out that some of CI's



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investigations involving legal industries, legal occupations, and legally earned income also involve other law enforcement agencies. When this situation occurs, CI classifies the case as illegal source. This allows CI to more accurately track those investigations that no agency other than IRS can address.

Draft Report Page 36, Figure 28

Figure 28 refers to the number of subjects sentenced for a crime each fiscal year by principle United States Code violation. For fiscal year 2003, the listed number of "Other" violations sentenced is 168. However, the correct number is actually 111. For fiscal year 2004, the number on the chart is 194, while the correct number is 91.

If you have any questions concerning this response, please contact me at (202) 622-3200 or contact Acting Director, Planning and Strategy, Andrea Whelan at (202) 622-7758.