



Department of Justice

STATEMENT OF

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BEFORE THE

**SUBCOMMITTEE ON COURTS, COMMERCIAL AND ADMINISTRATIVE LAW
COMMITTEE ON JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES**

REGARDING

OVERSIGHT OF THE TAX DIVISION

PRESENTED

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**Statement of Kathryn Keneally
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Tax Division
Department of justice**

**Before the
Subcommittee on Courts, Commercial and Administrative law
Committee on the Judiciary
United States House of Representatives**

**Concerning the
Tax Division of the
United States Department of Justice**

Chairman Coble, Ranking Member Cohen, and Members of the Subcommittee, thank you for inviting me here to testify on the work of the Tax Division. On April 6, 2012, I had the privilege of being sworn in as the Assistant Attorney General for the Division. While my arrival in the Department is fairly recent, my experience with federal tax administration and litigation is not. Over the course of my career I have represented many clients before the Tax Division, the United States Attorneys' Offices and the Internal Revenue Service (IRS) on a wide variety of civil and criminal tax matters. My career in tax law has instilled in me the belief that effective tax administration must be guided by two fundamental tax principles. First, all of us who work in tax administration owe it to all taxpayers who voluntarily comply with our tax laws to enforce the laws against those who do not comply. Second, because tax touches all citizens, residents, and income-earners, there must be a fair and consistent tax enforcement policy throughout the country. Based on my years of interaction with Tax Division prosecutors and attorneys, it came as no surprise to me that these values are deeply ingrained in the culture of the Division. As Assistant Attorney General, I look forward to reaffirming these principles and leading the Division in what can only be described as the increasingly more complex and global task of tax enforcement on behalf of the American taxpayer.

As the legal enforcement arm of the IRS, the Tax Division plays a critical role in the fair and consistent administration of our tax laws. The IRS has primary responsibility for determining and collecting taxes owed and, in most cases, the IRS's administrative powers are sufficient to ensure compliance with the tax laws. However, when taxpayers do not voluntarily comply, the IRS relies on the Tax Division to bring timely enforcement in federal court. Among other matters, the Tax Division enforces and defends IRS summonses to gather information for

ongoing tax examinations; collects and defends tax assessments when taxpayers do not pay voluntarily; obtains civil injunctions to shut down tax-scam promoters; authorizes almost all criminal tax prosecutions; and investigates and prosecutes criminal tax violations throughout the country. Each year the Division has approximately 6,000 civil cases in process, handles hundreds of civil and criminal appeals, and authorizes between 1,300 and 1,800 prosecutions.

The Tax Division's mission is to enforce the nation's tax laws fully, fairly, and consistently throughout the country in order to promote voluntary compliance with the tax laws, maintain public confidence in the integrity of the tax system, and promote the sound development of the law. In each and every case, Tax Division attorneys strive to collect the proper amount of tax due and owing -- no more and no less. Tax Division prosecutors authorize and prosecute cases after determining that there is a reasonable probability of conviction based on the existence of sufficient admissible evidence to prove all of the elements of the offense charged. To carry out its mission, the Tax Division currently has 378 attorneys, who are assigned either to one of sixteen sections and offices located in Washington, D.C., or to the Southwestern Civil Trial Section located in Dallas, Texas. Attorneys are supported by 153 administrative support employees.

The President's Budget for the 2013 fiscal year provides \$106.5 million in funding for the Tax Division. This funding level will allow the Division to continue its enforcement efforts through its prosecutions, collections, and injunction actions -- all areas that are critical to the full and fair enforcement of the tax laws enacted by Congress. Given that on average every dollar invested in a Division attorney results in a savings of at least \$13 to the Federal Treasury, the full funding of the Tax Division is a wise investment in the economic stability of the nation.

Civil Litigation

Civil Trial The Tax Division is responsible for litigating all matters arising under the internal revenue laws in all state and federal trial courts, except the United States Tax Court. Tax Division civil litigators enforce the Internal Revenue Service's requests for information in ongoing examinations, and collect and defend tax assessments when the examinations are completed. Tax cases filed against the United States comprise nearly 71% of the Division's caseload, both in the number of cases to be litigated and the number of attorney work-hours devoted to them each year. At any given time, Tax Division civil trial attorneys are responsible for nearly 6,000 cases in various stages of resolution. Each year, the Division's civil trial

attorneys save the Treasury hundreds of millions of dollars through their representation of the government in defense of refund claims brought by taxpayers. As of September 30, 2011, the Division was defending tax refund cases worth approximately \$10.4 billion to the Federal Treasury.

The Tax Division contributes significantly to closing the tax gap through its affirmative civil litigation to collect tax debts. The goal of this litigation is to enforce the tax laws and collect taxes that would otherwise go unpaid. Collection suits have a direct and positive effect on the Treasury. The Division consistently collects more each year than its entire budget. For example, over the past five fiscal years, the Division has collected in excess of \$1.2 billion in unpaid tax debts. Given that the IRS only refers to the Tax Division tax debts that the IRS has been unable to collect administratively, the Division's efforts are a tremendous return on investment in collecting the most difficult debts.

As a result of both its refund and collection litigation, the average return on investment over the last five fiscal years for each dollar invested in a Tax Division attorney is 13:1. While the direct return for each budget dollar invested is impressive, it pales in significance to the precedent our cases set. Many issues run across industry or other lines, affecting many more taxpayers than just those in suit, with an impact that continues year after year. Of equal importance, the Division's litigation assures honest taxpayers that those who choose not to pay their fair share will be pursued and penalized.

The portfolio of the Tax Division attorneys includes a wide array of procedural and substantive tax matters which can affect just an individual taxpayer or business, a large number of similarly-situated individual taxpayers or even an entire industry. Transactions at issue can range from the proper reporting of income and deductions on a Form 1040 to the consequences of an investment in a complex corporate tax shelter. Tax Division attorneys are also responsible for defending the interests of the United States in bankruptcy proceedings. When a matter is referred by the IRS for defense or litigation, the Division independently analyzes the facts and applicable law to ensure that the tax system is being enforced uniformly and fairly across the country. While the Division does not prevail in every case it litigates, Division attorneys are scrupulous about advancing positions they believe to be correct under the applicable statutes and judicial precedents, and settling or conceding cases when appropriate. As a result, the Tax Division civil attorneys are successful in more than 95% of civil cases that they litigate each year.

Voluntary compliance requires that all taxpayers fully and timely pay their fair share. While the overwhelming majority of taxpayers are compliant, unfortunately a small segment of the population is willing to promote schemes that encourage and facilitate noncompliance. In some instances, the government engages in parallel civil and criminal investigations to stop and punish the misconduct. As part of its civil tax enforcement, the Tax Division has a successful injunction program that has shut down many tax-fraud promoters and fraudulent tax-return preparers. The promoters sued range from those who design and market “too good to be true” eliminate-your-taxes schemes, to lawyers and accountants selling sophisticated, complex tax shelters to wealthy business owners. Since 2000, Tax Division attorneys have obtained injunctions against more than 500 tax-fraud promoters and return preparers. This number represents a dramatic increase over the 1990s, when the total number of promoters and preparers enjoined barely reached 25 for the entire decade. The schemes the Division has enjoined during the past several years had cost the Federal Treasury more than \$2 billion and placed an enormous administrative burden on the IRS. If permitted to continue unchecked, these schemes would undermine public confidence in the integrity of our tax system, and require both the IRS and the Tax Division to devote tremendous resources to detecting, correcting, and collecting the resulting unpaid taxes. As part of our injunction program, we have developed close working relationships with IRS agents and attorneys to ensure that misconduct is detected early, investigated fully, and referred quickly so that it can be stopped before it spreads further.

Civil Appellate Tax Division civil appellate attorneys are responsible for briefing and arguing civil federal tax cases before the United States courts of appeal. Civil appellate attorneys handle about 700 cases a year, and about half of the cases involve appeals from decisions of the United States Tax Court, with the balance arising from decisions of the United States district courts and the Court of Federal Claims. Civil appellate attorneys also assist the Solicitor General of the United States in drafting pleadings and briefs filed in federal tax cases considered by the United States Supreme Court. These include amicus curiae briefs in suits that present issues affecting the interests of the United States, or in which the Court invites the United States to provide its views on tax-related questions. When the government receives an adverse decision, the Appellate Section closely evaluates the legal and policy implications of the decision and provides a recommendation to the Solicitor General, taking care to ensure that resources are spent wisely only on the most meritorious government appeals.

Criminal Investigation and Prosecution

Criminal Trial In addition to our extensive civil practice, the Tax Division authorizes all prosecutions arising under the federal tax laws except for excise taxes and criminal disclosure violations. In most cases, Division attorneys either conduct or supervise these prosecutions, often in partnership with prosecutors from the United States Attorneys' Offices. The Division's twin criminal goals are to prosecute criminal tax violations and to promote uniform nationwide criminal tax enforcement. In many cases, the Tax Division receives requests from the IRS to prosecute violations after the IRS has completed an administrative investigation. In other cases, the IRS asks the Tax Division to authorize grand jury investigations to determine whether prosecutable tax crimes have occurred. Tax Division prosecutors review, analyze, and evaluate referrals to ensure that uniform standards of prosecution are applied to taxpayers across the country. In the past few years, the Division has authorized between 1,300 and 1,800 criminal tax investigations and prosecutions each year. After tax charges are authorized, cases are handled by a United States Attorney's Office, by a Tax Division prosecutor, or by a team of prosecutors from both. Tax Division prosecutors also conduct training for IRS criminal investigators and Assistant United States Attorneys, and provide advice to other federal law enforcement personnel, such as the DEA and the FBI.

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

Tax Division prosecutors also investigate and prosecute tax violations that have been committed along with other criminal conduct, such as securities fraud, bank fraud, identity theft, bankruptcy fraud, health care fraud, organized crime, public corruption, mortgage fraud, and narcotics trafficking. In addition, Tax Division prosecutors investigate and prosecute domestic tax crimes involving

international conduct, such as the illegal use of offshore trusts and foreign bank accounts used to conceal taxable income and evade taxes. As tax crimes have become more complex and international in scope, so has the workload of Tax Division prosecutors. In addition to the traditional cases involving unreported legal source income, over the last several years a greater proportion of our cases involve high net worth taxpayers and tax professionals who sell and implement dubious tax schemes. During FY 2011, Division prosecutors obtained indictments in 145 cases and convictions in 137 cases. The conviction rate for cases brought by Tax Division prosecutors usually exceeds 95%.

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

It is apparent from this brief overview that Tax Division attorneys and prosecutors are involved in every facet of federal tax enforcement. While we continue to maintain a sizeable caseload of what may be considered "traditional" tax enforcement matters, we are also mindful of the need to identify and respond to ongoing, growing, and new trends in civil and criminal noncompliance. I would like to take a moment to highlight four areas of noncompliance that are among our highest enforcement priorities -- stolen identity refund fraud, abusive tax shelters, offshore tax schemes, and tax defiers.

Stolen Identity Refund Fraud

Investigating, stopping and prosecuting individuals who engage in tax refund fraud have always been top priorities for the Tax Division. Using a variety of civil and criminal enforcement tools, the Division, along with our partners at the IRS and in the United States Attorneys' Offices, has successfully shut down hundreds of

unscrupulous preparers and individuals who viewed the Federal Treasury as a personal bank account. Their schemes have included filing returns containing inflated, false deductions or false W-2 income statements, or preparing returns and failing to remit the refund to the taxpayer. Recently a new and even more aggressive scheme has cropped up across the country at an alarming rate -- stolen identity refund fraud.

The plan is frighteningly simple – steal social security numbers, file tax returns showing a false refund claim, and then have the refunds electronically deposited or sent to an address where the wrongdoer then can get access to the refunds. In many cases, the taxpayer whose social security number has been compromised will later face difficulties when he or she files a tax return after the IRS has received a false return using that taxpayer's social security number. In other cases, the false returns are filed using social security numbers of deceased taxpayers or others from whom no federal tax return may be due for filing. These schemes are usually implemented in early January, so that the thieves can file before the proper taxpayer is expected to file, with the goal of taking advantage of the IRS's efforts to pay out refunds quickly. In many cases, the most vulnerable in our society are the victims of this form of identity theft. Names and social security numbers have been stolen at medical firms, prisons, and hospitals by dishonest employees who are often paid for the information. Postal workers have been compromised, robbed, and in one instance, murdered to gain access to the refund.

The low physical risk and high potential for financial gain has made stolen identity refund theft the new crime of choice for drug dealers and gangs. While the crime may seem deceptively simple, the scope and organization of these criminals is vast and growing. In certain cases, the proceeds of the crimes have been used to purchase illegal narcotics for resale, or funneled offshore.

For taxpayers who are direct victims of stolen identity refund fraud, the economic and personal consequences can be severe and often long-term. While the IRS will make good on the refund that is due to the taxpayer, the personal burden and delay can be considerable. Further, when a stolen identity is used to commit tax refund fraud, all taxpayers are victims, and all Americans are impacted by the loss to the Federal Treasury.

In recognition of the severity of the problem, the Department and the IRS have devoted significant resources to the successful prosecution of a number of individuals who have engaged in stolen identity refund fraud. Depending on the facts of a particular case, we can bring a variety of charges, including aggravated identity theft and theft of government property, in addition to tax charges such as false claims for refund, false returns, and tax conspiracy.

In the last several years, the Department has successfully prosecuted many significant cases in which a stolen identity was used to commit tax refund fraud. Recent examples of successful prosecutions include:

- On May 8, 2012, Veronica Dale was sentenced to 27 years and 10 months in prison, and her co-conspirator, Alchico Grant, was sentenced to 25 years and 10 months in prison, for their roles as the leaders of a Montgomery, Alabama stolen identity refund fraud ring. They were also ordered to pay over \$2.8 million in restitution to the IRS. Using the stolen identities of Medicare beneficiaries, Dale and Grant filed over 500 fraudulent refund claims, and then recruited others to set up a bank account in the name of a business into which more than \$1.5 million in fraudulently obtained refunds were deposited.
- In January 2012, Marsha Elmore, an Alabama tax return preparer, was sentenced to 15 years and 4 months in prison for filing false claims, wire fraud, and aggravated identity theft. Elmore admitted to stealing tax refunds by filing false tax returns using stolen identities. She was ordered to pay over \$1 million in restitution to the IRS.
- In December 2011, Shawntrece Sims, a Tampa, Florida resident, was sentenced to 9 years in prison for a tax and mail fraud scheme. Sims admitted to using stolen social security numbers to file false tax returns. In many cases, the individuals were not aware that their identities were being used and in other cases, the individuals were deceased. Sims was ordered to pay \$672,887 in restitution to the government.
- In November 2011, Roger Snells, also of Tampa Florida, was sentenced to 4 ½ years in prison for tax fraud and aggravated identity theft. Snells admitted to using identifying information of deceased individuals to electronically file fraudulent tax returns with the IRS. This case was part of Operation Rainmaker, a coordinated effort by the United States Attorney's Office, the U.S. Secret Service, U.S. Postal Inspection Service, IRS Criminal Investigation, the FBI, and the Tampa Police Department.

While these successful prosecutions are an important step in the right direction, they are but a step. We will do more – much more. The Tax Division, in conjunction with the IRS and United States Attorneys nationwide, has prioritized

the investigation and prosecution of individuals who engage in stolen identity refund fraud. The Department is targeting individuals involved in all stages of these schemes, including those who illegally obtain the personal identifying information, those who file the false returns with the IRS, those who knowingly facilitate cashing the checks or otherwise obtaining the refunds, those who receive the fraudulent refunds, and those who mastermind or promote these scams. For example, on January 31, 2012, the Department and the IRS announced the results of a massive national sweep cracking down on suspected perpetrators of stolen identity refund fraud. In the course of one week and across 23 states, the actions against 105 individuals included 80 complaints, informations, and indictments, 58 arrests, 19 search warrants, 10 guilty pleas, and 4 sentencings. The sweep reflected the extensive and well-coordinated investigative and prosecution efforts of the Department and the IRS.

Stolen identity refund theft schemes often cross state and international borders and our investigation and prosecution strategy must be similar in scope. The Tax Division is working closely with many United States Attorneys' Offices and the IRS to ensure effective information sharing and investigative cooperation as permitted by law. This approach is yielding significant results. For example, in Montgomery, Alabama, coordinated prosecutions by Tax Division attorneys and Assistant United States Attorneys have resulted in the indictment of 32 individuals, 12 pleas, 1 conviction following trial, and 9 sentencings in stolen identity refund fraud cases over the past 9 months. We are also working closely with our partners at the IRS to streamline the process for referring matters for grand jury investigation.

Enforcement efforts are important, but the goal must be to stop fraudulent refunds at the door. We would prefer to prosecute attempted stolen identity refund fraud rather than completed refund fraud, and we would prefer even more to deter these crimes from occurring. Civil injunctions have been and continue to be a vital tool in combating return preparers and promoters who engage in fraudulent tax schemes. The Division is equally committed to civil as well as criminal enforcement in the stolen identity refund fraud arena.

The Department's efforts to investigate, stop, and prosecute stolen identity refund fraud are in addition to the IRS's well-publicized efforts to detect and prevent the fraud before it occurs. These IRS efforts include designing new screening filters that will improve the IRS's ability to spot false returns before they are processed and before a refund is issued, as well as expanded efforts to place

identity-theft indicators on taxpayer accounts to track and manage identity-theft incidents.

While prevention and detection are always the first and best lines of defense, we recognize that prosecution is also a critical and effective tool in combating stolen identity refund fraud. It is an unfortunate truth that there will always be a small but persistent segment of society who will seize on any opportunity to “make a quick buck” at the expense of others. The Tax Division is committed to working with its federal, state and local law enforcement partners to shut this problem down. When we prosecute these cases, we send a clear message to those who engage in this conduct that they will be held accountable for their actions.

Abusive Tax Shelters

The Tax Division plays a major role in the government’s effort to stop the spread of abusive tax shelters. According to Department of Treasury estimates, over the past few decades the use of abusive tax shelters by large corporations and high-income individuals has cost the government many tens of billions of dollars. Tax shelter litigation is among the most sophisticated and important litigation handled by the Tax Division. Frequently, tax losses created by abusive tax shelters are completely artificial in that the transactions will not have generated any corresponding economic loss to the taxpayer. These transactions routinely use multiple special entities and involve complex financial schemes that often lack a real business purpose or any real economic substance. Many abusive tax shelter transactions involve participants located throughout the world, making discovery difficult and expensive to pursue. Despite the complexity and the cost of litigating these cases, the Tax Division is committed to shutting down abusive tax shelters that serve no other purpose than to avoid tax that is legally due.

A coordinated and effective effort is essential to prevent substantial losses to the Treasury and deter future use of abusive shelters by other taxpayers. Tax shelter cases are staffed by teams led by the Division’s most experienced litigators. The Division’s Tax Shelter Coordinator works closely with Division and IRS Chief Counsel attorneys to ensure that all legal positions taken are uniform throughout the country, and that all briefs and arguments include the most persuasive legal analysis.

Over the past few years, the Tax Division has been very successful in the abusive tax shelter area. For example:

- In January 2012, the Second Circuit rejected (for the second time) a “lease-stripping” tax shelter scheme engaged in by General Electric when it established a foreign-based partnership known as Castle Harbour that had been created by a General Electric subsidiary and two Dutch banks. This tax shelter scheme involved the U.S. taxpayer’s attempt to allocate tens of millions of dollars of U.S. taxable income to the Dutch banks (which did not pay U.S. taxes), even though the cash, in reality, stayed with the U.S. taxpayer. The Second Circuit’s opinions in this case are significant and will help the government fight the use of “sham” partnerships that serve no legitimate purpose except to evade taxes. The Second Circuit also found this type of lease-stripping scheme to be so abusive that it imposed significant penalties.
- In the fall of 2011, the Tax Division succeeded in upholding on appeal its victory in litigation involving the “distressed debt” tax shelter. In this type of abusive scheme, tax shelter promoters identify foreign entities that have suffered losses due to bad debts. The Tax Division litigated the first distressed debt tax shelter case against Texas billionaire Andy Beal, who had acquired a partnership known as Southgate that had been formed when a Chinese bank contributed nearly-worthless loans that were in default. The distressed debt tax shelter purports to allow a U.S. taxpayer to recognize, for U.S. tax purposes, the bad debt losses that were in fact suffered by foreign entities. The Division prevailed at trial. On appeal, the Fifth Circuit Court of Appeals rejected the use of the Southgate partnership to create these benefits. Subsequent to the original Southgate decision, the government has prevailed in other distressed debt tax shelter cases, and we continue to handle other distressed debt shelters that are pending in other trial courts.
- The Tax Division has handled many “Sale-in Lease-out” and “Lease-in Lease-out” (SILO / LILO) tax shelters. These abusive leasing schemes are designed to transfer, for a fee, tax benefits from one entity that cannot use them (such as a foreign corporation or a U.S. municipality) to a U.S. taxpayer. For example, through an extremely complicated stack of paperwork, a U.S. corporation in substance may pay a fee to a municipality that owns subway cars for the right to claim tax deductions relating to those cars under circumstances in which the municipality would not have been

allowed such deductions. The U.S. corporation, despite the maze of paperwork generated by clever tax advisors, does not truly own the subway cars on which it is claiming tax deductions. In a 2008 decision, the Tax Division prevailed in the Fourth Circuit in the BB&T litigation. After that victory, the IRS announced a settlement initiative that resolved, on terms that were very favorable to the government, 87% of the IRS's inventory of SILO/LILO transactions. Those taxpayers that did not settle have continued to litigate. In the spring of 2011, this abusive tax shelter scheme was rejected by the Federal Circuit in the Wells Fargo litigation.

Despite these significant victories, we continue to litigate tax shelter cases, and we anticipate that more cases will continue to be filed in the federal trial and appellate courts for the next several years. As examples, the Division is actively litigating cases in which taxpayers attempted to use distressed assets and debt, foreign tax credit generators, foreign currency straddles, and a variety of complex paper transactions that occurred for no other purpose than to avoid the payment of federal tax. We will continue to defend vigorously the IRS's disallowance of the sham benefits claimed by taxpayers who seek to elevate form over substance and undermine the tax system to avoid paying their fair share.

Offshore Tax Schemes

The Tax Division plays a lead role in investigating and prosecuting those who use foreign tax havens to evade taxes and reporting requirements. The increased technical sophistication of financial instruments and the use of the internet have made it all too easy to move money around the world instantly, without regard to national borders. According to a 2008 report issued by the Permanent Subcommittee on Investigations, Committee on Homeland Security and Government Affairs, United States Senate, the use of undeclared offshore accounts to evade U.S. taxes costs the Treasury at least \$100 billion annually. Using tax havens facilitates evasion of U.S. taxes and related financial crimes, and fosters the perception that if people have enough money and access to unscrupulous professionals, they can get away with hiding money offshore. Thanks to the considerable and highly publicized efforts of the Tax Division and the IRS, reality has caught up with those who chose to engage in this illegal behavior.

Offshore tax schemes are often difficult to detect and prosecute. Over the last several years, the Tax Division and the IRS have worked closely and devoted considerable civil and criminal resources to target taxpayers and professionals who

engage in and facilitate offshore tax evasion. The Division's initial efforts focused on UBS AG, the biggest bank in Switzerland and the seventh largest in the world. In 2009, UBS entered into a deferred prosecution agreement, paid \$780 million in disgorged profits, taxes and penalties, exited the cross-border business and provided account information for a large number of U.S. taxpayers. Separately, UBS agreed to provide the IRS information on thousands more U.S. taxpayer accounts. The Tax Division and the IRS engaged in extended negotiations with the Swiss government to obtain the necessary records under Swiss bank secrecy laws. Both the Department and the IRS continue to investigate offshore tax schemes worldwide. Charges have already been brought against a bank and numerous bankers, independent financial advisers and attorneys. The deterrent effect of these efforts has been substantial. Since 2009, nearly 30,000 taxpayers have voluntarily disclosed their hidden foreign accounts, compared to fewer than 100 voluntary disclosures of all types annually in prior years, and the IRS recently reported it has collected \$4.4 billion from those taxpayers. And the individuals who disclosed their foreign activities are now expected to go forward as compliant taxpayers, bringing much more into the Treasury.

There are constraints imposed by prosecutorial needs as well as statutory protections for grand jury secrecy and the confidentiality of tax information that prevent me from commenting on any ongoing investigations in this or any other area. However, I can say this: We have insisted, and will continue to insist, that individuals and companies doing business in this country comply with U.S. laws. And we have investigated and prosecuted, and will continue to investigate and prosecute, U.S. taxpayers who try to evade taxes by hiding money in offshore accounts and those who help them.

National Tax Defier Initiative

Tax defiers, also known as illegal tax protesters, have long been a focus of the Tax Division's investigative and prosecution efforts. For decades, tax defiers have advanced frivolous arguments and developed numerous schemes to evade their income taxes, assist others in evading their taxes, and frustrate the IRS, under the guise of constitutional and other meritless objections to the tax laws. Frivolous arguments used by tax defiers include, for example, spurious claims that an individual is a "sovereign citizen" not subject to the laws of the United States, that the federal income tax is unconstitutional, and that wages are not income. Schemes utilized include the use of fictitious financial instruments in purported payment of tax bills and other debts, as well as the filing of false liens and IRS reporting forms,

such as Forms 1099, designed to harass and retaliate against government employees and judges. In the most extreme circumstances tax defiers have resorted to threats and violence to advance their anti-government agenda.

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

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

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

Several recent cases demonstrate the scope and seriousness of tax defier misconduct.

- In May 2012, Karl Herrington was sentenced to 8 years and 1 month in prison for corruptly endeavoring to obstruct the administration of the internal revenue laws, filing false tax forms, and being a felon in possession of 6 different firearms. Herrington filed Forms 1099-OID, falsely reporting that

he had paid a form of interest income to law enforcement personnel and judges involved in a criminal case against him in Jackson County, Michigan.

- In April 2012, Kevin P. Mahoney of Attleboro, Massachusetts, was sentenced to 5 years in prison for corruptly endeavoring to obstruct the tax laws, filing false tax returns, and violating a permanent injunction to cease preparing and submitting false forms with the IRS. Mahoney, a financial advisor, attempted to pay tax-related debts by submitting to the IRS more than \$2.2 million in fictitious financial instruments called Bills of Exchange. Mahoney obtained the fake Bills of Exchange from American Rights Litigators, a defunct Florida-based organization that was permanently enjoined from promoting and selling a variety of fraudulent tax schemes.
- In February 2012, Andrew Issac Chance of Clinton, Maryland, was sentenced to 5 years and 5 months in prison for filing false claims for refund and for filing a false retaliatory lien against a federal prosecutor. At the time Chance filed the false retaliatory lien and the false claims for refund, he was on federal supervised release after a 2007 conviction for filing a false refund claim.

Every prosecution and conviction sends a strong message that any attempt to promote or participate in a fraudulent tax scheme will not be tolerated. Those who engage in tax defier activity risk criminal prosecution resulting in conviction, substantial penalties and time in prison, as well as the collection of taxes, interest and penalties. Prosecution of tax defiers also reassures the vast majority of taxpayers that their voluntary compliance with the tax laws is justified and that everyone will be held accountable under the law

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