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HEARING BEFORE THE  
COMMITTEE ON FINANCE  
UNITED STATES SENATE

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STATEMENT FOR THE RECORD

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Mr. Chairman, and members of the committee, I appreciate the opportunity to appear before you today to discuss illegal tax activities and their impact on the taxpaying public. I would also like to discuss some of my office's efforts to detect these situations, and proposals for the Internal Revenue Service (IRS) to further reduce illegal tax activities.

Let me begin by outlining the responsibilities of the IRS and the Treasury Inspector General for Tax Administration (TIGTA) as they relate to this topic. It is the responsibility of the IRS to identify and investigate potential violations of the tax laws. Within the IRS, the Criminal Investigation function is the primary unit involved in these activities. As an independent oversight body, TIGTA's responsibility is to investigate allegations that IRS employees have participated in or fostered the continuance of schemes. TIGTA also investigates individuals who impersonate or purport to be IRS agents in the furtherance of these schemes. TIGTA is also responsible for assessing the IRS' systemic controls to ensure that tax returns are successfully processed without allowing questionable deductions or credits.

Income tax schemes are destructive in many ways. While some of the individuals are willing participants motivated by greed, many involved are just unwitting victims who ultimately lose not only the anticipated tax benefit, but also the money they pay to the promoters of the scheme. Some of these taxpayers are elderly Americans who become victims of promoters. Individuals become participants in these schemes frequently through contact by unscrupulous promoters, falsely claiming that they have discovered legitimate, but little known, methods to avoid taxes. The "victims" subsequently learn that, once caught by the IRS, they must not only pay their entire tax liability, but they may also incur interest and penalty expenses, as well as the customary fee paid to the promoter.

It goes without saying that the proliferation of schemes aimed at providing individuals with an avenue to pay less than their fair share of taxes weighs heavily on the IRS' ability to ensure voluntary compliance levels are at their maximum.

I believe taxpayers are more inclined to comply with the tax laws if they trust that the system is fair and structured adequately to identify and penalize those who do not play by the rules. However, increasing concerns that taxpayers doubt the effectiveness of the tax system have begun to surface. In fact, there are indications that citizens are more accepting of tax cheating than in the past.

In calendar year 2001, the IRS requested my office's assistance in helping to improve its internal controls regarding a significant false tax claim - the Reparations Credit. In addition, we are devoting audit and investigative resources to assess other questionable activities including the Disabled Access Credit, Misuse of the Employer Identification Numbers (EIN), Advance-Fee schemes, and Impersonation scams. My office is dedicated to protecting the

integrity of the IRS and we're committed to assisting the IRS to better serve the taxpayers and maintain confidence in the tax system.

### Reparations Credit

Since the early 1990s, thousands of false claims have been filed with the IRS for reparations credits. Promoters use a variety of techniques to market the promise of a special tax credit to African-American taxpayers, who may be descendents of slaves. However, the Internal Revenue Code does not provide for such a credit. As a result, the IRS tries to identify tax returns containing these claims, deny the claims, and stop any resulting refunds before they are issued to taxpayers. IRS employees use a manual process and identify most of these claims before any data is input to the IRS' computer systems. Because the manual screening of tax returns by IRS employees is subject to human error, some claims for reparations credits are processed and refunds sent to taxpayers.

The number of returns claiming reparations is significant. Prior to Calendar Year (CY) 2001, the IRS did not consistently track the number of returns claiming reparations. In CY 2001, the IRS received over 77,000 returns with an estimated \$2.7 billion in claims. Generally, each claim asks for approximately \$43,000. The IRS has advised us that they are using a multi-faceted public relations approach to thwart this scheme. These efforts include a large media campaign, community outreach, consumer alert to penalties (\$500) and warning promoters of the potential for prosecution.

In early 2001, the IRS found that its manual controls were not always functioning as intended and some erroneous refunds were being issued. Recognizing the need to improve its internal controls, the IRS requested TIGTA to develop a computer program to identify these illegal claims. TIGTA developed a computer program and also initiated an audit to review the procedures and criteria used to identify these claims. The controls designed by the IRS to identify and stop claims for reparations credits were only partially effective. In some instances, refunds in excess of \$80,000 for married taxpayers claiming reparations credits for each spouse were issued.

TIGTA identified an estimated \$30 million in erroneous refund payments issued to taxpayers during 2000 and in part of 2001. The TIGTA-developed computer program identified over \$18 million in erroneous refunds that were issued in 2000 and over \$12 million in refunds that were issued during the February through April 2001 timeframe. For the remainder of 2001, the TIGTA-developed computer program helped identify an additional 392 claims totaling over \$16.1 million. After TIGTA notified the IRS, the IRS stopped 96% of these refunds. For the remaining refunds that were not stopped, TIGTA recommended that the IRS expand the use of a computer code in the future to stop these refunds during weeks when the IRS accelerates refund processing to avoid paying interest.

The details of our work in this area can be found in our audit report *Computer Programming Can be Used to More Effectively Stop Refunds on Illegal Claims for Reparations Credits* (dated March 28, 2002; report number 2002-30-071).

### Disabled Access Credit

The Disabled Access Credit is a business incentive credit enacted to help small businesses comply with the applicable requirements of the Americans with Disabilities Act (ADA). In Calendar Year 2000, through outreach and planning efforts, the IRS and TIGTA learned of taxpayers investing in pay telephones with volume controls and claiming Disabled Access Credits of up to \$5,000 on their individual income tax returns.

In September 2001 TIGTA reported that taxpayers were inappropriately receiving the Disabled Access Credit on Forms 1040 despite their tax returns indicating they had no business ownership or participation. Based on a limited sample, many of the taxpayers involved were elderly Americans who were possibly victims of promoters offering to sell expensive, coin-operated telephone equipment with the promise that the taxpayer could claim the disabled access credit because the telephones had volume controls.

In Tax Year (TY) 1999<sup>1</sup>, TIGTA identified 391 taxpayers claiming Disabled Access Credits totaling over \$1.09 million although their returns indicated no involvement in a business. The IRS issued refunds or applied overpayments to subsequent years' taxes for 304 of these cases totaling \$1.02 million. The average tax benefit received by these 304 taxpayers was over \$3,300. We now have indications that thousands more taxpayers showing some business activity on their tax returns may have also inappropriately claimed the credit. We recommended that the IRS publicize this issue to help educate taxpayers who may fall victim to fraudulent promotions, and develop a compliance approach for taxpayers taking the Disabled Access Credit without qualifying businesses. By taking this action, the IRS could potentially avoid erroneous payments in the amount of more than \$2 million. The IRS is continuing to develop its compliance approach for taxpayers claiming the Disabled Access Credit.

We also recommended that the IRS assess the results of our computer analyses for TY 1999, and perform similar analyses of TY 2000 returns. To facilitate the IRS' corrective action, we agreed to perform the computer analysis of TY 2000 tax returns. TIGTA subsequently analyzed these individual return filings and issued a report in January 2002. Our audit results showed that, for TY 2000, 28 percent more taxpayers inappropriately received over \$1.25 million in Disabled Access Credits even though their tax returns indicated no business involvement. We also determined that 64 taxpayers inappropriately received the credit for both TYs 1999 and 2000.

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<sup>1</sup> Individual Income Tax Returns processed in Calendar Year 2000.

## Misuse of Employee Identification Numbers (EINs)

Another prevalent scheme involves individuals who misuse IRS-issued EIN's as Social Security Numbers (SSN's) to create a new credit file for businesses or individuals with poor credit. This scheme is promoted nationwide and although it is illegal, the credit repair packages imply that the IRS endorses them.

The IRS process for issuing EIN's was created to have a unique number to use in filing tax returns. EIN's are the identifying numbers that the IRS assigns to business taxpayers. They identify corporations, partnerships, non-profit associations, trusts, sole proprietorships and similar non-individual entities.

In this scheme, most promoters encourage individuals to describe themselves as a sole proprietor in order to obtain an EIN and use it as an SSN. However, many of these SSN's are already assigned and being used by taxpayers with a legitimate right to the number. The switch is easy to accomplish since both EIN's and SSN's are comprised of nine digits. The only difference is the placement and number of hyphens. As a result, scheme participants could damage the credit histories, or steal the identities of; innocent taxpayers whose SSN's are duplicated.

TIGTA's interest with each EIN scheme is fourfold. First, is to protect the integrity of IRS' EIN Program; second, through investigation, assist the victims whose SSN's are misused; third is to determine whether any IRS employees are involved in the selection and sale of the EIN's; and lastly, address the related damage caused to the social security program. The EIN/SSN duplication scheme wastes scarce IRS resources with time spent reviewing and processing the applications. Improper EIN/SSN duplication also leads to problems with erroneous postings to taxpayer accounts.

Our special agents have investigated crimes involving EIN's since 1995. During the last few years, TIGTA has participated with the Federal Trade Commission (FTC) in providing presentations on the EIN scheme to other law enforcement agencies and U.S. Attorneys' offices. With the continued assistance of the FTC, TIGTA has also initiated a nationwide EIN Project that will enable TIGTA to develop valuable leads and to investigate those responsible for promoting these illegal schemes.

Since April 2001, TIGTA initiated 19 investigations involving the fraudulent use of EIN's as a result of the coordinated efforts with the FTC. In addition, TIGTA has initiated another 18 EIN investigations outside of this project.

## Advance-Fee Schemes

This scheme primarily targets the elderly, and is most prevalent in areas of the country where there is a high concentration of senior citizens. This fraud is perpetuated by individuals employing telemarketing techniques to mislead their victims by convincing them that they have won large cash sums or prizes. However, the victim must pre-pay various fraudulent fees and taxes before they can receive the prize. The amounts requested range from \$2,000 to \$20,000. In many cases, taxpayers believe the telemarketers, and they have been convinced to pay this money because the telemarketer has invoked the name of the IRS. Some victims, mostly elderly, have lost more than \$100,000 of their life savings to these scams. The telemarketing operations themselves are scattered throughout the country in boiler room type operations that can be quickly dismantled and relocated when discovered by law enforcement.

Since April 2001, TIGTA initiated 25 investigations involving advance-fee telemarketing. Additionally, TIGTA has closed 18 cases implicating 3 promoters and 3 individuals who lost more than \$296,000.

Many federal law enforcement agencies conduct investigations involving fraudulent telemarketing. TIGTA, however, is concerned with any individuals who purport to be IRS agents or profess that they represent IRS tax collection interests in order to collect money from unsuspecting individuals. The success of these schemes is dependent upon the ability to mislead the victims.

## Impersonation Scams

Impersonation is both a stand-alone crime and a tool used by the perpetrators of the schemes described above. Unlike other schemes I testified about earlier, impersonation does not target a specific group within the general population nor is it indigenous to one region of the country. Unscrupulous individuals can work alone or be employed by companies who track down parties who owe them money. In order to illegally obtain personal information, the impersonators give the impression that they are from the IRS and have money that belongs to the individual they are attempting to find. In other instances, impersonators may attempt to obtain personal information such as an SSN and then use the SSN to steal the identity of a person, collect money, or locate an individual. Impersonators are most often con artists, bill collectors, telemarketers, private investigators or disgruntled ex-spouses.

Since April 2001, TIGTA has initiated 158 investigations involving impersonation. TIGTA remains focused on investigating those individuals who purport to be IRS employees. TIGTA is additionally concerned with individuals who use IRS emblems or insignia in order to appear legitimate to its victims. For example, IRS impostors have used the words "Internal Revenue Service" on company letterhead or displayed fraudulent credentials in order to further a scheme.

In closing, I would like to state that the most effective approach for suppressing these types of crimes combines raising the level of risk to the promoter with better educating the taxpaying public. Past prosecutions of tax scheme promoters have resulted in significant criminal sentences for the promoters. Increased oversight in this area will increase the IRS' ability to identify and prosecute more unscrupulous promoters. Further, a continued public relations campaign will help discredit the promises made by the promoters. I believe the IRS is heading in the right direction in regard to both of these approaches.