

FEDERAL CRIMINAL TAX  
ENFORCEMENT IN 2009:

THE ROLE OF CRIMINAL TAX ENFORCEMENT IN  
THE FEDERAL “VOLUNTARY” SELF-ASSESSMENT  
AND PAYMENT TAX SYSTEM

By Robert Edwin Davis\* and Danny S. Ashby\*\*

I.	INTRODUCTION .....	235
II.	AN OVERVIEW OF THE TRADITIONAL FEDERAL CRIMINAL TAX ENFORCEMENT SYSTEM AND ITS CHARACTERISTICS.....	236
III.	THE GOVERNMENT AGENCIES INVOLVED AND THEIR ROLES.....	237
IV.	THE TRANSITION YEARS FOR CRIMINAL TAX INVESTIGATIONS: 1982 TO 1998 .....	239
	A. <i>The Drift Away From “General” Criminal Tax Enforcement and Administrative Investigations .....</i>	239
	B. <i>The Pursuit of Increasingly Aggressive Tax Investigations by IRS-CI .....</i>	241
V.	THE RESPONSE OF CONGRESS: SENATE FINANCE COMMITTEE HEARINGS AND LEGISLATIVE REFORM .....	242
	A. <i>The Internal Revenue Service Restructuring and Reform Act of 1998.....</i>	242
	B. <i>The Webster Review of 1999 .....</i>	243
VI.	TEN YEARS LATER, WHERE ARE WE TODAY?.....	245
	A. <i>The Response of the Commissioner and IRS-CI .....</i>	245
	1. The IRS-CI Continues to Neglect Enforcement Action Directed at Taxpayers with Legal Income Sources, and the IRS Is Not Setting the Agenda for IRS-CI.....	245
	2. The Total Number of the Field Special Agents Continues to Decline.....	246

\* Robert E. Davis (Southern Methodist University, B. A., J.D.), is a partner in the Dallas office of K&L Gates, LLP. Mr. Davis was formerly Deputy Assistant Attorney General in the Tax Division in Washington, D. C., in charge of the Criminal Section, and earlier served as a law clerk to Honorable T. Whitfield Davidson, U. S. District Judge, Northern District of Texas.

\*\* Danny S. Ashby (University of South Carolina, B. A., magna cum laude, Baylor University School of Law, J.D., highest honors), is a partner in the Dallas office of K&L Gates, LLP. Mr. Ashby was formerly a trial attorney in the Criminal Division of the U.S. Department of Justice in Washington, D.C., and earlier served as a law clerk to Honorable Edith H. Jones, U. S. Court of Appeals for the Fifth Circuit.

2009]	<i>CRIMINAL TAX ENFORCEMENT IN 2009</i>	235
	3. The Number of Fraud Referrals from Within the IRS Has Declined for the Past Three Years .....	246
	B. <i>Emerging Issues: Is IRS-CI Up to Meeting the New Challenges?</i> .....	246
VII.	CONCLUSION.....	247
VIII.	EXHIBITS .....	249
	A. <i>Statement before the Senate Committee on Finance By Robert Edwin Davis (April 28, 1998)</i> .....	249
	B. <i>Supplement to Statement before the Senate Committee on Finance By Robert Edwin Davis (April 28, 1998)</i> .....	253

I. INTRODUCTION

The United States Supreme Court has assured us that “our system of (income) taxation is based upon voluntary assessment and payment . . . .”<sup>1</sup> This characterization of our tax system has been repeatedly offered by subsequent Commissioners of the Internal Revenue Service (“IRS”), as well as other Treasury officials. Such statements are misleading since the federal income tax system is—and many believe must be—based upon strong involuntary elements, without which it could not successfully function.

Today, federal income tax is largely collected through involuntary withholding by third parties such as employers, dividend sources, and interest payers, all of whom pay taxpayer money to the IRS without the consent of the taxpayer. Civil tax penalties are involuntarily imposed by Chapter 68 of the Internal Revenue Code.<sup>2</sup> Interest may be imposed on late tax payments.<sup>3</sup> Most daunting of all, criminal fines, forfeitures and penal detention are available to punish deliberate tax scofflaws who fail to fulfill their statutorily imposed tax obligations.<sup>4</sup> There is nothing voluntary about any of the foregoing elements of the system. Many observers insist that taxpayers “voluntarily” self-assess and pay federal income taxes because the involuntary features make it necessary or at least prudent to do so.

Ours is a nation with a rich tradition of resistance to tax collection. Even during colonial times we showed our temper at the Boston Tea Party by lawlessly opposing the British taxation of tea, and later we took arms to oppose the taxation of alcoholic spirits during the Whiskey Rebellion.<sup>5</sup> We

---

1. *Flora v. United States*, 362 U.S. 145, 176 (1960).  
 2. *See, e.g.*, I.R.C. § 6662 (2002 & Supp. 2008).  
 3. I.R.C. § 6601 (2002 & Supp. 2008).  
 4. *E.g.*, I.R.C. § 7202 (2002 & Supp. 2008).  
 5. Even one of our founding fathers, Thomas Jefferson, expressed some support for the Whiskey Rebellion. In a letter to New York Senator William S. Smith on November 13, 1787 he said: “[W]hat country can preserve its liberty if its rulers are not warned from time to time that the people preserve the spirit of resistance?” THE WORKS OF THOMAS JEFFERSON 362 (Paul L. Ford ed., The Knickerbocker Press) (1904).

have witnessed tax protests spread during times of unpopular wars, such as the Vietnamese conflict. In more recent times we have seen literally hundreds of tax protest groups, such as the Posse Comitatus, and individual protest leaders like Gordon Kahl, Arthur Porth, and Irwin Schiff, raise vigorous protests and even violent resistance to federal tax administration.<sup>6</sup> A 2007 taxpayer attitude survey conducted by the IRS Oversight Board (in what were favorable economic times) showed that thirteen percent of the surveyed population believed that it was acceptable to cheat on their taxes.<sup>7</sup> In view of these realities, some insist that criminalizing non-compliance with federal tax laws is essential to an effective tax gathering system, which has long been the prevailing governmental view in the United States.<sup>8</sup>

Today, two unpleasant realities bring criminal tax enforcement sharply into focus: (1) the growing “tax gap,” which in 2001 was \$345 billion,<sup>9</sup> and (2) the growing budget deficit for FY 2009, which at this reading should exceed \$1 trillion. The tax gap badly needs to be reduced, and criminal tax enforcement could play a significant role in achieving that result.<sup>10</sup>

## II. AN OVERVIEW OF THE TRADITIONAL FEDERAL CRIMINAL TAX ENFORCEMENT SYSTEM AND ITS CHARACTERISTICS

It should be understood that criminal tax enforcement is unlike the enforcement of other federal criminal laws in several important ways. First, great restraint is placed on tax enforcement, and Congress contemplates that only a few criminal tax indictments and prosecutions should be pursued in a single year. By contrast, if there are hundreds of armed robberies of federally insured banks each year, it is expected that

---

6. Anti Defamation League, Tax Protest Movement, [http://www.adl.org/learn/ext\\_us/TPM.asp?xpicked=4&item=21](http://www.adl.org/learn/ext_us/TPM.asp?xpicked=4&item=21) (last visited February 15, 2009).

7. See Bruner-Cox L.L.P., *IRS Oversight Board Surveys Taxpayer Attitudes: Honesty Still on Top*, (March 2007), available at <http://www.brunercox.com/ASSETS/F0F30BFE88DC42EC87D86B5198A789A3/March%202007%20IRS%20Oversight%20Board.pdf>.

8. “In order to effectively administer the tax code, the IRS Commissioner needs the ability to direct the application of both civil and criminal sanctions.” Hon. William H. Webster, *Review of the Internal Revenue Service’s Criminal Investigation Division*, (Apr. 1999), available at <http://permanent.access.gpo.gov/lps19053/www.irs.gov/pub/irs-utl/27623d99.pdf> [hereinafter Webster, *Webster Review*].

9. See IRS, REDUCING THE FEDERAL TAX GAP 1, (Aug. 2007). Peculiarly, the IRS has not published an updated estimate of the gross tax gap since 2001.

10. Not all countries impose serious criminal sanctions for tax evasion. In Switzerland, “tax evasion” (by, for example, failing to report taxable income) is classified as a misdemeanor, and it may be punishable only by the imposition of a fine and not imprisonment. The Swiss do categorize “tax fraud” (committed by using false documents) as a felony and is punishable by imprisonment up to three years. By contrast, our sentencing guidelines for tax violations permit imprisonment for almost twenty years for tax evasions involving very large amounts of tax. See, e.g., Cynthia Blum, *Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail*, 6 FLA. TAX REV. 579, 640 n.194 (2004).

essentially all of them will be investigated, and, if sufficient evidence is gathered, all of the violators will be prosecuted. Although it may be evident to the IRS and the Department of Justice (“DOJ”) that hundreds of thousands of taxpayers with lawful incomes, perhaps millions, have refused to timely file correct returns and pay their taxes, criminal tax prosecutions have historically been limited to fewer than twelve-hundred individuals and businesses each year<sup>11</sup> through resource and budget constraints.

Second, because so few criminal tax cases are prosecuted, it is vital that cases selected for prosecution be chosen and investigated with the greatest of care. It is believed that deterrence can only be achieved if the conviction rate in this small universe of cases is very high and sentences are substantial. And it is evident that those twelve-hundred or fewer cases should be carefully directed at important areas of non-compliance.

Third, in order to assure that the foregoing principles are followed, there must be uniformity and centralized control over these investigations and prosecutions. It should be understood that there may be limited enthusiasm for criminal tax cases among some federal prosecutors and, surprisingly, some criminal tax investigators who prefer drug, currency and money laundering cases. This limited enthusiasm may result from several causes, including the fact that (1) such cases are often complex and deal with unfamiliar technical tax issues, and (2) wealthy and politically influential local figures and entities may be targeted for prosecution. It is easy to imagine that a local federal prosecutor would not be eager to indict and prosecute a prominent local community or business leader, especially if he or she aspires some day to be appointed a federal district judge in that same community.

The discussion that follows is intended to explain how the federal government attempts to work within the above principles using its unique criminal tax enforcement system.

### III. THE GOVERNMENT AGENCIES INVOLVED AND THEIR ROLES

There are three federal agencies that work more or less collaboratively within the tax enforcement system: (1) the IRS – CI (Criminal Investigation), (2) the Tax Division – DOJ, and (3) the offices of the United States Attorney – DOJ for the ninety-four federal judicial districts in the

---

11. IRS, *Enforcement Statistics – Criminal Investigation (CI) Enforcement Strategy*, available at <http://www.irs.gov/compliance/enforcement/article/0,,id=108792,00.html> (last visited Feb. 15, 2009). These numbers may arguably understate the impact of IRS-CI activity on tax compliance. In addition to criminal tax cases, the IRS-CI investigates some one-thousand additional financial crimes each year, such as money laundering and currency violations. *See id.* IRS-CI urges this may have some impact on tax compliance as well. *See id.* The Webster Review concludes, however, that these offenses have no obvious direct connection with tax compliance. *See Webster, Webster Review, supra* note 8.

United States. What follows is a brief and limited overview of a fairly complex system.<sup>12</sup>

The IRS – CI typically provides the initial case selection recommendation, the technical and investigative personnel to gather and evaluate the evidence to determine whether evidence of a tax crime is present, skilled professionals to assemble that evidence into a report that is subject to internal review, and then to refer the report and associated materials to the Tax Division – DOJ<sup>13</sup>. These cases may be either investigated solely by IRS personnel employing administrative summonses and formal or informal witness interviews, or they may be investigated by employing the much more robust investigative powers of a federal grand jury.<sup>14</sup> In the latter case the agents of the IRS are acting under the direction and authority of either a trial attorney of the Tax Division – DOJ or an Assistant U.S. Attorney – DOJ.

The Tax Division – DOJ reviews and evaluates the IRS-CI prosecution recommendation and Special Agent's Report, may grant a taxpayer conference if requested, offers comments and recommendations, and either (1) returns the case for further development (administratively or by grand jury), (2) declines the case, which puts it at an end, or (3) authorizes prosecution and sends the case forward to the appropriate office of the U.S. Attorney to be prosecuted.<sup>15</sup> Some of these cases authorized for prosecution are reserved for preparation and trial by attorneys in the Tax Division for any one of several reasons, including the unavailability of skilled resources in the smaller offices of the U.S. Attorney, the presence of local political considerations, a conflict of interest in the office, or simply a reluctance by the office of the particular Assistant U.S. Attorney to prepare and try what may be complex and demanding criminal tax cases.<sup>16</sup>

The offices of the United States Attorney – DOJ may conduct a supplemental investigation, prepare the case for trial, negotiate pleas where appropriate, and if necessary, try most of the criminal tax cases authorized by the Tax Division. Once the Tax Division has authorized prosecution, the local office of the U.S. Attorney may not thereafter decline to prosecute the case without Tax Division approval. The exclusive authority of the Tax Division to authorize and decline the prosecution of criminal tax cases has long irritated many U.S. Attorney personnel who, in general, may make decisions to prosecute or not to prosecute in other types of cases without

---

12. This topic is addressed in somewhat greater detail in Robert E. Davis, *Recent Developments in Criminal Tax Matters*, in 2 FORTY-SEVENTH INSTITUTE ON FEDERAL TAXATION 46-3 to -4 (1989).

13. IRS, *How Criminal Investigations are Initiated*, available at <http://www.irs.gov/compliance/enforcement/article/0,,id=175752,00.html> (last visited Feb. 16, 2009).

14. See U.S. ATTORNEY'S MANUAL § 6-4.110 (2007), available at [http://www.usdoj.gov/usao/eousa/foia\\_reading\\_room/usam/title6/1mtax.htm](http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title6/1mtax.htm).

15. See Davis, *supra* note 12, at 46-3 to -4.

16. See generally TAX DIVISION, U.S. DEP'T OF JUSTICE, CRIMINAL TAX MANUAL, §§ 1.00-4.00 (2001); see also 28 C.F.R. §§ 0.70-0.71 (2009) (authorizing the general functions of the Tax Division).

oversight from the DOJ Divisions in Washington, DC. In recent years, the Tax Division-DOJ has used its power to decline prosecution recommendations sparingly, especially where the case under review has been developed by a grand jury working with the assistance of an Assistant U.S. Attorney and the IRS-CI.

#### IV. THE TRANSITION YEARS FOR CRIMINAL TAX INVESTIGATIONS: 1982 TO 1998

##### A. *The Drift Away From “General” Criminal Tax Enforcement and Administrative Investigations*

It has long been understood among both federal criminal tax prosecutors and defense lawyers that the government should prosecute targets that resemble those it wishes to deter from criminal tax violations. If, for example, the government wishes to discourage physicians from failing to report cash skimmed out of their medical practices, then it should investigate and prosecute one or more prominent physicians in the community found to be skimming and not reporting cash collections. Prosecuting a local drug dealer for skimming cash out of drug sales to teenagers will likely have little or no impact on the tax reporting conduct of physicians in the community. That understanding has been largely accepted among IRS-CI personnel in the past; however, today, the more popular view among IRS-CI personnel is that any criminal tax prosecution will achieve deterrence.

It was also almost universal practice during that earlier time period to investigate federal tax crimes through administrative investigation—grand jury investigations were very rarely utilized. That is, IRS Special Agents would conduct witness interviews on their own and secure access to taxpayer and third-party records by issuing administrative summonses. Although the IRS could not grant immunities or offer meaningful assurances of non-prosecution to witnesses in the course of administrative investigations,<sup>17</sup> countless quality criminal tax cases were successfully pursued using the discovery tools and techniques available in such a comparatively non-intrusive investigation. However, that was to change dramatically in the early 1980s.

In 1982, President Reagan initiated the “War on Drugs,” and an appeal went out to various federal and state investigative agencies to take part and dedicate their resources to this initiative.<sup>18</sup> Further, it was made

---

17. See David B. Palmer, “Back to Tax!”: A Mid-Year Overview of IRS Criminal Investigation, TAX PRAC. & PROC. (Aug.-Sept. 2003) at 46 (explaining that the final decision to prosecute is reserved to attorneys in the DOJ).

18. Leslie Maitland, *President Gives Plans to Combat Drug Networks*, N.Y. TIMES, Oct. 15, 1982, at A20.

clear to the federal agencies being mobilized by the DOJ that traditional investigative restraints would be relaxed.

In 1983, Attorney General William French Smith approved a new, more liberal set of “undercover guidelines” for the FBI.<sup>19</sup> As soon as that became known, each federal investigative agency involved in the War on Drugs, including the IRS, sought approval for its own relaxed undercover guidelines modeled, more or less, on those approved for the FBI. But more than that, IRS-CI sought an authorization to permit it to purchase automatic weapons, body armor, mobile listening centers with electronic equipment that would permit it to intercept messages and conversations, and other tools which it had very rarely or never employed in the general enforcement of tax laws. In effect, it sought to have access to the same equipment and resources available to the FBI and DEA.

Fortunately, these ambitions of the IRS-CI were not fully realized. But this enlarged participation in drug investigations gave the senior IRS-CI personnel a new vision of their potential role in the broader enforcement of federal criminal laws. Regrettably, it also brought many IRS-CI Special Agents into frequent contact with the aggressive and intimidating techniques (search warrants, concealed recording equipment, undercover role playing, grand jury discovery, accessible immunities and assurances of non-prosecution) employed in defeating the often violent individuals and enterprises engaged in the drug trade, and the IRS-CI could readily visualize how those techniques might be brought to bear on criminal tax enforcement generally. That is exactly what occurred from 1982 until 1998.

For example, in 1984 and 1985, energetic IRS Special Agents established a Las Vegas bookmaking business in an attempt to identify unreported gambling income.<sup>20</sup> That operation resulted in continuing allegations of misuse of federal funds and prompted concerns over the adequacy of the IRS-CI’s controls and oversight of its undercover operations. Of course, IRS-CI was only doing what it had learned to do and found to be effective in its joint operations with the FBI and DEA in the War on Drugs. This led some to question the appropriateness of using the techniques employed in investigations of dangerous and sometimes violent drug peddlers against otherwise law abiding businessmen and women who filed a false income tax return or no tax return at all.

Unfortunately, the discussions seeking an answer to these questions did not progress very far, and they had only a limited influence on the IRS and its designs to use covert operations, “store front” businesses, concealed

---

19. OFFICE OF INSPECTOR GEN., THE FEDERAL BUREAU OF INVESTIGATION’S COMPLIANCE WITH THE ATTORNEY GENERAL’S INVESTIGATION GUIDELINES: SPECIAL REPORT § III.C. (September 2005), available at <http://www.usdoj.gov/oig/special/0509/chapter2.htm>.

20. U.S. GEN. ACCOUNTING OFFICE, GOVERNMENT ACCOUNTING OFFICE, TAX ADMINISTRATION: IRS UNDERCOVER OPERATIONS MANAGEMENT OVERSIGHT SHOULD BE STRENGTHENED 11 (1992).

recording equipment, search warrants, and deceit in the course of routine criminal tax investigations. It also had no impact on the new practice of seeking to convert almost all major criminal tax investigations into a grand jury proceeding, which was one of the most striking changes that came from the War on Drugs experience for the IRS-CI.

This drift away from the primary mission of the IRS-CI was hastened when the Treasury Department delegated the authority to several agencies, including the IRS-CI, to investigate money laundering following the enactment of the Bank Secrecy Act in 1970.<sup>21</sup> Later in 1984, Congress enacted § 6050I, which required businesses to report cash transactions exceeding \$10,000.<sup>22</sup> These statutory changes were followed with still other expansions of IRS-CI jurisdiction in money laundering.

B. *The Pursuit of Increasingly Aggressive Tax Investigations by IRS-CI*

During the sixteen years following the introduction of IRS-CI Special Agents into the active pursuit of drug investigations there was a continuous shift of IRS-CI “general enforcement” (legal income) investigations toward the drug enforcement model and the following changes became discernable:

1. The use of grand juries to investigate criminal tax cases “skyrocketed,”<sup>23</sup> according to the Webster Report;
2. The use of search warrants increased more than ten-fold;
3. The use of undercover investigations became an increasing part of legal income criminal investigations, and by 1985 had jumped to 244 operations annually.<sup>24</sup>

It was not long before serious concerns began to surface about (1) the wisdom of permitting these often heavy-handed techniques to be used in general tax enforcement, and (2) the willingness of the IRS-CI personnel to employ them with restraint and in compliance with the governing rules.<sup>25</sup>

Various improprieties began to surface including alleged misuse of search warrants. A criminal tax investigation was directed against Moncrief Oil Company, a family-owned business in Fort Worth, in 1994.<sup>26</sup> A family member testified that agents “stormed the offices like an army landing on an enemy beachfront. My employees heard the agents shout

21. Bank Secrecy Act of 1970, 31 U.S.C. § 1051 (2003 & Supp. 2008).

22. I.R.C. § 6050I (2002 & Supp. 2008).

23. “Over the last 20 years . . . the number of grand jury investigations in which CI participates with an Assistant United States Attorney has skyrocketed.” Webster, *Webster Review*, *supra* note 8.

24. *See id.*

25. *See id.*

26. Albert B. Crenshaw, *Alleged Victims Tell of IRS Raids That Hurt Business*, WASHINGTON POST, April 30, 1998, at A04, available at <http://washingtonpost.com/wp-srv/politics/special/tax/stories/irs043098.htm>

‘IRS! This business is under criminal investigation! Remove your hands from the keyboards and back away from the computers. And remember, we are armed.’”<sup>27</sup> The news media had been tipped to this raid and broadcast it widely, which, according to a business owner, “sent [the] business into a tailspin.”<sup>28</sup> It turned out a former accountant, fired for incompetence, had promised to lead the IRS agents to \$300 million in unpaid taxes in exchange for a proposed reward of \$25 million.<sup>29</sup>

As criminal investigations became more aggressive and invasive, similar criticisms of IRS civil examination and collection activity were also voiced: (1) that IRS tax return examiners were given quotas and production goals,<sup>30</sup> and (2) that there was inappropriate use of seizure authority in the collections division.<sup>31</sup> The Senate Finance Committee reacted by convening hearings to gather evidence bearing on these accusations in late 1997.<sup>32</sup>

#### V. THE RESPONSE OF CONGRESS: SENATE FINANCE COMMITTEE HEARINGS AND LEGISLATIVE REFORM

##### A. *The Internal Revenue Service Restructuring and Reform Act of 1998*

Almost immediately, numerous taxpayer complaints began to surface, including accusations directed against the IRS-CI, the Examination Division, and the Collection Division. Finally, in the fall of 1997, the Senate Finance Committee began holding hearings directed at allegations of IRS misconduct.<sup>33</sup> It was not long before Senate Finance Committee Chairman William V. Roth, Jr. (R-Del.), commented on the “stunning confession of the sins of the IRS.”<sup>34</sup> Senator Daniel Patrick Moynahan (D-NY) commented, “Wow, we have much to be concerned about the paramilitary performance of the (CI) IRS . . . . It’s government violence directed against citizens.”<sup>35</sup>

---

27. *Id.*

28. *Id.*

29. *Id.*

30. See Press Release #105-176, S. Finance Comm., Roth Opens IRS Investigative Hearings (Sept. 23, 1997), available at <http://finance.senate.gov/105-176.htm>.

31. See *id.*

32. See Press Release #105-167, S. Finance Comm., Roth to Take Unprecedented Look at IRS (Sept. 11, 1997), available at <http://finance.senate.gov/105-167.htm>.

33. See *id.*

34. Press Release #105-376, S. Finance Comm., Roth Says IRS Reports Validate Committee Findings (July 10, 1998), available at <http://www.senate.gov/~finance/105-376.htm>.

35. Crenshaw, *supra* note 12, ¶ 4; see also *infra* Part VIII.A (Robert Edwin Davis, Statement before the S. Finance Comm. (April 28, 1998), available at <http://www.senate.gov/~finance/davis.htm> (describing still further improprieties)).

The legislative reaction to these disclosures of administrative abuse was extraordinary. In response, a remarkable piece of legislation was passed entitled “The Internal Revenue Service Restructuring and Reform Act of 1998.”<sup>36</sup> Among the numerous changes in the Internal Revenue Code were detailed provisions including 71 new taxpayer rights.<sup>37</sup> The Senate hearings also resulted in the appointment of a new Commissioner of the IRS in late 1997, Charles O. Rossotti.<sup>38</sup> Among Commissioner Rossotti’s commitments to the Senate at the time of his confirmation was his assurance of a thorough review of each major IRS component, including IRS-CI.<sup>39</sup>

### B. *The Webster Review of 1999*

The task of reviewing the conduct and role of IRS-CI was assigned to Hon. William H. Webster, a former Judge on the U.S. Court of Appeals for the Eighth Circuit.<sup>40</sup> He had also served as the Director of the FBI and the Director of the CIA.<sup>41</sup> Judge Webster’s letter to Commissioner Rossotti covering the “Webster Review” (as it has come to be known) explained that he had assembled a “task force of federal law enforcement personnel with extensive experience in financial investigations” that “conducted a top to bottom review of CI.”<sup>42</sup> This Review required nine months of investigation and resulted in the interviewing of over six hundred persons, and the examination of “countless documents.”<sup>43</sup> The Webster Review was submitted to Commissioner Rossotti on April 9, 1999.<sup>44</sup> It contained a considerable number of important findings and recommendations, only some of which are especially relevant here.

From his Executive Summary<sup>45</sup> we draw the following:

---

36. Internal Revenue Service Restructuring and Reform Act of 1998, PUB. L. NO. 105-206, § 3411(A), 112 STAT. 685, 750 (1998).

37. See Doug Shulman, *Comm’r Doug Shulman Discusses 10-Year Anniversary of the IRS Restructuring and Reform Act of 1998*, IRS, July 18, 2008, available at 2008 WL 2780284.

38. Internal Revenue Service, Previous IRS Commissioners (1955-2008), DEPARTMENT OF TREASURY, <http://www.irs.gov/irs/article/0,,id=184235,00.html> (last visited Mar. 7, 2009).

39. See Letter from Hon. William H. Webster, Judge, Eighth Circuit, to Charles O. Rossotti, Comm’r, Internal Revenue Service, (April 9, 1999), available at <http://www.irs.gov/compliance/enforcement/article/0,,id=120415,00.html>.

40. See *id.* at 61.

41. See Chair, Homeland Security Advisory Council, Hon. William H. Webster, HOMELAND SECURITY, [http://www.dhs.gov/xabout/structure/biography\\_0077.shtm](http://www.dhs.gov/xabout/structure/biography_0077.shtm) (last visited Mar. 7, 2007); Directors, Then and Now, FEDERAL BUREAU OF INVESTIGATION, <http://www.fbi.gov/libref/directors/webster.htm> (last visited Mar. 7, 2009).

42. See Letter from Hon. William H. Webster, Judge, Eighth Circuit, to Charles O. Rossotti, Comm’r, Internal Revenue Service (April 9, 1999), available at <http://www.irs.gov/compliance/enforcement/article/0,,id=120415,00.html>.

43. See *id.*

44. See *id.*

45. Webster, *Webster Review*, *supra* note 8.

1. "CI's focus has drifted from its primary mission", to support the administration of the federal internal revenue laws;<sup>46</sup>
2. "Over the last twenty years, Congress and the Department of Treasury have expanded CI's jurisdiction to cover offenses not only under the Internal Revenue Code, but also under the money laundering and currency reporting statutes. . . . CI now plays a major role in the investigation of offenses that have no obvious direct connection with tax compliance."<sup>47</sup>
3. "The percentage of cases that CI investigates based upon referrals from Exam and Collection has dropped precipitously."<sup>48</sup>
4. "CI . . . should develop a compliance strategy that will enable it to determine how best to allocate its resources in a manner consistent with its tax enforcement mission. As an initial matter, rigorous empirical studies of noncompliance will enable CI to identify those cases that will deter noncompliance most effectively . . . ."<sup>49</sup>
5. "Unlike other law enforcement agents, CI Special Agents may employ only the 'least intrusive means' necessary to investigate their cases effectively."<sup>50</sup>
6. "Over the last several years, CI's agent force has shrunk."<sup>51</sup>
7. "Educational courses for experienced Special Agents should be refocused to correct the notable deficiency in topics related to substantive tax law."<sup>52</sup>

Commissioner Rossotti responded to Judge Webster's Review very cordially on April 12, 1999, and offered his assurance that "it will guide us to improve the work of this critically important component of tax administration for many years to come."<sup>53</sup>

Notwithstanding the cordiality and apparent receptiveness in the Commissioner's response,<sup>54</sup> the operational changes in IRS-CI proposed by Judge Webster have received only a limited measure of acceptance in actual practice.<sup>55</sup> A review of the subsequent statistical reports of the IRS

---

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

51. Webster, *Webster Review*, *supra* note 8.

52. *Id.*

53. Letter from Charles O. Rossotti, Comm'r, Internal Revenue Service, to Hon. William H. Webster (Apr. 12, 1999), *available at* <http://www.irs.gov/compliance/enforcement/article/0,,id=120414,00.html>.

54. *See id.*

55. *See infra* Part VI.

and Treasury Department make it very clear that the agency was unwilling to embrace major change.<sup>56</sup>

## VI. TEN YEARS LATER, WHERE ARE WE TODAY?

### A. *The Response of the Commissioner and IRS-CI*

Almost 10 years have passed since the Webster Review was submitted to the Commissioner.<sup>57</sup> To what extent has there been meaningful change in IRS-CI operations in response to that review? It should be instructive to evaluate just how extensive the changes to key areas have been.

#### 1. The IRS-CI Continues to Neglect Enforcement Action Directed at Taxpayers with Legal Income Sources, and the IRS Is Not Setting the Agenda for IRS-CI.

The Webster Review criticized the IRS-CI for neglecting its primary mission, “to act as the Internal Revenue Service’s criminal investigative component in support of the administration of the federal internal revenue laws,” and added, “CI now plays a major role in the investigation of offenses that have no obvious direct connection with tax compliance,”<sup>58</sup> referring to the volume of money laundering and currency violations being investigated by the agency. That condition persists today since 54.9% of all IRS-CI investigations are referred by United States Attorneys’ Offices.<sup>59</sup> Only 32.5% of its cases originated from within the IRS.<sup>60</sup> Obviously, the ninety-four offices of the United States Attorneys do not have tax enforcement as a priority and many, if not most, cases referred to the IRS-CI involve illegal income. As the Webster Review noted in 1999, “it is clear from interviews with agents that the IRS is not setting their [the IRS-CI] caseload agenda, but, instead mainly U.S. Attorneys and other law enforcement agencies are doing so.”<sup>61</sup> The IRS statistics indicate that nothing has changed in the last ten years.

---

56. See *infra* Part VI.

57. See Webster, *Webster Review*, *supra* note 8.

58. Webster, *Webster Review*, *supra* note 8.

59. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, REFERENCE NO. 2008-10-133, STATISTICAL PORTRAYAL OF THE CRIMINAL INVESTIGATION DIVISION’S ENFORCEMENT ACTIVITIES FOR FISCAL YEARS 2000 THROUGH 2007 (2008), at 9.

60. *Id.*

61. Webster, *Webster Review*, *supra* note 8.

2. The Total Number of the Field Special Agents Continues to Decline

In 1999, the Webster Review noted the decrease in investigative agents in the field.<sup>62</sup> That also has not improved because the total Field Agent staffing declined 6.7% from FY 2002 to FY 2007.<sup>63</sup> The most notable change is that the 2007 IRS-CI Special Agent force (2,684) is still smaller than it was (3,000) when the Webster Report was authored ten years ago.<sup>64</sup>

3. The Number of Fraud Referrals from Within the IRS Has Declined for the Past Three Years

Once again, this trend is not favorable. The number of referrals from U.S. Attorneys' Offices continues to climb, and the number of referrals from within the IRS has declined.<sup>65</sup> IRS-CI is simply not part of an IRS integrated effort to achieve taxpayer compliance. IRS-CI investigators are "free agents" to roam into almost any area<sup>66</sup> at the request of the U.S. Attorneys' Offices. If the IRS-CI agent serves the U. S. Attorney's Office in a bank fraud or healthcare fraud investigation, the Assistant U.S. Attorney will typically find a way to compensate the IRS Special Agent by adding one or more tax counts to the indictment thereby making it "tax related."

B. *Emerging Issues: Is IRS-CI Up to Meeting the New Challenges?*

The new challenges facing the IRS today are considerably more daunting and resource intensive than the challenges addressed in the Webster Review. Now the IRS must address tax evasion in a global economy fueled by movements of assets across international borders.<sup>67</sup>

The Senate Permanent Subcommittee on Investigations conducted hearings in 2006<sup>68</sup> disclosing that billions of dollars were being placed in offshore accounts, trusts and other business entities, and taxes were not

62. *Id.*

63. See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, *supra* note 59, at 6.

64. *Id.* at 19; see Webster, *Webster Review*, *supra* note 8.

65. See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, *supra* note 59, at 9.

66. Webster, *Webster Review*, *supra* note 8 (describing that some of these areas include "drug trafficking," "suspected tax fraud and related violations of the Internal Revenue Code," and "any investigation with a significant financial aspect").

67. See Internal Revenue Service, *The Tax Gap and International Taxpayers* (2008), available at <http://www.irs.gov/businesses/article/0,,id=180215,00.html>.

68. SENATE PERMANENT SUBCOMM. ON INVESTIGATIONS, TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS, AND SECRECY, 109TH CONG., (2006).

being paid on the income thus generated by U.S. taxpayers.<sup>69</sup> Identifying such transactions, gathering documents and conducting interviews in foreign countries, which may include documentation in foreign languages and witnesses who are not fluent in English, and securing testimony admissible in U.S. courts are all difficult and costly. Additionally, the federal tax laws in this area are not easily understood. More and better trained agents are needed for this kind of specialized work. The IRS is showing an awareness of the gravity of this problem.<sup>70</sup>

The investigations of large tax shelter promotions, such as those being pursued in the Southern District of New York, require highly sophisticated and well-trained Special Agents.<sup>71</sup> They may involve many taxpayers, scores of promoters and professionals, and the legal memoranda supporting these promotions may consist of hundreds of pages of very dense legal material. How many such cases can the present IRS-CI support at one time with its declining investigative personnel, who must divide their efforts between tax evasion investigations and money laundering investigations?

## VII. CONCLUSION

IRS-CI has long been regarded as the premier financial investigative agency in federal service.<sup>72</sup> As the Webster Review acknowledges, “[d]espite the fact that other federal law enforcement agencies have financial crimes section, CI’s preeminence in this area is unparalleled. Department of Justice officials acknowledge that they frequently attempt to involve CI in any investigation with a financial aspect.”<sup>73</sup>

But IRS-CI does not have adequate resources to be all things to all people and at the same time maintain the excellence of its investigative staff. These Special Agents must maintain their understanding of an endlessly changing Internal Revenue Code and regulations, must stay abreast of changing technology, as well as monitor new tax-focused schemes to evade tax. Long absences to aid drug, currency and money laundering investigations will erode the very skills that make, and have made, these fine agents so valuable to federal tax enforcement.

Some of these agents should be selected for retraining to learn to deal effectively with emerging criminal tax issues, including foreign evidence gathering, foreign language skills, and understanding the rules governing

---

69. *Id.* at 6. The IRS acknowledges that there is currently no specific data to indicate what portion of the “tax gap” is attributable to international taxpayers. See *The Tax Gap and International Taxpayers*, <http://www.irs.gov/businesses/article/0,,id=180215,00.html> (last visited Feb. 11, 2009).

70. See *The Tax Gap and How to Solve It: Hearing Before the S. Comm. on the Budget*, 109th Cong. (2006), at 6 (written testimony of Mark Everson, Comm’r of Internal Revenue).

71. See Stephen Joyce, *Tax Shelters: KPMG Verdict Shows IRS Will Use Criminal Courts to Combat Fraud*, *Lawyers Say*, 245 DTR K-1 (Dec. 22, 2008).

72. See Webster, *Webster Review*, *supra* note 8.

73. *Id.*

the admissibility of such evidence. The field in which IRS-CI excels is not static and to be its master requires constant effort.

The staffing of this agency should be increased, an appeal made ten years ago in the Webster Review.<sup>74</sup> And its diversion into currency and money laundering investigations should be reduced to the extent possible, as other agencies can and should fill that gap. The IRS should reclaim and reinforce its unique criminal investigation arm so that it can be optimally effective in addressing the tax gap issues of the next decade.

---

74. In a nation in which 155 million returns were filed in 2008, selecting only 1,200 taxpayers for prosecution seems a clearly inadequate gesture, especially when 13% of surveyed taxpayers admit they do not believe cheating on taxes is wrong. IRS News Release IR-2008-127 (Nov. 5, 2008), available at <http://www.irs.gov/newsroom/article/0,,id=188359,00.html>.

## VIII. EXHIBITS

A. *Statement before the Senate Committee on Finance By Robert Edwin Davis (April 28, 1998)*

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

*Identification and Personal Background*

My name is Robert Edwin Davis. I am an attorney, and I have practiced law in Dallas, Texas for almost 40 years. During most of those years, the greatest part of my practice has been devoted to representing taxpayers in civil and criminal tax litigation and controversies with the Internal Revenue Service (IRS) and the Department of Justice. During the years 1982 and 1983, however, I served as Deputy Assistant Attorney General in the Tax Division of the Department of Justice in Washington, D.C. I was then responsible for overseeing the functions of the Criminal Section and Review Section (large civil case settlements) of the Tax Division. I think it would be fair to say that there are few attorneys in the United States who have handled more civil and criminal tax cases on behalf of taxpayers than I have since 1960.

*Description of Issues to be Discussed*

Tax collecting has always been an unpopular calling. From biblical times to the present, there have been few—or no—warmly regarded tax collectors. Most of the employees in the IRS are sincere and honorable people, going about their thankless work of administering the rules and policies adopted by Congress, the Treasury Department and senior IRS officials. However, my personal experience is that all is not well with our tax system, and I believe that (1) the IRS has, to a significant extent, strayed from its proper path; (2) there is excessive use and misuse of intrusive and even oppressive investigative techniques within the Criminal Investigation Division (IRS CID); and (3) there are sometimes serious integrity issues within the agency, but that the IRS Inspection Service (IRS-Inspection) is simply not up to the task of investigating and correcting IRS agent misconduct when it does occur. I would like to present my views on these subjects to the Committee over the next several minutes, and in a supplemental written statement.

*Excessive Use and Misuse of Intrusive Investigative Techniques by the IRS CID*

Fifteen years ago, when I was the Criminal Deputy in the Tax Division, criminal tax enforcement practices were almost totally different from those which are encountered today.

- “Undercover” investigative techniques were almost entirely unknown in criminal tax matters;
- Search warrants were used in criminal tax cases only a dozen times in an entire calendar year;
- Grand jury investigations were a rare exception, and administrative investigations were the rule.

Today that is dramatically changed, and the use of these much more intimidating and intrusive techniques is commonly encountered. For example, search warrants are executed in criminal tax investigations today some *twenty times* as frequently as they were then.

It is not surprising that these changes have occurred. As the IRS CID has been increasingly used in the suppression of drug and organized criminal activity, its special agents have learned the investigative techniques which are employed by the DEA, the FBI and local law enforcement to deal with violent and dangerous criminals. These investigative strategies are then “borrowed” and used by IRS CID in routine criminal tax investigations of taxpayers who are neither dangerous nor violent. Many of us believe that this is a very bad tax enforcement policy. Today, we see too many “cowboy” agents, as they are called, who are undisciplined and inadequately controlled, and who think that the end (putting away the “bad guys”) justifies the means (intrusive, intimidating and oppressive investigations). Let me give you an example of the kind of abuses which concern me.

*An Example: Executing A Search Warrant to Obtain An Appraisal of Residential Furnishings.*

One summer morning in June of 1994, approximately ten IRS special agents appeared at a private residence at 7:30 a.m. They knocked on the door, which roused the only resident of the home from her bath. This resident, “Sally,” was a 45-year old woman who was living in a home which had formerly been owned by her grandmother. She put on a bath robe and responded to the knock at the door. There were approximately ten IRS special agents in her yard and on her porch, one of whom presented a warrant to search her house. The agents then entered her house. She was told she could either leave or stay, but if she left she would not be permitted to return so long as they were at the house. She elected to remain, and she was confined to one bedroom, where she remained in the presence of a female IRS agent. The remaining agents searched her home for about

eight hours, and then left. The only property which they “seized” and took with them when they left were some 86 old family photographs, many of them taken at Christmas gatherings. Sally was very upset by this forceful intrusion into her home. She missed an entire day of work, and had no idea why the ten agents had entered her house and taken the family photographs.

Later, Sally discovered the real reason for the invasive search. It was not to seize contraband, weapons, drugs or evidence of any crime. Instead, the agents had brought with them a furniture appraiser who went from room to room valuing the beds, sofas, chairs, tables and other personal effects which had been left in the house by her grandmother at the time of her death two and one-half years earlier. The Internal Revenue Service agents believed that Sally’s father, the executor, had undervalued the furniture on her grandmother’s estate tax return. Sally was not a suspect or in any way involved in the estate tax issues, and her father did not live in the house with her. The criminal investigation of Sally’s father was later abandoned by IRS CID.

The extravagant loss of agent time in preparing for and executing this “raid” on the home of an admittedly innocent party who was not a suspect at all was utterly needless. A simple telephone call to Sally would have resulted in consent for the IRS appraiser to inspect and appraise the furniture. Intimidating and intrusive “searches and seizures” are wholly unnecessary to develop valuation cases involving household furnishings. That was, in my opinion, one “search and seizure operation” which should never have been authorized or executed.

Several years later, after I demanded their return, the IRS belatedly gave back the 86 family photographs.

*Intrusive Investigative Techniques Should Not Be Used in Routine Criminal Tax Investigations.*

I believe, as do many others, that kicking down doors, wearing body armor, carrying automatic weapons and bursting into people’s homes with large raiding parties are techniques which should—if used at all—be reserved for investigations of dangerous and violent criminals. IRS CID should do what it was created to do: pursue the enforcement of the internal revenue laws, and it should leave violent and dangerous criminals to the DEA, FBI and local law enforcement authorities. The exceptions to this rule should be very limited.

I would also like to speak briefly on the subject of undercover operations. Some of us also believe that the deceit and misrepresentation which are inherent in undercover investigations and “sting” operations have no proper place in routine criminal tax investigations. Successful criminal tax prosecutions have long been made in this country without them. The IRS does serious and needless damage to its image and relationship with

the public—and government as a whole—when it lies to and deceives taxpayers in routine criminal tax investigations.

*One Final Appeal: Simplify Our Tax Laws*

There is a pervasive national frustration with our federal income tax system, which is far too complex and unintelligible to be fairly and uniformly administered by the IRS. Further, our tax laws cannot be understood or complied with by the great majority of our taxpayers. Indeed, it is my observation that even well-trained tax professionals frequently cannot comprehend and work competently with the Internal Revenue Code. I would respectfully urge that it is time for a major simplification, or some other fundamental change in our income tax laws.

B. *Supplement to Statement before the Senate Committee on Finance By Robert Edwin Davis (April 28, 1998)*

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I would like to submit for the consideration of the Committee and its staff some additional information which it is hoped may be useful in your deliberations regarding IRS integrity and conduct issues. In this supplement to my oral statement, I will briefly describe some actual matters which have been presented in my practice. They are described in a way which deletes any reference to the names of either individual taxpayers or IRS personnel.

*The IRS Inspection Service (IRS-Inspection) and the Office of Inspector General of the Treasury (OIG-Treasury) Should Not Have Exclusive Authority Over IRS Agent Misconduct Issues*

My professional experience has taught me to be seriously skeptical about the capacity and resolve of the IRS-Inspection to identify, investigate and fairly evaluate claims made by taxpayers and their representatives regarding IRS agent misconduct and abuse. I will acknowledge at the outset that many taxpayer complaints about IRS agent misconduct are unfounded, or at best, are only partly justified. I am personally satisfied, however, that serious agent misconduct has occurred and does occur today. I am also fully satisfied that IRS-Inspection is not the place to repose the exclusive power and responsibility to investigate and resolve these issues.

It is my opinion that IRS-Inspection investigators are often too close to the very personnel and offices which they are assigned to investigate. Further, some IRS-Inspection investigators seem to feel that their own agency suffers a "black eye" when agent misconduct is identified or confirmed. As a result, they often cannot and do not view taxpayer reports of agent misconduct with objectivity, and do not pursue them with appropriate zeal. I believe that is especially true regarding allegations of misconduct by IRS CID personnel.

Our national experience with police departments across the nation confirms one conclusion: the public does not have confidence that police investigators will objectively investigate allegations of misconduct by their own fellow officers. That public skepticism is justified. Similarly, "letting the IRS investigate its own" has not worked satisfactorily in the past, and it should not be relied upon in the future. I would like to provide the Committee with an example.

*IRS-Inspection Punishes Taxpayer Complainant*

Several years ago, I represented a taxpayer in a criminal tax case whom I shall call "Joe Smith". Mr. Smith and two of his employees provided me with affidavits asserting serious misconduct on the part of two IRS special agents, including perjury. Because I was skeptical about these claims, I asked these three witnesses whether they would agree to submit to a polygraph examination. Thereafter, Mr. Smith and the two employees individually passed separate polygraph examinations administered by a highly-skilled polygraph operator. I was assured by the polygraph operator that, in his professional opinion, my client and his two employees were telling the truth. The client and I believed that this serious agent misconduct should be presented to the IRS-Inspection.

Because a criminal indictment of Mr. Smith was then pending, we negotiated a direct and explicit agreement with the IRS-Inspection: that it would consider the taxpayer's complaint, including photographs, affidavits of Mr. Smith and his staff, as well as the results of three polygraph examinations, but that none of these materials would be disclosed either to the special agents or the Office of the United States Attorney prosecuting the case *until after the criminal case was concluded*. Not only did the IRS-Inspection accept that information, they also interviewed Mr. Smith and asked for other information as well. All information the IRS-Inspection requested was provided.

Notwithstanding the direct and explicit agreement that the materials provided by Mr. Smith would remain confidential until after the trial, investigators for the IRS-Inspection very promptly violated that agreement, and delivered over all of these materials they had obtained from Mr. Smith to the prosecutors and the special agents in order to aid them in prosecuting Mr. Smith. Thus, the IRS-Inspection served as a conduit of information harmful to the complainant in violation of its clear promise that it would not do so.

That same special agent misconduct was a major issue in the criminal trial of Mr. Smith. Fortunately, the jury correctly assessed the evidence, and found the testimony of Mr. Smith and his two employees was truthful. As a result, Mr. Smith and his co-defendant were found to be innocent of the tax crimes charged after less than one hour of jury deliberation.

Both the jury and the polygraph operator believed Mr. Smith and his two employees when they accused the two agents of perjury and other wrongful conduct, yet it is evident that no thorough investigative effort was ever pursued by IRS-Inspection, and apparently no corrective action was ever taken with respect to the two agents. Furthermore, no disciplinary action was taken to punish the IRS-Inspection investigators who promised that the information given to IRS-Inspection would not be given to the special agents and prosecutors until after the trial, and then consciously and deliberately violated that promise. OIG-Treasury also later reviewed the case and met with Mr. Smith. No corrective action was ever taken by OIG-Treasury.