

GAO

Report to the Joint Committee on
Taxation

March 1989

**TAX
ADMINISTRATION**

**Reducing Delays in the
Pursuit of Tax
Revenue on Closed
Criminal Cases**





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General Government Division

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The Honorable Dan Rostenkowski
Chairman, Joint Committee on
Taxation

The Honorable Lloyd Bentsen
Vice Chairman, Joint Committee
on Taxation
Congress of the United States

This report responds to your request that we (1) identify the amount of civil tax assessments and collections that result from the General Enforcement Program in the Internal Revenue Service (IRS), and (2) evaluate IRS's process for referring closed General Enforcement Program cases for the assessment and collection of taxes. This report contains recommendations for the IRS Commissioner and Chief Counsel to improve the timeliness of actions taken to assess and collect taxes on closed criminal prosecution cases.

As arranged with the Committee, we are concurrently sending a copy of this report to the Commissioner of Internal Revenue, the Chief Counsel of Internal Revenue, and other interested parties. We will also make copies available to others upon request.

This report was prepared under the direction of Jennie S. Stathis, Director, Tax Policy and Administration Issues. Other major contributors are listed in appendix III.

A handwritten signature in cursive script that reads 'Richard L. Fogel'.

Richard L. Fogel
Assistant Comptroller General

Executive Summary

Purpose

The Internal Revenue Service (IRS) estimates that in 1987, taxpayers failed to report and pay about \$85 billion in taxes on income from legal activities. While the amount owed by taxpayers who intentionally fail to report income or to pay taxes is not known, IRS' Criminal Investigation Division investigates allegations of such criminal violations under its General Enforcement Program.

Although the main purpose of a criminal investigation is to determine whether tax violations warrant criminal prosecution, such investigations, or cases, may also have potential for civil tax assessment and collection. The Joint Committee on Taxation asked GAO to (1) identify the amount of assessments and collections that result from the General Enforcement Program and (2) evaluate IRS' process for referring completed cases from the General Enforcement Program for the assessment and collection of taxes.

Background

For fiscal year 1987, the Criminal Investigation Division had a budget of about \$232 million and 4,100 staff years. Using these resources, the Division completed almost 5,600 criminal investigations, of which about 3,000 were General Enforcement Program cases.

The Criminal Investigation Division initiates a case from leads arising out of its other case work and from other sources, mainly the Examination and Collection Divisions. Leads from these divisions usually come from employees who identify indications of criminal tax violations while doing their regular duties.

Once a criminal case is initiated, the Examination or Collection Division generally cannot take civil action to assess or collect taxes owed until criminal action—the criminal investigation and any prosecution—is final. If the investigation does not result in a prosecution recommendation, the Criminal Investigation Division is responsible for advising the Examination or Collection Division that civil action can be taken. However, if the Criminal Investigation Division recommends prosecution, civil action generally cannot be taken until IRS' Office of Chief Counsel (Counsel) determines that criminal action is completed and authorizes civil action. To do so, Counsel relies on the Criminal Investigation Division to notify it of actions taken on cases recommended for prosecution. While Counsel reports to the Department of the Treasury, it also serves as the legal counsel for the Commissioner of IRS.

To estimate the amounts of tax assessments and collections, GAO selected a nationwide, random sample of 400 General Enforcement cases completed in fiscal year 1984, the latest year with substantially complete assessment and collection data. Because the amount of taxes assessed and collected on individual cases varied widely, the range of estimates varied widely. GAO attributed these amounts to Criminal Investigation, even though the Examination and Collection Divisions may have initiated cases, because no data indicated how much would have been assessed and collected if the criminal investigation had not occurred. To evaluate referral of cases for civil action, GAO tracked a sample of 120 cases that four IRS districts completed in the last half of fiscal year 1987. These districts had among the largest number of completed cases during this period.

Results in Brief

On the basis of a statistical sample, GAO estimates that IRS has assessed about \$204 million in taxes on General Enforcement Program cases it completed in fiscal year 1984. The taxes have been more difficult to collect; only an estimated \$89 million of these assessments have been paid. However, both of these figures could grow since IRS is still pursuing some of the 1984 cases.

GAO found that IRS generally was doing a good job of referring completed General Enforcement Program cases for civil action. But, the timeliness of the referrals was not so good when these cases had been recommended for criminal prosecution. Almost half of the 1987 cases recommended for prosecution were not referred within 1 month of criminal actions becoming final because IRS lost track of when these actions were completed.

Delayed referrals can impede the collection of taxes owed, and taxpayers may use the extra time to conceal and dissipate assets and income.

Principal Findings

Referred Cases Generated Sizable Tax Revenues

As of May 1988, IRS had assessed an estimated \$204 million on 2,470 criminal cases and was still auditing another 408 criminal cases that had been referred for civil action. Of the amount assessed, IRS had collected \$89 million, was actively trying to collect an additional \$58 million, and

had determined that the remaining \$57 million was currently uncollectible. IRS plans to further pursue the \$57 million if the taxpayers' ability to pay improves. (See pp. 14 and 16.)

Timeliness of Referrals Can Be Improved

IRS generally refers those cases having potential for civil action. But, the timeliness of the referrals can be improved, particularly for closed criminal prosecution cases, (i.e., cases recommended for prosecution). GAO estimates that referral was delayed an average of 7 months in 48 percent of 108 prosecution cases completed in four IRS district offices during the last 6 months of 1987. These cases involved an estimated \$1.5 million in potential tax, penalty, and interest assessments. IRS officials are concerned that such delays may cause a loss of tax revenue by giving taxpayers the opportunity to conceal assets and income. (See pp. 18 and 19.)

These delays resulted because the Examination or Collection Divisions were not authorized by Counsel to assess or collect taxes when all criminal action was completed. In over half of the prosecution cases with delays, GAO noted that the Criminal Investigation Division did not notify Counsel as soon as an action, such as sentencing or a decision not to prosecute, occurred so that Counsel could determine when to authorize civil action. In about a third of the cases, Counsel was notified but did not authorize civil action upon receiving the information. Both organizations contributed to delays in the remaining cases. (See p. 20.)

According to IRS officials, neither organization carried out its referral responsibilities promptly because of other priorities, such as ongoing criminal prosecutions. Without adequate internal controls to track cases that could be referred for civil action, these other priorities took precedence. Officials from the Criminal Investigation Division and Counsel acknowledged that the referral process has not carried a high priority in either organization and should receive more attention. (See pp. 20 and 21.)

Recommendations

To better protect the collection of tax revenues on completed criminal prosecution cases, GAO makes the following recommendations:

- The Commissioner of Internal Revenue should establish appropriate internal control mechanisms in the Criminal Investigation Division to better ensure prompt notification to the Office of Chief Counsel about

Executive Summary

actions taken on criminal prosecution cases and about delayed authorizations of civil action on such cases.

- The Chief Counsel of Internal Revenue should establish controls to better ensure timely authorizations of civil action on completed criminal prosecution cases.

Agency Comments

IRS' Commissioner and Chief Counsel generally agreed with GAO's findings and recommendations and described plans to implement the recommendations. (See pp. 22 and 23.)

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Abbreviations

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

How IRS Pursues Tax Revenue on Completed Criminal Cases

The Internal Revenue Service (IRS) estimates that in 1987 taxpayers failed to report and pay \$84.9 billion in taxes, not including taxes on illegal source income, such as drug trafficking, prostitution, and gambling. IRS' efforts to enforce the tax laws and to identify, assess, and collect taxes that are owed but not voluntarily paid are primarily carried out by its major compliance divisions—Examination, Collection, and Criminal Investigation. The Examination and Collection Divisions are responsible for taking civil action—that is, identification, assessment, and collection of taxes owed. The Criminal Investigation Division (CID) is responsible for investigating criminal violations of the tax laws and for recommending criminal prosecution when the evidence warrants it.

Most cases investigated by CID also have potential for civil action, since the investigated activity may involve income that taxpayers failed to report or pay. Once criminal action—such as the investigation and any prosecution—is completed, the case should be referred to IRS' Examination or Collection Division, if the case originated in either Division or otherwise has potential for civil action.

CID investigates criminal tax violations under two major programs. Under its Special Enforcement Program,¹ CID investigates tax violations involving illegal source income, such as drug trafficking. All other criminal investigations—such as intentional failure to report substantial income from a legitimate business activity—are investigated through the General Enforcement Program (GEP).

IRS' Criminal Investigation Division

For fiscal year 1987, CID had a budget of \$231.7 million and expended about 4,100 staff years (about 2,700 special agent and 1,400 administrative staff years) across IRS' national office, 7 regional offices, 63 district offices, and 10 service centers. Although the percentage varied from location to location, in fiscal years 1983 through 1987 CID devoted about half of its staff years to GEP investigations and about half to Special Enforcement Program investigations.²

¹GAO's report *Tax Administration: Investigating Illegal Income—Success Uncertain, Improvements Needed* (GAO/GGD-88-61, Apr. 25, 1988) discusses the Special Enforcement Program.

²CID officials said that during October 1988, they changed the way they categorize cases from programs like GEP to more violation-specific categories like money laundering. They also said that the information in this report would still be indicative of investigations involving legal source income.

In fiscal year 1987, CID completed 5,595 investigations, of which 3,042 were General Enforcement and 2,553 were Special Enforcement cases. During that year, investigations from these programs resulted in 2,906 taxpayers being prosecuted and 2,601 being sentenced.

IRS does not maintain statistics on the number of completed cases that CID referred for civil assessment and collection of taxes or the amount of tax assessments and collections that result from these referrals. At the request of the Joint Committee on Taxation, we examined IRS records to estimate the civil tax assessments and collections that result from GEP investigations.

The General Enforcement Program

GEP's primary objectives are to deter tax crimes and to encourage taxpayers to obey tax laws by investigating and prosecuting significant tax violations. IRS records showed that about 37 percent of the 3,806 GEP cases completed in fiscal year 1984 involved tax evasion, 35 percent involved failure to file tax returns or pay taxes, 11 percent involved filing a false return, 6 percent involved filing a false refund claim, and 11 percent involved other violations.³

We reviewed cases completed that year because IRS officials said it was the most recent year for which substantially complete assessment and collection data were available at the time of our review.

Leads for GEP investigations can come from a number of sources, including CID's case development work, other IRS compliance activities like the Examination and Collection Divisions, and sources outside of IRS. CID develops its leads through means such as informants and contacts with other law enforcement agencies. Leads from the Examination Division typically come from employees who identify indications of fraudulent tax violations during their audits of tax returns. Leads from the Collection Division typically come from employees who identify indications of tax fraud during efforts to obtain delinquent tax returns and collect delinquent taxes. Leads from other IRS sources also may come from service center employees, among others, who detect indications of unreported income and questionable refund schemes during their processing of tax returns. Finally, leads from sources outside of IRS typically come from other law enforcement agencies and local U.S. Attorneys.

³ Although these tax violations all may appear to be a form of tax evasion, the criminal provisions of the tax code and case law set forth different evidentiary tests to establish the listed violations.

Chapter 1
How IRS Pursues Tax Revenue on Completed
Criminal Cases

As table 1.1 illustrates, the Examination Division was the source of most of the 3,806 GEP cases completed in fiscal year 1984.

Table 1.1: Sources of GEP Cases Completed in Fiscal Year 1984

Source of case	Number of cases	Percent of total cases
Examination Division	1,647	43
Criminal Investigation Division	749	20
Collection Division	669	18
Other IRS Activities	323	8
Outside of IRS	418	11
Total	3,806	100

Source: CID records.

According to Examination Division officials, the main difference between audit cases retained in the Examination Division and those forwarded for criminal investigation was that cases sent to CID had stronger indications (e.g., taxpayer knowingly understated income, claimed fictitious or improper deductions) of intentional tax fraud and had higher potential amounts of tax evaded.

How CID Refers Completed Criminal Cases for Assessment and Collection

While a primary purpose of CID's criminal investigations, or cases, is to determine whether tax violations warrant criminal prosecution, these cases may also warrant civil action. Cases, especially those involving tax evasion and failure to file tax returns violations, which represented about three-quarters of the fiscal year 1984 cases, potentially involve significant amounts of unpaid taxes. Some violations CID investigates are not referred for civil action because, according to CID officials, they lack potential for tax assessments and collections. For example, in some cases the individual filed fictitious returns to obtain refunds, but IRS detected the fraud before any refunds were issued.

CID investigations result in CID either closing cases without recommending prosecution or recommending cases for prosecution. CID normally sends cases recommended for prosecution (i.e., referred to as prosecution cases, whether or not they are ultimately prosecuted) to IRS' Office of Chief Counsel.⁴ Counsel is responsible for reviewing the case and then forwarding it to the Department of Justice for further review

⁴While the Office of Chief Counsel reports to the Department of the Treasury, it also serves as the legal counsel for the Commissioner of IRS.

and/or prosecution through a United States (U.S.) Attorney. Until criminal action is completed, IRS is generally precluded from taking any civil action. When all criminal action is completed, cases are generally referred to the Examination or Collection Division for potential civil tax assessment and collection.

CID refers cases not recommended for prosecution to the Examination Division or the Collection Division by providing a copy of the investigating agent's closing report. The Examination Division, upon receipt of the report, either resumes its audit, opens a new audit, or decides to take no action. The Collection Division, upon receipt of the report, either resumes or begins efforts to obtain a delinquent return or collect delinquent taxes from an existing assessment, or it decides not to take action.

If CID recommends prosecution, IRS procedures require that CID should not close its criminal case nor should the compliance divisions pursue civil action until Counsel determines that all criminal actions, such as prosecution or a decision not to prosecute, are completed. Because Counsel is generally not directly involved in a prosecution, Counsel must rely on CID's investigating agent—who usually assists with the prosecution—to monitor and notify Counsel of each court action, such as sentencing and appeal.

Counsel uses this information from CID to make its determination on whether criminal action has been completed. In making the determination, Counsel must get confirmation from the Department of Justice that all criminal actions have been completed and that IRS can proceed with civil actions. Counsel is then responsible for authorizing CID to close its criminal case and Examination and Collection to pursue any potential civil action. Counsel does this to deter premature civil action that may jeopardize the criminal case. This authorization typically comes in the form of a closing memorandum prepared by Counsel and sent to CID, with copies going to the Examination or Collection Divisions, stating that all criminal action is completed.

Although they represent a small portion of GEP prosecution cases, two types—those directly referred to the U.S. Attorney and those involving a grand jury investigation—have different procedures to authorize civil action. Direct referral cases bypass Counsel in going from CID to the U.S. Attorney because the cases, usually being less complex, do not require Counsel's review. Since the cases seldom involve a tax liability, Counsel is not required to issue a closing memorandum. However, if civil tax liability is later established, Counsel must be notified by CID of the need for

a closing memorandum and then issue one before civil action can be taken. In grand jury cases, Counsel must receive written approval from the Department of Justice before Counsel can issue a closing memorandum. But, Counsel recently has arranged to get the approval verbally, as it now does in other prosecution cases, so that IRS can proceed with civil action.

During many investigations, especially when prosecution has been recommended, CID requests the Examination Division to assign a revenue agent to the investigation to help identify the amount of tax owed and not paid. In these cases, Examination Division officials said a substantial amount of their work needed to make additional assessments is often done before the investigation ends. However, the Examination Division cannot proceed to make the civil tax assessment until it receives authorization, since any premature assessment may inadvertently jeopardize IRS' criminal case.

Objectives, Scope, and Methodology

The Joint Committee on Taxation asked us to

- identify the amount of tax assessments and collections that result from GEP and
- evaluate IRS' process for referring completed GEP cases for civil action.

To respond to the Joint Committee's request, we (1) reviewed policies, procedures, records, case files, memoranda, studies, transcripts, and correspondence from IRS on GEP and taxpayers who were subjects of GEP investigations; (2) interviewed officials from CID, Examination Division, Collection Division, and Office of Chief Counsel at the National Office, Midwest Region, and four IRS district offices; and (3) selected and reviewed completed GEP cases.

We did detailed work at four IRS district offices (Chicago, Detroit, Oklahoma City, and Los Angeles). We selected the Chicago District for review because we had done some related work there and because Chicago had among the largest number of GEP cases completed in the last 6 months of fiscal year 1987. We selected the remaining three districts because the largest numbers of GEP cases in this period had been completed there. CID officials said that our results in these districts would be indicative of what was occurring at other districts.

Chapter 1
How IRS Pursues Tax Revenue on Completed
Criminal Cases

We selected a nationwide, stratified random sample of 400 completed GEP cases to estimate the assessments and collections that resulted from completed GEP cases and the number that were referred for civil action. This sample was drawn from cases completed in fiscal year 1984 because IRS officials said this was the most recent year for which civil action was substantially complete.

We randomly selected another sample of 120 cases completed in the last 6 months of fiscal year 1987 in the four districts we visited for more recent data to evaluate IRS' process for referring completed cases for civil action. Because we identified problems with the referral process, we then reviewed all 132 prosecution cases in these districts as of December 1987 in which the taxpayer had been sentenced, but that CID and/or Examination were holding in suspense awaiting the closing memorandum from Counsel. Between December 1987 and May 1988, we tracked how many of these cases received closing memorandums and then computed the delay in referring completed prosecution cases. Appendix I includes a detailed description of our sampling methodology.

We gathered information on cases in each sample from CID, the Examination Division, Regional and District Counsel, and IRS' National Computer Center. We tested the accuracy of key information for the sampled cases by reviewing case file documents. These tests indicated that the data were sufficiently reliable for the intended use. To ensure that we collected consistent data for all cases, we used structured data collection instruments.

We attributed all tax assessments and collections to CID even though they might have been generated without CID involvement. We did this because these amounts resulted from GEP cases and no data existed to indicate how much of these amounts would have been generated without CID's involvement. IRS officials said that assessments might well have been made regardless of CID involvement in GEP cases that started in the Examination Division. Similarly, delinquent returns might well have been obtained by the Collection Division and resultant assessments made regardless of CID involvement in GEP cases that started in the Collection Division. However, IRS officials could not estimate the amounts attributable to the Examination or Collection Division.

We did our audit work between June 1987 and May 1988 in accordance with generally accepted government auditing standards.

Tax Assessments and Collections Pursued on Completed GEP Cases

As of spring 1988, IRS had assessed an estimated \$204 million on GEP cases completed in fiscal year 1984. IRS had collected an estimated \$89 million of the assessments and was actively pursuing collection on \$58 million. The remaining \$57 million had been declared currently not collectible.¹

Most Completed GEP Cases Resulted in Assessments

We estimate that IRS assessed \$204 million in taxes on 2,470, or 65 percent of the 3,806 GEP cases completed in fiscal year 1984. Additional assessments may still result from the estimated 408 cases still open in the Examination Division as of spring 1988.

As shown in table 2.1, \$155 million, or 76 percent, of the assessments were made on cases that started in either the Examination or Collection Division. According to IRS officials, these are typically cases that IRS employees, during their audit or collection duties, recognized as possibly involving criminal violations. Further, other IRS activities, like the processing of tax returns, may identify compliance issues in cases that could have been forwarded directly to the Examination or Collection Division for assessment or collection of taxes owed. Because these cases also had criminal implications, the cases were first sent to CID for investigation.

Table 2.1: Estimated Assessments by Source of GEP Cases Completed in Fiscal Year 1984

Dollars in millions

Source of case	Number of cases	Percent of total cases	Total estimated cases with assessments	Total estimated assessments	Percent of assessments by source
Examination Division	1,647	43	1,319	\$116	57
Collection Division	669	18	467	39	19
Subtotal	2,316	61	1,786	\$155	76
Other IRS activities	323	8	164	9	4
CID	749	20	376	17	9
Outside of IRS	418	11	145	23	11
Subtotal	1,490	39	685	49	24
Total	3,806	100	2,470^a	\$204	100

^aDoes not add due to rounding.

¹Because the amount of taxes assessed and collected on individual cases in our sample varied widely, the range of estimates varied widely. For example, our estimates range between \$151 and \$257 million for assessments. See appendix I for details.

Chapter 2
Tax Assessments and Collections Pursued on
Completed GEP Cases

We also analyzed assessments by the type of violation involved in CID's investigation. Table 2.2 shows our estimates of the number of cases with assessments and the amount of assessments by type of violation.

Table 2.2: Estimated Assessments by Type of Violation Involved in GEP Cases Completed in Fiscal Year 1984

Dollars in millions

Type of violation	Number of cases	Percent of total cases	Total estimated cases with assessments	Total estimated assessments	Percent of assessment by type
Evasion	1,410	37	933	\$91.7	45.0
Failure to file or pay	1,328	35	1,036	66.3	32.5
False return	424	11	249	30.9	15.1
False refund claim	227	6	83	0.2	0.1
Other violations	417	11	168	14.9	7.3
Total	3,806	100	2,470^a	\$204.0	100.0

^aDoes not add due to rounding

We found that a small percentage of the cases resulted in a large percentage of the assessments. We estimate that about 7 percent, or 168, of the fiscal year 1984 cases with assessments resulted in about 50 percent, or \$101 million, of the \$204 million in assessments. The cases that resulted in the larger assessments involved different types of violations and sources, roughly in proportion to the universe of cases.

IRS Has Collected About Half of the Tax Assessments and Is Pursuing Others

As table 2.3 illustrates, we estimate that IRS has collected about \$89 million, or 44 percent, of the \$204 million assessed from 1984 cases. Our analysis showed that additional collections may still be made. As of spring 1988, the Collection Division was still pursuing another \$58 million, or 28 percent, of the assessments and had determined the remaining assessments—\$57 million—to be currently not collectible. According to IRS officials, a portion of this amount may be collected if the taxpayers' ability to pay improves.

Chapter 2
Tax Assessments and Collections Pursued on
Completed GEP Cases

**Table 2.3: Estimated Collections on GEP
Cases Completed in Fiscal Year 1984**

Dollars in millions

Status of collection efforts:	Amount	Percent of total assessments
Collections made to date	\$89	44
Collection action still pending	58	28
Outstanding balance declared currently not collectible	57	28
Total assessments	\$204	100

Conclusions

Although GEP cases focus on the need for criminal prosecution to deter tax violations and encourage taxpayer compliance, most of the cases also generate substantial tax assessments and collections. In order for these assessments and collections to be generated, CID must refer its cases to the Examination or Collection Divisions. Chapter 3 discusses the referral process and our concerns with it.

Completed GEP Cases Often Referred for Civil Action but Delays Existed for Prosecution Cases

We estimate that 90 percent of all completed GEP cases in fiscal year 1984 were referred to the Examination or Collection Divisions for potential civil tax assessment and collection. In the last 6 months of 1987, 87 percent of the cases completed in four selected IRS districts were referred. In both years, the small percentage of nonreferred cases existed usually because the cases had no potential for civil action.

Among the 1987 cases, however, we found long delays—an average of 7 months—in the referral of 48 percent of 108 cases in which prosecution had been recommended and criminal action had been completed. In these prosecution cases, the Examination or Collection Divisions were not authorized in a timely manner to take civil action. IRS officials said that delays in taking civil action can adversely affect collection because taxpayers may use such delays to dissipate assets, conceal income, and place assets beyond IRS detection.

Most Cases Were Referred for Assessment and Collection

Once all criminal action is completed (e.g., decision not to prosecute, acquittal, conviction with expiration of the period for filing an appeal), the cases should be referred to the Examination or Collection Division for civil assessment and collection of taxes owed but not paid. From our analysis of a sample of GEP cases completed in fiscal year 1984, we estimate that 3,408, or 90 percent, of the 3,806 GEP cases were referred for civil action. Of these,

- 3,254 (86 percent) were referred to the Examination Division,
- 154 (4 percent) were referred to the Collection Division, and
- 398 (10 percent) were not referred.

We found that the primary reason for our sampled cases not being referred was that the investigating agent determined that the case had no potential for civil action or did not warrant referral.

Table 3.1 shows our estimates of the actions taken on the 3,254 cases referred to the Examination Division.

Chapter 3
Completed GEP Cases Often Referred for
Civil Action but Delays Existed for
Prosecution Cases

Table 3.1: Estimated Examination Division Actions on Referred GEP Cases Completed in Fiscal Year 1984

Type of action	Number of cases	Percent
Decided to not open an audit	338	10
Resumed or opened an audit and		
audit completed with no assessments	475	15
audit completed with assessments	2,034	62
audit still open	408	13
Total	3,254^a	100

^aDoes not add due to rounding.

Referrals of the 290 cases completed at four districts in the last 6 months of 1987 had results similar to the 1984 cases. We estimate that 84 percent of these cases were referred to the Examination Division, 3 percent to the Collection Division, and 13 percent were not referred. CID decided not to refer these cases because they generally had no civil potential or did not warrant referral, according to the case files. During our discussion of these nonreferred cases with Examination officials, they supported CID's decisions.

Of those 1987 cases referred to the Examination Division, 85 percent resulted in audits being resumed or opened. For cases from both the 1984 and 1987 samples where the Examination Division decided against opening an audit, Examination officials usually attributed the reason to the potential assessments being too low for the projected costs of doing the audit.

Prosecution Cases Not Always Referred in a Timely Manner

IRS referred for civil action the 1984 and 1987 sampled cases—about 90 percent—that were completed and generally had civil potential. However, not all completed cases in which prosecution had been recommended were referred in a timely manner. The authority to authorize civil action on completed prosecution cases rests with IRS' Office of Chief Counsel. Counsel is responsible for issuing a closing memorandum to the Criminal Investigation, Examination, and/or Collection Divisions on prosecution cases before CID can close its criminal case and civil action can resume or begin.

CID agents are responsible for monitoring actions taken on prosecution cases, such as sentencing and appeal, and for notifying Counsel of such actions. Counsel relies on CID's notification to determine when all criminal action is completed, and civil action may be authorized through a

closing memorandum. CID agents are required to provide this information to Counsel “on the same day” it becomes available. IRS’ procedures do not provide specific criteria for the timely issuance of closing memorandums by Counsel but do require the “prompt” issuance of a closing memorandum once all criminal action is completed.

Many Closing Memorandums Delayed in the 1987 Sampled Cases

To evaluate the timeliness of the referral process, we visited four IRS districts—Chicago, Detroit, Los Angeles, and Oklahoma City—and randomly selected 120 of the 290 GEP cases that had been completed in those offices during the last 6 months of fiscal year 1987. This sample included 44 of the 108 cases that had been recommended for prosecution. We measured timeliness from the date the authorization should have been made, that is, when all the information needed to issue a closing memorandum was available. Generally, we defined this as the date all appeals were exhausted. We considered the issuance of a closing memorandum to be late if it was issued 1 month after the date all needed information became available. We judgmentally chose 1 month to allow for delays due to staffing shortages, employee leave, and higher priority work. IRS officials agreed that our criteria were reasonable.

On the basis of information contained in sampled case files, we estimate that closing memorandums were issued 1 month or more late in 48 percent, or 52, of the 108 completed cases that had been recommended for prosecution.¹ Delays ranged from 3 to 18 months. Most were delayed from 4 to 6 months, and the average delay was 7 months. Some closing memorandums were not issued until after we brought the cases to IRS’ attention.

By reviewing CID case files, we estimate that untimely issuance of closing memorandums in the 52 prosecution cases delayed taking civil action on \$2.8 million of unreported income and \$1.5 million of additional tax, penalties, and interest. While we found that civil action on these cases was delayed, we found no examples where the delays barred IRS from assessing taxes before the statutory time period for assessment had expired. These case files did not enable us to determine whether any of the taxpayers had actually dissipated assets, concealed income, or placed assets beyond IRS’ detection on any of these cases.

¹This estimate was based on weighting the results of our analysis of the 44 sampled prosecution cases.

Causes for Delays With Closing Memorandums

We found that delays most frequently occurred at two points in the process. CID agents were not promptly informing Counsel about actions taken on prosecution cases, and Counsel did not always act promptly on the information it had to issue a closing memorandum. According to IRS officials, CID agents or Counsel attorneys did not always carry out their responsibilities for referring these cases because their attention was directed to other priority work, such as ongoing criminal prosecutions. CID and Counsel officials acknowledged that the referral process should receive more attention from both organizations.

Because of inadequate internal controls, CID agents and Counsel attorneys did not act on their referral responsibilities. Adequate internal controls would have increased the likelihood of prompt referrals, even during staff shortages or workload increases, by informing management of prosecution cases needing immediate attention.

For example, CID does generate a monthly computer report that CID managers use to track the status of all cases in their jurisdiction. However, CID has not used this internal control to ensure that it had promptly notified Counsel about the status of criminal action and that it had promptly received a closing memorandum. In fact, CID did not use this control to follow its requirement to keep cases open until Counsel issues a closing memorandum. Among the estimated 52 cases with late closing memorandums, we found that CID prematurely closed 45 of the cases before receiving a closing memorandum. While CID knew that criminal actions on the cases had been completed, its internal control did not prompt CID to check whether the closing memorandums had been issued. Counsel, on the other hand, did not have adequate methods, such as a computer program or tickler file, to track prosecution cases and identify when closing memorandums should be issued.

For the estimated 52 cases where a closing memorandum was issued late, we estimate that CID was responsible for the delays in 29, or 56 percent, and Counsel was responsible for 19, or 36 percent, of the delays. In four cases, or 8 percent, delays were attributable to both CID and Counsel. The following examples illustrate delays caused by CID or Counsel.

- A banker was sentenced in December 1986 for conspiring to prepare a false U.S. estate tax return. Allowing time for possible appeal, Counsel could have issued its closing memorandum in early February 1987. However, the Examination Division's actions toward making an assessment on a \$105,000 disguised loan the banker received for his part in

Chapter 3
Completed GEP Cases Often Referred for
Civil Action but Delays Existed for
Prosecution Cases

the crime were delayed nearly 12 months until Counsel issued its memorandum in January 1988, after we notified Counsel of the delay. CID and Counsel officials agreed that the delay was caused by CID's failure to notify Counsel that sentencing had taken place.

- An attorney was sentenced in March 1987 for failing to file income tax returns. CID notified Counsel of sentencing in March 1987. Allowing time for possible appeal, Counsel could have issued its closing memorandum in early May 1987. However, the Examination Division's actions toward making approximately \$150,000 in assessments were delayed 8 months because Counsel did not issue its closing memorandum until January 1988, after we notified Counsel of the delay. According to Counsel officials, the delay was caused by its other workload priorities.

IRS is attempting to improve the procedures for authorizing civil action in prosecution cases involving a direct referral to the U.S. Attorney or a grand jury investigation. Although CID and Counsel were responsible for delayed referrals, we estimated that 12 of the 52 prosecution cases in which delays occurred also involved one of these two types of cases. For direct referral cases, IRS changed its manual in November 1988 to require CID to authorize civil action on those cases that are closed and involve a tax liability. For grand jury cases, the Department of Justice has agreed that Counsel may decide when all criminal action is completed and may issue a closing memorandum without Justice's approval, as long as Counsel, upon taking such actions, informs Justice. According to Counsel officials, Counsel implemented these changes in October 1988.

To further test the timeliness of referrals of prosecution cases, we reviewed 132 GEP cases being held in suspense in the four districts we visited. In each of these cases the taxpayer had been sentenced, but CID and/or the Examination Divisions were still awaiting the issuance of a closing memorandum as of December 31, 1987. Our analysis of closing memorandums issued through May 1988 showed results similar to those of our statistically sampled 1987 CID cases; closing memorandums were issued late in 46 percent, or 61, of the 132 cases.

According to IRS' manual:

"Delay in handling cases in which an allegation of fraud has been made is disadvantageous to the Government, especially in matters affecting collection. Speedy determination should be made in these cases warranting investigation so that conclusion of the civil aspect of a case is not unnecessarily hindered."

IRS officials said that any delay in authorizing the Examination or Collection Divisions to commence civil action also delays the assessment and collection of any taxes owed but not paid. IRS officials said that the longer the delay in making civil tax assessments, the less likely the taxpayer will voluntarily pay and the more difficult it is to enforce collection. An IRS study concluded that taxpayers have used delays to dissipate assets, conceal income, and place assets beyond IRS detection.

Conclusions

The timely referral of criminal cases for civil action is important to protect federal revenues, especially since most of the referred cases have resulted in taxes being assessed. While completed criminal cases usually were referred for civil action, almost half of the completed cases that had been recommended for prosecution were referred late. Delayed referrals were due primarily to internal controls being inadequate to ensure that CID provided the necessary information to IRS' Office of Chief Counsel and that Counsel provided the required authorization for civil action. Both organizations need to establish or improve controls—such as a computer program or tickler file—to track actions taken on cases recommended for prosecution and to identify when closing memorandums should be but have not been issued. CID and Counsel officials agreed with the need to strengthen controls to ensure timely referrals of completed criminal cases—especially those involving prosecution.

Recommendations to the Commissioner and Chief Counsel of Internal Revenue

To better protect the collection of tax revenues on completed criminal prosecution cases, we recommend that the Commissioner of Internal Revenue establish appropriate internal control mechanisms in the Criminal Investigation Division to better ensure prompt notification to the Office of Chief Counsel about actions taken on criminal prosecution cases and about delays in the issuance of closing memorandums to authorize civil action on criminal prosecution cases.

We also recommend that the Chief Counsel of Internal Revenue establish controls to better ensure timely authorization of civil action by promptly issuing closing memorandums on completed criminal prosecution cases.

Agency Comments and Our Evaluation

IRS generally agreed with the above findings and recommendations. In a letter dated December 29, 1988, the Commissioner of Internal Revenue described actions taken or planned by Criminal Investigation and Counsel. (See app. II.) The Chief Counsel of Internal Revenue did not provide

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separate comments but did notify us that Counsel's actions were properly described in the Commissioner's letter. We discussed the described actions with IRS officials to ensure that we fully understood how they will be implemented.

IRS determined that the major weakness in the present system was due to the U.S. Attorney's office not timely notifying the Tax Division of the Department of Justice that the criminal aspects of the case had been closed. Without this notification, the Tax Division cannot in turn notify Counsel that the case is closed. To remedy this problem, the special agent assigned to the case will be responsible on the day of sentencing, discontinuance of the case, or other type of closure for having the U.S. Attorney sign three form letters indicating that the criminal aspects of the case were completed. The U.S. Attorney's office is then to send the signed letters to the Department of Justice's Tax Division, IRS' Assistant Chief Counsel (Criminal Tax), and IRS' Examination Division so that civil action can be started or resumed.

To ensure that the letters get signed in a timely manner, CID is planning to change its management information system so that special agents will not be able to close prosecution cases unless they account for the date the letters are signed. In addition, CID officials said that their managers will be responsible for periodically reviewing the status of open prosecution cases to see if special agents are closing these cases as quickly as possible.

Counsel has also attempted to tighten controls over the closure of criminal cases by requiring its Criminal Tax Division attorneys to close criminal cases, which includes issuing closing memorandums, within 5 workdays of being informed that all criminal actions have been completed. Counsel officials advised us that this criterion will be incorporated into its management information system and will be used by managers to measure attorneys' compliance with it. In addition to these specific changes, Criminal Investigation and Counsel officials said that they are re-emphasizing the importance of referring prosecution cases for civil action.

We believe that these IRS actions, if effectively implemented, should improve the timeliness of the referral of prosecution cases for civil action.

Sampling and Data Analysis Methodology

As a part of our review, we collected data on the tax administration results of sampled GEP cases closed in fiscal year 1984 and the last half of fiscal year 1987. Our sampling methodology enabled us to make statistical estimates of the GEP cases closed (1) nationwide in fiscal year 1984 and (2) in four IRS districts in the last half of fiscal year 1987. This appendix describes our sample design and presents the 95 percent confidence intervals for the estimates in the report.

Sample Selection and Scope

We used two random samples. We selected 400 cases on the basis of investigation source and outcome from the universe of 3,806 GEP cases closed nationwide during fiscal year 1984. We selected a second sample of 120 of 290 GEP cases closed in the last 6 months of fiscal year 1987 in four IRS districts.

We used the nationwide sample of 400 cases closed during fiscal year 1984 to estimate the assessments and collections that resulted from them and the number and percentage of cases that were referred for civil action. We used fiscal year 1984 because, according to IRS officials, it provided the most recent and complete data available. These officials told us it typically takes about 3 years to complete all tax assessment and collection activity on closed GEP cases. In addition, IRS officials said there was nothing unusual about cases closed that year. The results of our analysis are projectable to the nationwide universe of GEP cases closed during fiscal year 1984. Because of the time it would require and the burden it would impose on CID to provide us with a case closing report or other referral documentation for each of 400 cases closed nationwide over 3 years ago, we considered a case to be referred if civil action had been taken later on any of the tax periods CID had investigated or if CID could provide us with a case closing report or other referral documentation. All referral, assessment, and collection figures shown in the report are estimates based on our analysis of sampled cases unless otherwise noted.

To evaluate IRS's current procedures for referring closed GEP cases for civil action, we randomly selected 120 of 290 GEP cases closed during the last 6 months of fiscal year 1987 in the four districts we visited—Chicago, Detroit, Los Angeles, and Oklahoma City. We selected this time period because CID officials said this was the most recent 6-month period for which complete data was available. In addition, CID officials told us that this 6-month period in these four districts was typical of other time periods and that the cases closed would be generally indicative of all GEP cases. We obtained a case closing report or other referral documentation

from CID, the Examination Division, and/or the Collection Division for each of the cases in this sample to determine if the case had been referred for civil action or not.

Because we identified problems with the timeliness of the referral of closed prosecution cases, we reviewed additional GEP cases in the four districts we visited to examine in greater detail the delays involved in beginning or resuming civil action on these cases. We reviewed all 132 GEP prosecution cases as of December 31, 1987, in which (1) the taxpayer had been sentenced, and (2) CID and/or the Examination Divisions were awaiting the issuance of a closing memorandum from the IRS Chief Counsel's Office.

In selecting the nationwide sample, we identified the source of the lead for criminal investigation (e.g., the Examination Division) and the outcome (i.e., prosecuted or not prosecuted) for each GEP case closed in fiscal year 1984. Since there were five sources and two outcomes, the cases were divided into 10 groups or strata. We took a simple random sample of cases from each group. We also took a simple random sample of GEP cases closed in the last half of fiscal year 1987 at each of the four IRS district offices we visited.

Not all of the fiscal year 1984 closed GEP cases resulted in assessments. Thus, we adjusted our universe to reflect only the cases with assessments and projected our assessment and collection findings to the adjusted universe. In table I.3, we also adjusted our universe to show the actions taken on the cases that were referred to the Examination Division after the completion of criminal action. Similarly, we adjusted our universe of the cases closed in the four IRS districts in the last 6 months of fiscal year 1987 to reflect the cases that were recommended for prosecution. This is a common statistical procedure used to provide conservative estimates, since no statement is made about the values of the unknown segment of the universe. Tables I.1 and I.2 show the adjusted sample and universe sizes of the closed GEP cases reviewed.

Appendix 1
Sampling and Data Analysis Methodology

Table I.1: Adjusted Sample Design for Fiscal Year 1984 Completed GEP Cases

Source and outcome	Universe of closed cases	Sample size	Cases in sample with assessments	Adjusted universe
Recommended for Prosecution				
CID	296	35	23	195
Examination	350	35	31	310
Collection	153	30	25	128
Other IRS	122	30	19	77
Outside IRS	115	30	15	58
Not recommended for prosecution				
CID	453	50	20	181
Examination	1,297	90	70	1,009
Collection	516	35	23	339
Other IRS	201	30	13	87
Outside IRS	303	35	10	87
Total	3,806	400	249	2,470^a

^aDoes not add due to rounding

Table I.2: Adjusted Sample Design for Completed GEP Cases in the Last 6 Months of Fiscal Year 1987

District office	Universe of closed cases	Sample size	Cases recommended for prosecution in sample	Cases recommended for prosecution in universe
Chicago	49	30	14	22
Detroit	96	30	12	44
Oklahoma City	64	30	14	32
Los Angeles	81	30	4	10
Total	290	120	44	108

Sampling Errors for General Enforcement Program Data

Because we reviewed a statistical sample of closed GEP cases, each estimate developed from the sample has a measurable precision, or sampling error. The sampling error is the maximum amount by which the estimate obtained from a statistical sample can be expected to differ from the true universe value estimated. Sampling errors are usually stated at a certain confidence level; in this case, it is 95 percent. This means the chances are 19 out of 20 that if we reviewed all the GEP cases closed nationwide in fiscal year 1984 and the cases closed in the last 6 months of fiscal year 1987 in the four districts, the results of our review would differ from the estimates obtained from our samples by less than the sampling errors of such estimates.

Appendix 1
Sampling and Data Analysis Methodology

Because the amount of taxes assessed and collected on individual cases in our sample varied widely, the sampling errors varied from 26 to 91 percent of the estimates.

Tables I.3 and I.4 show the upper and lower limits of the confidence intervals of key estimates for data on results from GEP. While the individual key estimates add to the totals reflected in the tables, adding the related individual upper and lower limit estimates will not equal the totals because of weighting.

Appendix 1
Sampling and Data Analysis Methodology

Table I.3: Confidence Intervals for Key Universe Estimates From the Fiscal Year 1984 Sample

Dollars in millions			
GEP results	Key estimates	95 percent confidence interval	
		Lower limit	Upper limit
Number and percent of case referral actions:			
Case referred for civil action	3,408 90%	3,310 87%	3,506 93%
Referred to Collection Division	154 4%	78 2%	230 6%
Referred to Examination Division	3,254 86%	3,137 82%	3,371 89%
Cases not referred	398 10%	300 7%	496 13%
Number and percent of Examination Division's actions on case referrals			
No audit opened	338 10%	237 7%	439 13%
Audit still open	408 13%	291 9%	525 17%
Audit closed with:			
no assessments	475 15%	354 11%	596 19%
with assessments	2,034 62%	1,871 57%	2,197 67%
Amount of dollars in millions for assessment actions			
Total assessments	\$204	\$151	\$257
Collected assessments	\$89	\$50	\$127
Collection action pending	\$58	\$37	\$79
Assessments uncollectible	\$57	\$21	\$94
Total assessments in millions of dollars and number of cases by source of the case:			
Examination Division	\$116 1,319	\$69 1,206	\$163 1,432
CID	\$17 376	\$8 303	\$26 449
Collection	\$39 467	\$24 387	\$53 547
Other IRS activities	\$9 164	\$3 126	\$14 202
Outside of IRS source cases	\$23 145	\$6 98	\$40 190

(continued)

**Appendix 1
Sampling and Data Analysis Methodology**

GEP results	Key estimates	95 percent confidence interval	
		Lower limit	Upper limit
Total assessments in millions of dollars and number of cases by type of violation:			
Tax evasion	\$91.7 933	\$47.1 830	\$136.2 1,036
Failure to file or pay	\$66.3 1,036	\$48.7 945	\$83.9 1,127
False return	\$30.9 249	\$2.8 196	\$59.0 302
False refund claim	\$0.2 83	\$0.1 60	\$0.4 106
Others	\$14.9 168	\$2.9 124	\$26.8 212

Table I.4: Confidence Intervals for Key Universe Estimates From Sampled Cases at Four IRS Districts During the Last 6 Months of Fiscal Year 1987

GEP results	Estimates	95 percent confidence interval	
		Lower limit	Upper limit
Number and percent of cases:			
Referred to Examination Division	242 84%	226 78%	258 89%
Audits opened/resumed	205 85%	192 79%	218 90%
Referred to Collection Division	10 3%	4 1%	17 6%
Not referred	38 13%	24 8%	52 18%
Number and percent of prosecution cases with closing memo delays			
Average delay in issuing closing memos in months	52 48%	41 38%	63 58%
Average delay in issuing closing memos in months			
Delayed memos affected assessments on cases with: (dollar estimates in millions)			
Unreported income of	7	6	8
Additional tax, penalty, and interest	\$2.8	\$1.8	\$3.8
	\$1.5	\$1.1	\$2.0

Comments From The Internal Revenue Service



COMMISSIONER

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

DEC 29 1988

Mr. Richard L. Fogel
Assistant Comptroller General
General Government Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

We have reviewed your recent draft report entitled "Tax Administration: Reducing Delays in the Pursuit of Tax Revenue on Closed Criminal Cases," and generally agree with its findings and recommendations. I want to take this opportunity to bring you up to date on actions taken and planned by both Criminal Investigation and the Criminal Tax area of Chief Counsel to implement the report's recommendations.

The draft report's initial recommendation was that appropriate internal control mechanisms be established in the Criminal Investigation Division to better ensure prompt notification to the Office of Chief Counsel about court actions and delays in the issuance of closing memoranda to authorize civil action on criminal prosecution cases.

Recently, Criminal Investigation established a task force to determine the best way of notifying Examination when they can resume civil action on a criminal case closed by the U.S. Attorney's office. The task force determined the major weakness in the present system was the U.S. Attorney's office not timely notifying the Tax Division of the Department of Justice that the criminal aspects of the case had been closed. Without this notification, the Tax Division can not in turn notify Chief Counsel that the case is closed.

To remedy this problem, the task force recommended that at the conclusion of a criminal case by the U.S. Attorney's office, the IRS special agent assigned to the case would be responsible for having the U.S. Attorney or his/her representative sign three letters indicating that the criminal aspects of the case were completed and that civil action could be started or resumed. These letters would be signed on the day of sentencing, discontinuance of the case, or other form of closure. These three letters would be sent to the Tax Division, Department of Justice, and to the appropriate IRS District Counsel and Chief, Examination Division.

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Comments From The Internal Revenue
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We anticipate that in most instances the letters to District Counsel and the Chief, Examination Division would be hand-carried to them on the same day that they were signed. Criminal Investigation plans to develop a form letter for the U.S. Attorney to sign, in concert with the Department of Justice Tax Division and the Assistant Chief Counsel (Criminal Tax).

To insure that these letters are prepared and signed timely, Criminal Investigation plans to add a new data field to its Form 4930, Criminal Investigation Case/Project Report, to include the date the letter was signed by the U.S. Attorney or his/her representative. In addition, Criminal Investigation will have a validity check which will not permit their management information system to accept an entry in the date of sentencing field unless the date the letter was signed is also included.

The draft report's second recommendation was that Chief Counsel establish controls to better ensure timely authorization of civil action by promptly issuing closing memorandums on completed cases.

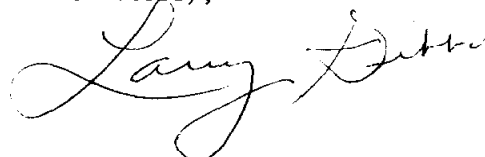
Historically, the Department of Justice has failed to timely inform the Service of the termination of criminal referrals. As a result, the "Automatic Closing" provisions of CCDM (31)350(6)(b) were developed. In brief, Counsel can now close criminal tax cases without having received written notification from the Department of Justice terminating the referral. (These automatic closing provisions have recently been expanded to include grand jury investigations.) For these automatic closing provisions to operate effectively, Counsel must know that the criminal aspects of the case have been terminated. To do this, the Service has adopted a procedure where the Criminal Investigation Division gathers the information necessary for the closing and provides it to Counsel. This is usually accomplished via Form 1327, prepared by the case special agent.

The Criminal Tax Division has attempted to further tighten controls in this area by requiring that Chief Counsel attorneys close criminal cases within five workdays of receipt of sufficient information from which it can be reasonably determined that the criminal aspects of the case has concluded.

We trust this information will be useful in preparing the final version of the report.

With kind regards,

Sincerely,



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