

Testimony of Patricia Haynes
Deputy Chief, Internal Revenue Service, Criminal Investigation
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Current Issues in Campaign Finance Law Enforcement
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Chairman Whitehouse, Ranking Member Graham, and distinguished Members of the Subcommittee on Crime and Terrorism, thank you for the opportunity to appear before you this morning. My name is Patricia Haynes, and I am the Deputy Chief of the Internal Revenue Service ("IRS"), Criminal Investigation (CI).

At the request of the Subcommittee, today I will discuss IRS enforcement under Internal Revenue Code section 7206 as well as how the IRS-CI interacts with the Department of Justice and other law enforcement agencies. The IRS-CI has authority over potential criminal violations of the Internal Revenue Code.

I. Overview of IRS Criminal Investigation

The mission of the IRS-CI office is to serve the American public by investigating potential criminal violations of the Internal Revenue Code and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law. IRS-CI consists of approximately 2,400 special agents worldwide who investigate criminal violations of the Internal Revenue Code and the money laundering and Bank Secrecy Act statutes. IRS-CI works closely with the Department of Justice and U.S. Attorneys' Offices around the country to bring criminal tax offenders to justice. Criminal tax enforcement is a crucial component of the IRS's overall effort to encourage voluntary compliance.

II. Title 26 U.S.C. § 7206(1)

Statutory Overview and IRS Investigative Procedures

A. Introduction

The making of false or fraudulent statements to the IRS may be prosecuted under 26 U.S.C. § 7206(1), which provides the following:

§ 7206. Fraud and false statements.

Any person who--

(1) Declaration under penalties of perjury.--Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; [...]

shall be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than 3 years, or both, together with the costs of prosecution.¹

Although the most common prosecutions under this provision involve the underreporting of income or the fraudulent inflation of deductions on federal income tax returns, § 7206(1) may also be charged in cases involving other types of false statements made on documents submitted to the IRS. *See, e.g., United States v. Mubayyid*, 658 F.3d 35 (1st Cir. 2011) (affirming § 7206(1) convictions based on defendant's false responses to Question 76 on IRS Forms 990, Return of Organization Exempt from Income Tax, which asked "Did the organization engage in any activity not previously reported to the IRS?").

B. Elements of the Offense

Courts have held that § 7206(1) has the following four elements:

- (1) that the defendant made or caused to be made, a return, statement, or other document for the year in question which he verified to be true;
- (2) that the return, statement, or other document was false as to a material matter;
- (3) that the defendant signed the return, statement, or other document willfully and knowing it was false; and
- (4) that the return, statement, or other document contained a written declaration that it was made under the penalty of perjury.

See, e.g., United States v. Griffin, 524 F.3d 71, 76 (1st Cir. 2008); *United States v. LaSpina*, 299 F.3d 165, 179 (2d Cir. 2002).

1. Materiality

The second element of § 7206(1), which requires the government to prove that the return, statement, or document in question was "false as to a material matter," has been subject to varying judicial interpretations.² The Circuit Courts of Appeal have applied

¹ Pursuant to 18 U.S.C. § 3571, the maximum permissible fine has been increased to \$250,000 for individuals and \$500,000 for corporations.

² Under *United States v. Gaudin*, 515 U.S. 506 (1995), materiality is considered a mixed question of law and fact for the jury, not the court, to decide.

the following two tests to determine whether an item is material for purposes of § 7206(1):

i. Under the first test, any item required on a tax return necessary for a correct computation of tax is considered material.

See, e.g., Neder v. United States, 527 U.S. 1, 16 (1999) (noting that several courts have determined that any failure to report income is material); *United States v. Scholl*, 166 F.3d 964, 979 (9th Cir.1999) (“information is material if it is necessary to a determination of whether income tax is owed”) (quoting *United States v. Uchimura*, 125 F.3d 1282, 1285 (9th Cir. 1997)); *United States v. Clifton*, 127 F.3d 969, 970 (10th Cir. 1997) (a material statement is one that is “necessary in order that the taxpayer...compute his taxes correctly”); *United States v. Klausner*, 80 F.3d 55, 60 (2d Cir. 1996); *United States v. Taylor*, 574 F.2d 232, 235 & n.6 (5th Cir.1978) (recognizing and describing both tests); *United States v. Warden*, 545 F.2d 32, 37 (7th Cir. 1976).

ii. Under the second test, an item is material if it has a natural tendency to influence or impede the IRS in ascertaining the correctness of the tax declared, or in verifying or auditing the taxpayer’s returns.

See, e.g., Neder v. United States, 527 U.S.1, 16 (1999) (“In general, a false statement is material if it has a natural tendency to influence or [is] capable of influencing, the decision of the decisionmaking body to which it is addressed.”); *United States v. Presbitero*, 569 F.3d 691, 700-701 (7th Cir. 2009); *United States v. Tarwater*, 308 F.3d 494, 505 (6th Cir. 2002); *United States v. DiRico*, 78 F.3d 732, 736 n.1 (1st Cir. 1994); *United States v. Greenberg*, 735 F.2d 29, 31 (2d Cir. 1984); *United States v. DiVarco*, 484 F.2d 670, 673 (7th Cir. 1973); *see also United States v. Fawaz*, 881 F.2d 259, 264 (6th Cir. 1989); *United States v. Taylor*, 574 F.2d 232, 235 & n.6 (5th Cir. 1978) (recognizing both *Warden* and *DiVarco*).

These two tests are arguably not in conflict, but are rather two “complimentary but separate tests, with one test embracing the other.”³ Nevertheless, when evaluating a

³ Department of Justice Criminal Tax Manual, § 12.10. The Seventh Circuit has explicitly endorsed both tests. *Compare United States v. Warden*, 545 F.2d 32, 37 (7th Cir. 1976), with *United States v. Presbitero*, 569 F.3d 691, 700-701 (7th Cir. 2009); *United States v. DiVarco*, 484 F.2d 670, 673 (7th Cir. 1973); *see also United States v. Boulterice*, 325 F.3d 75, 82 (1st Cir. 2003) (“A ‘material’ matter is one that is likely to affect the calculation of tax due and payable, or to affect or influence the IRS in carrying out the functions committed to it by law, such as monitoring and verifying tax liability.”).

case for referral to the Department of Justice, it is important to consider the relevant Circuit precedent. In criminal investigations of tax-exempt entities, IRS-CI and Criminal Tax Counsel consult with experts in the Office of Division Counsel / Associate Chief Counsel (Tax Exempt and Government Entities) to assess the materiality of any allegedly false matter.

2. Willfulness

Section 7206(1) is a specific intent crime requiring a showing of willfulness. The Supreme Court has defined "willfulness" as "a voluntary, intentional violation of a known legal duty." *Cheek v. United States*, 498 U.S. 192, 200 (1991). In *United States v. Pomponio*, 429 U.S. 10 (1976), a § 7206(1) prosecution, the Supreme Court approved the following jury instruction on willfulness: "[t]o establish the specific intent the Government must prove that these defendants knowingly did the acts, that is, filing these returns, knowing that they were false, purposely intending to violate the law." 429 U.S. at 11 n.2.

C. IRS Investigative Procedures

The central mission of IRS-CI is to investigate potential criminal violations of the Internal Revenue Code, including potential violations of § 7206(1), and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law.

1. Administrative Investigations

Investigations worked outside of the grand jury process are referred to as "administrative investigations." Most administrative investigations involve Title 26 and tax-related Title 18 violations and are generally initiated when a CI special agent anticipates working without the cooperation of other agencies. Administrative investigations may be initiated whenever information indicating possible violations of tax, money laundering, or bank secrecy laws is received or developed. CI also receives criminal fraud referrals from civil compliance employees via Form 2797, Referral Report of Potential Criminal Fraud Cases. Criminal fraud referrals consist of information acquired during a civil examination or a collection proceeding that is provided to CI by another IRS business operating division after affirmative acts (firm indications) of fraud are established and criminal criteria are met.

If information supports the potential for criminal prosecution, CI will determine whether to initiate a subject criminal investigation ("SCI"). The object of an SCI is to gather pertinent evidence to prove or disprove the existence of a violation of the laws enforced by the IRS. An SCI is considered a full-scale criminal investigation and, therefore, may include the broad spectrum of investigative techniques available to law enforcement officers.

2. Grand Jury Investigations

CI may submit a request to the Department of Justice to initiate a grand jury investigation either before, during, or after conducting an administrative investigation. A grand jury investigation may be requested when use of a grand jury would be more efficient; or when an investigation has proceeded as far as the administrative process allows, but prosecution potential would be strengthened by the grand jury process. In addition, an attorney for the government, such as an Assistant United States Attorney, may request CI's assistance in an ongoing or proposed grand jury investigation whenever the information available to the attorney indicates possible commission of crimes under the jurisdiction of the IRS.

C. Standards of Review

1. Evaluation of Administrative Cases for Prosecution

At the conclusion of an administrative investigation, CI forwards the Special Agent's Report and accompanying exhibits to Criminal Tax Counsel for review. Criminal Tax Counsel will evaluate the materials to determine whether the evidence relied upon to support CI's prosecution recommendation is sufficient to indicate guilt beyond a reasonable doubt and whether there is a reasonable probability of conviction. A Criminal Tax attorney prepares a criminal evaluation memorandum on the basis of this evaluation and transmits the memorandum to the IRS-CI Special Agent in Charge ("SAC"). The SAC is the referral authority for prosecution recommendation to the Department of Justice.

2. Review of Referrals for Grand Jury Investigation

If certain factors are present consideration may be given to referring the case for grand jury investigation. A referral for grand jury investigation is accomplished by the SAC, who refers CI's recommendation to the Department of Justice. Before this referral takes place, Criminal Tax Counsel reviews and evaluates the request and provides a legal analysis to the SAC. The review by Criminal Tax Counsel is to determine:

- i. Whether there are articulable facts supporting a reasonable belief that a crime has been committed;
- ii. Whether referral for grand jury investigation would be necessary and appropriate in the circumstances; and
- iii. Whether there are legal impediments or other factors that substantially detract from or negate the prospect of ultimately developing admissible evidence necessary to establish guilt beyond a reasonable doubt and reasonable probability of conviction.

3. Evaluation of Grand Jury Cases for Prosecution

At the conclusion of a grand jury investigation, Criminal Tax Counsel will review and evaluate grand jury cases for legal sufficiency and will identify any legal or other impediments that detract from the prospects of successful prosecution. A grand jury criminal evaluation memorandum is prepared by a Criminal Tax attorney on the basis of this evaluation and is transmitted to the SAC.

Conclusion

Thank you for allowing me to discuss IRS enforcement under Internal Revenue Code section 7206 as well as how the IRS-CI, which has authority over potential criminal violations of the Internal Revenue Code, interacts with the Department of Justice and other law enforcement agencies. This concludes my testimony. I would be happy to answer any questions you may have.