Department of Justice

STATEMENT

OF

EILEEN J. O'CONNOR
ASSISTANT ATTORNEY GENERAL
TAX DIVISION

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

CONCERNING

"CORPORATE AND PARTNERSHIP ENFORCEMENT ISSUES"

PRESENTED ON

JUNE 13, 2006

Statement of
Eileen J. O'Connor
Assistant Attorney General
Tax Division
Before the
Committee on Finance
United States Senate

Concerning

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Introduction

I thank the Committee for inviting me to discuss the work of the Tax Division of the United States Department of Justice. I last had an opportunity to come before the Committee a year ago, and there is much to report on our progress in addressing the challenges of improving the climate of tax compliance.

My remarks this morning will detail our recent experience in dealing with tax matters that affect taxpayers within the responsibility of the Large and Midsize Business Division of the IRS (LMSB) - - including corporations, sub-chapter S corporations, and partnerships with assets greater than $10 million. Due to the good work of our attorneys, there are many successes to report. I will also discuss the challenges we face in defending the fisc when we are up against large and well-financed legal opponents, as is often the case in tax shelter litigation. Following this, I will respond to your more specific questions concerning the Supreme Court's holding in *Cheek v. United States*, 498 U.S. 192 (1991), and the recommendations contained in letters by Ms. J.J. MacNab and Mr. Jay Adkisson. As you requested, I will also attempt to address issues that we view as limiting the ability of our office to effectively enforce the tax laws passed by the Congress or matters that we believe are frustrating the spirit or intent of law passed by the Congress.

The Tax Division

The primary mission of the Tax Division is to enforce the nation's tax laws fully, fairly, and consistently. The Tax Division enforces the nation's criminal tax laws. The Tax Division authorizes all grand jury investigations and prosecutions involving violations of the Internal Revenue Code and, in conjunction with the United States Attorneys, tries criminal tax cases in the federal courts and represents the United States in criminal appeals. The Tax Division represents the United States in federal civil tax trials in all state and federal courts, except the United States Tax Court, represents the United States in all appeals of cases involving or affecting the administration or enforcement of federal tax laws in the federal circuit courts of appeals and in the state appellate courts, and assists the Solicitor General of the United States in Supreme Court cases involving those matters.

At any given time, we have about 7,000 civil cases in progress and about 750 cases before the United States Courts of Appeal. This past fiscal year, we authorized the prosecution of more than 1,400 defendants, an increase of 2% from the prior year, which itself was an increase of 22% over the year before that. To accomplish all of this, the Tax Division employs about 500 people, of whom about 295 are attorneys.

The Tax Gap

The IRS estimates that the Tax Gap - the difference between taxes owed and taxes paid on a timely basis - was approximately $345 billion in 2001. This amount was reduced by late payments and enforced collection activity to a net tax gap of $290 billion in 2001. The two components of the Tax Gap most relevant to the focus of today's hearing are underreporting by large corporations and underreporting of business income by individuals. The IRS estimates that the first category -- large corporate underreporting -- accounts for about $25 billion of the Tax Gap. Underreporting of business income by individuals accounts for $109 billion of the Tax Gap, and a portion of this total includes underreporting by the high-net-worth individuals who have owned interests in the large passthrough entities - - partnerships, LLCs, or S Corporations -- that are believed to have engaged in improper tax shelter transactions.

President Bush has made tax enforcement a priority: IRS's enforcement funding for the current year is $442 million more than it was last year, and the President's Budget for the upcoming fiscal requests another $137 million increase. If Congress passes the FY 2007 increase the President has requested, IRS will have $579 million more devoted to enforcement in FY 2007 than it did in FY 2005.

The Tax Division's caseload is a direct result of IRS enforcement activity, and generally occurs about two years after it. For this reason, the President's budget request for FY 2007 includes increased funding for the Tax Division to enable it to follow through on the IRS's increased enforcement efforts.

The immediate results of the Administration's increased focus on closing the Tax Gap are clear to see. IRS has increased enforcement revenue from audits of corporations and individuals to $17.7 billion in 2005 compared to $10.7 billion in 2003. In all, from 2004 to 2005, collection from heightened enforcement efforts rose 10%, from $43.1 billion to $47.3 billion.[1]

The Tax Division's work on this mission has an immediate payoff. Over the last five years, Tax Division attorneys on average have returned 24 dollars to the Treasury for every dollar they cost to employ. Significant as the dollars are, they are but a fraction of taxes voluntarily paid by taxpayers because of the precedents set by the Division's cases and taxpayers' trust in the integrity of the tax system that results from them. Thus, the effects of the Division's litigation on tax administration extend well beyond the cases that it handles. Decisions in the Division's cases settle

[1] Source: "Testimony of Commissioner of Internal Revenue Mark Everson Before the Senate Committee on the budget on the Tax Gap and How to Solve It," February 15, 2006.

questions of law that frequently govern millions of taxpayers. One favorable decision can resonate far beyond the parties directly involved and lead to billions of dollars in additional tax collections. Similarly, as discussed in more detail later, criminal prosecutions brought or authorized by the Division deter many taxpayers who might consider evading taxes in ways large and small.

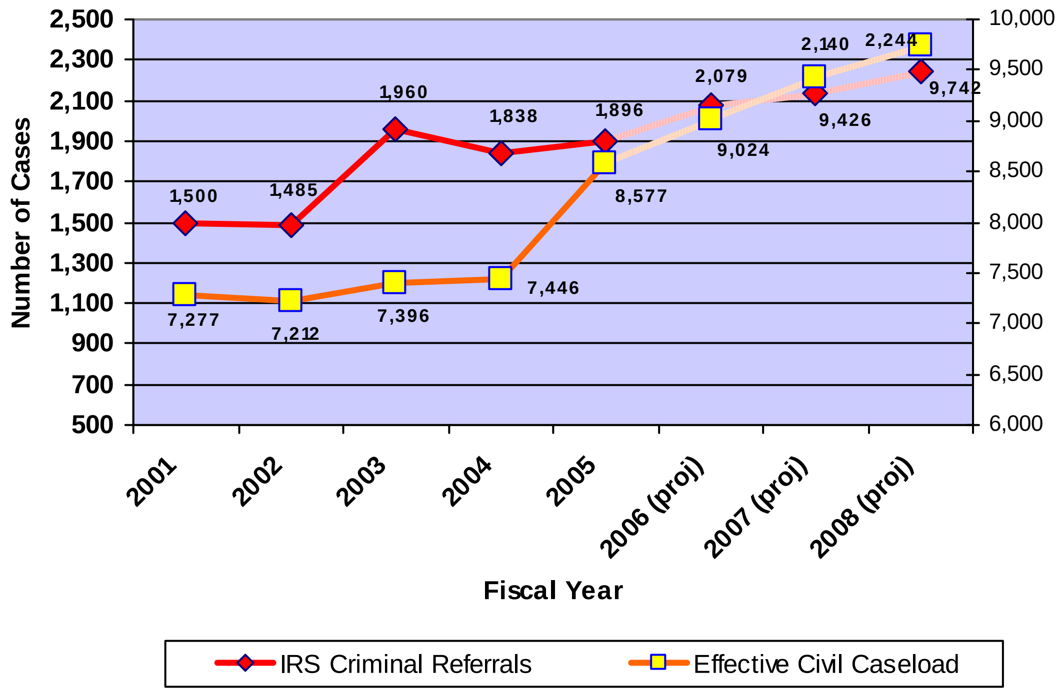
Additionally, the Division's independent review of the merits of cases to be brought or defended significantly improves the consistency of the Government's position with applicable law and policy. This balance of independence and, where appropriate, aggressive litigation, helps to ensure that taxpayers pay the taxes the law requires and at the same time helps to maintain their perception of the fairness of the law.

The Tax Division is a key player in efforts to close the Tax Gap. In addition to its work collecting taxes for the Government, a significant portion of the Division's time and resources is directed to stopping the spread of improper tax shelters, shutting down promoters of tax schemes and scams, and assisting the IRS in collecting the information necessary to identify persons marketing and using tax avoidance packages.

The work of the Tax Division has been and will continue to be directly and significant impacted by the increased level of IRS enforcement activity. For example, in addition to stepping up audits and investigations, the IRS has increased its use of "settlement initiatives" - - such as the multi-billion dollar Son of BOSS tax shelter settlement initiative - - under which the IRS publicly states the terms under which it will agree to resolve a dispute concerning the taxes, penalties, and interest owed as a result of a specific tax shelter. Tax Division litigation plays a major role in the success of IRS settlement initiatives. First, the Tax Division's vigorous litigation to obtain judicial enforcement of IRS summonses resulted in the identification of tax shelter participants who might otherwise have evaded detection. Secondly, the Tax Division's success in litigation challenging the merits of improper tax shelters creates the credible threat that shelter participants will lose in court, which encourages them to settle.

The IRS received full funding support of its FY 2006 budget request, which focuses primarily on enforcement initiatives. The Tax Division has been an integral part of the Administration's increased enforcement initiatives, resulting in ever-increasing workloads for the Division's attorneys. However, the additional resources being devoted in the IRS's FY 2006 and FY 2007 budget will push the Tax Division's workload for FY 2008 even higher, as the IRS develops even more civil and criminal cases the Tax Division will be called upon to litigate. The Congress' continued support of the President's resource requests for tax law enforcement for FY 2006 and FY 2007 and future years is very important. The chart below depicts the Tax Division's workload growth.

Increases in IRS Enforcement
Drive Tax Division Caseloads Higher



Civil Litigation

The Division's civil trial and appellate work covers a broad spectrum of litigation in the United States district courts, the United States Court of Federal Claims, United States bankruptcy courts, the United States Circuit Courts of Appeals (and working with the Office of the Solicitor General, the United States Supreme Court), and state courts. The Division's civil trial attorneys are responsible for assuring public compliance with the nation's internal revenue laws, while advocating fair and consistent positions.

The Tax Division's civil litigation has both a direct and an indirect impact on federal tax laws. In cases the Tax Division handles, billions of dollars are directly at stake, either defending against unjustified refund claims taxpayers have filed against the United States Treasury or through affirmative litigation that seeks to collect revenue to satisfy unpaid tax debts. Defensive litigation has averaged, since FY 2001, 75% (by hours) and 78% (by cases received), respectively, of the Tax Division's civil caseload. Equally important, the Tax Division's civil trial and appellate litigation results in precedents that control the disposition of thousands of cases pending administratively with the IRS, thus giving the Division's work an even more significant, indirect impact on tax administration.

For civil cases, the Tax Division measures cases successfully litigated, in total or in part, by the resolution of a claim through judgment or other court order. In FY 2005, the Division won the following percentages of cases decided:

Trial Courts – 96%
Taxpayer Appeals – 95%
Government and Cross Appeals - 70%

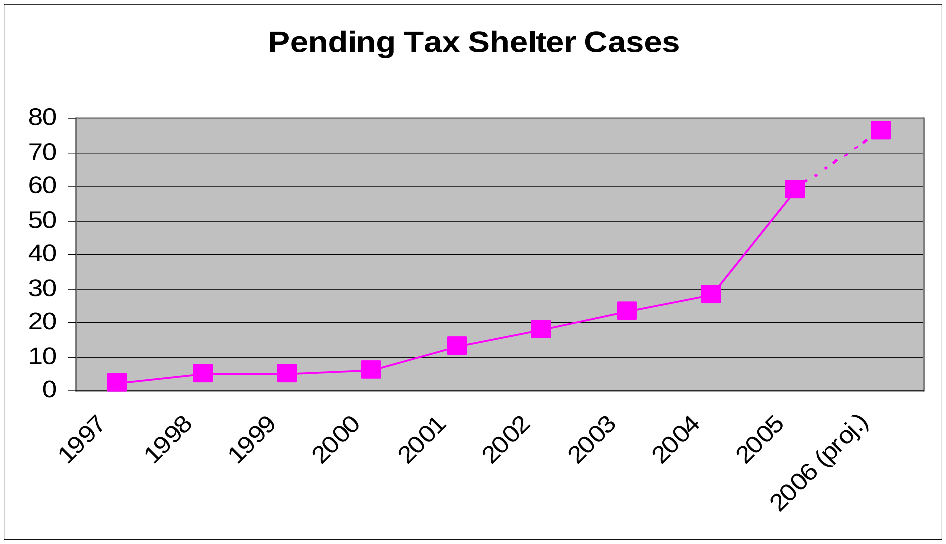
a. Civil Litigation Involving Large Taxpayers

i. Stopping the Spread of Tax Shelters

Abusive tax shelters cost the Government many billions of dollars each year. The IRS says that tax-shelter proliferation is one of the most significant problems confronting our tax system. A February 2005 GAO report concluded that 207 Fortune 500 companies engaged in tax-shelter transactions, costing the Federal Treasury as much as $56 billion. Sophisticated tax professionals promote these complicated transactions to corporations and wealthy individuals. Frequently, the individuals are key officers in these business entities. Tax shelters typically involve multiple, complex, and sometimes well-disguised transactions that have been structured to provide substantial tax benefits that were not intended by Congress or that otherwise lack economic substance independent of those tax benefits. Because these transactions involve enormous sums of money and often attract significant media attention, a coordinated and effective effort is essential to prevent substantial losses to the Treasury and to deter future use of such shelters by other taxpayers.

The Tax Division plays an important role in the Government's efforts to combat improper tax shelters by defending in the federal district courts, the Court of Federal Claims, and the appellate courts the IRS's determination that the tax shelter is abusive tax avoidance. The cases the Division defends involve millions of dollars in tax revenue, and affect potentially billions of dollars of tax revenue owed by other taxpayers.

The chart below shows how the number of tax shelter cases in litigation has been steadily increasing. As of March 31, 2006, the Division is handling 68 groups of related cases, involving over 200 taxpayers. The Division projects a total of 76 groups of shelter cases by the end of the Fiscal Year. Despite victories in significant cases, the number of tax shelter cases being handled by the Tax Division continues to increase substantially. As IRS continues to vigorously investigate tax shelters, the Tax division's litigation to support that effort – by litigating to enforce summonses and to defend tax shelter refund claims – will continue as well.



The Tax Division anticipates that over the next several years, tax shelters will continue to be hotly contested in the federal district courts and in the Court of Federal Claims. New significant cases are anticipated in the near future. Some of these transactions coming to the Tax Division involve complex leasing arrangements, known as "LILO" and "SILO" transactions, and were addressed in part on a prospective basis by Congress in 2004 (The 10-year revenue estimate provided for the legislative amendments was $26.56 billion[2]).

Many of tax shelters use structures partnership structures that introduce special considerations and particular problems into their resolution. For example, the partnership provisions of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") did much to consolidate the resolution of partnership matters in a single proceeding, which matters previously had been subject to as many lawsuits as there were partners. More than two decades after enactment, many TEFRA procedural issues remain to be resolved. Distinguishing between partnership-level items and partner-level items, for example, continues to be problematic. We often must litigate the question whether a given issue is within the jurisdiction of the court hearing the TEFRA suit. There are three significant problems areas:

- First, disputes involving the proper character of items under TEFRA, which must be briefed and argued, and which are a tactical concern that must be handicapped and planned by the lawyers, are a drain on resources -- the Department's, the taxpayers,' and the courts.'

- Second, the line currently drawn between partner and partnership items leaves outside of the TEFRA suit some issues that, we believe, would be best resolved in that suit -- issues that should be resolved in one setting for all the partners, but that, under the current regime, must instead be resolved in a plurality of post-TEFRA partner proceedings.

[2] Staff of the Joint Committee on Taxation, "Estimated Budget Effects Of The Conference Agreement For H.R. 4520, The 'American Jobs Creation Act Of 2004,'" October 7, 2004.

- Third, the distinction creates the possibility of a sport of whipsaw. An issue that *may* be resolved in the TEFRA suit *must* be resolved there. An issue that is eventually determined to have been a partner*ship*-level issue is untimely if asserted later at the partner level in the post-TEFRA proceeding. On the other hand, the statute of limitations to assess tax arising from an issue that is eventually determined to have been a *partner*-level issue will have run if the issue was wrongly characterized as a partnership-level issue. For that reason, either the Government may lose a defense by guessing wrong about its ultimate characterization, or else the Government takes protective action to maintain *both* possibilities, and proceedings are thereby multiplied.

More recent partnership litigation has arisen in a somewhat different procedural context than the controversies which gave rise to the original legislation. The original TEFRA procedures were designed primarily to address controversies involving large partnerships with dozens of unrelated partners. In those cases, efficient resolution of the controversies required limitation of the litigation to the handful of common issues involving all of the partners; resolution of issues unique to the individual partners would complicate the proceeding and delay resolution of the proceeding. In contrast, more recent controversies have involved partnerships with fewer partners, most of whom are related. In those instances, the presence of issues unique to the individual partners is less significant; indeed, issues previously thought unique to individual partners in the case of large partnerships are often common to many (if not all) of the individual partners in these cases. As a result, a broader definition of the issues which may be resolved at the partnership level would provide for the most efficient resolution of the controversy.

There are several other areas related to tax shelter litigation that are also worthy of consideration by the Committee.

ii. Summons Enforcement Litigation

When individual or business taxpayers do not comply with an IRS summons, the IRS can refer the matter to the Department of Justice to seek a judicial order compelling enforcement. These judicial proceedings not only provide the Government with an essential tool for obtaining information in appropriate cases, but also afford those affected by the summons important procedural and substantive rights.

The Tax Division's success in significant summons enforcement litigation was a key to the ability of the IRS to identify many tax-shelter participants. When prominent law firms and public accounting firms began marketing tax shelters to corporations and wealthy individuals, the IRS asked for information the firms were required by law to maintain and provide, and the firms shielded the identify of these customers with invalid claims of privilege. Subsequently, the Tax Division obtained judicial enforcement of IRS summonses issued to Jenkens & Gilchrist, Sidley Austin Brown & Wood, KPMG, BDO Seidman, and Arthur Andersen. Materials produced by these summoned parties were the catalyst for the IRS' ability to clamp down on Son-of-BOSS tax shelters and, ultimately, to collect billions of dollars. Of equal importance, this litigation sent a clear message to promoters and their customers that the Government would not allow them to hide in dark corners behind invalid, and sometimes bogus, claims of privilege. These victories produced important general deterrence, chilling the market for improper tax shelters.

The Tax Division's development of these cases before filing suit is essential to its success. Challenges to claims of privilege require that we review hundreds, sometimes thousands, of pages of documents and testimony to demonstrate that the communications are not privileged because the communications were not confidential, had been disclosed, were not made for the purpose of seeking or giving legal advice, or were made in connection with an on-going or contemplated crime or fraud.

On occasion, we may even need to identify and hire an expert witness. For example, in order to prepare the summons enforcement action for tax accrual workpapers which was recently filed in *United States v. Textron*, (D. R.I.), the Tax Division decided that to adequately explain the relationship of tax accrual workpapers to the audit process, an expert witness should be retained to inform the court about the nature of tax accrual workpapers, the manner in which they are prepared, and the reasons they are prepared. The expert's declaration anticipates many of the arguments that we expect will be made by taxpayers with respect to these documents, including claims of privilege and work-product.

The Division's reputation for tenacious and thorough litigation of summons cases on occasion permits us to obtain voluntary compliance even prior to filing a petition. Of course, these are cases where the IRS was unable to secure compliance on its own. In two tax accrual workpaper referrals, for example, Department attorneys met with taxpayers' counsel and persuaded them to comply (at least in substantial part) with the summonses, thereby obtaining information quickly and without litigation.

iii. Stopping the Promoters of Schemes and Scams

In addition to the complex and technical improper tax shelters used by corporations, large partnerships, and the wealthy persons that invest in them, there are a multitude of less sophisticated tax schemes and scams. Other recent schemes have included:

1. Claims that people are not required to pay taxes for frivolous reasons, such as that Section 861 of the Internal Revenue Code exempts U.S. citizens from paying taxes on income received in the U.S.; or that one can expatriate oneself from the tax system without leaving the U.S.

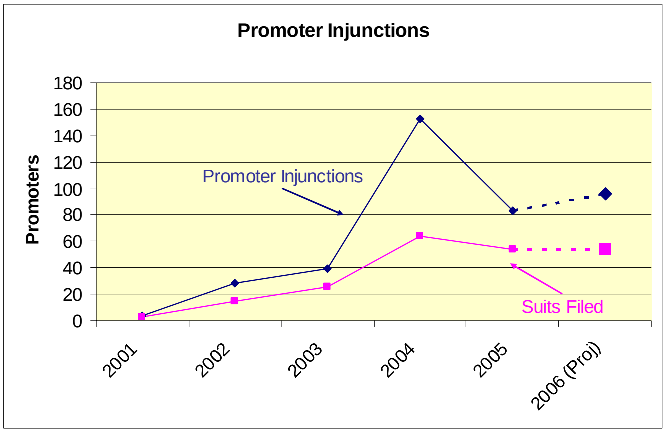
2. Filing large refund requests through the amended returns process to avoid extensive scrutiny.

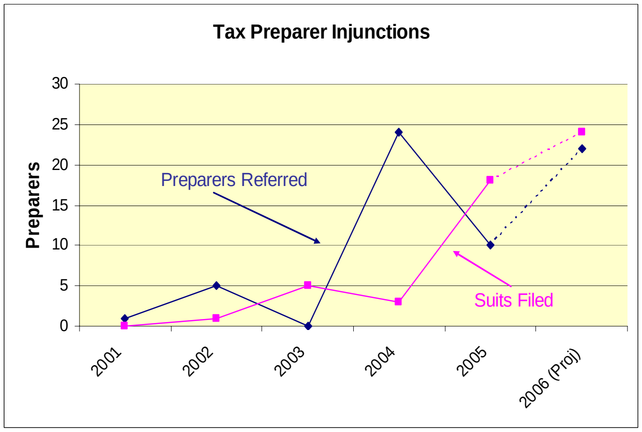
3. Schemes setting up sham trusts to allow taxpayers to deduct personal expenses.

4. "Warehouse banks" to commingle and conceal assets.

5. Schemes advocating filing tax returns falsely reporting "zero" income.

6. Urging employers to fail to withhold, report, or pay payroll and income taxes.





Note: The spike in FY 2004 reflects a single case involving 45 promoters. Referrals of tax scam promoters for injunction litigation are expected to continue at a high rate.

Typically marketed by persons who purport to be tax experts, these scams in reality are nothing more than false and fraudulent "do-it-yourself" tax-relief packages sold to individuals who are uninformed or willfully naïve. Tax Division efforts have led to over 180 injunctions entered against tax scam promoters and fraudulent tax return preparers, shutting down scams involving nearly 400,000 taxpayers and over one billion dollars.

Such schemes place an enormous burden on the IRS. Substantial audit, collection, and administrative resources must be devoted to detect, correct, and collect unpaid taxes that result from improper filings by purchasers of these illicit arrangements. The schemes undermine public confidence in the integrity of our tax system, if honest taxpayers see tax fraud scams being aggressively marketed and going unchallenged.

The Division has encouraged the IRS to target these schemes at their source, *i.e.*, the promoters, so they can be shut down before they result in the need for more IRS examination and collection activity. The Tax Division has developed an expedited referral process so that the cases are quickly and properly investigated. Division employees have helped to train hundreds of Internal Revenue Service agents and lawyers about developing injunction and penalty cases against tax scam promoters.

The Division has recently obtained several notable victories in this area. In April 2006, a federal judge granted the Division's request to permanently enjoin a large organization, ostensibly a charitable one, from falsely advising that its program of providing down payment assistance by home sellers gave rise to a charitable deduction. The IRS estimated that tens of millions of dollars in improper deductions had been claimed by taxpayers based on this erroneous advice.

In September 2005, a court in Florida ordered an individual to stop promoting a variety of tax fraud schemes that had cost the Treasury nearly $18 million and ordered the production of the addresses of hundreds of customers that were involved in filing these false returns. Another example is an injunction obtained in May 2005 against a New York man who was promoting a tax plan that allegedly permitted employers to deduct contributions to certain employee benefit plans. The court found that the plans were schemes designed to enable employers to deduct non-deductible deferred compensation for select high-level employees by disguising the deferred compensation as employee benefits.

The Division expects the increase in injunction cases to continue. In FY 2005, the Division filed suits against 72 promoters and preparers. In the first seven months of FY 2006, the Division has already filed suit against 40 promoters and preparers, and there are many more suits being prepared. The IRS has nearly 1,100 promoters under examination, and each of those examinations is a potential suit in the future.

b. Defending the United States

Suits brought against the United States comprise the majority of the Division's caseload, and the plaintiffs in many of these cases are large corporations or partnerships. The Division defends these lawsuits, which include requests for refund of taxes, challenges to federal tax liens, and allegations of wrongdoing by IRS agents. Overall, the Division's representation of the Government in refund litigation saves the Treasury many hundreds of millions of dollars annually -- *in Fiscal Year 2005 alone the direct savings totaled $1.02 billion.*

c. Civil Tax Appeals

The Tax Division represents the United States in all appeals involving federal tax statutes in the United States circuit courts and their state government equivalents (except for appeals from the Southern District of New York). During the past year, many of the Division's most important cases have involved corporate or large partnership tax shelters. The Division's appellate section attorneys also assist the Solicitor General of the United States by preparing initial drafts of pleadings and briefs in tax cases filed in the Supreme Court, and by preparing drafts of *amicus curiae* briefs when the Supreme Court has called for the Government's views in tax-related cases in which the United States is not a party. The Division also closely reviews all adverse decisions entered by the lower courts in tax cases to determine whether the Government should appeal, and prepares a recommendation to the Solicitor General. The appellate section generally recommends appeal only in those cases where there is a substantial likelihood the Government will ultimately prevail or where an important principle is at stake. Vigorous review of these cases not only secures the result that Department resources are spent wisely on only the most meritorious appeals, but also advances the Tax Division's mission of promoting the fair, correct, and uniform enforcement of the federal tax laws.

The Tax Division has established an impressive record in the appellate courts. For FY 2005, the Tax Division prevailed, in whole or in part, in 95 % of the appeals in which it was defending a favorable lower court decision, and in 70% of the appeals in which it was urging reversal. For FY 2006 (interim through March 31, 2006), the figures are 98% for taxpayer appeals and 87% for Government appeals.

The following cases illustrate the Division's appellate work with specific reference to cases involving corporations, large partnerships or the promoters of tax schemes:

Adverse summary judgment reversed and remanded in $270 million tax shelter case – *Black & Decker Corp. v. United St*ates (United States Court of Appeals for the Fourth Circuit)

In February, 2006, the Fourth Circuit remanded a $230 million tax shelter case involving an attempt by Black & Decker to deduct a $560 million contingent liability as a business loss. The court stated that the Tax Division had introduced "ample evidence" from which a reasonable trier of fact could conclude that the deductions were not authorized.

Government Victory in Corporate Owned Life Insurance Tax Shelter case– *Dow Chemical Co. v. United States* (Sixth Circuit)

Dow Chemical purchased life insurance policies on the lives of many of its employees, and it paid for the premiums, to a large extent, by borrowing from the insurers and using the cash value of the policies as collateral. For the years 1989 to 1991, Dow Chemical claimed tax deductions of more than $33 million for interest on the loans. The Sixth Circuit disallowed the deductions, determining that the life insurance plans were economic shams because without the benefit of the claimed interest deductions the plans would generate negative cash flows.

Courts of appeals affirm injunctions and enforce summonses against tax-shelter promoters– *U.S. v. Gleason* (Sixth Circuit); *U.S. v. Saladino* (Ninth Circuit); *U.S. v. Ka*hn (Eleventh Circuit); *U.S. v. Hargis* (Ninth Circuit)

The Sixth, Ninth, and Eleventh Circuits affirmed lower-court injunctions against promoters of a variety of tax-avoidance schemes. Daniel Gleason assisted his customers in deducting their personal living expenses by setting up sham businesses in their homes. Joseph Saladino had his clients drop out of the tax system by becoming private churches or by invoking fictitious constitutional and common-law rights to exclude their compensation from income. Bryan Malatesta, a CPA and a participant in abusive tax schemes promoted by Eddie Ray Kahn, sent frivolous FOIA requests to the IRS on behalf of Kahn's customers and filed frivolous complaints against IRS employees. The Ninth Circuit affirmed a summons enforcement order against Anthony Hargis and his "warehouse bank," through which Hargis assisted his customers in hiding their income, assets, and identities from the IRS.

Tax Shelter "Investors" Owe Negligence Penalties – *Mortensen v. Commi*ssioner (Sixth Circuit); *Van Scoten v. Com*missioner (Tenth Circuit)

The Sixth and Tenth Circuits affirmed negligence penalties imposed on taxpayers who invested in sham cattle-breeding partnerships promoted by Walter J. Hoyt III. The courts rejected the taxpayers' claims that the penalties should not be imposed because they reasonably relied upon representations of Hoyt and others in his organization. Hundreds of other taxpayers are also facing negligence penalties on account of their Hoyt partnership investments.

Deliberative process privilege need not be invoked by agency head – *Marriott Int'l Resorts, L.P. v. United States* (Federal Circuit)

The Federal Circuit, reversing the Court of Federal Claims, held that the deliberative-process privilege permits delegation and does not need to be invoked by the agency head. During discovery, Marriott sought documents from the IRS that the Government claimed were protected by the privilege. The privilege had been invoked by a delegate of the Commissioner of Internal Revenue, rather than by the Commissioner himself. The court of appeals held that delegation is permissible if it is carefully undertaken, and the Commissioner's delegation order satisfied this test because it provided detailed criteria to his delegates for invoking the privilege.

Tax Court properly upheld $350 million in deficiencies – *Chrysler Corp. v. Commissioner* (Sixth Circuit)

In resolving all three litigated issues in favor of the Government, the Sixth Circuit disallowed Chrysler's claim for a deduction of $287 million for anticipated warranty liabilities, its claim for almost $62 million in foreign tax credit carryovers, and its claim for a deduction of $327 million for amounts paid to redeem its common stock held by a trust as part of an employee stock ownership plan.

Criminal Prosecution and Appeals

The Tax Division's criminal trial attorneys investigate and prosecute individuals and corporations that attempt to evade taxes, willfully fail to file returns, submit false tax forms, or otherwise violate the federal tax laws. They also investigate and prosecute tax violations committed with other criminal conduct, such as narcotics trafficking, securities fraud, bankruptcy fraud, health-care fraud, organized crime, and public corruption. In addition, Tax Division attorneys investigate and prosecute domestic tax crimes involving international conduct, such as the illegal use of offshore trusts and foreign bank accounts to conceal taxable income and evade taxes. They also conduct Organized Crime and Drug Enforcement Task Force (OCDETF) and terrorism-related criminal investigations, and prosecute organizers of Internet scams.

The Tax Division authorizes and either conducts or supervises all prosecutions under the federal tax laws. The Division's two-pronged mission is: to prosecute criminal tax violations; and to promote a uniform nationwide approach to criminal tax enforcement. In many cases, the Tax Division receives requests from the IRS to prosecute tax violations after the IRS has investigated them administratively. In other cases, the IRS asks the Tax Division to open grand jury investigations to determine whether prosecutable tax crimes have occurred. Tax Division lawyers review and analyze these referrals to assure that uniform standards of prosecution are employed and that criminal tax violations warranting prosecution are prosecuted. After the Division authorizes tax charges, the cases are handled either by the respective United States Attorney's Office (USAO) or, in complex cases or cases in which the USAO is recused or requests assistance, by the Tax Division's own experienced prosecutors. Tax Division prosecutors conduct training seminars for IRS criminal investigators and Assistant U.S. Attorneys, and often provide advice to other federal law enforcement personnel, including the DEA and FBI.

The Tax Division's Criminal Appeals and Tax Enforcement Policy Section (CATEPS) represents the United States in appeals in criminal tax cases prosecuted by Division attorneys, and supervises appeals in matters tried by the USAOs around the country. Similar to the initial review of tax cases by criminal trial attorneys, the appellate review plays a vital role in promoting the fair, correct and uniform enforcement of the internal revenue laws. CATEPS also assists in the negotiation of international tax assistance treaties and policy issues, such as the application of the sentencing guidelines.

Although many such cases are difficult to prosecute, the Division has maintained a conviction rate at or greater than 95%. In FY 2005, the Division's conviction rate was 98% in tax cases. During the first half of FY 2006, the conviction rate was 100%. While the Tax Division is very proud of its conviction rate, the emphasis is on uniform and fair enforcement of the tax laws.

a. Prosecutions of "Pure Tax" Crimes

Many of the cases reviewed, investigated and prosecuted by the Tax Division involve so-called "legal source income." As the name implies, these cases encompass tax crimes involving unpaid taxes on income earned legally (*e.g.*, a restaurateur who skims cash receipts; or a dentist who inflates deductible expenses.) The Division also prosecutes many return preparers who fraudulently inflate deductions or underreport income to obtain unwarranted refunds for their customers. The defendants frequently include return preparers, non-filers and individuals engaging in illegal protest activities.

Evasion of taxes on income from legal sources significantly erodes the federal tax base, so the Division works hard to maintain a strong deterrent. Failure of the Government to vigorously prosecute such cases would undermine the confidence of law-abiding taxpayers and jeopardize in the Government's ability to operate a revenue collection system that depends upon voluntary compliance.

When these cases involve difficult issues of tax law or complex methods of proof, USAOs often call upon the special skills that Tax Division prosecutors bring to the Justice Department's goal of reducing white-collar crime. Prosecutions in these cases often receive substantial local press and media coverage and assure law-abiding citizens who pay their taxes that those who don't aren't getting away with it. During the past year, Division attorneys investigated and prosecuted cases involving tax crimes committed by individuals from all walks of life, including corporate executives, business owners, attorneys, doctors, dentists, an artist and others. A few examples:

In ***United States v. Thomas Mower, et al.*** (D. Utah), a jury convicted Thomas and Leslie Mower, the owners of Neways, Inc., a multilevel marketing company, of conspiracy and evading income taxes for six years. The indictment charged that the Mowers, with the assistance of their corporate counsel, James Thompson, devised a scheme to conceal from the IRS in excess of $1 million in Neways, Inc.'s overseas gross receipts and in excess of $3 million in commission income the Mowers received from Neways. The defendants will be sentenced in September 2006.

In December 2005, in ***United States v. Ronald Bailey*** (E.D. Va.), a former manager of a nursing home in Northern Virginia was sentenced to 51 months in prison and ordered to pay $1.4 million in restitution to the IRS, for committing tax evasion and filing false tax returns. From 1991 through 2000, Bailey withheld taxes from the nursing home employees' wages, but he failed to pay over those taxes to the IRS. In addition, he filed false returns for 1992 through 1995, on which he understated his income and falsely claimed that taxes had been withheld from his income, and he evaded his income taxes for the years 1997 through 2000.

On April 27, 2006, in ***United States v. James Delfino and Jeaniene Delfino*** (E.D. Va.), husband and wife business owners were sentenced to 78 months in prison and 63 months in prison, respectively, for conspiring to impede the IRS and evading the payment of more than $2 million in income tax. The defendants own and operate a successful computer consulting business, but have not paid personal income tax since 1993. The Government proved at trial that the defendants concealed their income and assets from the IRS using sham trusts.

In ***United States v. Walter Anderson*** (D.D.C.), a telecommunications entrepreneur was charged in a 12-count indictment with tax evasion, obstructing the Internal Revenue Service, and defrauding the District of Columbia government by failing to pay well in excess of $200 million in taxes owed to the federal and District of Columbia governments. Anderson is in federal custody pending his trial, which is currently scheduled for January 2007.

The Tax Division and the IRS have encouraged the entry of restitution orders in criminal tax cases in order to facilitate collection of the related civil tax liability. But, while a restitution order can be entered as an independent element of a sentence after conviction for any Title 18 offense, *see* 18 U.S.C. 3663(a)(1)(A), under current law, a restitution order can only be entered as an independent part of a sentence for a Title 26 offense if the defendant consents to paying restitution in a plea agreement. Otherwise, a court may order restitution for such an offense only as a condition of probation or supervised release. *See* 18 U.S.C. 3663(a). In the case of supervised release, collection of restitution is delayed: the restitution requirement does not go into effect until the defendant begins serving the supervised release. The tax loss suffered by the United States is currently treated differently from other kinds of pecuniary loss suffered by the Government or private citizens. There are also issues presented when the Service attempts to collect tax ordered to be paid as restitution. In order for the Service to collect a tax, it must first assess the tax. At present, it appears that the Service may assess amounts of restitution actually paid by a taxpayer with respect to his tax obligation, *see* 26 U.S.C. 6213(b)(4), but there is some question as to whether the Service may assess unpaid amounts of tax ordered to be paid as restitution.

b. Promotions of Improper Tax Shelters

The Division also prosecutes persons who promote or use fraudulent tax shelters and other schemes to evade taxes and hide assets. The number of taxpayers who use these schemes to improperly reduce, or totally evade, their federal income tax liabilities has increased significantly in recent years. One type of scheme involves the use of domestic or foreign trusts to evade taxes. Promoters of these schemes, often using the Internet, aggressively market trusts by employing strained, if not demonstrably false, interpretations of the tax laws. Employing what they often call "asset protection trusts" (ostensibly designed to guard an individual's assets from creditors, including the IRS), these promoters are in fact helping taxpayers to fraudulently assign income and conceal their ownership of income-producing assets in order to evade paying taxes.

In ***United States v. KPMG.*** (S.D.N.Y.), the Government entered into a deferred prosecution agreement with KPMG that charges KPMG with conspiracy to defraud the IRS by developing, implementing and marketing numerous illegal tax shelters. KPMG admitted that its personnel took deliberate steps to conceal the existence of the tax shelters from the IRS. The agreement provides that prosecution against KPMG will be deferred until December 31, 2006, if specified conditions, including payment of the $456 million in fines, restitution, and penalties, are met.

In ***United States v. Jeffrey Stein, et al.*** (S.D.N.Y.), eighteen former officers and associates of the Big-Four accounting firm KPMG and a former tax partner of a national law firm were charged with conspiracy to defraud the IRS, tax evasion and obstruction of the internal revenue laws arising out of illegal tax shelters that KPMG and others designed, marketed and implemented. The shelters allegedly generated at least $11 billion in fraudulent tax losses and resulted in at least $2.5 billion in tax evaded by wealthy individuals. In late March 2006, former KPMG partner David Rivkin pleaded guilty to conspiracy and tax evasion charges. Trial against the remaining defendants is currently scheduled for September 2006.

In February 2006, in ***United States v. HVB*** (S.D.N.Y.), Germany's second largest bank, entered a deferred prosecution agreement with the United States in connection with its role in facilitating tax shelters marketed by KPMG. According to the agreement, HVB will pay nearly $30 million to the United States in fines, penalties and restitution stemming from its work on four questionable tax shelters, and will implement substantial compliance improvements to its operations.

In ***United States v. Michael A. Vallone, et al.*** (N.D. Ill.), nine defendants were charged with participating in a nearly decade-long conspiracy to market and sell sham domestic and foreign trusts through "The Aegis Company." The defendants marketed the scheme to more than 600 wealthy taxpayer clients throughout the United States to hide hundreds of millions of dollars in income, resulting in a tax loss to the United States of at least $68 million. Trial is scheduled to begin in November 2006.

In ***United States v. Graham, et al.*** (S.D. Ohio), six defendants are charged with promoting sham Aegis Company trusts to 220 clients that resulted in a $20 million tax loss to the Federal Treasury. During the course of the scheme, the defendants prepared fraudulent tax returns that concealed clients' income from the IRS. Trial of these defendants is scheduled to begin in Spring 2007.

c. Return-Preparer Fraud

Corrupt accountants and unscrupulous tax return preparers are a major concern of the Tax Division and IRS. Some accountants and return preparers financially benefit by duping unwitting clients into filing fraudulent returns and then take a significant portion of the unwarranted refund as a fee. Other corrupt accountants and unscrupulous return preparers serve as willing "enablers," providing a veneer of legitimacy for clients predisposed to cheat. In either kind of case, the professionals often commit a large number of frauds, and their status, as "professionals," may be perceived as legitimizing tax evasion thereby promoting disrespect for the rule of law. Tax Division attorneys continue to aggressively investigate and prosecute such cases, including the following:

On January 27, 2006, in ***United States v. Jerome H. Harris*** (S.D. Tex.), a Federal judge sentenced the defendant, a full-time City of Houston employee and the owner and operator of a bookkeeping and tax service, to 57 months in prison for preparing hundreds of false tax returns for tax years 1995 through 2000. The false returns the defendant prepared resulted in claims for fraudulent refunds by his clients totaling almost $1.3 million. The Tax Division's Criminal Appeals and Tax Enforcement Section is now handling the defendant's appeal to the United States Court of Appeals for the Fifth Circuit.

On May 2, 2006, in ***United States v. Susan O'Brien, et al.*** (S.D. Cal.), after an eleven-week trial, a Federal jury convicted a professional tax return preparer and two associates of tax fraud. The defendants were charged with promoting a $1 million tax fraud scheme involving sham trusts and the fraudulent preparation of income tax returns. Five other defendants pleaded guilty to felony tax charges before trial.

In ***United States v. Michael Craig Cooper, et al.*** (D. Kan.), four individuals and the organization "Renaissance, the Tax People, Inc.," are charged with conspiracy to impede the IRS, mail fraud and wire fraud in connection with an $84 million tax scheme. From June 1997 though April 2002, the defendants marketed a fraudulent home-based business package through which was offered purportedly legitimate tax return preparation, tax advice and audit protections. Trial of the defendants is scheduled for November 2006.

d. Tax Fraud Promotion

Another Tax Division initiative focuses on active promotion of tax fraud. Tax schemes in this category include claims that an individual is a "sovereign citizen" not subject to U.S. laws, the U.S. income tax is unconstitutional. Other related conduct may include taxpayers taking sham "vows of poverty" and harassing Government employees and judges.

On February 24, 2006, in ***United States v. Irwin Schiff, et al.*** (D. Nev.), a federal judge sentenced high profile tax scam promoter Irwin Schiff to 151 months in prison for tax fraud, an additional 12 months for contempt of court and ordered Schiff to pay $4.2 million in restitution to the IRS. Schiff's two associates, Lawrence Cohen and Cynthia Neun were sentenced to prison terms of 33 months and 68 months, respectively. The defendants were convicted by a federal jury in October 2005, after a six-week trial. Schiff, a nationally recognized tax-protest organizer, and his associates encouraged taxpayers to impede the IRS by filing tax returns with zeroes on each income and expense line, resulting in fraudulent claims for refunds of taxes paid. As a result of the heavily-marketed scheme, taxpayers filed nearly 5,000 fraudulent "zero returns" during a three-year period. The Tax Division's Criminal Appeals and Tax Enforcement Section is currently handling appeals arising out of the convictions.

On February 21, 2006, in ***United States v. David Carroll Stephenson*** (W.D. Wash.), a federal jury convicted the defendant of conspiring to defraud the United States and willful failure to file income tax returns for 1998 through 2000, in connection with his promotion of a tax evasion scheme using "pure equity trust" organizations. Co-conspirator Michael Joseph Shanahan pleaded guilty to the conspiracy charge and failing to file an income tax return for 1999. They falsely advised more than 400 clients that they could avoid paying income tax if they placed their income and assets in "pure equity trusts," while continuing to maintain control over such income and assets. The defendants received more than $2 million in revenue from the scheme. In May, 2006, Stephenson was sentenced to 96 months in prison.

On November 22, 2005, in ***United States v. Larken Rose*** (E.D. Pa.), a federal judge sentenced the defendant to 15 months in prison. A jury convicted Rose, the owner of a medical transcription business, of five counts of willfully failing to file tax returns. Rose is a leading proponent of the so-called 861 position, which incorrectly claims that wages earned by Americans working for domestic companies are not taxable. The federal courts have consistently denounced the 861 position as frivolous.

e. Scams by Prison Inmates

On June 29, 2005, the House Ways and Means Committee, Subcommittee on Oversight held a hearing “to examine tax fraud by inmates.” During the past decade, there has been a significant problem with false tax refund claims schemes organized and perpetrated by incarcerated persons, usually in state facilities, often with the assistance of friends and relatives on the outside. While organizers have been prosecuted for criminal tax violations, such prosecutions are time consuming and we found that often, the perpetrators were already serving terms of imprisonment more lengthy than those received for the tax crimes. Also, periodic prisoner transfers spread “know-how” concerning such schemes to other prisons.

Particularly in light of the increasing demands on scarce prosecutorial and judicial resources, the disclosure of information about these schemes to prison officials would facilitate application of administrative punishments, such as isolation and loss of other privileges, which would be more prompt and effective in halting the spread of the schemes than federal criminal prosecutions. The tax “privacy” act, 26 U.S.C. 6103, does not currently authorize disclosure of tax information to state and local prison officials for use in imposing administrative sanctions against prisoners perpetrating federal tax fraud schemes.

On December 15, 2005, the Honorable Jim Ramstad introduced H.R. 4549 to permit the IRS to disclose information about prison inmates to the heads of federal and state correctional agencies for use in preventing the filing of false tax returns, including imposing punishments for violating administrative rules of the prison facility. The principal focus of H.R. 4549 is the filing of false refund claims. However, we have also encountered other fraudulent filing by inmates that did not involve refund claims. The Department has sent a letter to the Subcommittee on Oversight of the House Ways and Means Committee supporting efforts to deal with these problems. Fraudulent actions of inmates are a significant tax enforcement problem that deserves the attention of this Committee.

f. Enforcing the United States’ Tax Laws in Today’s Global Economy

Americans’ abuse of foreign tax havens is on the rise, and abusive tax shelters often make use of tax haven domiciles for the partnerships or other business entities. Increased technical sophistication of financial instruments and the widespread use of the internet have made it easy to instantly move money in and out of the United States, around the world, irrespective of national borders. Usage of tax havens facilitates evasion of United States taxes and the commission of related financial crimes.

Offshore tax schemes are often difficult to detect and prosecute. The countries whose banks are used in such schemes usually have strict bank secrecy laws and will not, or cannot, provide assistance to investigators for the United States. Sophisticated criminals may also use jurisdictions other than traditional tax haven countries, such as Latvia or Germany, in attempting to confuse the U.S. Government and hide their crimes. Some examples of Tax Division efforts follow:

In ***United States v. Daniel P. Andersen, et al.*** (W.D. Wash.), five defendants were charged with operating a multi-level marketing program through an entity named "The Institute for Global Prosperity" that promoted tax evasion schemes to thousands of customers through audio tapes and offshore seminars. The defendants concealed more than $40 million in revenue from the scheme using offshore nominee entities and offshore bank accounts. Four defendants have pleaded guilty to felony tax charges, including the two co-founders of Global Prosperity. The remaining defendant in this case, Global Prosperity co-founder David Struckman, fled to Panama. In early 2006, after months of searching, Panamanian officials arrested Struckman, expelled him from Panama, and accompanied him to the United States. Struckman has been arraigned and is being detained in Seattle pending trial, which is scheduled for January 2007.

In December 2005, in ***United States v. John J. Rizzo*** (D. Ariz.), the defendant, a former state municipal judge, was sentenced to 43 months in prison for promoting a tax fraud scheme at offshore seminars hosted by "The Institute of Global Prosperity." At the seminars, Rizzo marketed written materials that he called the "Millennium 2000 Reliance Defense Program," which were designed to provide taxpayers a good faith reliance defense against potential criminal tax prosecutions. The tax loss for this case is estimated at $200,000.

In ***United States v. Paul Harris, et al.*** (D. Colo.), after a five-week trial, a jury convicted Paul Harris and Lester Retherford of conspiracy and aiding and assisting in the preparation of fraudulent tax returns. The defendants used trusts, offshore debit cards, false invoices, and false option agreements to surreptitiously move clients' money offshore, primarily to the Turks & Caicos Islands, to avoid the scrutiny of the IRS. In December 2005 and January 2006, respectively, a federal judge sentenced Retherford to four years in prison, and Harris to more than five years in prison, for their roles in the scheme. The court found that the tax loss in the case was between $2.5 million and $7 million, but the Judge departed downward from the Sentencing Guidelines for Retherford because of his age and health.

In ***United States v. Evanson, et al.*** (D. Utah), six professionals (two attorneys, two CPAs, an accountant and an investment broker) were charged with conspiracy, fraud and tax charges in connection with promoting a tax fraud scheme that cost the Federal Treasury over $20 million in taxes. The defendants' scheme used, among other things, offshore entities, offshore bank accounts and the services of offshore nominees to create bogus expense and capital loss deductions for their clients. The court has not scheduled a trial date for this case.

Our existing money laundering laws reach domestic laundering of the proceeds of specified unlawful activity with intent to evade tax, s*ee* 18 U.S.C. § 1956 (a)(1)(A)(ii), but there is no corresponding money laundering offense addressing the international movement of funds with the intent to commit a tax offense. Section 1956(a)(2)(A) criminalizes the international movement of funds with the intent to promote the carrying on of "specified unlawful activity," a defined term that does not include tax offenses. Section 1956(a)(2)(B) also does not apply because the funds involved in the offense must represent the proceeds of some form of unlawful activity; and the transportation of such funds must be intended either to conceal or disguise the proceeds of specified unlawful activity or to avoid a transaction reporting requirement under State or Federal law.

An increasing number of criminal tax trials require the use of evidence obtained from overseas. One problem we face when dealing with evidence obtained from overseas is admissibility of the evidence. Most of the countries with which we exchange information for use in criminal tax trials have systems that differ significantly from our own. Under 18 U.S.C. § 3505, we can use foreign business records as evidence at a criminal trial, if the records are accompanied by a certificate signed by the custodian of the records. For purposes of section 3505, a "foreign certification" means "a written declaration made and signed in a foreign country by the custodian of a foreign record of regularly conducted activity or another qualified person that, if falsely made, would subject the maker to criminal penalty under the laws of that country." 18 U.S.C. § 3505(c)(2). The systems of some countries (for example the Netherlands) however, simply do not provide for such certifications by custodians of records.

h. International Cooperation to Investigate Evasion of U.S. Taxes

Tax Division attorneys provide advice and assistance to Government attorneys and agents seeking information and assistance from other countries for both civil and criminal investigations and cases. Recently, the Division provided advice and assistance to attorneys and agents seeking information from numerous countries including Sweden, Germany, Israel, Canada, the Cayman Islands, the Netherlands Antilles, Brazil, Panama, Venezuela, and Switzerland.

Tax Division attorneys also advise and assist in efforts to secure increased cooperation with foreign nations. The Division recently assisted the Department of State deciding what countries to put on the Treaty Priority List for the current year. The Division also helped the Treasury Department in its negotiations on tax treaties with Belgium, Bulgaria, and other countries. The Division also assisted in negotiating important Tax Information Exchange Agreements that recently went into effect in the Cayman Islands, Jersey, Guernsey, and the British Virgin Islands.

The Division also provided significant assistance to the IRS in drafting a démarche to be sent to U.S. Embassies located in countries that are members of the Organization of American States (OAS). The démarche urges the Embassies to encourage the countries in which they are located to sign a protocol to the OAS Mutual Legal Assistance Treaty (MLAT). The protocol requires member states to exchange information in criminal tax cases. The current OAS MLAT allows member states receiving a request for information to refuse to provide the information if the offense is a tax offense, unless the offense involves laundering of proceeds of an offense covered by the agreement. The State Department expects to issue the démarche soon.

The Division also consults with and provides advice to the Financial Action Task Force (FATF) to combat money laundering and the financing of terrorism. The Tax Division also helps teach international training programs to improve other countries' tax administration and enforcement programs, and seeks to foster international cooperation in tax, money laundering, and counter terrorist financing matters.

Cheek Defense

The Chairman's letter of June 1, 2006, asked us to comment on the impact of the Supreme Court's holding in *Cheek v. United States* (498 U.S. 192, 112 L. Ed. 2d 617, 111 S. Ct. 604 (1991)) that a good-faith defense does not need to be objectively reasonable to negate "willfulness"– the state of mind that the Government must establish in order to prove a tax crime. In her March 15, 2006, letter to the Committee, J.J. McNabb recommends that the Congress enact legislation requiring that willfulness be based on a reasonable misunderstanding of the law.

As the Supreme Court explained in *Cheek*, the tax laws are complex, and Congress did not intend that a taxpayer's *bona fide* misunderstanding of the tax law should be penalized as a criminal violation. The courts typically exclude as irrelevant or confusing defendants' efforts to show that there are others who agree with their outrageous claims about the state of the tax law. The more outrageous the alleged belief, of course, the easier it is for the Government to prove that the taxpayer violated a known legal duty. In our view, changing the standard from subjective reasonableness to objective reasonableness would not be particularly helpful.

Furthermore, we doubt that the availability of the so-called *Cheek* defense is responsible for the proliferation of "absurd theories" Our continuing success in prosecuting the peddlers of those theories, both before and after *Cheek*, has shown that *Cheek* in fact offers the scam artists no real shelter. We see frivolous defenses now for the same reasons we always have: the scammers are greedy and think they can get away with it.

Comments on Points Raised by J.J. MacNab and Jay D. Adkisson

The Tax Division appreciates the focus, determination, and energy Ms. MacNab and Mr. Adkisson bring to putting a halt to tax scams. And we share it. The Tax Division has obtained more than 180 injunctions against tax scam promoters and fraudulent tax return preparers. These scams involved nearly 400,000 taxpayers and more than a billion dollars. This stands in stark contrast to the mere handful of injunctions obtained during the preceding eight years.

Complementing our civil efforts to stop promoters of tax-fraud schemes and scams are our criminal prosecutions. During the past five years, more than 120 tax fraud promoters have been convicted. Many had nationwide reach and visibility. They include well-known tax scammers mentioned by Ms. MacNab—Irwin Schiff, Lynne Meredith, Larken Rose, Anderson's Ark Associates, and the Institute for Global Prosperity—as well as many others.

We appreciate Ms. MacNab's and Mr. Adkisson's positive feedback and compliments on the work of the Tax Division and the assistance they have provided to the Department on several occasions in identifying individuals who defied injunction orders or whose illegal conduct otherwise merited our attention.

Publicity

In our view, justice must not only be done, it must be seen to be done. We all know that the tax system would not work if, believing that the tax system was not fairly administered, people did not voluntarily comply with their tax obligations. An IRS three or four times its present size could not compel payment of a fraction of the trillions of tax dollars paid into the Treasury each year, if compulsion were the only means for getting payment. For our system of voluntary compliance to succeed, it must be seen to be fairly enforced.

For this reason, when I took office, the Tax Division began issuing press releases on our civil injunctions and criminal prosecutions, and posting them on our website. Our website at http://www.usdoj.gov/tax/taxpress2006.htm publicizes our enforcement actions, and our cases have garnered substantial favorable press coverage in major local and national media outlets over the past five years. We continue to improve our website to ensure that those who might otherwise be tempted by the latest tax scam will easily be able to find information about our law-enforcement efforts against scam promoters and participants.

Coordination

The Tax Division and the Internal Revenue Service work hand-in-glove on all matters that could involve litigation, including tax fraud schemes. Our executives meet regularly to discuss emerging challenges and to establish priorities. As appropriate, our personnel engage in cross-training. One challenge unique to tax enforcement, of course, is the privacy necessarily accorded return information.

Other Technical Issues That Affect Enforcement

The Committee asked us to identify issues that make tax enforcement difficult or that are not in keeping with the spirit or intent of the tax law. Here are a few:

- The budget President Bush submitted to congress for the upcoming fiscal year recommends legislation giving the United States Tax Court jurisdiction over all collection due process (CDP) cases and providing for post-levy review of levies relating to unpaid employment taxes. These proposals would significantly improve the CDP procedures, and deserve the Committee's prompt attention. The Honorable James S. Halpern made a similar suggestion last year, when he testified at a confirmation hearing regarding his reappointment to the United States Tax Court.

- Under current law, the offense of willful failure to file a tax return is a misdemeanor punishable by imprisonment for no more than one year. As a result, the sentence for this offense is limited to one year. On several occasions, most recently in S. 2020, the Tax Relief Act of 2005, this Committee has approved legislation creating a new felony offense for an aggravated failure to file–the failure to file a tax return for three or more consecutive years.

- We have successfully enjoined many cases of abusive conduct on the authority of IRC §§ 7407 and 7408. We are studying whether changes to the injunction provisions would be helpful, and may have proposals at a later date.

- Congress has enacted numerous penalties to crack down on tax shelter promoters and to ensure that "reportable transactions" are disclosed to the IRS. As with all other tax penalties, these new penalties are subject to discharge in a bankruptcy proceeding that is commenced more than three years after the penalty transaction occurs. Nontax penalties generally cannot be discharged.

Conclusion

The dedicated men and women of the Tax Division are fully committed to the fair and uniform enforcement of the internal revenue laws, and to restoring and maintaining the integrity of the federal tax system. Since I last had the opportunity to address the Committee, we have made significant progress. And, as then, considerable challenges remain.

Thank you, Mr. Chairman and Members of the Committee. I will be pleased to respond to any questions you might have.