



Internal Revenue Service Criminal Investigation Tax Fraud Alert

General Tax Fraud

www.irs.gov

IRS Keyword: Fraud

Fiscal Year 2003

Overview

The term voluntary compliance means that each of us is responsible for filing a tax return when required, and for determining and paying the correct amount of tax. Fortunately, the vast majority of Americans recognize their legal responsibility, and properly report and pay over their tax obligations.

The efforts of Criminal Investigation (CI) are directed at the portion of American taxpayers who willfully and intentionally violate their known legal duty of voluntarily filing income tax returns and/or paying the correct amount of income, employment, or excise taxes. These individuals pose a serious threat to tax administration and the American economy.

The General Fraud Program is Criminal Investigation's largest enforcement program encompassing a wide variety of investigations involving tax and money laundering crimes. This program includes investigations involving a broad spectrum of individuals and industries from all facets of the economy, from small business owners to self employed to large corporations. General Fraud cases constitute the main component of CI's efforts to most directly influence taxpayer compliance with the Internal Revenue Code.

General Fraud is the program from which CI identifies emerging areas of non-compliance in both Legal Source Tax Crimes and Illegal Source Financial Crimes.

These emerging areas are instrumental in ensuring CI is focusing resources to most effectively achieve our mission.

Legal Source Tax Crimes involve legal industries and legal occupations, and more specifically, legally earned income, in which the primary motive or purpose is the violation of tax statutes (United States Code Title 26 and Title 18, Sections 286, 287, and 371K). The Legal Source Tax Crimes Program also includes cases that threaten the tax system, for example frivolous filers/non-filers, unscrupulous return preparers and the Questionable Refund Program.

The Illegal Source Financial Crimes Program recognizes that illegal source proceeds, which are a part of the untaxed underground economy, are a threat to the voluntary tax compliance system. Failure to investigate these cases would erode public confidence in the tax system. Within the guidelines of the Illegal Source Financial Crimes Program, CI commits resources to those investigations that involve proceeds derived from illegal sources other than narcotics. This program encompasses all tax and tax-related violations (Title 26 and Title 18, Sections 286, 287, and 371K), as well as money laundering (Title 18, Sections 1956, 1957, and 371M) and currency violations (Title 31). Linked to the investigation of the criminal charges within this program is also the emphasis for the effective utilization of the forfeiture statutes to deprive individuals and organizations of illegally obtained assets.

IRS-CI Cross-Functional Efforts: Civil to Criminal

The Fraud Referral Program is a partnership primarily between IRS-Criminal Investigation (CI) and the Small Business/Self Employed operating division. Auditors reviewing tax returns are trained to identify "badges of fraud." If auditors detect fraud, the return is forwarded to CI for possible criminal investigation.

As a result of the IRS' increased emphasis on the fraud referral program, Criminal Investigation (CI) anticipates a gradual increase of quality referrals with a congruent increase in Legal Source Tax Crimes Investigations.

Types of Fraudulent Activities

Although not all inclusive, listed below are some of the criminal activities in violations of the tax law:

- Deliberately underreporting or omitting income,
- Overstating the amount of deductions
- Keeping two sets of books
- Making false entries in books and records
- Claiming personal expenses as business expenses
- Claiming false deductions
- Hiding or transferring assets or income

Where Do You Report Suspected Tax Fraud Activity?

If you suspect tax fraud or know of an abusive return preparer, you should report this activity to your nearest Internal Revenue Service office. This information can be communicated by phone or in writing to your local IRS office.

You can contact the IRS by phone at 1-800-829-0433.

Related Statutes and Penalties

Note: This is not all-inclusive

| Title and Section | Definition |
|---|---|
| <p>Title 26 USC § 7201</p> <p>Attempt to evade or defeat tax</p> | <p>Any person who willfully attempts to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof:</p> <ul style="list-style-type: none"> • Shall be imprisoned not more than 5 years • Or fined not more than \$250,000 for individuals (\$500,000 for corporations) • Or both, together with the costs of prosecution |
| <p>Title 26 USC § 7202</p> <p>Willful failure to collect or pay over tax</p> | <p>Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to penalties provide by the law, be guilty of a felony</p> <ul style="list-style-type: none"> • Shall be imprisoned not more than 5 years • Or fined not more than \$250,000 for individuals (\$500,000 for corporations) • Or both , together with the costs of prosecution |
| <p>Title 26 USC § 7203</p> <p>Willful failure to file return, supply information, or pay tax</p> | <p>Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof:</p> <ul style="list-style-type: none"> • Shall be imprisoned not more than 1 years • Or fined not more than \$100,000 for individuals (\$200,000 for corporations) • Or both, together with cost of prosecution |
| <p>Title 26 USC § 7206(1)</p> <p>Fraud and false statements</p> | <p>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 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;</p> <ul style="list-style-type: none"> • Shall be imprisoned not more than 3 years • Or fined not more than \$250,000 for individuals (\$500,000 for corporations) • Or both, together with cost of prosecution |
| <p>Title 26 USC § 7206(2)</p> <p>Fraud and false statements</p> | <p>Any person who...(2) Aid or assistance - Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the Internal Revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document; shall be guilty of a felony and, upon conviction thereof:</p> <ul style="list-style-type: none"> • Shall be imprisoned not more than 3 years • Or fined not more than \$250,000 for individuals (\$500,000 for corporations) • Or both, together with cost of prosecution |
| <p>Title 26 USC § 7212(A)</p> <p>Attempts to interfere with administration of Internal Revenue laws</p> | <p>Whoever corruptly or by force endeavors to intimidate or impede any officer or employee of the United States acting in an official capacity under this title, or in any other way corruptly or by force obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title, upon conviction:</p> <ul style="list-style-type: none"> • Shall be imprisoned not more than 3 years • Or fined not more than \$250,000 for individuals (\$500,000 for corporations) • Or both |
| <p>Title 18 USC § 371</p> <p>Conspiracy to commit offense or to defraud the United States</p> | <p>If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each:</p> <ul style="list-style-type: none"> • Shall be imprisoned not more than 5 years • Or fined not more than \$250,000 for individuals (\$500,000 for corporations) • Or both |

“If it sounds too good to be true, it probably is!” Seek expert advice before you subscribe to any scheme that offers instant wealth or exemption from your obligation as a United States Citizen to pay taxes. Buying into a tax evasion scheme can be very costly.

Statistical Information

How to Interpret Criminal Investigation Data: Since actions on a specific investigation may cross fiscal years, the data shown in cases initiated may not always represent the same universe of cases shown in other actions within the same fiscal year.

| | FY 2001 | FY 2002 | FY 2003 |
|-----------------------------|---------|---------|---------|
| Case Initiations | 1392 | 1810 | 1814 |
| Prosecution Recommendations | 789 | 837 | 974 |
| Indictments/Informations | 805 | 758 | 770 |
| Convictions | 824 | 726 | 688 |
| Incarceration Rate* | 80.4% | 75.4% | 79.8% |
| Average Months to Serve | 23 | 24 | 28 |

* Incarceration may include prison time, halfway house, home confinement, or a combination thereof.

FY 2003 Archive Significant Case Summaries

The following case summaries are excerpts from public record documents on file in the courts in the judicial district in which the cases were prosecuted.

Former Katun Corporation CEO Sentenced For Tax Evasion

On June 18, 2003, Terence Michael Clarke was sentenced to 24 months in prison and one year supervised release. Clarke pled guilty to intentionally omitting millions of dollars in income on his federal income tax returns and agreed to pay more than \$6 million in fines, tax penalties, and restitution. In addition, Clarke will be required to cooperate fully with federal and state tax authorities in paying his outstanding tax liabilities, including interest. Clarke admitted that between 1997 and 2001, he intentionally underreported his income by more than \$3.4 million on his personal federal income tax returns filed with the IRS. These false returns resulted in a tax loss of approximately \$1.4 million.

Concrete Construction Company Owners Sentenced For Tax Evasion

On June 9, 2003, in St. Paul, MN, Patricia Knish was sentenced to 30 months in prison, Steven Knish was sentenced to 24 months in prison. The Knishes were also ordered to serve three years of supervised release, which will include 300 hours of community service for each defendant. The Knishes also agreed to pay

their outstanding federal tax liabilities, with interest and penalties, could total as much as \$2.5 million. The Knishes pled guilty in January 2003 to three counts of tax evasion for calendar years 1997-1999. Both admitted that they had failed to report approximately \$1,990,000 in income on their joint federal personal income tax returns, resulting in a tax loss of \$810,000. The Knishes willfully underreported their income in each year by repeatedly obtaining, and not reporting as income to the IRS, various and numerous payments and reimbursements from customers and insurance companies in connection with their concrete construction business.

Wimbledon Farmer Sentenced For Role In \$14 Million Agri-Business Fraud Scheme

On June 4, 2003, in Fargo, ND, Duane Huber, and his farm business entities, Huber Farms General Partnership and Huber Farms Inc. were sentenced on assorted fraud, racketeering, tax and conspiracy charges related to a \$14 million dollar farm program fraud scheme. Huber was sentenced to five years in prison, followed by three years-supervised release, and ordered to forfeit \$5,876,970 to the United States. Defendants fraudulently received crop insurance and federal farm program payments by helping others prepare and submit false claim forms. False crop production worksheets and supporting documents, and by helping others apply for and re-

ceive farm program benefits that they were not eligible to receive. Proceeds from the scheme were used to pay farm expenses and loans, as well as to provide gifts, in effect promoting the scheme and concealing the true nature and ownership of the proceeds. Huber was also found guilty of tax fraud, having willfully made and subscribed false United States Individual Income Tax Returns. From 1994 through 1999 Huber laundered over five million dollars through the sham farm operations. None of the money was reported on either Huber's individual tax returns or the Huber Farms partnership tax returns. Huber falsely reported gifts of money to family members as deductible farm-related expenses.

Company Official Sentenced For Polluting Cape Fear River With Waste Oil

On June 2, 2003, in Wilmington, NC, Andrew Jackson Simmons Jr., President of High Rise Services Company Inc., was sentenced to 24 months in prison, a fine of \$50,000, and a supervised release term of three years. High Rise Services Company Inc. will be sentenced on September 2, 2003 after have pled guilty to conspiracy to violate the Clean Water Act; the unlawful discharge of oil onto the shoreline and into the navigable waters of the United States; and improper storage of used oil. Also, the company pled guilty to a Criminal Information that charged it with conspiracy to impede and obstruct the Internal Revenue Service in

the collection of taxes. Simmons pled guilty to the negligent discharge of pollutants and failure to report a spill. Additionally, he pled guilty to a Criminal Information that charged him with two counts of attempting to evade or defeat federal income taxes.

Doctor Sentenced To 41 Months In Prison For Tax Evasion

On May 30, 2003, in Athens, GA, Dr. Bradford G. Brown was sentenced to serve 41 months in federal prison for tax evasion. At trial, the government introduced evidence that Brown, during the 1994 and 1995 tax years, evaded income taxes on more than \$1.2 million of income by failing to deposit all of his medical receipts into his business account. Instead, he deposited income into bank accounts that he never disclosed to his accountant, thus breaching their explicit agreement that all of his income would be deposited into his business bank account for purposes of computing his income. Brown's scheme included the 1996-2001 tax years when he delinquently filed tax returns for these years that included a total tax liability in excess of \$1 million while only being credited by the IRS with paying \$4,192 of his total tax liability for the 1994-2001 tax years. In addition to his prison sentence, Brown was ordered to pay a \$40,000 fine and make restitution to the IRS in excess of \$3 million.

Woman Sentenced For Tax Fraud Relating To Her Embezzlement Of Over \$3 Million

On May 8, 2003, in Charleston, WV, Patricia Griffith was sentenced to 27 months in prison and fined \$6,000 for income tax evasion. Griffith, who pled guilty this past January, admitted she embezzled in excess of \$3 million from 1990 through 1999 from Kanawha Valley Radiologists, Inc. Griffith failed to report to the IRS the money she embezzled. In particular, in the 1997 tax year, the tax year for which she was charged, Griffith failed to report over \$400,000 of monies she embezzled resulting in a tax loss of over \$120,000 for that year alone. Griffith was ordered by the Court to work with the IRS with respect to restitution for the 1997 tax year.

Former Orange County Man Sentenced To 30 Months In Prison For Fraudulent \$4 Million Oil and Gas Promotion

On April 7, 2003, in Los Angeles, CA, Patrick Wayne Maloy was sentenced to 30 months in prison and ordered to pay \$3,938,936 in restitution after pleading guilty to mail fraud and tax evasion. Maloy admitted that he solicited victims to invest in companies that were purportedly involved in the exploration, development and production of oil and gas producing properties. Maloy raised more than \$4 million from over 100 investors throughout the United States. Maloy represented to investors that their funds would be used to acquire interests in oil and gas wells, and that investors would receive regular interest and dividend payments and high returns in connection with their investment. Instead of acquiring interests in oil and gas wells, Maloy diverted investor funds for his personal use.

Attorney Sentenced For Tax Evasion

On April 2, 2003 in Minneapolis, MN, Thomas K. Schoppert was sentenced to two years in prison, followed by two years supervised release after being convicted of tax evasion. The jury found Schoppert willfully attempted to evade and defeat the payment of the income tax due by him to the United States. Schoppert reported a combined income of over \$650,000 for tax years 1998 - 2000. Total tax due was \$220,767, which he failed to pay. Schoppert was also found guilty in his attempt to evade and defeat a large part of the payment of tax for the years 1986 through 1992, 1995 and 1997, in the amount of approximately \$250,000.

Founder and Owner of Color Wheel Gets 37 Months Imprisonment

On March 26, 2003 in New York, NY, Haluk Ergulec, founder and owner of Color Wheel, an advertising services company, was sentenced to 37 months in prison, three years supervised release, and ordered to pay \$1.5 million in restitution. Ergulec was found guilty on one count of conspiracy to obstruct the IRS and three counts of conspiracy to commit mail fraud. Beginning in approximately 1991 until July 2000, Ergulec and other co-conspirators issued false and fraudulent invoices relating to contracts to produce advertising services and materials.

Typically, invoices were inflated to allow the conspirators to get kickback money for personal expenses. Ergulec paid kickbacks to corrupt purchasing agents of other advertising companies or paid cash on a monthly basis in amounts exceeding \$10,000. In exchange for the kickbacks, the corrupt purchasing agents ensured that Color Wheel was an approved vendor, and that Color Wheel would receive a portion of the total value of the contracts awarded by the defrauded customers. By paying the kickbacks, defendant Color Wheel was able to maintain its prices at noncompetitive levels because it did not have to set prices in response to open and honest competition from other vendors. As a result, the defrauded customers and their clients paid higher prices than they would have if the corrupt purchasing agents had aggressively and honestly solicited competitive prices from other vendors.

Former Lucent Technologies Employee Sentenced

On March 25, 2003, in Dallas, TX, Demeshia Rachel Davis was sentenced to 41 months in prison and ordered to pay \$1,776,137.92 in restitution to Lucent Technologies, Inc. Davis pleaded guilty in January 2003 to a two-count Information that charged her with tax evasion and mail fraud. According to documents filed in Court, from August 1998 until June 2002, Davis, and her boyfriend, Anthony Jackson, executed a scheme to defraud Lucent Technologies. Davis was an employee at Lucent and made up fake companies and invoices that caused Lucent to pay the fake invoices. Jackson assisted by establishing a mailbox to receive the fraudulent checks. In 2000, Davis earned approximately \$322,648 from the scheme, although in total, as much as \$1.7 may have been stolen during her scheme. When Davis filed her federal tax return for 2000, she willfully failed to report this income. In December 2002, Jackson pleaded guilty to one count of mail fraud and was sentenced to 33 months imprisonment and ordered to pay \$1,776,137 in restitution.

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