

TO EXAMINE TAX FRAUD COMMITTED BY PRISON
INMATES

HEARING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED NINTH CONGRESS

FIRST SESSION

JUNE 29, 2005

Serial No. 109-36

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE

24-905

WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
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**TO EXAMINE TAX FRAUD COMMITTED BY
PRISON INMATES**

WEDNESDAY, JUNE 29, 2005

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:05 p.m., in room 1100, Longworth House Office Building, Hon. Jim Ramstad (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
June 22, 2005
No. OV-3

CONTACT: (202) 225-7601

Ramstad Announces Hearing to Examine Tax Fraud Committed by Prison Inmates

Congressman Jim Ramstad (R-MN), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to examine tax fraud committed by prison inmates. **The hearing will take place on Wednesday, June 29, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Invited witnesses will include Members of Congress, and witnesses representing the Internal Revenue Service (IRS), the Treasury Inspector General for Tax Administration, State correctional systems and a prison inmate who committed this tax fraud for approximately a decade.

BACKGROUND:

While the vast majority of Americans pay their taxes with honesty and integrity, a small minority is responsible for large amounts of refund fraud. The IRS estimates there is a total of approximately \$375 million lost to refund fraud each year, and remarkably, prison inmates are contributing to the problem from behind bars. The IRS estimates that 7.5 to 15 percent of all refund tax fraud is being committed by prison inmates. Furthermore, it appears that this problem is growing rapidly. Prisoners nationwide have developed elaborate schemes to receive refunds by fraudulently reporting earnings or claiming false eligibility for tax credits. Each year, prisoners are devising new methods to defraud the tax system, at the expense of American taxpayers.

The IRS has some procedures meant to detect and stop tax fraud by prison inmates, including maintaining a database of individuals who have been in prison within the last two-and-a-half years. According to IRS data, during 2004, individuals listed in the IRS prisoner database filed 455,097 returns, seeking \$758 million in refunds. The IRS successfully identified 18,159 (4 percent) of these returns as fraudulent, but only stopped 14,033 (77 percent) of the refunds, worth \$53 million, from being issued. The hearing will examine IRS efforts to combat inmate tax fraud and consider improvements that could be made. In addition, the Subcommittee will hear about the efforts of State correctional systems to combat this fraud.

In announcing the hearing, Chairman Ramstad stated, "Tax fraud in any form is unacceptable. It is especially troubling when prison inmates are able to game the system from behind bars. We must find ways to stop this outrageous behavior."

FOCUS OF THE HEARING:

The hearing will focus on the current laws, policies and procedures to detect and deter tax fraud committed by prison inmates, and will explore further steps that can be taken by the IRS or Congress to eliminate this fraud.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "109th Congress" from the menu entitled, "Hearing Archives" (<http://waysandmeans.house.gov/Hearings.asp?congress=17>). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the on-line instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You **MUST REPLY** to the email and **ATTACH** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Wednesday, July 13, 2005. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://waysandmeans.house.gov>.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman RAMSTAD. The hearing will come to order. Tax fraud in any form is unacceptable and illegal, but it is particularly outrageous when it is committed by prison inmates while still behind bars. Increasingly, it seems that instead of repaying their debt to society many prison inmates are actually profiting at the expense

of American taxpayers. Refund fraud by prison inmates is a significant problem that is growing dramatically each year. The IRS (IRS) estimates that tax refund fraud by prison inmates accounts for as much as 15 percent of all tax refund fraud. The fraud is growing as word spreads among inmates how easy this scam is and how unlikely it is that inmates will be caught or punished. Prisoners nationwide have developed elaborate schemes to get refunds by fraudulently reporting earnings or claiming false eligibility for tax credits. There are several basic steps in this kind of fraud. It typically starts with a prison inmate who has little to lose and is already serving a lengthy sentence. The inmate then acquires access to tax forms. The prisoner subsequently makes up phony income and withholding and claims to be entitled to a large refund. Then the prisoner either mails the forms to the IRS or gets help from someone on the outside to put them in the mail.

This fraud is simple, and unfortunately, effective. I have here 6 fraudulent tax forms filled out by a group of prison inmates in Florida. These inmates would have profited over \$29,000 if these returns had been mailed as intended. These inmates in Florida prepared over 20 returns that they were planning to file this year. Now, this represents just one group of inmates at one State prison. There is evidence the problem of tax fraud by inmates is quite widespread. Now, the IRS does have procedures in place designed to stop inmate tax fraud. We will hear today that last year the IRS stopped over 14,000 refunds from going to inmates who had prepared fraudulent returns. That is a good start, but as today's hearing will make clear, we have a long way to go. One witness comprising the second panel today, a prison inmate, will tell us how common and easy this scam is. This one inmate has defrauded the U.S. Government of several million dollars—that is million with an “M”—over the years by filing between 600 and 700 fraudulent returns and getting refunds 90 percent of the time. We will also hear testimony from State prison officials who have been on the frontlines of combating tax fraud inside prisons. While these officials have made strides, they are hindered by the IRS' inability to share information on these cases. I look forward to the witnesses' testimony and to discussing how we can stop this outrageous tax fraud by prison inmates. I now recognize the distinguished Ranking Member and my good friend from Georgia, Mr. Lewis, for his opening statement.

[The prepared statement of Chairman Ramstad follows:]

Opening Statement of The Honorable Jim Ramstad, Chairman, and a Representative in Congress from the State of Minnesota

Tax fraud in any form is unacceptable and illegal. But it is particularly outrageous when it is committed by prison inmates while they are behind bars. Increasingly, it seems that instead of repaying their debt to society, many prison inmates are actually profiting at the expense of American taxpayers.

Refund fraud by prison inmates is a significant problem that is growing dramatically each year. The IRS estimates that tax fraud by prison inmates accounts for 15 percent of all tax refund fraud. The fraud is growing as word spreads among inmates how easy this scam is and how unlikely it is that inmates will be caught or punished.

There are several basic steps in this type of fraud. It typically starts with a prison inmate who has little to lose and is already serving a lengthy sentence. The inmate next needs access to tax forms. The prisoner makes up phony income and withholding, and claims to be entitled to a large refund. He either mails the forms into

the IRS himself, or gets help from someone on the outside. This fraud is simple and unfortunately, effective.

I am holding 6 fraudulent tax forms filled out by a group of prison inmates in Florida. These inmates would have profited over \$29,000 if these returns had been mailed as intended. These inmates prepared over 20 returns they were planning to file this year. This represents just one group of inmates at one prison. There is evidence the problem of tax fraud by inmates is widespread.

The IRS does have procedures in place designed to stop inmate tax fraud. We will hear that last year, the IRS stopped over 14,000 refunds from going to inmates who prepared fraudulent returns. That's a good start, but as this hearing will make clear, we have a long way to go. One witness—a prison inmate—will tell us how common and easy this scam is. This one inmate has defrauded the U.S. government of several million dollars over the years, and he is not alone.

We will also hear testimony from state prison officials who have been on the front lines of combating tax fraud inside prisons. While these officials have made great strides, they are hindered by the IRS' inability to share information on these cases.

I look forward to the witnesses' testimony and to discussing how we can stop this outrageous tax fraud by prison inmates.

I now recognize the distinguished ranking member from Georgia, my good friend, Mr. Lewis, for his opening statement.

Mr. LEWIS. Thank you very much, Mr. Chairman, my friend and my colleague, and on this Committee as Chair and Ranking Member, I think we tend to refer to each other from time to time as brothers. Today's hearing will focus on tax refund fraud committed by individuals in prison. Recent news reports indicate that some inmates have been able to scam our tax system by filing fraudulent tax returns with the IRS for the purpose of attaining tax refunds. Apparently millions of tax dollars are at stake and the number of fraud cases have continued to increase in recent years. It seems that there are two key questions to ask in addressing the situation. Can the IRS stop payment on bogus tax refund claims in a timely and effective manner? Are the IRS, State law enforcement agents, prison officials and others coordinating their efforts to address this situation?

The witnesses will provide us with important information about how this illegal activity is able to occur and what steps need to be taken to better enforce the law. Mr. Chairman, I applaud you for scheduling this hearing. I look forward to a most informative hearing and follow up as is needed. I want to welcome our colleagues from Florida on the first panel who know this issue well, following news reports involving Florida prisons. I must apologize, Mr. Chairman. I left my glasses over in the Capitol, and I do not think I can see all of you, but thank you very much.

[The prepared statement of Mr. Lewis follows:]

**Opening Statement of The Honorable John Lewis, a Representative in
Congress from the State of Georgia**

Today's hearing will focus on tax refund fraud committed by individuals in prison. Recent news reports indicate that some inmates have been able to scam our tax system by filing fraudulent tax returns with the Internal Revenue Service (IRS) for the purpose of obtaining tax refunds.

Apparently, millions of tax dollars are at stake and the number of fraud cases has continued to increase in recent years. It seems that there are two key questions to ask in addressing the situation: Can the IRS stop payment on bogus tax refunds claims in a timely and effective manner? Are the IRS, state law enforcement agencies, prison officials, and others coordinating their efforts to address the situation?

Witnesses will provide us with important information about how this illegal activity is able to occur and what steps need to be taken to better enforce the law.

I applaud Subcommittee Chairman Ramstad for scheduling this hearing. I look forward to a most informative hearing and followup as is needed. Finally, I want to welcome Members of the Florida Delegation on the first panel who know this issue well following news reports involving Florida prisons.

Thank you.

Chairman RAMSTAD. Well, thank you to my friend and distinguished Ranking Member from Georgia, who has contributed so much to not only this Subcommittee and the full Committee, but the Congress. The Chair now would call the first panel comprising the Honorable Jim Davis from Florida, the Honorable Ric Keller from Florida, and the Honorable Tom Feeney from Florida. I want to thank all three of you colleagues for bringing this matter to our attention. Mr. Davis, please.

STATEMENT OF THE HONORABLE JIM DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. DAVIS. Thank you, Mr. Chairman. Always a pleasure to work with you, and thanks for the chance to visit your panel and to be with Congressman Lewis, who I think so highly of as well. I want to start by acknowledging Congressman Keller for his leadership on this issue. He initially took the initiative on this. Congressman Feeney and I have worked with Senator Nelson from Florida on this. Unfortunately, Florida may be at the forefront of this problem, and hopefully we will be at the forefront of the solution as well with your help. As you mentioned earlier, I think it is important to underscore, first, this problem is growing, and we do not honestly know how rapidly it is growing. I am not even sure we know the full extent of the problem, but we do know that if we do not do something about it, many, many taxpayers in this country are going to be cheated because they are paying their taxes. Certainly in my community folks pay their taxes. They know it is part of citizenship, and they expect others to pay as well, and they don't expect people to be cheating the government. We have had between 1,500 and 18,000 returns that have been falsified. In the year 2000, best we can tell, there were about 1,500. By 2004, 18,000. This is growing at a rapid rate.

As you mentioned earlier, Mr. Chairman, the good news is about 80 percent of these fraudulent returns have been identified. The problem is about \$15 million fell through the cracks and were erroneously refunded to prisoners. In our State alone, the IRS records show that in the year 2005 about 22,000 returns were filed using prisoners' Social Security numbers, and upon investigation, about 1,000 of these returns have results in about \$4.6 million in fraudulent tax refunds. Unfortunately, the response has been slow by the Federal Government to this problem. Congressman Keller, myself, and I think others have spoken directly to the IRS Commissioner about this. We have asked them to fully appreciate the magnitude of the problem and to identify, to those of us that serve in Congress, what tools they need to do their job. If we need to be part of the solution, we need to know that yesterday.

It is not evident to me that the IRS has been as aggressive about tackling this problem as they should be, and if the Congress needs to be more aggressive as well, so be it. I am confident, Mr. Chairman, that in your hands and in the Ranking Member's hands that there will be prompt action after this hearing. Part of the problem certainly seems to be the sharing of information between the State Departments of Correction in Florida and other States, as well as the IRS. If there are changes in the law that need to be made to facilitate that, we certainly should do it. I know that the Congress will be debating tonight in the House of Representatives a proposed 8-percent increase, at least an increase that was proposed by the IRS, of 8 percent in enforcement. We need to be mindful of exactly what the IRS needs to do their job.

I just want to close by saying that we all recognize that paying taxes is part of living in our society. It is our job as Members of Congress to uphold people's sense of confidence and fairness here. I can't think of a more egregious example than what you have called this hearing about, and I look forward to working with you, Mr. Chairman, and Congressman Lewis on a prompt, effective solution to this problem. Thank you very much.

[The prepared statement of Mr. Davis follows:]

**Statement of The Honorable Jim Davis, a Representative in Congress
from the State of Florida**

Mr. Chairman and Members of the Subcommittee,

Thank you for holding this oversight hearing on tax scams committed by prison inmates. Although I am not a Member of this Committee, I appreciate the opportunity to participate in this hearing and hope that we can begin to work on constructive ways to prevent criminals from collecting unearned wages from the Internal Revenue Service. I would like to thank Congressman Keller for his determination in pursuing the illegal tax filing scams in our prisons and pushing for this hearing.

It has come to our attention that prisoners are filing false tax returns, collecting millions of dollars a year in fraudulent claims. With the help of a few outsiders, two inmates serving long sentences in Florida prisons for murder filed fraudulent tax returns and received refunds of around \$5,000 from the IRS for wages they never earned.

Sadly, this is a growing trend. Fraud by prisoners in both state and federal prison systems is growing at alarming rates. Between 2000 and 2004, false returns increased from about 1,500 to over 18,000. The good news is that 80 percent of the fraudulent returns were identified by the IRS and the refunds were stopped in 2004. None the less, nearly \$15 million fell through the cracks and was erroneously refunded to prisoners by the IRS. We must be sure that the IRS has all available tools that it needs to prevent these criminals from abusing the system.

In my home state of Florida, there are currently 150,000 prisoners listed in the IRS's file. IRS records show that, in 2005, approximately 22,000 returns were filed using a prisoner's Florida social security number. Many of these returns likely are legitimate, such as a married couple filing joint where one spouse is incarcerated and the other has full-time wage income. However, the IRS investigated this group and found that about 1,000 of the returns are fraudulent to the tune of about \$4.6 million.

With very little left to lose, prisoners with long sentences are taking advantage of a tax system that is currently under review by a nine-member presidential commission that was created to study tax reform this past January. Formally known as the Advisory Panel on Federal Tax Reform, the commission includes former Florida Senator Connie Mack. With the actions of the Ways and Means Committee in partnership with the various agencies involved in investigating these crimes, it is my hope that we can prevent further abuses within the tax system.

Even more discouraging is the response from the IRS when we attempted to work hand in hand with them to clarify various instances of fraud and the poor treatment of those involved in these situations. Sent on a bureaucratic merry-go-round, we eventually were forced to call in the Inspector General for answers. It befuddles me

that the IRS refuses to work with the state prison systems as they are the two players that will find the solution to these fraudulent claims together.

I urge the Subcommittee to take action to prevent further crimes of this nature. Mr Chairman, again, I thank you and the Members of this Subcommittee for the opportunity to address you today and look forward to working with you on this and many other issues in the future.

Chairman RAMSTAD. The Chair thanks the distinguished Member from Florida, Mr. Davis, for your testimony. The Chair now recognizes another distinguished gentleman from Florida, Mr. Keller.

STATEMENT OF THE HONORABLE RIC KELLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. KELLER. Well, thank you, Mr. Chairman and Members of the Subcommittee for holding this important hearing today. Let me begin by telling you how I became aware of this problem. In November of 2004 WESH News Channel 2, a local TV station in the Orlando, Florida area, reported disturbing information about how numerous Florida prisoners received tax refund checks even though they didn't work or pay income taxes. The WESH investigation showed that numerous prisoners, including murderers and rapists, were submitting bogus tax returns to the IRS, and being rewarded with generous tax refund checks. My constituents in Central Florida, who work hard and play by the rules, were understandably upset that their taxpayer dollars were being wasted on dishonest prisoners who don't work hard and don't play by the rules. That is why on November 19, 2004, Congressman Feeney and I wrote to IRS Commissioner Mark Everson to determine what the IRS is doing to combat this fraudulent scheme. Since personally meeting with Commissioner Everson and working with his criminal investigation staff, I have learned that my initial suspicions are correct: the problem is huge and it is not limited to Florida.

Last year there were over 18,000 bogus tax returns filed by prisoners, which could have cost taxpayers over \$53 million, if undetected by the IRS. Fortunately, we are now starting to see some action to crack down on this problem. Recently, seven people in Florida were indicted for participating in this prison refund scam. Three of them were behind bars while submitting fake tax returns. The others were accomplices on the outside helping the prisoners. Shockingly, one of the accomplices was an IRS employee. On February 18, 2005, Congressman Feeney and I asked this Subcommittee to conduct an oversight hearing on this problem. We need your expertise to help the IRS come up with some constructive remedies to prevent this criminal and fraudulent waste of taxpayer dollars in the future. For example, it is my understanding that investigators currently have "one arm tied behind their back" because current law prevents the IRS from sharing tax information about prisoners with the State Departments of Correction. Perhaps a very narrow change to this law, along with better enforcement of existing laws, would go a long way.

I want to again thank the Chairman and Members of the Subcommittee for holding this hearing. I also want to especially thank

Congressman Jim Davis and Congressman Tom Feeney for their strong interest and leadership on this issue. I believe this hearing is an important first step in making sure the IRS has the tools they need to fight this problem, and I look forward to working with the Subcommittee to crack down on this waste of taxpayer dollars.

Thank you.

[The prepared statement of Mr. Keller follows:]

**Statement of The Honorable Ric Keller, a Representative in Congress
from the State of Florida**

Thank you, Mr. Chairman, and members of the subcommittee, for holding this important hearing today.

Let me begin by telling you how I became aware of this problem. In November of 2004, *WESH NewsChannel 2*, a local television news station that serves the greater Orlando area, reported disturbing information about how numerous Florida prisoners received tax refund checks, even though they didn't work or pay income taxes.

The *WESH* investigation showed that numerous prisoners, including murderers and rapists, were submitting bogus tax returns to the IRS, and being rewarded with generous tax refund checks.

My constituents in Central Florida, who work hard and play by the rules, are upset that their precious taxpayer dollars are being wasted on dishonest prisoners who don't work hard and don't play by the rules.

That's why, on November 19, 2004, Congressman Feeney and I wrote to IRS Commissioner Mark Everson to determine what the IRS is doing to combat this fraudulent scheme. Since personally meeting with Commissioner Everson, and working with his Criminal Investigation staff, I've learned that my suspicions are correct. The problem is huge, and it's not limited to Florida. Last year, there were over 18,000 false tax returns filed by prisoners, which could have cost taxpayers over \$53 million if undetected by the IRS.

Fortunately, we're now starting to see some action to crack down on this problem. Recently, seven people in Florida were indicted for participating in this prison refund scam. Three of them were behind bars while submitting fake tax returns, the others were accomplices on the outside helping the prisoners. Shockingly, one of the accomplices was an IRS employee.

On February 18, 2005, Congressman Feeney and I asked this subcommittee to conduct an oversight hearing on this problem. We need your expertise to help the IRS come up with some constructive remedies to prevent this criminal and fraudulent waste of taxpayer dollars in the future. For example, it is my understanding that investigators currently have "one arm tied behind their back" because current law prevents the IRS from sharing tax information about prisoners with the State Department of Corrections. Perhaps a very narrow change to this law, along with better enforcement of existing laws, would go a long way.

I want to again thank the Chairman and the Members of the subcommittee for holding this hearing. I believe this hearing is an important first step in making sure the IRS has the tools they need to fight this problem and I look forward to working with the subcommittee in cracking down on this waste of taxpayer dollars.

Chairman RAMSTAD. The Chair thanks the distinguished Member from Florida, and now recognizes the third distinguished Member of the panel from Florida, Mr. Feeney.

STATEMENT OF THE HONORABLE TOM FEENEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. FEENEY. I want to start by thanking Chairman Ramstad, Ranking Member Lewis and the Members of the Committee for inviting us to testify here today. Today we are here to discuss a shocking epidemic of tax fraud that plagues our Nation and our prison system. Inmates all over the country are filing false tax re-

turns and collecting real refunds at the expense of American taxpayers. My colleague, Representative Ric Keller, and I became aware of this problem as a result, as he indicated, of a November WESH Channel 2 tax fraud discovery. Steve Stock was the investigative reporter. We have later been joined in our efforts by people like Congressman Davis, who I want to thank, and Senator Nelson as well on the Senate side. Since we began our investigation we have been in close contact with the IRS and met directly with Commissioner Mark Everson. Additionally, we have asked the Committee and the government Accountability Office (GAO) to examine the matter as Congressman Keller said.

The full extent to which the prison inmates are committing tax fraud against American taxpayers far exceeds levels that I first imagined. Recent figures show that the IRS reports that as much as 15 percent of all of the tax fraud committed in the United States is committed by prisoners. These numbers are staggering, but they only represent the fraud that we have been able to detect. Prisoners throughout the country are likely going undetected in their schemes. I would like to offer some broad suggestions, and in my written testimony I have some suggestions about principles and ideas to clean up this horrible mess. In the first place an open dialog of information sharing and communications between the IRS and State prison officials is a must. States should be rewarded when they cooperate with Federal authorities in rooting out fraud.

The Office of the Treasury Inspector General for Tax Administration has reported to my office that five of the nine correctional institutions with the highest numbers of prisoners caught in tax fraud are in Florida. Thus, you have three Florida Congressmen here today. By no means do I believe that criminals in Florida are any more ingenious than Federal criminals through the rest of the country. In fact, I believe the report actually indicates that it is our prison officials that have been most cooperative, and if we can get the prison officers in 49 other States we will get to the bottom of fraud elsewhere in the country. It is unacceptable that State prisons receive Federal funding and yet are unwilling to cooperate with Federal authorities to prevent inmates from defrauding the Federal Government. The need to share information goes both ways. Under current Federal law the IRS is unable to share the identity of convicts who committed fraud with prison officials. This information could be used by prison officials to monitor known offenders and discipline prisoners caught in the act.

Finally, I would like to close, again, by thanking Congressman Davis. Congressman Ric Keller and his staff have done a tremendous job leading on this issue, and we appreciate, Chairman Ramstad, your taking the time of the important Committee on Ways and Means to help us get to the bottom of this matter.

[The prepared statement of Mr. Feeney follows:]

**Statement of The Honorable Tom Feeney, a Representative in Congress
from the State of Florida**

Mr. Chairman, Members of the Committee, thank you for inviting us to testify. I would first like to commend the Committee for its desire to investigate this troublesome and in my opinion preventable criminal activity. We are here to discuss an epidemic of criminal tax fraud, being committed from behind bars, against unsuspecting taxpayers. When convicted criminals are sent to prison, the American

people should be able to rest assured that the criminal justice system will prevent these convicts from committing further crimes while they are in custody.

As members of Congress we are responsible for the stewardship of the American people's tax dollars. We should fully embrace our role of oversight into how that money is spent and make every possible effort to ensure these funds are not wasted or stolen from taxpayers by criminals who commit tax fraud.

Today, we are here to discuss a particularly egregious form of fraud. Prison inmates all over the country are filing *false* tax returns, and collecting *real* refunds. There are a number of common schemes that prisoners use. In one often used scheme, the inmates submit a fake W2 along with a tax return that qualifies them for a refund. Then they wait for the government to send a check or make a direct deposit into their prison bank account. The IRS is aware of this scheme and others, and it has ideas on how to prevent them, but it lacks the proper investigative procedures, tools, and information sharing capabilities to ensure prevention.

I first became aware of this scheme when a local reporter uncovered it in an investigative report. I would like to give credit where credit is due. Steven Stock of WESH Channel 2 in Orlando brought to light a serious problem facing our taxpayers.

It was Mr. Stock's reports that first led my colleague Representative Ric Keller and me to probe further into the matter beginning in November of 2004. I applaud Ric and his staff for their efforts. In April of this year, our coalition expanded to include Representative Jim Davis and Senator Bill Nelson.

Since we began examining this issue, we have exchanged several letters with the IRS regarding the matter, Mr. Keller and I met personally with IRS Commissioner Mark Everson, our staffs have met directly with IRS Criminal Investigation, and our entire coalition has requested the GAO look in to this fraudulent activity.

Throughout my investigation, my two primary goals have been to determine the full extent to which these crimes are being committed and to identify possible legislative solutions to reduce or prevent this criminal activity.

Despite some initial difficulties obtaining satisfactory answers to our concerns, the IRS has lately been corporative with my staff and me as we examined this issue.

We have come to learn that the scope of this problem is much larger than previously believed. It appears the coalition's inquires, the prospect of this hearing, and the additional scrutiny Chairman Ramstad and the Committee have placed on this matter have brought more clarity to the facts of the case.

The full extent to which prison inmates are perpetrating tax fraud against the American taxpayer is astonishing and far exceeds levels I first imagined when I began looking into this matter. The most recent figures I have obtained from the IRS report that just over 15% or 18,159 of 118,075 fraudulently filed refund returns detected by the IRS in filing year 2004 were generated by prisoners. These fraudulent returns accounted for more than \$68 million in detected fraud in filing year 2004.

These numbers are staggering, but they only represent the fraud that has been detected. In reality no system can be 100% effective in detecting all of the fraud that occurs and consequently prisoners throughout the country are likely going undetected in their schemes. It would be irresponsible for me to even speculate as to what level of fraud goes undetected each year, but it is difficult to imagine criminals engaging in such an activity unless success was a possibility.

When you consider that the U.S. prison population amounts to less than 1% of the entire U.S. population, but could be the source of 15% of tax fraud, these statistics become even more troubling. When a criminal is incarcerated the American people believe the criminals are no longer a threat to their safety or their property. In this case that is not true, and the American people deserve better.

I am confident that the other panelists can speak in more detail about the best legislative solutions to this problem, but I would like to offer some broad suggestions and principles to keep in mind when considering this matter further.

IRS Criminal Investigation is already aware of the schemes prisoners use to commit tax fraud. The greatest obstacle they face is having enough information about prisoners to detect the fraud when it occurs.

An open dialogue of information sharing and communications between the IRS and state prison officials are essential elements in the effort to prevent and detect this criminal activity before it occurs. In states where prison officials cooperate with the IRS, the number of fraudulent returns detected is higher than states not involved in the process. States should be rewarded when they cooperate with federal authorities in rooting out fraud.

The office of the Treasury Inspector General for Tax Administration (TIGTA) has reported to my office that of the nine prisons or institutions with the highest number of prisoners caught committing this type of fraud five are located in Florida. By

no means do I believe criminals in Florida are smarter than criminals elsewhere in the country. In fact TIGTA informed my office that officials in Florida cooperate more with the IRS than official in other states.

It is unacceptable that state prisons receive federal funding, yet some are unwilling to cooperate with the IRS to prevent inmates from defrauding the federal government. I encourage the committee to explore ways to encourage or to provide incentives to states to share basic information about inmates with the federal government. Details about the identity of inmates, pay roll information about prison employment, and routing numbers for prison bank accounts could help investigators identify fraudulent returns.

The need to share information goes both ways. Under current federal law the IRS is unable to share the identity of convicts committing fraud with prison officials. IRS Criminal Investigation has reported to my office that this ability would be useful in their investigations and their efforts to prevent future fraud. Additionally, if prison officials were equipped with this information they could use it to discipline inmates attempting to commit this crime.

Many of these schemes committed by prisoners require the aid of an accomplice outside of the prison to collect and cash refund checks. While prisoners often engage in this form of criminal activity without concern for the consequences because they are already incarcerated, tougher penalties for coconspirators on the outside could be a useful deterrent. Informing potential accomplices, such as family members, friends, and roommates of the potential liability would be useful.

In closing I would like to once again commend this committee for its willingness to examine this important issue. I encourage you to take this opportunity to fully examine the extent to which this fraud is being committed and use the expertise of the other witnesses to fully examine possible remedies to this problem.

Chairman RAMSTAD. The Chair thanks all three of you for your testimony here today and for bringing this matter to our attention, and the Chair would now recognize the distinguished Ranking Member, Mr. Lewis, to direct questions to the witnesses.

Mr. LEWIS. Thank you very much, Mr. Chairman, and again, I want to add my thanks to those of the Chairman in thanking you for being here today. Congressman Davis, in your testimony you indicated that the IRS was less than helpful when you attempted to work hand in hand with them to clarify various instances of fraud. What should we ask the IRS that would help you understand the situation and lead to a possible solution in your State?

Mr. DAVIS. Thank you for the question, Congressman Lewis. I had a very good conversation with the Commissioner. I think he personally is very concerned, but I don't think the Agency is moving quickly enough, and I think, because this is such a growing problem, that they need to move more quickly. I think the Committee ought to be looking at whether there needs to be changes in the law in terms of the ability of the IRS to share prisoner tax information with the Department of Corrections. If there is a problem with the Department of Corrections cooperating, we need to figure out how to work with the Nation's Governors or whatever Federal laws might affect those correction facilities. If the IRS claims not to have sufficient resources to invest in investigation and enforcement, certainly that ought to be discussed immediately since we are now debating tonight the Treasury Appropriations Bill.

I would finally say, Congressman Lewis, that if in fact there is prosecution taking place, that needs to be widely known to the public because, while there isn't much incentive to further punish people that are in prison, this operation of scam takes place with help

from people on the outside who certainly do not want to face criminal charges and imprisonment. So, I think by you asking the right questions, hopefully, we can get the system responding more quickly.

Mr. LEWIS. Thank you very much. Congressmen Feeney and Keller, can you tell us more about the results of your local television station investigation in Orlando into prisoner tax refund fraud? How did they go about it? Did it take a television station to bring it to the attention of the larger community? Why was someone else not on top of this before a TV station?

Mr. KELLER. I will take a stab at it, then yield to Congressman Feeney, but the short answer is, yes, it did take the television station to bring it to my attention. I had no idea that this was going on, was shocked when I learned about it, and was further shocked when I learned how broad the problem was. Somehow through—in good investigative reporting, this particular reporter was able, Steven Stock, to develop sources that I certainly didn't have, and those sources gave him tips that this was a widespread problem, and he pursued those, and it turned out that the more bark we pulled off the tree, the more termites were there. So, yes, that is what got us moving. Then we got the channels rolling here with respect to the GAO investigation and asking you to do an oversight hearing, as well as meeting personally with the IRS Commissioner. Finally, we see that there is more effort to crack down on this problem, in large part, frankly, because of the sunlight that was shone on the problem.

Mr. LEWIS. Thank you.

Mr. FEENEY. Thank you, Congressman Lewis, to my knowledge, WESH Channel 2 has done at least five different reports on this matter. The first one is November 16 of last year, where they located an individual who was on the outside. She was not a criminal. She had received 10 different tax returns based on somebody that she knew in the prison system. She felt that was odd, and they were able to discover that this was a coordinated conspiracy, where prisoners were teaching one another how to defraud the IRS. The returns were very much alike. They identified her only by her first name of "Cathy," and she indicated that each of the 10 returns asked for a tax refund of between \$4,300 and \$5,100. Since then WESH has followed up on the activities that Congressman Keller and I and others, including Congressman Davis and Senator Nelson, have engaged in, but it is sort of interesting.

One of the reasons the IRS has not paid a lot of attention to this is that most of the fraud amounts are relatively small, 2, 3, 4, 5,000 dollars. The other reason is that there is actually very little way to deter a murderer, for example, that is sentenced to 50 years behind bars, in terms of committing small-time tax fraud. So there are some challenges the IRS faces, but this came to Congressman Keller's attention and mine through a local TV station.

Mr. LEWIS. I think one of you suggests that maybe we should conclude that if this is taking place in Florida, it could be going on nationwide in other parts of our country.

Mr. FEENEY. I have a theory that every successful con man in the world eventually makes his or her way through my home State of Florida.

[Laughter.]

Mr. LEWIS. Well, maybe by the way of Georgia. You have to go down 75, 95.

Mr. FEENEY. Having said that, I find it hard to believe the ingenuity of the average Federal prisoner in Florida is much greater than the statistical average for the rest of the United States.

Mr. LEWIS. Thank you all very much, thank you. Thank you, Mr. Chairman.

Chairman RAMSTAD. The Chair would now recognize the distinguished Subcommittee Member from Florida, Mr. Shaw, for questions.

Mr. SHAW. Thank you, Mr. Chairman. Very, very briefly, could you walk us through this a little bit? Is this a cooperative effort in which they are using each other's identity? Is this a question of identity theft? How are they getting the Social Security numbers and matching it up with the names? There is a lot of questions here that I am not sure that you all really know, and perhaps the next witness, who himself is one of the perpetrators, would give further insight, but can you give us some idea of how all of this happens and why is it unique to prisons? Ric?

Mr. KELLER. I will take a stab at that, Congressman Shaw. One of the most common techniques is a prisoner will fill out a form saying that he doesn't have a W-2 form to attach to the tax return because his particular business is out of business. There is an alternative form that you fill out, and it asks you to estimate what your income is; he sends that in with the fake tax return and has an address outside of the prison, often an address of a relative or a friend. It requires an accomplice, either a relative or a friend, to assist him in getting the check and cashing the check. In one particular case the accomplice was a prisoner's mother who was an IRS employee, and she facilitated that, and now they are both sitting in a prison. That is one of the techniques. There are many others, but that is the one that initially came to my attention.

Mr. SHAW. I can understand how somebody might be able to pull this off if they have somebody on the inside of IRS working, but to me, to make up a name, no W-2 form, and giving an estimate—and I assume this is a refund of withholding, alleged reforming withholding taxes. I guess they are just not checking it. Is that the case?

Mr. KELLER. Well, as the IRS Commissioner explained it to me, one of the red flags is when they use one of these alternative forms, but the challenge he has is that some prisoners really do have income. Martha Stewart had a massive income even though she was in prison. Others are submitting joint returns and they have a spouse on the outside who does have income, and so there is a bit of a challenge. It is not an automatic red flag, but that is one of the clues.

Mr. SHAW. God knows, if you don't pay enough estimated, they certainly can come after you for that. I just don't understand why they don't check to see what has actually been paid in under your Social Security number. Anyway, thank you, and congratulations to all of you, real proud of the work that you have done. Thank you.

Chairman RAMSTAD. The Chair recognizes the gentleman from North Dakota, Mr. Pomeroy.

Mr. POMEROY. I thank the Chairman. I will just make a brief point. First of all, I value very much the information you have brought to our attention. We will want to play the oversight role to the fullest in terms of seeing that IRS is responding to this issue and that we are slamming the door on this one so that we are not going to have this kind of monkey business in the future. The point I want to make is that this is a particularly timely hearing on this topic, a tax fraud scheme uncovered, but uncovered only after it is all too prevalent, at the cost of millions to U.S. taxpayers. The IRS has some significant enforcement challenges. Tax cheats can be found every corner of this country. Fortunately, the great majority of people in this country do what they ought to do, and that is deal honestly with their legal obligation under the Tax Code. We will have people always trying to find shortcuts and basically get out of their legal obligation.

In this regard we need enforcement dollars for the IRS, and that is a budget matter. With the Treasury Postal on the floor, at this very hour we are considering funding levels for the IRS that are not what the advisory Committee for the IRS tells us is required in order to keep this system at the level where it could provide optimal service to the taxpayer while completely chasing down those that, in the end, aren't paying what they ought to be paying. In fact, we earlier received some information that for every additional dollar in enforcement there was a substantial return on that commitment of that revenue. We would get much more back than we would ever spend out if we would fund the IRS so that it could adequately attend to these pressing enforcement issues. I guess I don't need a response from you. I just note the joinder of the issues. We have under-funding of the IRS. We have tax fraud schemes abundant in this country. If we do a better job with IRS funding, we are going to do a better job of cracking down on these schemes. Thank you, Mr. Chairman. I yield back.

Chairman RAMSTAD. On behalf of the Ranking Member, Mr. Lewis, and all the other Members of the Subcommittee, the Chair thanks all three of you for blowing the whistle on this tax fraud scheme and for your helpful testimony here today. Thank you very much. Before calling the second panel, the Chair has an announcement for all the Members of the audience, including the press and the staff here today. There will be a slight pause while the hearing room is configured for the anonymous testimony of the inmate witness. I would like to also read the statement regarding inmate anonymity. I would like to note that as I mentioned in my opening statement, we will be having a prison inmate testifying as a witness comprising the second panel.

The inmate is current serving time in the South Carolina Department of Corrections. The South Carolina Department of Corrections has a policy against inmates appearing on television in an identifiable manner while they are in prison. The Department has therefore requested that the inmate testify anonymously. They have also requested that he appear behind a screen while testifying so that his image is not broadcast. I would ask the cooperation of the press and any other person in the audience to adhere to that policy of anonymity. The inmate will be testifying, as I said, as the sole Member of the second panel, and again, I reemphasize to all

photographers in the hearing room, please refrain from taking any pictures of the inmate as he is brought into and out of the hearing room by the U.S. Marshals. Thank you.

The Chair would call the second panel. Consistent with the inmate anonymity policy of the South Carolina Department of Corrections, the Chair recognizes John Doe, Inmate, South Carolina Department of Corrections. I want to thank you, sir, for coming forward, agreeing to testify here today, and I would remind the witness of the 5-minute rule. I would ask that the witness deliver his testimony. Please proceed.

**STATEMENT OF JOHN DOE, INMATE, SOUTH CAROLINA
DEPARTMENT OF CORRECTIONS**

Mr. DOE. To start off with I would like to read the testimony. Biographical: I am 37-years-old and am currently serving a 25-year sentence in the South Carolina Department of Corrections for burglary, grand larceny and arson. I have been incarcerated since 1987. My total sentence ends in 2007. Upon completion of my State sentence, I have 60 months of time to serve in the Federal Bureau of Prisons for tax fraud and bank fraud.

How I Committed Tax Fraud: In 1991 I saw a television commercial made by the IRS promoting early filing of tax returns to avoid the spring tax rush. I decided to file 10 returns using fellow inmates' information just to see what would happen. The tax forms were readily available at the institution through the library because they had a prison industry program where inmates work for minimum wage. All 10 refunds went through. The refunds ranged from \$4,200 to \$5,400 each. No effort was made to avoid detection. When nothing happened behind those returns, I started filing every year for whatever groups of inmates I was friends with. The number increased each year. I was paid \$1,000 for each return I filed. The remainder of the money belonged to the name of the person on the return. The first year I bought new shoes, a color TV, a jam box and lots of drugs. In the last few years, especially since 2000, the checks were harder to get in. I started having the checks mailed to outside addresses. Eventually every one went to the direct deposit system. The money would either be sent back in small amounts through the inmate's account, smuggled in through visits in cash, or used by family and friends on the outside to fund drug rings connected to the prison system. In most cases now there is no money trail that can be followed from an inmate's account.

Extent of Fraud: Over the years I have filed 600 to 700 returns. The total dollar amount would be approximately \$3.5 million face value. Of all of the returns I have filed, approximately 90 percent were successful. On some occasions that I am aware of, some inmates who I filed for owed back taxes or child support.

How I Got Caught: In 2000, Investigator Bentley at the McCormick Correctional Institution caught on to my scheme and confiscated most of the checks coming in. He brought me in and interviewed me, and I admitted to what I was doing. He said he was going to contact the IRS and someone would come and talk to me. I never heard any more from it that year. The following year I filed returns again. I had a few checks sent to the institution as a test. These were caught. The others I had mailed to addresses outside

provided by the inmates on their return. In 2002 an IRS investigator finally came and talked to me. I confessed again to my scheme. I still filed a few more in 2003 and 2004, but not as much as usual. In 2005 I filed some because I was threatened by a group of inmates who knew my reputation. After filing those returns, I forwarded some of the information in order to have those returns stopped. I have provided information to Investigator Bentley as lately as this month.

Extent of Current Fraud Agency Wide: The tax fraud scheme is larger this year in the South Carolina Department of Corrections than it has ever been. It has steadily increased each year, but literally exploded in 2005. All of the maximum security institutions and many of the medium security institutions have multiple groups working. The inmates have learned that it is easy money. If they don't get caught by the staff making copies of forms or smuggling out the forms, they are home free.

Where Does the Money Go? I would estimate that 70, 80 percent of all illegal tax refunds are used in the illegal drug trade. Some is used by addicts to purchase drugs for their own use. Much is used to fund illegal drug rings to smuggle drugs into prisons. I don't know that prison gangs, as an organization or involved in preparing returns, but many Members are participating. The money and drugs eventually lead to beatings, stabbings and extortion. With the money I personally made, I often looked out for poor or indigent inmates who got no help from home. I donated a significant fund last year to the Muslim community in order to be in their good graces for security reasons. Mostly, I purchased and used illegal drugs, and supplied them for my friends. I am currently drug free and hope to remain so.

[The prepared statement of Mr. Doe follows:]

Statement of John Doe, Inmate, South Carolina Department of Corrections

BIOGRAPHICAL

I am 37 years old. I am currently serving a 25 year sentence in the South Carolina Department of Corrections for Burglary, Grand Larceny, and Arson. I have been incarcerated since 1987. My total sentence ends in 2007. Upon completion of my State sentence, I have 60 months of time to serve in the Federal Bureau of Prisons for Tax Fraud and Bank Fraud.

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EXTENT OF FRAUD

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HOW I GOT CAUGHT

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EXTENT OF CURRENT FRAUD AGENCY WIDE

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Chairman RAMSTAD. I want to congratulate you on being drug free. You have been a busy guy in prison, Inmate Doe. You estimate, if I heard your testimony correctly, that you filed between 600 and 700 fraudulent tax returns. Is that correct?

Mr. DOE. Yes, sir, That is correct.

Chairman RAMSTAD. That is over a period of how much time?

Mr. DOE. Since 1991.

Chairman RAMSTAD. From 1991 until the present. When was the last fraudulent tax return that you filed?

Mr. DOE. The last ones I filed were this year, approximately February.

Chairman RAMSTAD. Following your conviction for tax fraud?

Mr. DOE. Yes, sir, with the—I just got convicted like a month ago.

Chairman RAMSTAD. I see. Have you filed any returns since your conviction?

Mr. DOE. No, sir.

Chairman RAMSTAD. The average refund was about \$5,000, is that correct?

Mr. DOE. Between \$4,000 and \$5,000.

Chairman RAMSTAD. So, it is your testimony that you have been able to defraud the U.S. Government of \$3½ million since 1991; is that correct?

Mr. DOE. Yes, sir, That is correct.

Chairman RAMSTAD. You personally profited how much from each fraudulent return you filed for another inmate?

Mr. DOE. I would charge each inmate \$1,000 a piece.

Chairman RAMSTAD. So the total amount you made was about \$600,000, is that right?

Mr. DOE. Approximately \$600,000 or \$700,000.

Chairman RAMSTAD. You were successful over what percent of the time? What percent of the fraudulent tax returns were successful in securing refunds?

Mr. DOE. I would have to say probably 70, 80 percent.

Chairman RAMSTAD. You said 70, 80 percent. So in the 20 to 30 percent of the cases where you weren't successful, where the IRS stopped you, did anything happen other than the IRS stopping the check, the refund check?

Mr. DOE. No, sir. They would just stop it, or the institution would stop it at the mail room and send it to the investigators in Columbia, South Carolina.

Chairman RAMSTAD. How widespread, in your judgment, is tax fraud among prison inmates?

Mr. DOE. Well, not only South Carolina, within the United States, it is very large.

Chairman RAMSTAD. How do you know that?

Mr. DOE. How do I know that? I got a lot of friends that come from different States and they tell me how people file taxes at their institutions.

Chairman RAMSTAD. Do most of the inmates committing tax fraud have lengthy prison sentences?

Mr. DOE. No, sir. Some of them don't have lengthy prison sentences. Some of them just have 4 or 5 months left, and they file taxes.

Chairman RAMSTAD. Is there any fear? Are inmates afraid of getting caught committing tax fraud?

Mr. DOE. Well, if they get caught, the majority of time they just charge them a fine and a penalty.

Chairman RAMSTAD. So, it is fair to say there is not a lot of fear out there among the inmate population for getting caught?

Mr. DOE. No, sir, there ain't a lot of fear.

Chairman RAMSTAD. The Chair would recognize the Ranking Member, Mr. Lewis, for questions.

Mr. LEWIS. Thank you very much, Mr. Chairman. Thank you very much for being here, sir. Let me ask you, what do you recommend be done to stop tax refund fraud by inmates? What is your recommendation?

Mr. DOE. Well, if I had to recommend something to stop it, I would change the actual W-2 form. When I say change it, I mean like put a hologram or something in it where you can't duplicate the form, because it is so easy to run a Xerox of it, say, for instance, for the inmates, that we could run copies all the time and file the taxes. If there is a hologram of something like that within the paper where you can't duplicate a copy, it would pretty much

prevent it because the only copying machines they have at the institutions is the standard copying machines. We don't have color copiers or nothing like that within the institutions.

Mr. LEWIS. Thank you. What did the IRS investigator tell you when he finally visited you in prison?

Mr. DOE. The two investigators just asked me if I had done it. I admitted to doing it, and then they wanted to know how long I had done it, how many years I had done it, and this and that, and how much money was involved. I was just honest with them. I told them yes, I had done it. I filled out the taxes for pretty much everybody. I typed them up. I was just basically honest with them.

Mr. LEWIS. Did you mention that you had help and maybe cooperation from individuals outside of the institution?

Mr. DOE. You say did I have help from—

Mr. LEWIS. Right.

Mr. DOE. Well, what we would do, say I went to a inmate and filed his taxes. He might send it to his girlfriend. He might send it to his sister or his mom or someone like that, or they might have a bank account on the street and we would direct deposit the checks to the bank account.

Mr. LEWIS. You had the ability and the capacity to do all of this from inside of the prison?

Mr. DOE. Yes, sir.

Mr. LEWIS. Let me ask you—and be candid, frank, if you can—why are you testifying here today? What if anything did you get from the prison system or the Subcommittee in exchange for your testimony today? Did anyone offer you anything or—

Mr. DOE. No, sir, I have not been offered nothing. I come here on my own free will. I didn't have to come here. One reason I came here is I want to get out of prison. I have been locked up in the South Carolina prison since 1987.

Mr. LEWIS. That is a long time.

Mr. DOE. I have been in 18 years. I just recently caught 5 years Federal time. I am wanting to get this behind me. I don't know what it is like to go to a Winn-Dixie to buy some groceries. I don't know what it is like to go shopping. I want to get out and I want to go home.

Mr. LEWIS. In testifying here today and telling of your own experience, you believe that you are helping to make a contribution that will help the IRS and help the Federal Government to put an end to tax refund fraud in the prison?

Mr. DOE. I hope it does, because like I said, I want to get out and be a productive citizen 1 day myself. So, if I am out on the street and I am working in a legit job and filing legit taxes, I don't want some inmate filing taxes and beating the government as I have. So, that is one reason I came to testify also.

Mr. LEWIS. That is a good desire, and that is something to look forward for, and I, for one, wish you well. Thank you, Mr. Chairman.

Chairman RAMSTAD. Thank you, Mr. Lewis. The Chair recognizes Mr. Shaw for questions.

Mr. SHAW. Thank you, Mr. Chairman. Does the South Carolina Department of Corrections, do they censor the mail coming in and going out of the prison?

Mr. DOE. Yes, sir, they do censor the mail coming in and coming—and the outgoing mail. We cannot seal it up. The main way we have been sending them out is through the visitation. Just recently this year, the investigators for South Carolina Department of Corrections have started searching the inmates going on visit because a lot of time we smuggle out letters, like sending the IRS tax forms in, already sealed up. We might give it to our visitor and they will drop it in the mail for us. Recently this year right here, they started searching us when we go on a visit, where we can't take no mail out to mail out.

Mr. SHAW. Did any of your customers get prosecuted for this?

Mr. DOE. Yes, one other guy was prosecuted also. Actually it was him and his mother that was involved, which he—the guy is still in the South Carolina Department of Corrections, and they gave his mother probation because the only thing she done was gave us her bank account number, which we lied to her to get the bank account number. We told her that we had some friends that worked in the prison industry, which prison industry makes minimum wage in South Carolina. So we lied to her and told her that we had some friends that wanted to deposit their checks, so she gave us her bank account number. Then we put the fraudulent checks into her bank account. So the judge gave her probation last month in Federal court.

Mr. SHAW. How do the inmates get the \$1,000 to pay you, and how do they get that into the prison system?

Mr. DOE. Okay. Once they get the checks, say it is direct deposited to one of their girlfriends or wherever or sent to the street, and they get somebody to cash it. Then they smuggle the \$1,000 back to me or else I have it sent to my South Carolina Department of Corrections prison account, or I have one of my friends on the street pick the money up for me.

Mr. SHAW. That prison account, is that an account within the prison?

Mr. DOE. Yes, sir, it is an account that we got. We got a debit card where we get to go to the canteen to spend our money from my account.

Mr. SHAW. You must have had one of the biggest accounts in the South Carolina prison system.

[Laughter.]

Mr. DOE. Well, I wouldn't say that because I looked out for a lot of guys that was poor and indigent, and a lot of these guys don't have no family or nothing so I would look out for them. Some of them don't even have toothpaste and soap and stuff to wash with or brush their teeth with, and I would make sure I supplied that to them.

Mr. SHAW. Have any of your buddies in the prison, are you fearful at all that they might try to retaliate since you went ahead and pled out and confessed to what you had done?

Mr. DOE. No.

Mr. SHAW. I assume you named some names too.

Mr. DOE. Most definitely. They know everybody that I filed the taxes for, but I ain't going to have no repercussions of it because I pleaded guilty to them. It was actually my handwriting, my format, my typing and handwriting where I signed. I signed them

people's names, the other inmates names on the tax returns, so I pled guilty to all of that.

Mr. SHAW. Now, you filed the name plus the correct Social Security number on the return itself?

Mr. DOE. Did you say "Was it a correct name?"

Mr. SHAW. Yes. Did you print the correct name plus the inmate's Social Security number on the return itself?

Mr. DOE. On the returns? Yes, sir. I put all of that in my handwriting.

Mr. SHAW. Now, there is nothing unique about this that means that it goes on in prison and can't go on anywhere else, is it?

Mr. DOE. No, I am sure there is probably people on the outside in society doing it also. So, that is why I recommended the hologram or something on the W-2 form where you couldn't—

Mr. SHAW. Well, the W-2 is supplied by the employer and sent to the employee, so I don't know how you could protect that because anybody can pick them up because the employers are required to get those to file them on their employees, and most of them are—large employers, they are computerized anyway. So I am not sure that would work. It might be something we should bring up with the IRS when they come, the next panel. The fact that it had some identifying number that couldn't be counterfeited on it doesn't mean that you couldn't get a supply of them because the employers are required to use them.

Mr. DOE. Yes, sir, you are correct about that, but also you have to have your Federal employer number to get them W-2 forms.

Mr. SHAW. You are a smart man. You will make it all right when you get outside if you stay straight.

Mr. DOE. I hope I can. I hope I can get out hopefully soon, the sooner the better.

Mr. SHAW. I hope you are a lot smarter now than you were when you went in.

Mr. DOE. Yes, sir, I am.

Mr. SHAW. Thank you, Mr. Chairman.

Chairman RAMSTAD. Thank you. The Chair recognizes Mr. Hayworth, distinguished gentleman from Arizona.

Mr. HAYWORTH. Thank you, Mr. Chairman. Inmate Doe, you have offered some insight. I don't know, we could nickname this scam H&R Cellblock, because you really had a racket going on. In your South Carolina Department of Corrections account, how large did that grow, or did you take efforts to hide and shift funds so it would never reach a considerable sum?

Mr. DOE. I kept it as low as \$1,000 on it. I would shift the money around. I wouldn't have no more than \$1,000 on my account, because they monitor it. The South Carolina Department of Corrections, they monitor all the accounts.

Mr. HAYWORTH. This is so incredible. I guess different States have different policies in terms of mail. You said you were able to Xerox tax forms. What about the envelopes you would use? Does South Carolina have any regulation as to the envelopes being utilized for mail? Was there anything that would flag your mail heading out to the IRS?

Mr. DOE. No, sir. We get regular post office envelopes. We get to buy them from the canteen, same as outside envelopes, but if we

mailed it through the mail room it would have Department of Corrections stamped on the back of it.

Mr. HAYWORTH. Let's retrace some of your testimony. When an investigator from the South Carolina Department of Corrections basically got onto you and then alerted the IRS, what year was that?

Mr. DOE. That was 2001 when they got onto me.

Mr. HAYWORTH. Two-thousand one?

Mr. DOE. Yes, sir.

Mr. HAYWORTH. You filed fraudulent returns as recently as this year, 2005?

Mr. DOE. Yes, sir.

Mr. HAYWORTH. When did you finally encounter an IRS agent or investigator? Did it happen that same year of 2001, or was there—

Mr. DOE. No, they didn't come that year. They wouldn't come. The investigator, Mr. Bentley contacted them, but they wouldn't come to investigate it, so nobody came. So, 2002 is actually when they came and talked to me about it.

Mr. HAYWORTH. What was the nature of the contact: a questionnaire, a telephone call, a meeting, a joint meeting with the prison investigator?

Mr. DOE. A meeting. They came to the institution and talked to me. That is when I admitted to it.

Mr. HAYWORTH. Now, I really want to get this straight in my own mind. The IRS was alerted in 2001?

Mr. DOE. Yes, sir.

Mr. HAYWORTH. You had no contact with them in follow up until when?

Mr. DOE. Till 2002, like June of 2002.

Mr. HAYWORTH. So a year went by?

Mr. DOE. Maybe just a little over a year.

Mr. HAYWORTH. Over a year?

Mr. DOE. Yes, sir.

Mr. HAYWORTH. After this had been flagged.

Mr. DOE. Yes, sir.

Mr. HAYWORTH. As you mentioned, this is widespread. You are hearing from inmates who end up in South Carolina from other States and the talk in the prison yard is this is a common scam?

Mr. DOE. Yes, sir. That is the word that I am getting, that it is a pretty large-scale scam right now as we speak. Probably this year alone, if I had to estimate, they probably done lost a couple million dollars, the IRSs, just on the Eastern Region, which would be Atlanta, Georgia where you file there—Florida, North Carolina, South Carolina files to Atlanta, probably at least done lost a couple million dollars.

Mr. HAYWORTH. Well, this testimony is most insightful. Mr. Chairman, we have to slam the door shut on H&R Cellblock. I yield back.

Chairman RAMSTAD. The Chair recognizes Mr. Beauprez, the distinguished gentleman from Colorado.

Mr. BEAUPREZ. Thank the Chairman. Inmate Doe, I thank you for being with us today and being very candid. You are absolutely correct, unfortunately, that this is a widespread problem. I am fa-

miliar with a case in Colorado, and I am referring now to a news article, February 11, 2004, printed in the Rocky Mountain News about an inmate from Buena Vista, Colorado, our correction facility there, one of them. He was a bit more aggressive than you, sir.

[The information follows:]

Rocky Mountain News: February 11, 2004, Wednesday, Final Edition, Page 4A
Inmate Cooks Up Fraud: From Prison Kitchen Comes W-2 That Nets Him Huge Tax Refund

By Karen Abbott

If you make a mistake on your Federal tax return, the IRS likely will correct it, just as it did for John Wesley Sarpy.

The Federal return that Sarpy filed in 2002 indicated he earned nearly \$1 million in 2001 and was due a refund of \$213,000 and change.

The IRS, noticing he hadn't claimed the standard deduction for himself, corrected his return and sent him a refund check for more than \$215,000.

There was just one problem.

Sarpy's tax return was false.

He based it on a fake W-2 form that he created on a computer in the prison kitchen at the Buena Vista Correctional Facility.

At the time, Sarpy was incarcerated in Buena Vista, doing time for aggravated motor-vehicle theft.

"He's somewhat unique," said John Harrison, special agent and spokesman for IRS criminal investigation in Colorado.

He said the agency usually catches refund cheats before it sends them checks.

This time, it was an alert employee at a check-cashing store who contacted authorities when Sarpy's fiancée tried to cash the noticeably large check.

Sarpy, 31, has pleaded guilty to making a false claim, a Federal felony. Denver U.S. District Judge Edward Nottingham will sentence him Friday.

It's not Sarpy's first round in Federal court.

In 1998, when he was a senior claims representative in the Denver office of Allstate Insurance, he was charged with writing checks for phony insurance claims and depositing them in an account he opened under a fake name.

The next year, Sarpy was back in Federal court, accused of writing an unauthorized check on a business account at Norwest Bank.

He served Federal time in a prison on the Texas-New Mexico border and was back in Colorado, doing time for the auto-theft conviction, when he filed the fake tax return.

Sarpy claimed he had worked for a company called Synova Inc. In fact, he had.

He had earned \$16,752 in 2001, between prison terms, and Synova had withheld \$3,287 for his Federal taxes, according to court documents.

On the prison computer, those amounts became earnings of \$987,219 and a withholding total of \$576,495.

Harrison said the IRS started its Questionable Refund Program in 1977, after it became apparent that some people were filing false claims for income-tax refunds.

He said tax returns are examined and scored on a variety of items that might make them suspicious.

"They look at literally thousands and thousands of returns," Harrison said.

The math is checked, too.

All that happened to Sarpy's tax return, he said.

"The only problem, of course, in this particular case, is the guy had apparently enough legitimate information to fool the system," Harrison said.

Since the Questionable Refund Program began, refund cheats have claimed more than \$2 billion of refunds they aren't entitled to receive, Harrison said.

"And of that amount, we successfully stopped an average of 86 percent," he said.

Sarpy, he said, "falls kind of in that other 14 percent."

INFOBOX

Tax time

While you're figuring out your 2003 returns, John Wesley Sarpy will be serving time in a Federal prison for filing a fake return for 2001. His case by the numbers:

\$213,383 Net refund from the IRS.

\$1,972 Average individual refund last year.

108 The number of average refunds it takes to match Sarpy's.

Mr. BEAUPREZ. He had filed a claim with the IRS, stating that he had earned a million dollars in 2001, asked for a refund check

of \$213,000. The IRS, in its benevolence, corrected that, said that he hadn't claimed the standard deduction for himself, so they sent him a check for \$215,000.

[Laughter.]

Mr. BEAUPREZ. He made one rather critical error. He gave the check to his girlfriend, and she went to a check-cashing facility and they thought that that was a little unusual that someone would walk up with nearly a quarter of a million dollar check at that sort of a facility and ask that it be turned into cash. Thankfully, the attendant at that facility reported it to the authorities, who followed up. I want to follow the direction of Mr. Lewis a little bit, and ask more. If this is so easy—and I respect that you are suggesting in order to make it not so easy, how do we stop this, that some kind of a unique document is one suggestion. I am assuming that maybe there are others. Please help us. I sense your sincerity and I admire that. How might we get in front of this curve?

Mr. DOE. Okay. One way, like I said, would be the hologram on the actual W-2 form itself. Another way would be when your employer gives you your W-2 form, make you put your thumbprint on it. The reason I say your thumbprint is because if the IRS runs an National Crime Information Center (NCIC) check on it, it is going to show. If I am an inmate and I put my thumbprint on this W-2 form, it is going to show that I am a convicted felon. So, that would be another way.

Mr. BEAUPREZ. You mean everybody or people incarcerated?

Mr. DOE. Everybody that gets a W-2 form, have their employer put one thumbprint on it.

Mr. BEAUPREZ. All right.

Mr. DOE. There should be a section on there for you to put your thumbprint. From what I have noticed over the years, there ain't no place to put no thumbprints or no type of prints or nothing. That is how a lot of people is getting identity theft, stealing people's identity. It is so easy to steal your identity now that it is a shame, it is pathetic; but one thing for sure is, the fingerprints won't lie. It is just like your DNA, it ain't going to lie. So, that is another way: your fingerprints, put fingerprints on your W-2 forms.

Mr. BEAUPREZ. What about the penalty? You said that basically no fear, one, not very many people seem to be getting caught, and even if you get caught, by your experience, I guess you sit around waiting for justice to show up at your door. Would increasing the penalty somehow catch anybody's attention or not?

Mr. DOE. Well, I would kind of doubt that also, because of so many people that file, it is actually hard to catch you unless they audit you. You can cheat and lie on your taxes and get away with it as long as they don't audit you.

Mr. BEAUPREZ. I don't think so. I am a Member of Congress. They watch us pretty closely.

Mr. DOE. If they audit you, then that is when they are going to catch you. So, stiffening the penalty would actually be—that really wouldn't do much neither. From what I can see, I don't think that would even help.

Mr. BEAUPREZ. In the time I have remaining I want to make mention of part of the rest of your testimony. Mr. Chairman, I note

with some considerable concern that this crime, as serious as it is, seems like it really begets further crime. The abuse of drugs—it is really feeding, it looks like, illegal drugs in our prisons. In your testimony you state that the money and the drugs eventually lead to beatings, stabbings, extortion. It is turning our correction facilities into more of a problem, not less of a problem. The word “correction” seems to be maybe misplaced. By not controlling, enforcing this problem, the money problem, the source of money, we are only adding fuel to the fire. Would that be a fair characterization, Mr. Doe?

Mr. DOE. Yes, sir, that sounds about correct. It is leading to a lot of destruction and a lot more drugs and stuff into the institutions, and you are pretty much right, what you said. Like the extortion, a lot of extortion goes on because there is so much money and drugs coming into the institution. So, actually, there has been a lot of more crime coming into the institutions. Back when I first started doing my time there wasn’t as many stabbings and stuff as there actually are now. The director we got in South Carolina is a good director. He pretty much tries to control like the tax forms and stuff coming in. They got memorandums up that they are strictly contraband. The mail room people— you can’t get them mailed in and stuff. So, he pretty much is trying to control it in South Carolina, but it is still out of hand.

Mr. BEAUPREZ. I thank the gentleman. Thank you very much for being with us.

Chairman RAMSTAD. The Chair recognizes the gentleman from North Dakota, Mr. Pomeroy, for questions.

Mr. POMEROY. Mr. Chairman, I apologize for missing part of this witness’s testimony. There was a debate on the floor I was participating in. I would just say to the witness, I want to thank you for coming forward. For this Committee to do its oversight job, we really have to be able to get at what is really happening out there, and relative to this prison scheme your testimony is very helpful in that regard. I appreciate you coming forward, and I would certainly hope that no harm will befall you as you go back to incarceration for helping us out as a Committee. Thank you very much. I yield back, Mr. Chairman.

Chairman RAMSTAD. The Chair recognizes the esteemed gentleman from California, Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman. I want to thank you, Inmate Doe, for being here today, for your testimony. Most of the questions have already been asked, but I did find it interesting in your testimony, toward the end when you talk about where your money went to, you mentioned the Muslim community, in order to be in their good graces for security reasons. Could you expand on that?

Mr. DOE. Okay. What I was talking about for security reasons, like the stabbings and extortion and stuff like that. With a person that was making that kind of money within an institution like myself, I had to have some kind of security so I wouldn’t get stabbed or whatever. Sometimes when somebody would come and want to talk to me about filing taxes, they were liable to have to get strip searched and all just to even come to see me. The reason I done it like that is because, you never know, somebody might have been jealous of me making that kind of money and want to come and

kill me. So, I wasn't taking no chances. I was trying to make this money, get this money. I have been locked up all my life. It ain't like I had no job on the street or nothing, and I wanted to make money. So, that was the only way I could make money. If I had been out in society, I am sure I probably would have never even done this scheme or scam if I had been out in public society. With the situation I was in, I had to come up with something to make money because I like to drink drinks, I like to eat, I like to have things and there wasn't no way possible without it. My mom, she might send me \$10 a month, but expensive as stuff is, like cigarettes is like \$5.40 a pack inside the prison, I couldn't supply myself. So, I had to come up with something; that is another reason I came up with the plan. What you said, the security reasons, that is why I gave the Muslims \$5,000 for security, so nobody would try to hurt me.

Mr. NUNES. The Muslims within the prison where you are?

Mr. DOE. Within the prison, yes, sir.

Mr. NUNES. I want to thank you for your testimony. Mr. Chairman, with that I yield back the balance of my time.

Chairman RAMSTAD. On behalf of Mr. Lewis and the entire Subcommittee, the Chair thanks Mr. Doe for voluntarily testifying before the Subcommittee and shedding light on the problem of tax refund fraud by prison inmates. The Chair also appreciates, as do the other Committee Members, your candor here today, your forthrightness, and we wish you well in your recovery from addiction that you talked about earlier. Thank you again, Mr. Doe.

Mr. DOE. You are welcome.

Chairman RAMSTAD. The Chair, as soon as the hearing room is reconfigured, would call the third panel.

The Chair now calls the third panel consisting of Nancy J. Jardini, Chief of Criminal Investigation of the IRS; the Honorable J. Russell George, Treasury Inspector General for Tax Administration, U.S. Department of the Treasury; John M. Moriarty, Inspector General, Texas Department of Criminal Justice; and Jeff Bentley, Criminal Investigator, South Carolina Department of Corrections. I would remind the witnesses of the 5-minute rule. Thank you for appearing here today, and we look forward to your testimony. We will begin please with Ms. Jardini.

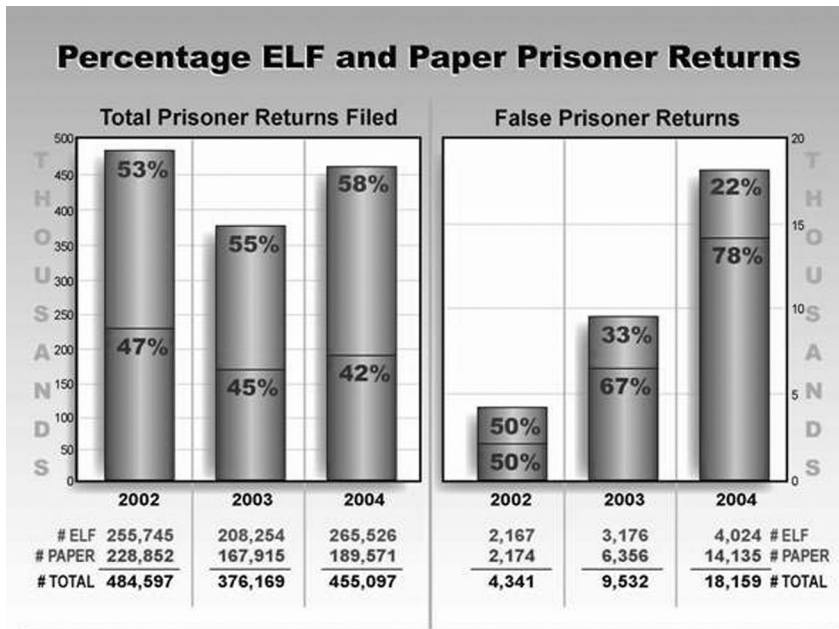
**STATEMENT OF NANCY J. JARDINI, CHIEF, CRIMINAL
INVESTIGATION, IRS**

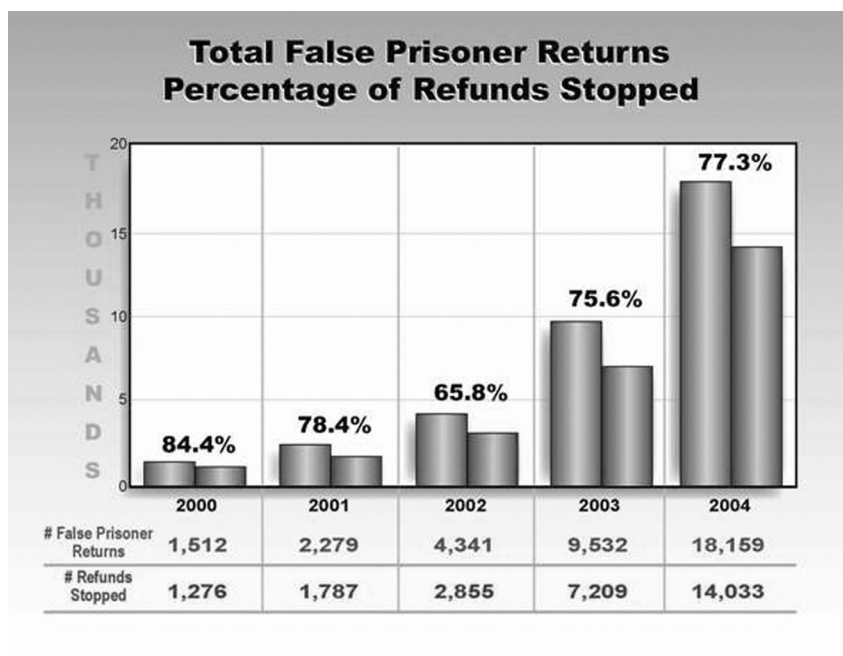
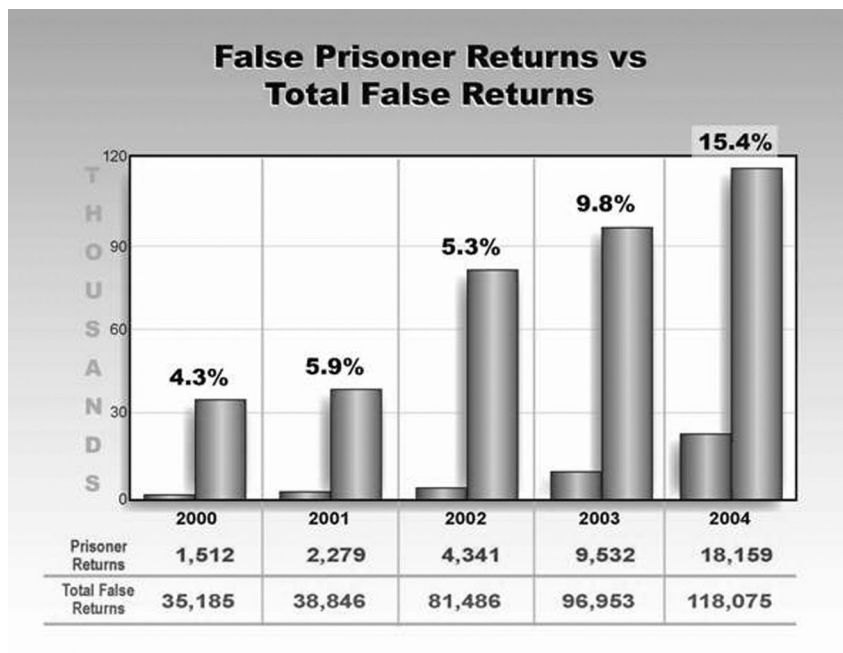
Ms. JARDINI. Thank you very much. Thank you for the opportunity to discuss the dramatic increase in fraudulent prisoner returns. This is an urgent problem that erodes legitimate taxpayer confidence in our system. I would especially like to commend this Subcommittee and your leadership, Chairman Ramstad, as well as Ranking Member Lewis, for your interest and support in helping us address this burgeoning area of fraud. Additionally, I wanted to commend the Subcommittee staff, who were extremely helpful as we worked together to prepare for today's hearing. During 2004, 106 million refund returns were filed with the IRS. The majority of these returns were filed by legitimate taxpayers who were deserving of a prompt refund. Fraudulent claims totaled 122,000 re-

turns, or less than 1 percent of all refund returns. Eighteen thousand of those were fraudulent prisoner returns.

Despite the relatively small percentage that prisoner fraud represents of overall refund fraud, we recognize its enormous impact on our system of voluntary compliance. We have seen exponential growth in prisoner fraud in the last 5 years. As Exhibit 1 to my report demonstrates, prisoner refund fraud represented only 5 percent of overall refund fraud just 3 years ago compared to 15 percent last year. When we look behind these numbers, we can identify some specific trends. As Exhibit 2 demonstrates, overall prisoner returns are filed electronically more frequently than on paper, as with the general population. However, a majority of false prisoner returns are paper returns. In fact, in 2004, 78 percent of all false prisoner returns were filed on paper. For this reason, we have devoted additional resources to detect fraudulent prisoner paper returns and stop those returns at the same rate we stop electronic returns that are false. Further, 99 percent of false prisoner returns use either single or head-of-household filing status. While false Schedule C income and substitute W-2s are used in prisoner refund fraud, the majority of claims involve false or forged W-2 documents. As Exhibit 3 demonstrates, almost 80 percent of false prisoner returns are identified and stopped by the IRS prior to the issuance of the refund. As you can see from the chart, despite the dramatically increased volume in prisoner refund fraud, in 2004 we at the IRS stopped more false prisoner refunds than we did in the prior 4 years combined. Notwithstanding these efforts, there is much more to be done.

[The exhibits follow:]





Ms. JARDINI. Our first priority at the IRS in prisoner refund fraud is to identify the false claims quickly enough to stop the re-

funds before they go out. Criminal Investigation employs approximately 600 investigative analysts in our Fraud Detection Centers nationwide who use sophisticated data mining techniques and critical investigative analysis to detect and stop fraudulent claims for refund before they go out. A second and equally important defense against refund fraud is our highly sophisticated data mining system, the Electronic Fraud Detection System (EFDS). The EFDS screens every single refund return that comes into the IRS. That means last year 455,000 prisoner returns were analyzed by this data mining tool. Another critical tool in the fight against prisoner refund fraud is our relationships with our State and Federal prison authorities, like my colleagues on this panel. Their cooperation in providing prisoner identifying data which we load into the data mining systems is absolutely vital to our detection efforts.

Despite these tools, we in the IRS face significant challenges in improving our fraud detection efforts. One challenge that has already been mentioned is the non-disclosure provisions of section 6103, which prohibit disclosure of tax information unless that disclosure meets an enumerated exception. None of the exceptions in 6103 permit the IRS to refer inmate refund fraud information to prison officials for the imposition of administrative sanctions. Piling on additional years of incarceration to a hardened inmate may not be the most effective deterrent. If prisons could take away prisoners' administrative privileges for engaging in this conduct, the oh-so-important cigarettes, candy bars, television, and visitation privileges, it would create a cost-effective deterrent that would benefit both the Federal Government and the prison systems.

Another significant challenge is that despite the fact that State and Federal prison officials are very helpful in providing prisoner identifying data, almost 20 percent of the data that we receive from the States is inaccurate. Further, the disparate formats utilized by the individual States are time-consuming and difficult to reconfigure to upload into our systems. Criminal Investigation within IRS has numerous competing resource demands. Even though our resources have remained relatively flat over the last few years, we have dedicated an additional 35 percent of our resources to the 600 employees I previously mentioned in the Fraud Detection Centers to address refund fraud growth. Those resources must be diverted from our other important enforcement priorities, including high income tax evaders, offshore abusive schemes, and abusive charitable entities.

Despite the fact that our annual budget exceeds \$500 million and we have over 4,100 current employees in Criminal Investigation, the President's 2006 budget has one budget initiative request for Criminal Investigation. That request is for \$10.7 million to be used strictly to curtail fraudulent refund fraud, and we urge you to support that budget request. Mr. Chairman, we appreciate very much the opportunity to be here to discuss this with you, and I will be happy to take any questions at the appropriate time.

[The prepared statement of Ms. Jardini follows:]

**Statement of Nancy J. Jardini, Chief, Criminal Investigation,
Internal Revenue Service**

Thank you for the opportunity to discuss our concerns regarding the dramatic increase we are seeing in fraudulent prisoner refund fraud schemes. Like you and all

taxpayers, we are appalled at this attack on our federal revenue. Your support for removing identified impediments to preventing these schemes will help us more effectively address this burgeoning area of fraud and will also assist us as we continue to identify, anticipate and stop prisoner refund fraud.

Overview of Prisoner Refund Fraud

There is no question that prisoner refund fraud is on the rise. Even though prisoner returns comprised less than one half of one percent of all individual federal income tax returns filed in 2004, over fifteen percent of all false refund returns used prisoner names and taxpayer identification numbers.

Overall refund fraud has increased significantly since 2001 along with prisoner refund fraud. A majority of these false refund requests are identified and frozen prior to the issuance of the refund. During processing year 2004, over 130 million returns were filed with IRS, including approximately 455,000 prisoner returns. During the same period, CI reviewed nearly 500,000 questionable refund returns including at least 36,000 prisoner returns. Of those, we identified more than 118,000 fraudulent tax returns including 18,000 false prisoner returns. To explain this in terms of potential harm to the government, overall fraudulent refund claims that we are able to identify exceeded \$2.2 billion¹ in 2004 of which we were able to stop the issuance of refunds in over 94%. Of the \$68 million claimed on false prisoner returns that we are able to identify we were able to stop the issuance of 78%.

The number of American taxpayers choosing to electronically file their tax returns continues to rise each year from 36% in 2002, to over 50% in 2005. This electronic filing trend holds true for the overall prisoner population, yet the number of false prisoner paper returns has risen considerably. Between 2002 and 2004, total paper returns filed by prisoners decreased by 21%. However, in 2004, 78% of all false prisoner returns were paper returns, compared to only 50% of false prisoner paper returns in 2002. Incomplete 2005 data reflects continued growth in fraudulent activity in paper returns and increasing fraud in electronic filings.

Types of Schemes

The manner and means by which prisoners deploy fraudulent refund schemes is constantly evolving. Schemes can be as simple as false wage and Earned Income Credit (EIC) claims using a cellmate's social security number, or as complex as a prisoner, in concert with outside co-conspirators, filing false income tax returns online utilizing stolen identities, followed by sophisticated financial transactions intended to disguise the true source of the funds. The characteristics of prison refund schemes are as varied as refund schemes implemented by non prisoners.

Of the 18,000 fraudulent prisoner returns detected in 2004, a number of different fraud schemes were utilized including identify theft, filing numerous false forms including Schedule C, Form 1099, Miscellaneous Income, Form W-2, and Form 4852, Substitute for W-2. Numerous tax credits to which the prisoners were not entitled were also claimed, including the EIC, Advanced Earned Income Credit, Child and Dependent Care Credit, Education Credit, Child Tax Credit, and the Adoption Credit. In perpetuating these schemes, many prisoners received outside assistance from family or friends.

Tools Used To Identify and Stop Prisoner Refund Fraud

A wide range of tools are used by the IRS overall to identify and stop prisoner refund fraud. These tools include automation processes, manual review of questionable returns and return information, referral of questionable returns identified by IRS processing functions and referred to our Fraud Detection Centers (FDCs), and ongoing coordination and communication with correctional facilities, banks, other government agencies, individuals, and electronic return originators (EROs).

Tools—Fraud Detection Centers

The fundamental mission of the IRS Criminal Investigation, or CI, is to serve the American public by detecting and investigating criminal violations of the Internal Revenue Code and related financial crimes. As a part of the CI mission, Fraud Detection Centers and the Office of Refund Crimes are staffed by highly skilled and trained analysts who specialize in statistics and analytical areas such as return processing, computer operations, the Questionable Refund Program (QRP), and the Return Preparer Program (RPP). FDCs are responsible for the detection and development of fraudulent refund schemes at the 10 IRS Campuses where returns are processed. These teams of investigative analysts evaluate data identified by data mining algorithms, conduct critical investigative analysis, and work together with

¹This number includes one scheme with two returns totaling \$1.8 billion.

our partners in the civil divisions of the IRS to detect fraudulent returns and delete fraudulent claims for refund. Once schemes are identified and refunds are stopped, these schemes may be referred to a CI special agent for criminal investigation or to an IRS civil division for examination. The CI Office of Refund Crimes manages the FDCs and is based in CI Headquarters.

Tools—Technology

In the mid 1990s, the IRS worked with an outside contractor to study refund processing. One of the key results of that study was the development and deployment of a highly sophisticated data mining system which is utilized by the Electronic Fraud Detection System (EFDS), an automated system that improves the effectiveness of the manual screening process. EFDS is used by the Criminal Investigation FDCs to screen all returns filed with the IRS requesting a refund. EFDS houses more data than any other computer system at the IRS with the exception of the IRS Master File and has the capability to combine refund returns with other IRS files into one centralized system.

All refund returns are scrutinized by EFDS, which results in the identification of a substantial proportion of false returns. While this system has greatly enhanced the way the IRS identifies false returns, IRS is still unable to detect all false returns. As new schemes are identified, we program our computer systems to identify them to maximize the efficiencies of the automated systems.

When we identify new schemes, it is often after some refunds have already been issued. We are then faced with the challenge of collecting that money. If we determine that a return is false after the refund has already been issued, controls are placed on the taxpayer's account to prevent future refunds from being issued based on subsequent false returns.

In 2004, over 50% of false prisoner returns requested either direct deposit refunds or Refund Anticipation Loans (RALs). Prisoners usually request these refunds be routed to any number of locations including their prison account or to bank accounts in accomplices' names outside the prison. Similar to tax evasion schemes, prisoners or non-prisoners may set up complex financial transactions that span the globe in an attempt to obscure the money trail.

Tools—Analysis

We are vigilant about our efforts to quickly identify new refund schemes, stop those refunds and update our data mining tools with data regarding that scheme. We have had success with our automated systems—they do a great job with the information we give them. However, these systems cannot do what our trained, skilled investigative analysts and criminal investigators do, which is to find fraud through a physical, manual review of refund returns utilizing their knowledge and expertise. Once a fraud scheme is identified, analysts and criminal investigators must work quickly to determine the full scope of the scheme by conducting further research, evaluating all scheme characteristics, and conducting criminal investigations if warranted.

Tools—Prevention and Coordination

In an effort to prevent prisoner refund fraud, we have developed a close working relationship with many states and with individual prison officials. In some instances, tax forms have been removed from prison law libraries, and some states have declared tax materials found in prison cells to be contraband. Most states, the District of Columbia, and the Federal Bureau of Prisons strive to comply with IRS requests for an annual listing of all inmates. The prisoner information included in these listings is used to identify prisoner refund returns which are then incorporated into the data mining system utilized by EFDS to identify questionable prisoner returns.

Another significant deterrent for prisoner schemes is the agreement by many prison officials to identify and forward to CI any inmate mail addressed to the IRS for review. However, some prisoners don't seem to appreciate this scrutiny as evidenced by correspondence we have received. For example, a letter addressed to Commissioner Everson from an inmate complaining that the prison officials "didn't let me send my letter" is signed by a prisoner who falsely claimed that he was self employed and wanted to file his taxes and receive his earned income credit. In another instance, a clever greeting card was made in a prison craft shop. On one side it had a hidden pocket containing six false Forms W-2 and the other side contained a hidden pocket containing six fraudulent returns. The card was addressed to someone outside the prison system. Alert correction officers noticed that the card was heavier than a normal greeting card and, after discovering its contents, forwarded it to CI for further investigation.

Tools—Outreach

Our outreach includes meetings with prison officials on the local and national level to discuss the types of schemes we see emanating from their institutions. These meetings have been highly successful in helping prison officials know what to look for and whom to contact when they identify potential fraud.

We have also enhanced our efforts to educate and work with EROs and practitioners to alert them to the possibility that prisoners may attempt to engage them to file false returns on their behalf. Our publicity, education and outreach have expanded to include prison publications and websites. For the past 11 years, CI has participated in fraud discussions with practitioners at the IRS Nationwide Tax Forums. Our outreach efforts at these forums is far reaching; CI has presented a Refund Fraud seminar to approximately 18,000 practitioners and enrolled agents in the last two years alone. We also meet with local practitioner groups to continue the dialogue about badges of fraud and have established a tip line especially for practitioners to alert the IRS about potential fraudulent schemes.

Each CI field office has a QRP coordinator whose outreach efforts may include meeting with local prison officials to identify methods to recognize potential schemes and to publicize, within the prisons, those cases where individuals working outside the prison to help perpetrate the fraud have been prosecuted. As you will notice from the following cases summaries, many of these prison schemes are aided by individuals outside the institutions who help facilitate the fraud.

Tools—Criminal Prosecution

One of the functions of the FDCs is to identify and develop criminal cases and refer these cases to IRS special agents for investigation. Once a refund scheme has been identified and developed, the FDC and the field office work cooperatively to identify all co-conspirators, which may include prisoners as well as those on the outside assisting the inmates. Once the investigation is complete, the case is referred for prosecution.

The government cannot prosecute every prisoner who commits refund fraud because we must be prudent with the federal governments' limited investigative and prosecutorial assets. Therefore, we also focus our efforts on identifying those on the outside that assist with these schemes, even though these outside links can sometimes be difficult and time consuming to track. CI has demonstrated and publicized that individuals who assist prisoners with the perpetration of refund fraud schemes will also be prosecuted. We have had continuing success with these prosecutions along with outreach and publicity efforts. The following is information from the public record about cases that have been prosecuted:

- In February 2003 a Florida prisoner serving a life sentence was sentenced to 33 additional months in prison for filing false claims. The prisoner prepared 64 fraudulent tax returns for other prisoners using their names and social security numbers. He also prepared a "self help" manual instructing others on how to prepare fraudulent tax returns.
- In February 2005 in South Carolina, three individuals pled guilty to filing false claims. Two individuals were prisoners and the other individual was the parent of one of the prisoners. One inmate prepared a number of legitimate looking but completely fictitious W-2 forms using the names and social security numbers of real but unsuspecting fellow inmates. The prisoner then prepared at least ten false income tax returns using the W-2s and the refunds were issued. The other inmate convinced his mother to permit her checking account to be used as a receptacle for many of the refunds.
- In January 2005, a Minnesota prisoner pled guilty to filing false claims. This scheme involved a prisoner who established legitimate Employee Identification Numbers (EINs). At least 23 Forms 941, quarterly tax returns, were filed claiming advanced EIC paid to deceased individuals. The prisoner then aided in filing at least 29 fraudulent returns for other prisoners using his business EINs and identifying them as his employees. Some of the prisoners were aware he was doing this and conspired with him to share the false refunds. Other prisoners claimed they were not aware he had used their identities.
- In February 2005 in Missouri, false Forms W-2 were prepared by one prisoner and were attached to 66 returns filed by other prisoners claiming refunds. In each case the W-2 was photocopied and the payee information was changed. This prisoner was recently sentenced to an additional 33 months.
- On May 11, 2005, a woman in Louisiana was sentenced to 15 months in prison to be followed by three years of supervised probation and was ordered to pay restitution to the United States in the amount of \$73,725. In addition to other refund fraud schemes, she prepared and filed eleven fictitious individual tax re-

turns in the names of inmates who were in the custody of the Louisiana Department of Corrections during 2002. She obtained the names and social security numbers of the eleven inmates and then prepared a 2002 IRS Form 1040 on behalf of each inmate. She used a Schedule C to falsely claim business income by the inmates/alleged taxpayers and falsely represented that the inmates supported dependants to qualify the inmates for EIC.

Refund Fraud Challenges and Potential Solutions

Since 2001, the number of fraudulent returns detected by the FDCs has increased over 200%, and refund fraud using prisoner identities has increased almost 700%. While overall CI staffing has remained relatively steady, IRS has dedicated an additional 30% of personnel resources to Refund Crimes and the FDCs to address refund fraud growth. In addition, CI resources must be divided among a broad range of chronic and emerging compliance issues, including Refund Crimes, to address the overall IRS Enforcement Strategy.

Short of conducting a 100% audit of each refund return, the IRS cannot stop all fraudulent claims for refunds. However, using the tools available to us, we have been successful at stopping a substantial number. We believe we can do better and we continue to look for solutions that will help enhance our efforts to halt refund fraud.

Section 6103 (a) of the Internal Revenue Code prohibits the disclosure of tax information unless that disclosure meets an enumerated exception. None of the exceptions permit the IRS to refer inmate refund fraud information to prison officials for the imposition of administrative sanctions. Thus, while the IRS may possess information related to ongoing criminal activities in prisons, it is unable to alert prison officials of these activities.

Prisoner Information

Each year, the Director, Refund Crimes requests information from the Federal Bureau of Prisons, the 50 states and the District of Columbia for the previous two and one-half year period of prisoners on rolls. That information is entered into a database and uploaded into EFDS to populate the prison file used by CI. While each source supplies us with the same type of data, there is minimal consistency due to differing levels of technology, staffing and equipment. In addition, because the prisons are not mandated to provide verified data this program can be a low priority. We have determined that up to 20% of the prisoner identification information we receive is inaccurate.

National Directory of New Hires (NDNH)—Health and Human Services (HHS) Database

The Department of Health and Human Services (HHS) maintains the National Directory of New Hires (NDNH), which is a database that contains up-to-date new hire, quarterly wage, and unemployment compensation information. The President's fiscal year 2006 Budget contains a legislative proposal to expand the IRS's access to information already being maintained in the NDNH. Funding for, and expanded access to this database would allow CI to continue our efforts in automating the employment verification process, thereby reducing the overall staff hours spent on telephonic and fax verification of wage and employment information eventually determined to be valid. Expanded access to NDNH data for general tax administration purposes would also assist the IRS in data matching, verification of taxpayer claims during return processing, preparation of substitutes for return for non-compliant taxpayers, and identification of levy sources. It is anticipated that access to NDNH information will also enhance taxpayer satisfaction by reducing both the quantity and time valid refunds are either frozen or delayed for verification. This should also reduce the number of taxpayer complaints to the Taxpayer Advocate Service because fewer legitimate refunds will be delayed.

Under current law, can only request this information if EIC is claimed on the tax returns in question. Full access to this database would permit the IRS to better verify all returns, not just EIC returns, and would enable the IRS to more timely and effectively verify W-2 income claimed on questionable returns. It would also assist with revenue protection by providing an automated tool to identify fraudulent returns and to stop the corresponding refunds more quickly. In addition to the legislative proposal for expanded IRS access to the NDNH database, the fiscal year 2006 Budget requests \$10.7 million to be used to curtail fraudulent refund crimes. If approved, this would provide initial funding for the NDNH data base.

Contraband in Prison Facilities

A majority of false prisoner returns in 2004 were filed using paper Forms 1040 and Forms W-2 or Substitute Forms W-2. Some states have already declared tax

materials found in prison cells to be contraband to eliminate these "paper tools" prisoners use to file false income tax returns. IRS encourages prison systems to take these actions. If prisoners have a legitimate need to file a federal income tax return to fulfill their obligation to file, then volunteer income tax assistance could be provided.

IRS forms are also available to download and print off the Internet. Therefore, in addition to encouraging prison systems to declare tax materials in prison cells to be contraband, IRS encourages correctional facilities to block all IRS and online filing websites to prevent prisoners having another way to access tax forms or to file false electronic returns from a prison computer.

Ongoing Efforts

- In processing year 2006, refunds for returns meeting certain questionable criteria will be delayed for two weeks instead of one to allow more time to identify and stop fraudulent refunds from issuing.
- A computer programming change request has been submitted to limit the number of refunds that can be directly deposited into the same bank account.
- We will continue to coordinate the acquisition of accurate prisoner information to maximize the effectiveness of our automated systems for timely identification of questionable prisoner returns.
- We will continue to diligently analyze the characteristics of known false prisoner returns to maximize the effectiveness of our data mining system and to fully utilize the specialized expertise of FDC analysts.
- We will conduct training sessions regarding prisoner schemes with all QRP field coordinators and management to discuss expectations of the fraud program, emerging trends in prisoner refund schemes, and to share best practices for coordinating fraud prevention efforts with correctional facilities.
- Field offices are increasing their coordination efforts with correctional institutions, especially those with emerging or existing refund fraud issues. This coordination will include routine liaison contacts to discuss indications of fraud schemes, possible prevention techniques, and to obtain information pertaining to open criminal investigations involving prisoners.
- We will assure all FDCs have procedures in place to coordinate fraud prevention efforts with the prisons in the states that the FDCs service. This may include the establishment of procedures for the FDCs to review IRS correspondence sent by prisoners.

Closing

Mr. Chairman, we appreciate the opportunity to appear before this distinguished committee to discuss our concerns and our efforts regarding prisoner refund schemes, and we welcome your continued support. I will be happy to answer any questions you and the other committee members may have.

Chairman RAMSTAD. Thank you, Ms. Jardini. Mr. George, please.

STATEMENT OF J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, U.S. DEPARTMENT OF THE TREASURY

Mr. GEORGE. Thank you, Chairman Ramstad, Representative Lewis, Members of the Subcommittee. Thank you for the opportunity to discuss with you the growing problem of tax refund fraud committed by individuals incarcerated in Federal and State prisons. My office is currently reviewing the extent of prisoner fraud and the effectiveness of IRS efforts to combat it. While our work is ongoing, I am able to draw some conclusions at this point. Like all other taxpayers, people who are incarcerated have a legal obligation to pay their taxes and generally have the right to a refund of overpaid taxes. This civic duty and legal right only partially explains why the IRS received approximately 455,000 tax returns from prisoners last year. However, another explanation is that pris-

oners have found ways to exploit weaknesses in the operations of the IRS in order to receive refunds to which they are not entitled. The IRS must close gaps in its policies and procedures to prevent this affront to America's system of tax administration from continuing to expand.

The number of tax fraud schemes perpetrated by those in prison is on the rise. According to the IRS, prisoners filed about 4,300 fraudulent returns in the year 2002. Just 2 years later, that number quadrupled to over 18,000. These figures only account for returns identified by the IRS as fraudulent during the processing of tax returns. With over 1 million returns filed by incarcerated individuals during the past 3 years, there is a great risk that false returns are slipping through the system undetected. It should come as no surprise that a disproportionately higher percentage of fraudulent tax returns are filed by people incarcerated for committing other crimes. Even though prisoner returns account for only a fraction of 1 percent of the overall total number of returns filed, they constitute 15 percent of the fraudulent returns identified by the IRS. Of particular concern is the fact that even when the IRS identifies a tax return as fraudulent, it often still pays a refund on that return. Last year, the IRS paid 36,000 refunds on returns that it determined to be false, 4,100 of which were issued to prisoners. In 2004, returns identified by the IRS as false still had a 31 percent chance of being issued a refund. When you consider that false refunds last year averaged approximately \$3,600 per return, the IRS paid \$131 million in refunds that were identified as fraudulent. Of this amount, \$14.7 million was wrongly paid to those in prison.

With prisoners filing increasing numbers of fraudulent returns, one would expect a strong coordinated response from the IRS to combat these schemes. Unfortunately, until recently, the IRS did not have an overall comprehensive approach to working with Federal and State prison officials to address tax fraud. Instead, the IRS let its 10 Fraud Detection Centers, which are the frontline for detecting fraudulent refund schemes, establish their own policies and procedures for working with prison authorities in their region. These centers coordinated to varying degrees with the prisons in their area. For example, we discovered that 4 of the 10 Fraud Detection Centers have not established any procedures to ensure that mail addressed to the IRS by those in prison is sent directly to the detection centers for screening. As a result, this mail is received by the IRS just like any other tax return, and the IRS must rely on its incomplete and often inaccurate prisoner database to identify the filer as an incarcerated person.

In addition, 8 of the 10 centers do not inform State revenue authorities that a prisoner has been caught filing a fraudulent Federal tax return. Sharing such information would go a long way toward helping to ensure that prisoners caught cheating the Federal Government would not be allowed to cheat State governments with impunity. The IRS Criminal Investigation division has taken some steps to address this matter. Management of the Criminal Investigation division has proposed, as you heard, several legislative and procedural remedies that will improve coordination with Federal and State prison officials. The Criminal Investigation division has also requested computer programming changes to provide more

time to verify tax return information and to pinpoint common characteristics of prisoner refund schemes. If properly implemented, I believe these actions will help reduce prisoner tax refund fraud.

It is important to note that Federal and State prison officials also have a role to play in confronting this problem. They must transmit complete and accurate information on their prisoner population to the IRS for the prisoner database to be effective. We estimate that almost 20 percent of the 2.8 million prisoner records the IRS received last year contained missing, incomplete, or inaccurate information. About 416,000 of these records had invalid or duplicate Social Security numbers. We also identified an additional 134,000 records of prisoners incarcerated between September and December of 2003 that were not included in the 2004 prisoner database. These records were not included because the IRS requires all prisoner information to be submitted by, approximately, August of the preceding year in order to have time to perfect the data and enter it into the prisoner database for use in the upcoming tax year.

If Congress required Federal and State prison officials to provide accurate Social Security numbers and other prisoner information in a consistent format, the IRS could obtain the information much later in the year and include it in the prisoner database for the upcoming tax season. This common sense improvement, Mr. Chairman, to the quality of the information the IRS relies upon would help prevent prisoners from bilking the government out of millions of dollars every year. Mr. Chairman, Members of the Subcommittee, this concludes my prepared remarks. I would be happy to answer any questions you have at the appropriate time.

[The prepared statement of Mr. George follows:]

Statement of The Honorable J. Russell George, Treasury Inspector General for Tax Administration, U.S. Department of the Treasury

Chairman Ramstad, Representative Lewis, and Members of the Subcommittee, thank you for the opportunity to discuss with you today a particularly troublesome tax administration issue: tax refund fraud committed by Federal and State prisoners.

In response to a request by this subcommittee, the Treasury Inspector General for Tax Administration is conducting an audit of the extent of prisoner refund fraud and IRS efforts to combat it. While our work is ongoing, we are able to draw some conclusions at this point and recommend solutions to this growing problem.

Prisoners, like all other taxpayers, have a legal obligation to pay their taxes and have the legal entitlement to a refund of overpaid taxes. This civic duty and legal right only partially explain why the IRS received approximately 455,000 tax returns from prisoners last year. Another explanation for some of these tax returns is that prisoners have found ways to exploit weaknesses in IRS operations in order to receive refunds to which they are not entitled. The IRS must close gaps in its policies and procedures to prevent this affront to the American public from continuing to expand.

Findings on Prisoner Tax Fraud

The number of tax fraud schemes perpetrated by prisoners is on the rise. According to the IRS, prisoners filed approximately 4,300 fraudulent returns in processing year 2002. Two years later, that number quadrupled to over 18,000. It is worth noting that these figures only account for those prisoner returns that the IRS identified as fraudulent during tax return processing. During the past three years, prisoners have filed over 1.3 million returns, so the risk that fraudulent returns are slipping through the system undetected is great.

During the course of our review, we obtained data from the IRS Criminal Investigation Division (CI), the IRS entity responsible for detecting fraudulent returns. The chart on the following page provides statistics on the total number of returns

filed and the refund amounts claimed by all individuals and by prisoners as of April 1, 2005.

Number of Returns	Processing Year (PY) 2004		
	Total	Prisoner	Percent
Total Returns Filed	130,459,600	Not Available ¹	
Refund Returns Filed	106,420,000	455,097	0.43
Returns Reviewed for Potential Fraud	463,222	36,126	7.80
False Refund Returns ²	118,075	18,159	15.38
False Refunds Stopped	81,922	14,033	17.13
False Refunds Issued	36,153	4,126	11.41
Amount of Refunds			
Refunds Requested	\$227,573,835,000	\$758,951,862	0.33
False Refunds	\$440,773,403	\$68,179,070	15.47
False Refunds Stopped	\$309,961,554	\$53,456,963	17.25
False Refunds Issued	\$130,811,849	\$14,722,107	11.25
Average False Refund	\$3,733	\$3,755	
Average False Refund Stopped	\$3,784	\$3,809	
Average False Refund Issued	\$3,618	\$3,568	

¹The IRS cannot identify the total number of prisoner returns filed because the prisoner data file is only matched against refund returns.

²This could include false returns identified during IRS returns processing by the Electronic Fraud Detection System (EFDS), which is an automated system that is used by personnel in Fraud Detection Centers (FDCs) to review potentially fraudulent tax returns. False returns can also be identified with the assistance of prison officials, informants, or other sources.

This chart shows that a disproportionately higher percentage of fraudulent returns are filed by incarcerated individuals. Although prisoner returns account for only .43 percent of all refund returns, they account for over 15 percent of the fraudulent returns identified by the IRS. It is difficult to be surprised that those already imprisoned for committing a crime are more prone than the general public to commit another crime.

Of particular concern is the fact that the IRS frequently pays refunds on returns it has identified as fraudulent. In 2004, the IRS paid 36,000 refunds on returns that it determined to be fraudulent; 4,100 of these refunds were issued to prisoners. Stated another way, if a taxpayer submitted a fraudulent return in 2004—and the IRS determined that return to be fraudulent—that taxpayer still had a 31 percent chance of receiving a refund. Taking into account that the average false refund amount last year was about \$3,600 per return, the IRS paid \$131 million in refunds on returns that it identified as fraudulent. Of this amount, \$14.7 million was erroneously paid to prisoners.

Prisoners who cheat the tax system use a variety of tactics. For example, two Louisiana inmates were sentenced this past March for using the names and Social Security Numbers (SSNs) of other inmates to file fraudulent tax returns. This scheme eventually resulted in their conviction for conspiring to receive \$266,000. In Missouri, two former inmates, while in prison, charged fellow prisoners \$100 each to prepare a false tax return. These returns were then filed by co-conspirators outside of the prison to obtain illegitimate refunds. In April 2005, one was sentenced to one year and nine months in prison; the other was sentenced to two years and six months.

As this last example illustrates, prisoners often use individuals outside of prison to perpetrate fraud. Although the current IRS management information system cannot report specific information on how many prisoners use the names of other individ-

uals to commit fraud, our analysis of 18,343 false refunds involving prisoners for the 2004 processing year:³

- Identified 1,193 schemes claiming \$68.7 million in false refunds; and,
- Included 113,797 returns, not identified as prisoner returns, claiming an additional \$380.8 million in refunds.⁴

These figures demonstrate that prisoners often work collaboratively with persons outside of prison in sophisticated and complex refund fraud schemes, as evidenced by the large number of false returns relating to prisoner schemes but not identified as prisoner returns.

At this point during our review, we can confidently state that prisoner tax fraud is rising, prisoners file a disproportionately higher percentage of fraudulent returns than the general public, the IRS frequently pays refunds on tax returns despite identifying these returns as fraudulent, and the IRS lacks adequate data to ascertain the extent of the prisoner fraud problem.

IRS Process for Detecting Fraudulent Refund Returns

As these findings demonstrate, prisoner tax fraud is a serious problem. To fix this problem, the IRS must improve its ability to identify fraudulent prisoner returns.

Currently, the IRS sends all refund returns through its Electronic Fraud Detection System (EFDS) before issuing a refund. If the filer is a prisoner according to information provided by Federal and State prison officials, the return is flagged with a prisoner indicator. The prisoner indicator is one of several elements used by the EFDS to assign a data mining score to tax returns. The higher the score a return receives, the greater the likelihood that the return is fraudulent.

In general, returns that receive a high data mining score must also request a refund that exceeds a certain threshold established by CI to be selected for further screening. The number of returns selected for screening is then based on the amount of resources available to screen the returns. Thus, detection of false refunds is a function of the data mining score, the threshold established for screening, and the amount of CI resources. These three criteria determine how many false refunds are identified and how many false refunds slip through the processing system undetected.

The IRS' Fraud Detection Centers are the frontline for detecting fraudulent refund schemes. In processing year 2004, these Centers physically screened only 36,126 of the 455,097 prisoner returns filed. As we continue our analysis of this data, we will evaluate how—with improved prisoner data and an invigorated commitment by the IRS to aggressively pursue prisoner refund fraud—the IRS can identify more high-risk prisoner returns.

Reasons False Refunds Were Erroneously Paid

As previously noted, the IRS often issues refunds on tax returns it eventually identifies as fraudulent. The IRS attributed many of its erroneous payments of fraudulent tax refunds to the short time constraints it sets for itself. Part of its customer service philosophy is to pay tax refunds promptly since the vast majority of tax refunds are legitimate. This attempt to pay refunds promptly generally gives the IRS about three weeks to prevent a fraudulent refund from being paid. During that time, CI evaluates the return for indicators of fraud, verifies any wage and withholding information with employers, and scans other potentially fraudulent returns for similar return characteristics, such as a common employer, street address, or bank account. The IRS must work quickly within this time frame to ensure legitimate refunds are paid promptly.

Paper returns in particular present the IRS with unique challenges. The CI function must physically review the return to collect return information that is not entered electronically. CI has even less time on paper returns that request an electronic direct deposit of the refund into a bank account. Prisoners may have already discovered this weakness in the system, since over three-fourths of all fraudulent refund returns filed by prisoners in processing year 2004 were filed by paper instead of electronically.

³In the chart on page two, 18,159 false refunds were reported by CI as of April 1, 2005. Since that date, this number has risen to 18,343 false refunds because false returns are continuously being identified.

⁴Returns not identified as prisoner returns could actually be submitted by prisoners but not identified as prisoners due to the incompleteness of the prisoner file. There could also be situations of prisoners using the Social Security Numbers of non-prisoners. Similarly, there could be only a few returns identified as prisoner returns in a scheme with many other non-prisoner returns.

We obtained a computer extract from CI that described the reason why a refund was not stopped despite being identified as fraudulent. As of May 4, 2005, the record contained 4,261 records of false refunds issued to individuals identified in the 2004 prisoner file. The following table shows the five most common reasons the IRS listed for issuing refunds on false returns.⁵

Reason Refund Not Stopped	Total Refunds Not Stopped
Identified after Cycle Cutoff ⁶	2196
Other ⁷	786
No Selection ⁸	462
Tax Examiner Error ⁹	320
Prior Year Return ¹⁰	128
Total Top Five Reasons	3,892

⁶“Identified after Cycle Cutoff” means that the tax refund, after going through various computer routines at a Submission Processing Center to perfect the data for processing, was issued before certain additional analyses could be completed that would have identified the return as fraudulent.

⁷“Other” is a generic catch-all category that TIGTA believes should be used sparingly, as it may prevent CI from identifying the actual reason a false refund was issued and impair its ability to improve its system. The CI function advised that time constraints during processing may have led to the high use of this category.

⁸“No Selection” is also a generic catch-all category that TIGTA believes should be used sparingly, as it may prevent CI from identifying the actual reason a false refund was issued and impair its ability to improve its system. The CI function advised that time constraints during processing may have led to the high use of this category.

⁹“Tax Examiner Error” means that an IRS employee may have entered or interpreted data incorrectly, or otherwise possessed information to prevent a refund from being issued, but did not stop the refund.

¹⁰“Prior Year Return” includes returns that were processed in the previous year but were detected during the current processing year. Some of these returns are identified at a later date due to an informant or the return being associated with a current year scheme.

The chart above shows that CI chose the category of “Other” or “No Selection” for why refunds were erroneously issued to prisoners in over 29 percent of its cases. While some use of these reasons is legitimate, TIGTA believes they should be used sparingly to enable CI to identify the actual reason why an erroneous refund was issued and enable CI to correct deficiencies in its system.

CI conducted an additional analysis of the reasons tax refunds were not stopped despite being identified as fraudulent, and identified the causes in the chart on the next page.¹¹

Reason Refund Not Stopped	Total Refunds Not Stopped
Return Preparer Case ¹²	156
Prior Year Return ¹³	179
Did Not Meet Data Mining Tolerances ¹⁴	903
Untimely Receipt of Paper Return ¹⁵	694
Direct Deposit Refund of Paper Return ¹⁶	576
Volume of ELF Scanning (resource issue) ¹⁷	428
Human Detection, Data, or Input Errors ¹⁸	1,064

⁵ These five reasons were given as explanations for 91% of the refunds issued to prisoners who submitted fraudulent returns.

¹¹ This analysis is based on 4,000 refunds; therefore, it cannot be precisely compared with the data we obtained on the 4,261 refunds identified in the 2004 prisoner file. Although CI’s additional analysis provides a better indication of the reasons refunds were issued, CI based some of its assumptions on data analysis, not actual reviews of cases.

Reason Refund Not Stopped	Total Refunds Not Stopped
Total Refunds Issued	4,000

¹² CI management explained that refunds are usually not stopped in return preparer cases because the focus of the investigation is the return preparer, not the individual taxpayers who, knowingly or unknowingly, are party to fraud.

¹³ Prior year returns were processed in the prior year but detected during the current processing year.

¹⁴ This category indicates that the return did not meet data mining tolerances when it was processed. However, analysts later determined the return to be false upon reviewing a subsequent return with similar characteristics.

¹⁵ In order to identify the return as fraudulent, analysts must review the paper return; however, analysts did not receive the paper return in time to review it and stop the refund.

¹⁶ Similar to the previous category, analysts must obtain the paper return to determine its legitimacy. In these cases, the refunds were already deposited electronically into bank accounts before the refund could be prevented.

¹⁷ In citing this reason, the CI function assumed that the volume of electronic filing scanning was so large that analysts could not review them in time to determine whether they were false.

¹⁸ This category includes IRS employees who entered or interpreted data incorrectly, or otherwise possessed information to prevent a refund from being issued, but did not stop the refund.

IRS Efforts to Combat Tax Refund Fraud

With the dramatic increase in fraudulent refund returns filed by prisoners, one would expect a strong, coordinated response from the IRS to combat these schemes. However, until recently, the IRS did not have an overall, comprehensive approach to working with Federal and State prisons to address prisoner tax fraud. In some locations, prisoner tax refund fraud was not considered to be a prevalent issue. Further, according to CI management, some U.S. Attorney's offices are reluctant to pursue these investigations, believing it is not a prudent use of resources, particularly if the person is already incarcerated and another conviction would not likely yield additional punitive sanctions.

Instead of an overall, comprehensive approach, our review has discovered that the IRS let its 10 Fraud Detection Centers located around the country establish their own policies and procedures for working with prisons in their region. These Centers coordinated to varying degrees with the prisons in their area. For example, we discovered that 4 of the 10 Fraud Detection Centers have not established any procedures to ensure that prison mail addressed to the IRS is sent directly to these Centers for screening. As a result, this mail is received by the IRS just like any other tax return, and the IRS must rely on its incomplete and inaccurate prisoner database to identify the filer as a prisoner. Furthermore, 8 of the 10 Centers do not share information with State tax revenue authorities that a prisoner has been caught filing a fraudulent Federal tax return. Sharing such information would help ensure that prisoners caught cheating the IRS would not be allowed to cheat the State revenue authorities with impunity.

Despite the IRS' inconsistent and incomplete approach to address prisoner refund fraud, the CI function has conducted criminal investigations on certain prisoners and prisoner refund schemes. Our comparison of the prisoner database to the March 2005 Criminal Investigation Management Information System (CIMIS)¹⁹ shows that the CI function had initiated 312 primary investigations on schemes involving 3,069 prisoner returns. From 75 of these primary investigations, CI has initiated 128 subject investigations. We will continue to analyze this data and provide the results of our analysis in a report to the IRS.

Proposed Actions to Enhance Tax Refund Fraud Detection

The Criminal Investigation Division has taken some steps to address the concerns expressed by this subcommittee and in response to our review. Management of CI has proposed several legislative and procedural remedies that will improve coordination with Federal and State prisons. CI has also requested computer programming changes to provide more time to verify tax return information and to pinpoint common characteristics of prisoner refund schemes. If properly implemented, I believe these actions will strengthen the ability of the IRS to detect and deter prisoner refund fraud.

Need for Accurate and Complete Prisoner Information

I want to emphasize that the IRS is not solely responsible for confronting this problem. Federal and State prison officials should be required to transmit complete and accurate information on the prisoner population to the IRS. The IRS uses the

¹⁹ CIMIS is a database that tracks the status and progress of IRS criminal investigations and the time expended by special agents. It is also used by IRS management as a basis for national and local resource and inventory decisions.

data submitted by Federal and State prison officials in its Electronic Fraud Detection System. As with any computer-based analytical tool, the ability to quickly and accurately identify potential tax refund fraud is only as good as the data used in such analyses, and we have found that much of this data is inaccurate and incomplete.

During the 2004 processing year, we estimate that approximately 550,000, or almost 20 percent, of the 2.8 million prisoner records the IRS received contained incomplete or inaccurate information. These records were inadequate for the following reasons:

- About 255,000 records did not have a valid SSN. For example, over 252,000 of these records listed 000-00-0000 as the SSN.
- About 118,000 records had duplicate SSNs.
- Almost 43,000 records were invalid because they exceed the highest SSN issued by the Social Security Administration.
- About 134,000 records were not in the 2004 prisoner file because the IRS required all prisoner information to be submitted by August 2003, in order to have time to perfect the data and enter it into IRS computer systems. This early deadline excluded individuals incarcerated between September 1, 2003, and December 31, 2003.

The inaccuracies in the prisoner file prevent the IRS from detecting all false refund returns filed by prisoners. The IRS must have a current and accurate prisoner file to alert CI to prisoner-filed returns. An improved prisoner file would also enable the IRS Submission Processing function to stop false prisoner refunds on those returns that do not meet CI criminal investigative criteria before they are issued. If Congress were to require Federal and State prisons to provide accurate Social Security Numbers and other prisoner information in a consistent format, the IRS could obtain the information much later in the year and include it in the prisoner database for the upcoming tax season. This improvement to information quality would help prevent prisoners from bilking the Government out of millions of dollars.

Conclusion

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to discuss this important tax administration issue today. As I stated initially, our review of the extent of prisoner fraud and the effectiveness of IRS efforts to prevent it is still ongoing, but we will continue to work with the IRS and this subcommittee as we near completion. I will be happy to answer any questions you have at the appropriate time.

◆◆◆◆◆

Chairman RAMSTAD. Thank you very much, Mr. Inspector General. The Chair now recognizes Mr. Moriarty, please.

STATEMENT OF JOHN M. MORIARTY, INSPECTOR GENERAL, TEXAS DEPARTMENT OF CRIMINAL JUSTICE, AUSTIN, TEXAS

Mr. MORIARTY. Mr. Chairman and Members of the Committee, thank you very much for the privilege of allowing me to testify here today on the matter of inmate income tax fraud. My office initially became aware of the problem in the mid-eighties, and it has been conducting criminal investigations inside the walls of the Texas prisons since that time. I believe that in order to fully appreciate the challenge that the State systems face, you must understand how large the State penal systems are. Texas has 151,000 inmates incarcerated in 105 secure facilities. New York, Florida, and California are large systems also, with similar size issues. There is a common false belief that when a person is incarcerated, they stop committing crime. Law enforcement investigators who operate inside the State prisons have a very difficult job. Unlike free-world criminal investigators, the prison criminal investigator is dealing daily with hard-core, street-smart convicts in most of his investigations.

The inmate income tax scam is a very simple crime to perpetrate. All that is needed is a few simple items: forms W-2 and 1040, a valid tax ID number, and a prison law library typewriter. The other half of the scam involves the recruitment of someone who can open post office boxes, cash the returns, and divide up the proceeds to the inmate trust fund, and whoever else may be involved in the scheme. The inmates, prior to Texas implementing procedures to combat this problem, referred to what happened next as "it was raining money." In one case we tracked some of the proceeds to an offshore account that we believed contained over \$1 million. Those funds were never recovered. Once the inmates learn the scheme, it is like a virus; it spreads quickly. It is my experience that the money obtained in these schemes is used to further the inmates trafficking in drugs, cell phones, and other contraband within the prison. In several cases we investigated, we found that Members of the correctional staff were corrupted and had been actively participating in the schemes.

When we initially began investigating cases in the mid-eighties, we were surprised to learn how easy it was to defraud both the Federal and State income tax systems. Early on in our investigations we identified as many as 400 inmates in the Texas system actively filing false Federal income tax returns. This information developed by recovering documents from suspects and investigative interviews, not from an IRS source. As you can imagine, this was a massive drain on our investigative resources. We immediately sought help from the IRS in investigating these cases. Our requests for IRS investigative assistance were initially denied. A few years later, approximately 30 inmates were Federally indicted by the IRS, once the magnitude of the problem was realized. It was our understanding that our initial request did not meet the dollar threshold that was in place at that time by the IRS. The second and most important issue was the inability of the IRS to share their information. I do understand that the law does not permit them to disclose taxpayer information to law enforcement. This is a major handicap to the successful investigation of these fraudulent activities.

An example of how it hinders successful investigations occurred this month in an active Federal income tax fraud case that my office initiated. An Office of the Inspector General (OIG) investigator developed an inmate informant that was willing to work with him and the IRS as an informant in an undercover capacity. The informant had been solicited by another inmate to participate in an identity theft and tax fraud scheme. The utilization of inmates as informants has major safety implications that most investigators who operate in the free world do not understand or deal with in their work with informants. That is one reason why a team approach of IRS and prison criminal investigators who are familiar with working informants in correctional settings is imperative to a successful and safe operation. In this case, IRS responded promptly and the investigation began. The case involved co-conspirators in the free world as well as incarcerated offenders. The OIG investigator requested information from the IRS investigation; however, because of both IRS policy and Federal income tax law, the IRS investigation was unable to share that information with the OIG in-

investigator. The IRS investigator was just doing his job as prescribed by law.

It is my understanding that the IRS is currently investigating 250 possible cases of income tax fraud being allegedly perpetrated by inmates in Texas. My office has only one active case opened at this time. It would be beneficial to my office, as well as all taxpayers, to determine whether the inmate suspects are committing these crimes when they are in the custody of the State of Texas, Federal custody, or in county jails. We have implemented steps to mitigate the inmates from continuing this scheme. Inside the prisons of Texas, we have made tax forms a contraband item. Texas prison officials do realize that in certain circumstances inmates have to file returns; however, they can only possess one return form with the permission of the prison administration. The second step that was taken was to supply IRS with the names of all 151,000 persons currently incarcerated in the Texas prison system. This, of course, does allow IRS to flag those returns. The only drawback to this is that if the IRS identifies an inmate that is engaging in this criminal activity, they are prohibited from informing my office. A cooperative effort is necessary to be successful in combating this problem. Mr. Chairman, I thank you again for this opportunity and would be happy to take questions that you might have.

[The prepared statement of Mr. Moriarty follows:]

Statement of John M. Moriarty, Inspector General, Texas Department of Criminal Justice, Austin, Texas

Mr. Chairman and members of the committee, thank you very much for the privilege of allowing me to testify here today on the matter of inmate income tax fraud. My office initially became aware of the problem in the mid eighties and has been conducting criminal investigations inside the walls of Texas State prisons since that time. I believe that in order to fully appreciate the challenge that state systems face, you must understand how large the state penal systems are. Texas has 151,000 inmates incarcerated in 105 secure facilities. New York, Florida, and California are large systems also, with similar size issues. There is a common false belief that when a person is incarcerated they stop committing crime. Law enforcement investigators who operate inside of the state prisons have a very difficult job. Unlike free world criminal investigators, the prison criminal investigator is dealing daily with hard-core, street-smart convicts in most of his investigations.

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We have implemented steps to mitigate the inmates from continuing this scheme. Inside the prisons of Texas we have made tax forms a contraband item. Texas prison officials do realize that in certain circumstances inmates do have to file returns, however they can only possess one return form with the permission of the prison administration. The second step that was taken was to supply IRS with the names of all of 151,000 persons currently incarcerated in the Texas prison system. This of course does allow IRS to flag those returns. The only drawback to this is that if the IRS identifies an inmate that is engaging in this criminal activity they are prohibited from informing my office. A cooperative effort is necessary to be successful in combating this problem.

Mr. Chairman, I thank you again for this opportunity. I would be happy to take any questions you might have.

Chairman RAMSTAD. Thank you, Mr. Moriarty. The Chair now recognizes Mr. Bentley, please, for your testimony.

**STATEMENT OF JEFF BENTLEY, CRIMINAL INVESTIGATOR,
SOUTH CAROLINA DEPARTMENT OF CORRECTIONS, COLUMBIA,
SOUTH CAROLINA**

Mr. BENTLEY. Thank you, Mr. Chairman and Members of the Committee.

Chairman RAMSTAD. Sir, excuse me. I do not think your microphone is on.

Mr. BENTLEY. Thank you, Mr. Chairman and Members of the Committee. Tax fraud by inmates has steadily increased year to year since my first knowledge of the scheme in 2000 until present. The most significant increases were in 2002 and 2005. Our division has received information of tax fraud in varying degrees from every maximum security institution in the State as well as some medium

security facilities. The overall fraud has increased from a few dozen in the early stages to several thousand at present. The scheme has fed on itself in that inmates have realized that they can receive thousands of dollars of "free money" without the threat of being detected for months or even years. By the time the fraud is detected, the money has long been spent. There also is very little threat of prosecution for most inmates. The vast majority of the money received by inmates is used in the drug trade. Illegal drug use is an ongoing problem in prison systems nationwide. Some money is used by simple addicts for their own habits, while some is used to form or expand illegal drug-trafficking rings. Connected with the drug rings are assaults and extortion over territory, or unpaid debts. Unfortunately, some of the money is used to lure employees into illegal activity.

The methods that inmates use have some common characteristics but may vary from group to group. Generally, either one inmate or a small group of inmates will be the head of the ring. They will have one or more inmates who are responsible for actually filling out the returns. The ring leaders will then recruit inmates to participate by offering to file a return in their name. The ring leaders receive varying amounts of the refund, from a few hundred dollars to half the face amount, and the inmate supplying the information receives the remainder of the return. In some cases the inmate providing the information must supply an account number and routing number for direct deposit. In many rings, the ring leaders have the funds deposited directly into accounts they have set up on the outside in order to assure they are paid their cut. Generally, the ring leaders provide the blank forms and the information for a W-2. Once they get those numbers, they may use that information on many returns. Some rings have been found to have a set of figures and information down to the penny where all that is needed is the personal information to be "plugged in" for a completed return. Once the returns are completed, most are smuggled out through visitation or by other means.

Once a refund has been received, cash is smuggled back into the institutions through visitation or laundered through the inmate's family and friends. Often the money never comes back as cash but is used to purchase drugs or other contraband. Cell phones are common contraband because they can be used to operate drug rings inside and outside the institutions without being monitored. Also, inmates can contact each other within an institution where they normally would be segregated as well as contact inmates at other institutions. The potential threat to security is staggering. Ironically, most rings have one inmate who uses a cell phone to contact the IRS to check on the status of returns they have filed. Again, that information is vital so that all parties can assure they are being paid properly. Drug credit is often extended based on that information.

Since tax fraud schemes have flourished, we have implemented measures to help combat the problem as much as possible. Incoming and outgoing mail is now monitored more closely. Telephone calls of potential suspects are monitored. All tax forms and related materials are considered contraband whether blank or filled out. Inmates who have legitimate returns—either through being em-

ployed by Prison Industries, new arrivals, or have income from the outside—are required to contact the administration at their institutions who have designated staff Members to assist in proper filing of their returns. When an inmate is found to be in possession of contraband tax forms, he is charged administratively and may face punishments ranging from administrative segregation, custody reduction, loss of earned good time, and/or loss of privileges. All information gathered is referred to the IRS investigators for possible criminal prosecution. According to information I have received, only a very small number of individuals have been successfully prosecuted.

Although the total costs of inmate tax fraud to our agency will never be completely known, there have been measurable costs. The IRS stated that Evans Correctional Institution had the second largest number of fraudulent returns based on their prisoner database information. This information was not revealed to us until a few days ago. In late 2004, Evans Correctional Institution was placed on total lockdown due to rampant criminal behavior. The amount of contraband drugs, cash, and other contraband such as cell phones being confiscated was phenomenally high, as were allegations of employee misconduct. For a period of approximately 2 months, Evans Correctional Institution staffing was at least doubled, and at times more, in an effort to bring the situation under control. The extra staff was provided by other institutions from throughout the State. When figuring man-hours worked, overtime by detached officers, overtime by the detached officers' home institutions to cover their absence, and transportation for those officers, the financial burden on our agency was catastrophic. Bear in mind that South Carolina operates our Department of Corrections on a budget of approximately \$12,170 per inmate per year. That budget is reported to be the lowest inmate cost in the Nation.

A vast amount of information is given to the IRS every tax year concerning tax fraud. Virtually nothing is given to us in return. Once it is determined that the information has been used to file a tax return, the IRS then deems it to be "confidential taxpayer information." Once the information is turned over, our agency has no idea what happened or if it is, in fact, a fraudulent return. Was a refund issued or was it stopped in time? Where did the money go? Are there going to be prosecutions? Do I need to worry about the informant's safety? The confidentiality rules to normal citizens should not apply to inmates committing fraud.

I am sure the solution to this problem is much more complicated than I understand. Why not have a database of inmate information, updated each month, of all inmates incarcerated in their systems? Have the IRS computers flag all of this information and pull those returns before a refund is issued; examine those returns closely; process the legitimate returns and notify the States of fraudulent ones. In due time, when inmates realize it doesn't work anymore, they will quit trying so often. Of course, some will continue to try. I contend that no threat of prosecution is going to stop the fraud. The system must be fixed where it just will not work. Thank you.

[The prepared statement of Mr. Bentley follows:]

**Statement of Jeff Bentley, Criminal Investigator, South Carolina
Department of Corrections, Columbia, South Carolina**

INTRODUCTION

I am a Criminal Investigator employed by the South Carolina Department of Corrections, Division of Investigations and have been so employed for 13 years. I have a total of over 25 years of Law Enforcement and Investigative experience. It is the primary duty of our division to investigate criminal violations within, and connected to, our prison system.

PRISON TAX FRAUD IS A SIGNIFICANT PROBLEM

Tax fraud by inmates has steadily increased year to year from my first knowledge of the scheme in 2000 until present. The most significant increases were in 2002 and 2005. Our division has received information of tax fraud in varying degrees from every maximum security institution in the state as well as some medium security facilities. The overall fraud has increased from a few dozen in the early stages to several thousand at present. The scheme has fed on itself in that inmates have realized they can receive thousands of dollars of "free money" without the threat of being detected for months or even years. By the time the fraud is detected, the money has long been spent. There also is very little if any threat of prosecution for most inmates. Many have life sentences or very long sentences which makes federal prosecutors reluctant to spend the money to prosecute inmates who very well may not ever be released anyway.

WHERE THE MONEY GOES

The vast majority of the money received by the inmates is used in the drug trade. Illegal drug use is an ongoing problem in prison systems nation wide. Some money is used by simple addicts for their own habits while some is used to form or expand illegal drug trafficking rings. Connected with the drug rings are assaults and extortion over territory or unpaid debts. Unfortunately, some of the money is used to lure employees into illegal activity. While some employees would not be tempted to risk termination and arrest for \$100, they may be swayed if the amount is several times that amount. The drug dealers and tax preparers now have that extra money to spend.

HOW PRISON TAX FRAUD OCCURS

The methods that inmates use have some common characteristics but may vary from group to group. Generally, either one inmate or a small group of inmates will be the head of the ring. They will have one or more inmates who are responsible for actually filling out the returns. The ring leaders will then recruit inmates to participate by offering to file a return in their name. The ring leaders receive varying amounts of the refund (from a few hundred dollars to half the face amount) and the inmate supplying the information receives the remainder of the return. In some cases the inmate providing the information must supply an account number and routing number for direct deposit. In many rings, the ring leaders have the funds deposited directly into accounts they have set up on the outside in order to assure they are paid their cut. Generally, the ring leaders provide the blank forms and information for a W2. They receive state and federal employer identification numbers from sources outside. Once they get those numbers, they may use that information on many returns. Some rings have been found to have a set of figures and information down to the penny where all that is needed is the personal information to be "plugged in" for a completed return. Once the returns are completed, most are smuggled out through visitation or by other means. Institutional mail rooms will not mail sealed envelopes without checking the contents for contraband. It should be noted that although most returns bear inmate information, some are surfacing which contain non-inmate data. Some of those have been traced to inmate families, others are unknown. At least one Jury List has been located which an inmate received through discovery at his trial. The list contained Social Security Numbers which could be used to file false returns. Once a refund has been received, cash is smuggled back in to the institutions through visitation or laundered through the inmate's family and friends. Often, the money never comes back as cash but is used to purchase drugs or other contraband. Cell phones are common contraband because they can be used to operate drug rings inside and outside the institutions without being monitored. Also, inmates can contact each other within an institution where normally they would be segregated as well as contact inmates at other institutions. The potential threat to security is staggering. Ironically most rings have one inmate who uses a cell phone to contact the IRS to check the status of returns they have filed. Again, that information is vital so that all parties can assure they are being paid properly. Drug credit is often extended based on that information.

WHAT WE DO AS AN AGENCY TO COMBAT THE FRAUD

Since the tax fraud schemes have flourished, we have implemented measures to help combat the problem as much as possible. Incoming and out going mail is now monitored more closely. Telephone calls of potential suspects are monitored. All tax forms and related materials are considered contraband whether blank or filled out. Inmates who have legitimate returns (either employed through Prison Industries, new arrivals, or have income on the outside) are required to contact the administration at their institutions who have designated staff members to assist in proper filing of their returns. When an inmate is found to be in possession of contraband tax forms, he is charged administratively and may face punishments ranging from Administrative Segregation (lock-up), custody reduction, loss of earned good time, and/or loss of privileges. All information gathered is referred to the IRS investigators for possible criminal prosecution. According to information I have received, only a very small number of individuals have been successfully prosecuted.

WHAT THE COSTS HAVE BEEN TO OUR AGENCY

Although the total costs of inmate tax fraud to our agency will never be completely known, there have been measurable costs. The Internal Revenue Service stated that Evans Correctional Institution had the second largest number of fraudulent returns based on their prisoner database information. This information was not revealed to us until a few days ago. In late 2004, Evans Correctional Institution was placed on total lockdown due to rampant criminal behavior. The amount of contraband drugs, cash, and other contraband such as cell phones being confiscated was phenomenally high as were allegations of employee misconduct. For a period of approximately two months, Evans CI staffing was at least doubled, and at times more, in an effort to bring the situation under control. The extra staff was provided by other institutions from throughout the state. When figuring man hours worked, overtime by the detached officers, overtime by the detached officers' home institutions to cover their absence, and transportation for those officers, the financial burden on our agency was catastrophic. Bear in mind that South Carolina operates our Department of Corrections on a budget of approximately \$12,170 per inmate, per year. That budget is reported to be the lowest per inmate cost in the nation. For comparison, our neighboring state of Georgia spends approximately \$18,500 per inmate, North Carolina approximately \$23,000 per inmate and the Federal Bureau of Prisons close to \$30,000 per inmate.

WHAT WE NEED TO HELP DETER INMATE TAX FRAUD

The above question can be answered in part by one word . . . "cooperation." A vast amount of information is given to the IRS every tax year concerning inmate tax fraud. Virtually nothing is given to us in return. Once it is determined that the information has been used to file a tax return, the IRS then deems it to be, "confidential taxpayer information." Once the information is turned over, our agency has no idea what happened to it or if it is in fact a fraudulent return. Was a refund issued or was it stopped in time? Where did the money go? Are there going to be prosecutions? Do I need to worry about my informant's safety? The confidentiality rules to normal citizens should not apply to inmates committing fraud. If we could acquire this information, we could punish the responsible inmates administratively whether they are prosecuted criminally or not. That may serve as a deterrent to some extent.

POSSIBLE SOLUTIONS

I'm sure the solution to this problem is much more complicated than I understand. Why not have a database of inmate information, updated by each state monthly, of all inmates incarcerated in their systems? Have the IRS computers flag all of this information and pull those returns BEFORE A REFUND IS ISSUED. Examine those returns closely. Process the legitimate returns and notify the states of the fraudulent ones. In due time, when inmates realize it doesn't work anymore, they will quit trying as often. Of course, some will continue to try. I contend that no amount of threats of prosecution is going to stop the fraud. The system must be fixed where it just won't work.

ACKNOWLEDGEMENT

I must acknowledge Special Agent Russell Sciandra, Jr. of the IRS Columbia, South Carolina Field Office. Several agents have come and gone as a result of promotions and reassignments over the past few years, but Agent Sciandra has been vigilant in his investigation since the beginning. I cannot recall an instance when he has failed to return a telephone call. I feel that he has learned a great deal about inmate tax fraud and probably has the best ideas about how to deal with it. Of

course, he is not at liberty to discuss those ideas due to confidentiality rules within his agency. I, on the other hand, have learned a great deal about bureaucracy.

Chairman RAMSTAD. Thank you, Mr. Bentley. The Chair thanks all four Members of this distinguished panel for your very helpful testimony, and I would like to ask first Ms. Jardini, you testified that the IRS detected over 18,000 cases of fraud by prison inmates last year alone. Is that correct?

Ms. JARDINI. That is correct.

Chairman RAMSTAD. Even when the IRS detects inmate tax refund fraud, I understand that the IRS fails to stop the refund checks from being issued in 20 percent of the cases, only 20 percent of the cases. Why is that?

Ms. JARDINI. Well, let me give you the scope of the problem. We received and reviewed in our Fraud Detection Centers in 2004 106 million refund returns last year. It is a fine balancing act between identifying the fraud quickly and stopping the refund and getting the overwhelming majority of legitimate refunds out to deserving taxpayers expeditiously. We have between 10 days and 3 weeks to get those returns out, and we look at them as quickly as possible within our Fraud Detection System to ensure that we identified bad returns and stop them. Our rate of success, while we would like to improve on 80 percent, is significant given the challenges that we face. Nonetheless, within that process, the fact that we do not have accurate prisoner data is a significant challenge to us in identifying these returns and stopping them more quickly.

Chairman RAMSTAD. Let me ask you, before I get into the confidentiality problem that you face, how many of the 18,000 cases detected last year were prosecuted?

Ms. JARDINI. Well, let me say in terms of prosecution, that is a little bit out of our control. Last year, we referred 500 of these fraudulent refund cases—that is 500, not solely prisoner cases, but 500 investigations—to our field offices for further investigation.

Chairman RAMSTAD. So, 500 of the 18,000 cases?

Ms. JARDINI. Five hundred investigations of the 122,000 overall fraud refund returns were referred to our field offices for prosecution. With respect to the prisoner cases, currently in our field offices we have somewhere between 100 and 200 ongoing investigations, but I have to tell you that these cases are not terribly attractive for criminal prosecution. When you consider—and this is not by any means a criticism of the Department of Justice, but when you consider that their limited resources are deployed to counterterrorism, corporate fraud, narcotics, general crimes and violent crimes, putting a prisoner who is sitting in a South Carolina prison for 25 years in prison, and using prosecutorial resources for that type of investigation, is not at the top of their list of priorities. In an instance like Prisoner Doe, where you had an inmate who was prepared to be released in 2007, who was a serial offender who had a significant amount to lose, that is exactly where our prosecutorial resources and investigative resources should be targeted.

Chairman RAMSTAD. Well, Ms. Jardini, with all respect, I understand priorities as a Member of Congress, but I think every taxpayer I know would be outraged to learn that Inmate Doe grossed \$3.5 million from taxpayer refund fraud. It seems to me that more needs to be done than just to say, "It is not a priority."

Ms. JARDINI. I completely agree with you, sir, and believe me, Mr. Chairman, I am not saying it is not a priority. I am saying it is not a priority necessarily for criminal prosecution. I believe that all of my panel Members would agree that increased criminal prosecution in this arena is not the answer. The answer is allowing us to work more effectively with the States to provide—we have 118,000 pieces of evidence on criminal fraud related to people who are sitting in their prisons, and we cannot tell them about it. They cannot apply administrative remedies, which I believe even Prisoner Doe admitted was more effective than criminal prosecution for long-term hard-timers. So, I am not saying it is not a priority. I am saying criminal prosecution is not necessarily the answer.

Chairman RAMSTAD. Thank you for recognizing my flawed example because my reference to Inmate Doe was a bad one because he was prosecuted. He was one of the few that was prosecuted. In your judgment, would more prosecutions happen if you were able to share information with prison officials at the State level?

Ms. JARDINI. Targeted criminal prosecutions are important in the instance of serial offenders and high-level offenders, particularly those who may be released in the near future. What we would hope to accomplish by being able to share this information with the States would be their ability to impose administrative sanctions within the prison. Frankly, to someone serving life, his cigarettes and his chocolate bar are probably more important to him than whether we tack on an additional 60 months to his sentence.

Chairman RAMSTAD. Under present law, you are totally prohibited from sharing information about those cases with the State prison officials; is that right?

Ms. JARDINI. That is correct.

Chairman RAMSTAD. Let me just ask you, Mr. George, before I recognize the Ranking Member, if you have any comments on that line of questioning.

Mr. GEORGE. Yes, Mr. Chairman. You have competing interests in terms of Internal Revenue Code section 6103. One, you want to assure honest taxpayers that the information they provide to the Federal Government will be protected and not shared in a way that would be adverse to them. At the same time, the situation, as your hearing is describing, shows that indeed there is a need to share information relating to taxpayer malfeasance in many instances. As Nancy Jardini noted, with very limited exceptions, the sharing of information between Federal and State officials is not allowed.

Chairman RAMSTAD. The Chair again thanks you for your responses and does not mean to slight Mr. Moriarty or Mr. Bentley. I am sure other Members of the panel will have questions for you gentlemen. The Chair would now recognize Mr. Lewis.

Mr. LEWIS. Thank you very much, Mr. Chairman, and let me thank each Member of the panel for being here. Ms. Jardini, does the IRS send refund checks directly to the prison address? Or are

most of the refund checks sent outside of the prison? Or would you have that type of information?

Ms. JARDINI. Well, they ask for all of those things. They ask for them to be sent to the prison. They ask for them to be sent to outside addresses. They ask for electronic funds transfers both to prison accounts and outside accounts. So, prisoners are seeking all of that. We do our best not to send them out at all, but with respect, particularly to prison addresses, some States—for example, South Carolina—have been very vigorous in ensuring that we have the appropriate information we need to be able to identify those addresses and stop them.

Mr. LEWIS. Maybe you responded to the Chairman's question and gave an answer, but I want to come back and try to ask the question in a different way, maybe to get a little more information. What type of information is not in the IRS prisoner database which would help identify bogus returns filed by inmates?

Ms. JARDINI. There are two big problems with the prisoner database. One is that prisoners, as they enter the facility, do not always give accurate data to the prison officials, and because the prison officials do not have an immediate need to verify it, we frequently get that inaccurate data. That is one problem. The second problem is that each of the 50 States maintains these systems and this identifying data in a different format, so it is extremely time-intensive for us in our Fraud Detection Centers to get this information and then put it into a format that is readable and searchable in our own system. As a consequence, it is the disparate forms of data that we receive as well as the inaccurate data that we receive that presents the biggest impediments with relation to the prisoner file.

Mr. LEWIS. In recent years, has there been a conference, maybe just some meeting, a regional meeting, a nationwide meeting, between officials of the IRS and State correction and Federal correction officials?

Ms. JARDINI. Yes, sir. We met regularly with individual State prison authorities in the first half of this year, particularly in the States where we are seeing dramatic growth in the fraud: Florida, South Carolina, Texas, California. We meet, both our National officials as well as our local officials, including our special agents in charge who are investigative leaders out in the field, as well as the regional leaders of these Fraud Detection Centers, are meeting with their local prison authorities to attempt to address some of the problems we are having.

Mr. LEWIS. Thank you. Mr. George, how does tax fraud by prisoners compare to other types of tax fraud?

Mr. GEORGE. In terms of the comparison, it occurs both within the prison system and outside of it. Mr. Lewis, we are in the process now of doing an extensive review of this situation, and in order to give a more complete response, if I may supply that answer for the record.

[The information is being retained in the Committee files.]

Mr. LEWIS. I would appreciate it. Is there a big difference or some greater scheme on the part of the people in prison than those on the part of people on the outside engaging in tax fraud? Tax refund fraud, I should say.

Mr. GEORGE. I may defer to Nancy Jardini, but allow me to say at this time that there is no question that many individuals who are incarcerated have a lot of free time on their hands.

Mr. LEWIS. Well, do you think that people that are incarcerated, maybe they learned a great deal of this before they got into prison, that this was a way of life before they got in?

Mr. GEORGE. I would agree with that. Yes, Mr. Lewis.

Mr. LEWIS. So, it is not something that they discovered when they became an inmate.

Mr. GEORGE. Again, we are surmising this, but I would agree with that statement.

Ms. JARDINI. Mr. Lewis, let me tell you that in answer to your first question, of the overall refund population of all citizens who file for refunds, less than 1 percent of those are fraudulent. Of the prisoner refund population, more than 4 percent of those are fraudulent. So, we are seeing a greater rate of fraud in the prisoner population, which is why we devoted additional resources to it. Obviously, the problem with prisoners is, first of all, we are dealing with a population with a proclivity to lie and steal, frankly. These are criminals at base. Second, they are housed in a manner that fosters communication about fraud schemes in a much more effective way because of their close quarters and their constant contact. We believe those are the primary reasons why we are seeing such growth in that area.

Mr. LEWIS. I notice my time is up, but, Mr. Chairman, if you will bear with me for a moment, Mr. George, what are the States nationwide doing to deal with prisoner tax fraud?

Mr. GEORGE. First and foremost, again, if you send a message that people can bilk the system, you are sending a message that no one wants spread throughout the Nation: that you can get away with cheating on your taxes. Then the message essentially is sent that people who are already incarcerated for committing other crimes are able to do this seemingly with impunity. That is just the wrong message that we would want to send, Mr. Lewis.

Mr. LEWIS. It sounded like John Doe got 5 years for Federal tax fraud added to his existing 5-year sentence for Federal bank fraud, but to be served concurrently. How did the Federal tax charge hurt him? It seems like he got no additional jail time. Am I misreading that somewhere?

Mr. GEORGE. I do not believe you are misreading it. Keep in mind, as Ms. Jardini noted, out of 14,000 fraudulent prison returns stopped last year, thus far this year only 312 have had investigations initiated. Those numbers are a drop in a bucket. More needs to be done. As Ms. Jardini noted, this is not a high priority for U.S. attorneys because of the lack of resources. Again, as was noted earlier, for people who are spending life in jail, how much more can you do to them? It is a complicated issue, and that is why, again, I want to thank Mr. Ramstad and all the Members of this Committee. This is an extraordinarily important issue that you raised that has prompted my office to engage in this extensive investigation. I understand this has prompted the Criminal Investigations division to do more extensive research, and we hope to have a substantive report back to you shortly.

Mr. LEWIS. Thank you.

Thank you very much, Mr. Chairman.

Chairman RAMSTAD. Thank you, Mr. Lewis. The Chair recognizes Mr. Beauprez.

Mr. BEAUPREZ. I thank the Chairman and I thank our panel for being with us today. You are right, Mr. George; it is, I think, obviously an important issue, one I hope we can get our arms around soon. Just to frame the magnitude of the challenge in front of us, let me go down some of the numbers track again, if I might, Ms. Jardini. About 130 million tax returns are filed; is that correct?

Ms. JARDINI. That is correct, in 2004.

Mr. BEAUPREZ. How many refunds, again?

Ms. JARDINI. One hundred and six million refunds returns.

Mr. BEAUPREZ. Almost all of them.

Ms. JARDINI. Yes.

Mr. BEAUPREZ. Eighty-some percent, I guess that is. A massive number, which speaks to the complexity, I guess, of the Tax Code. Another issue that is in front of this Committee is addressing tax simplification, so we give you an enormous problem. You have already identified repeatedly—actually, both you and Mr. George—the need for administrative reform. I am going to guess—and I want to get your answer on the record—that that is both tax fraud that is committed within the prison system, which is what we are talking about today, but also outside the prison system. I think, Mr. George, you commented on that a moment ago. Do you care to comment more extensively?

Mr. GEORGE. I would say your statement is correct, and I would also note that, again, many of the people who are involved who are incarcerated in these types of schemes do have the assistance of people outside of the prison system, as was noted by the testimony of Mr. Doe on the earlier panel.

Mr. BEAUPREZ. That is exactly where I would like to go with Mr. Moriarty and Mr. Bentley. If we went at this problem from purely a prosecutorial point of view, after it happens we go chase it—which I am not suggesting we should not do that. Obviously we need to, but if we did a really good job of that, might we just push the problem outside the prison walls to their co-conspirators?

Mr. BENTLEY. Prosecution is a threat to the co-conspirators on the outside because they cannot get the money back at the institutions. It has to go somewhere outside, and somebody outside has to set that up.

Mr. BEAUPREZ. So, they essentially always have a partner.

Mr. BENTLEY. Certainly.

Mr. MORIARTY. Yes.

Mr. BEAUPREZ. So, in kind of following this circle, at least in my mind, it goes right back to preemption, making it more and more and more difficult to perpetrate in the first place. Inmate Doe said rather emphatically that he thought the form, the ease of the form—and we all like that. I guess we have been operating on the honor system. Is there merit in what he suggested in somehow creating a unique form? I used to be in the banking business, and one of the safeguards we had in counterfeiting our currency was that it is pretty unique. So he mentioned a unique form. He also mentioned the possibility in this day and age we live in of biometrics

somehow being entered into it. What is the feasibility, in your opinion, of going down that path?

Mr. GEORGE. Mr. Beauprez, when I first heard Mr. Doe mention that, it struck a chord. I thought, wow, that is a rather interesting concept, but having a brief discussion with my staff here, and then thinking about it further, you again have competing interests here. What the Federal Government is attempting to do is enhance voluntary compliance. In order to do so, you want to make it as easy as possible for people to report the amount of tax that is owed. When you try to balance that with making it harder to duplicate these devices, again, these are competing interests that this body needs to consider.

Mr. BEAUPREZ. So, one of the other big suggestions, I think, that has come out of this collective dialog today is the sharing of information. I want to close in the little time I have with both of the gentlemen from Texas and South Carolina and ask you: Would the States embrace that, or are the States, if there was more of a standardized policy, procedure, almost a mandated—I will use that word—cooperative relationship, again, with the Federal Government and the States, would they see that as helpful in this situation? Or perhaps is it yet another Federal mandate that you say here comes another burden on us?

Mr. MORIARTY. I definitely think the sharing of that information is critical to us putting a stop in it. Again, to back up what was said earlier about the prosecution remedies, that is not going to solve the problem itself. If we know that an inmate is committing that fraud, we can look at him—in the eighties when we first started looking at this, we would go into cells and find 100 W-2 forms and 10forties. We do not allow them to copy anything. We do not allow them to possess the forms now. I think we have got a big responsibility to enforce that on our end, but in order to keep a closer eye, like in the cases reported that there are 250 cases they are looking at in Texas, I surely would like to know who those 250 are out of the 151,000 that I am responsible for.

Mr. BEAUPREZ. That seems rather obvious. Mr. Bentley, if I could beg some forgiveness from the Chairman, would you care to add to that?

Mr. BENTLEY. Yes, sir. We would be able to handle a lot more of the investigations and be able to punish the inmates administratively, even if they are not going to be prosecuted criminally, we would be able to do something to them. It has got to be where it is not appealing anymore. Right now, as Mr. Moriarty said, it is raining money. The problem that it causes is the crimes that stem from free money, and that is the point, as I look at it, and as far as the agency is concerned, the overall amount of money it is costing us. We have to do something to make it where it is not as appealing.

Mr. BEAUPREZ. I thank all four of you. Thank you for being here.

Chairman RAMSTAD. Thank you, Mr. Beauprez. The Chair now recognizes Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. Ms. Jardini, does the IRS send refund checks to prison addresses?

Ms. JARDINI. We try not to. As I mentioned earlier, we get information on the prison addresses, and we do our best to prevent those from going out. There are instances, if we have inaccurate information from the prison or if that return was not filed with a prisoner identification number, a prisoner's Social Security Number, it might not hit our data mining tolerances which would alert us to look at that address. So, anything is possible and it might get out, but we do our best not to.

Mr. POMEROY. I am no computer whiz, but it would seem like you could capture the addresses of prisons—it is not an infinite list—put it into the system and have a trigger if there is an envelope going to that address.

Ms. JARDINI. Right. Well, our EFDS does recognize addresses of prisons and other suspicious characteristics. However, it might not reach—that would not necessarily in and of itself identify it as a fraudulent return.

Mr. POMEROY. It will not in and of itself end it, but that is kind of a basic first thing we ought to be able to do that is going to at least make it more difficult for the defrauders.

Ms. JARDINI. That is right. Well, I do not know what percentage of these are being mailed out in paper to prisons, frankly. In fact, as Prisoner Doe pointed out, sending the money actually to the prison or the prison account is actually becoming less common.

Mr. POMEROY. Right, but we could make it way less common if we just electronically dealt with it.

Ms. JARDINI. Right.

Mr. POMEROY. It seems to me, again, that kind of—is that going on?

Ms. JARDINI. We are engaging in efforts to be more accurate in that area.

Mr. POMEROY. Now, it would seem to me, I hear you saying about being able to share information. Certainly, at least as a prima facie matter, it would seem like there ought to be an ability to share information much more fully when you detect fraudulent activity of an incarcerated individual. I do not know entirely the legal matters of, well, is this an allegation or is it a proven Federal violation. I have not sorted all that out yet, but it would seem to me, if nothing else, you could provide bulk data, non-specific, non-identifying data so you can tell Mr. Bentley he has got 250 defrauders in there and tell Mr. Moriarty that he has got 1,000 scattered around the system, here, there, and everywhere. That would certainly allow them to deal with the shift and say keep your eyes and ears open, we know there is a scam going on here. Is that kind of bulk data provided?

Ms. JARDINI. We are able to provide information about broad trends or schemes that we are seeing for future fraud detection. Investigator Bentley has met with our supervisory special agent and other Members of our leadership team in South Carolina in an effort to deal with some of these issues. As they pointed out, they do have data, and we are happy to provide whatever general data we can provide to them. It is not specific enough for them to go in and take the action that would create a deterrent impact.

Mr. POMEROY. No, it does not direct you to a particular person in a particular cell, but it certainly is, I think, useful. I would find

it useful if you would provide information to our Subcommittee; identified by State, identified by facility to the extent that that data is captured the violations.

Ms. JARDINI. We would be happy to. Absolutely.

[The information is being retained in the Committee files.]

Mr. POMEROY. Mr. Chairman, possibly that information could be put up on the website that prison officials could access around the country, give at least a notion in terms of what is going on.

Chairman RAMSTAD. I think that is an excellent idea.

Mr. POMEROY. Do you have action on identity theft or use of fraudulent Social Security numbers so that when you do identify a fraudulent filing, that also contains a fraudulent Social Security number, that action is followed up?

Ms. JARDINI. Yes, absolutely. Our Fraud Detection Centers are developing those schemes. That is their primary role, to find identity theft, false refunds, schemes involving tax professionals, which is one of our top enforcement priorities of the Service, identify those, identify the scope of that scheme, and ensure that that is referred out to a field office for investigation.

Mr. POMEROY. Great. You mentioned in your testimony the matter of funding. Do you know what the Service requested by way of funding for this anti-fraud activity? What was contained in the budget and what is contained on the floor? I know that the President's request was not funded, and I believe we come in about \$500 million below the President's request. That is a lot of anti-fraud policing. Do you know specifically how the anti-fraud function was funded?

Ms. JARDINI. Yes, I do. In the 2006 budget request the President requested \$10.7 million for this effort, and as I mentioned previously, it was the only 2006 budget initiative for the overall Criminal Investigation effort at the IRS, which is—we have the responsibility to engage in criminal investigations to create voluntary compliance across the entire spectrum of hundreds of thousands and millions of taxpayers. I understand that on the floor that was not funded, but I am not 100 percent certain of that, that \$10.7 million figure.

Mr. POMEROY. Right, it was not fully funded. I think it was funded to the tune of \$10.2 billion for a \$500 million shortfall.

Ms. JARDINI. I am sorry. I am referencing strictly the initiative that would impact this subject matter. In terms of the overall IRS enforcement budget, I cannot speak to that. That would have to do with revenue officers and revenue agents who were doing other—

Mr. POMEROY. It is your belief—and I know my time is up here. It is your tentative understanding that the requested funding by the administration to tackle this fraudulent activity was not funded in the House appropriations activity?

Ms. JARDINI. That is my tentative understanding.

Mr. POMEROY. Mr. Chairman, I would ask that our—I think we can develop that information in-house. Let's research that one so that we have a clear idea on the appropriation response to this problem. I yield back, Mr. Chairman.

Chairman RAMSTAD. Thank you, Mr. Pomeroy. Before adjourning the hearing, the Chair would just have a couple follow-up questions. First, to Mr. George, your testimony described “an incon-

sistent and incomplete approach” by the IRS in addressing this problem. Is the inconsistent and incomplete approach, as you call it, by the IRS because there are not adequate procedures in place to share information with prison officials at the State level relating to fraud by inmates? Or do taxpayer confidentiality laws effectively block the IRS from sharing this information?

Mr. GEORGE. Both of those are factors, and I would add a third: the requirement for expedited refunds for people who submit tax returns. You have that factor. In order to comply with that requirement, the Criminal Investigation unit has a very limited amount of time in which to determine whether or not this is a fraudulent return. So, yes, Mr. Chairman, both of the factors you mentioned as well as the third that I noted.

Chairman RAMSTAD. Again, in summary fashion, I would ask is it a reasonable restatement of present law that the IRS cannot tell States about cases in which their inmates are caught committing taxpayer fraud because of taxpayer confidentiality laws?

Mr. GEORGE. That is my understanding, Mr. Chairman.

Chairman RAMSTAD. There is an absolute prohibition?

Mr. GEORGE. There is an exception: If the underlying crime that the IRS would like to communicate to the State relates to tax crimes of some sort, in that instance it is my understanding that communications are permitted. Otherwise, there is a very strict—6103 is something that within the Treasury Inspector General for Tax Administration we are very concerned about. There are just strong prohibitions about communicating certain information.

Chairman RAMSTAD. Would you recommend to the Congress, to the Subcommittee, changing that statute?

Mr. GEORGE. I would in this circumstance, yes.

Chairman RAMSTAD. I would like to ask the same questions of Ms. Jardini.

Ms. JARDINI. I would defer to the Treasury Department in terms of making legislative requests of this Committee, sir. However, I would point out that—

Chairman RAMSTAD. You view present law as an absolute prohibition, absolute ban on information sharing with State prison officials when discovering tax fraud.

Ms. JARDINI. Under these circumstances, yes, there are enumerated exceptions, one of which is, for example, if an inmate is on parole for a tax offense or the underlying offense is a tax offense, we are able to communicate about that because of the underlying tax offense that exists. If we are in an ongoing investigation, I can communicate, for example, with Investigator Bentley, an investigator from IRS, only to the extent that I get the information that I need. I cannot tell him anything about my case. So, yes, there is an absolute ban, and the exceptions do not cover it.

Chairman RAMSTAD. Well, Mr. George, if you or one of your colleagues at Treasury could provide recommendations to the Subcommittee as to changes in the statute, that would be greatly appreciated.

Mr. GEORGE. Will do. Thank you.

[The information was not received at the time of printing.]

Chairman RAMSTAD. To address this problem, we obviously need to look at that. Let me just finally ask you a question, Mr.

Moriarty. You state in your testimony that in the mid-eighties you identified over 400 inmates within the Texas system filing fraudulent tax returns. What happened when you took this evidence to the IRS?

Mr. MORIARTY. Initially, we did not get a response for quite a while. We ended up—I guess they indicted 30 Federally; 30 inmates were prosecuted behind that. We also utilized the Postal Inspection Service to deal with some of those issues.

Chairman RAMSTAD. So, 30 of 400 alleged cases, alleged incidents were prosecuted?

Mr. MORIARTY. Yes, sir.

Chairman RAMSTAD. Let me ask you finally—and I mean finally this time—Mr. Bentley, what has been your experience? I know from your testimony that your investigation record is very impressive also. You uncovered a number of cases of inmate fraud, tax fraud. What was your experience with your fraud cases when you turned them over to IRS field offices?

Mr. BENTLEY. Well, I originally got onto the scheme in 2000. I got no response from the IRS in 2000. I did talk to a nice lady at the Fraud Detection Center in Atlanta, and when I confiscated the check, I would void the check and mail it back to her. She was very grateful, and I did the same thing in 2001. Whenever I get a check, I void the check and send it back to them. Finally, in 2002—and it just so happened that in 2002 the scheme really blossomed. That is when the word started getting out, and like I said, it started feeding on itself. That is also when somebody built a fire under the IRS, and we got them involved in it. It has worked out very well since then.

Chairman RAMSTAD. So, the IRS has been responsive since then?

Mr. BENTLEY. Yes, sir. We do not have enough IRS investigators. Usually no more than maybe two, three are available to work the prison cases. One in particular, Russell Shandra that I have been working with since 2002, has been very vigilant. He works with me very well. He always returns my calls. I have turned over just reams of information to him, but I only know of six prosecutions, six successful prosecutions from 2002 to the present out of I don't know how many hundreds of cases. Like I say, I know it is not—they may not think it is good resources to prosecute inmates, but out of several hundred cases, I know that there are people on the outside that could be prosecuted. Of the six prosecutions, five of them were inmates.

Chairman RAMSTAD. Mr. Bentley, are you referring to last year when I understand the IRS identified 287 cases of inmate tax fraud in your State? You are referring to last year, to calendar year 2004?

Mr. BENTLEY. Yes, sir. I am not sure because I found two different figures. One says something close to 800. One says 260-something, 270-something.

Chairman RAMSTAD. Our figures show 287 cases of inmate tax fraud in South Carolina last year identified by the IRS.

Mr. BENTLEY. Okay, and that is the point that I do not understand, whether if that is the cases that they identified through catching them through computer flags and what-not, or if that is

cases overall, counting the ones that we found the old-fashioned way, by searches and what-not. Apparently that is the ones they caught, not counting the ones that we picked up through—

Chairman RAMSTAD. Well, I think it is clear to all Members of the panel that we need to make some changes. Certainly this is a widespread problem and deserves more attention. The taxpayers of America are just not going to stand for this kind of inmate fraud. So, I am looking forward to your continuing input, working together in a collaborative way, and I want to thank all four Members of this panel. You have been very, very helpful and have enlightened the Subcommittee. I want to thank all three panels for the testimony here today. I also want to thank the audience, the press, and staff for being so cooperative in terms of honoring the anonymity of Inmate Doe. Finally, I want to thank our outstanding Subcommittee staff who worked very hard to put this Subcommittee hearing together. I want to thank David Kass, chief counsel of the Subcommittee; Payson Peabody; Pete Davila; and Scott Berman. Thank you all for your hard work. If there is no further business before the Subcommittee, this hearing is adjourned.

[Whereupon, at 4:11 p.m., the hearing was adjourned.]

[Questions submitted from Chairman Ramstad to Nancy J. Jardini and her responses follow:]

Question: What can be done to improve the quality and timeliness of prisoner information provided to the IRS by states and the Federal Bureau of Prisons?

Answer: Requested data elements and format are included with the information request provided to the states, District of Columbia and the Federal Bureau of Prisons (BOP) each year. IRS will continue to work with these parties to improve the timeliness and accuracy of this information to allow IRS to develop programs to utilize the data during the process of returns. Question: Is the IRS doing anything to improve its success rate in stopping refund checks when it determines that fraud has taken place?

Question: Is the IRS doing anything to improve its success rate in stopping refund checks when it determines that fraud has taken place?

Answer: Yes, the analytical data mining process analyzes over 100 million refund returns each year and is constantly being improved and enhanced. We continue to diligently examine the characteristics of known false prisoner returns to maximize the effectiveness of our data mining system and to fully utilize the specialized expertise of Fraud Detection Center (FDC) analysts. These efforts have contributed to a steady increase in the IRS's success rate in stopping fraudulent refunds.

Beginning in processing year 2006, refunds for returns meeting certain questionable criteria will be delayed for an additional week. This will allow extra time to identify and stop fraudulent refunds from being issued.

A computer programming change will be instituted for filing season 2006 that will limit the number of refunds that can be directly deposited into the same bank account.

A computer programming change to flip all prisoner direct deposit refunds to paper checks is being implemented for 2006. This will provide additional time to verify the validity of the refund return.

Question: The testimony of inmate John Doe raises some serious questions about the responsiveness of the IRS to information provided to state prisons. Is the IRS trying to develop comprehensive procedures to make sure that its field personnel work closely with correctional officials to receive information about fraud cases uncovered by prison officials?

Answer: Yes, the IRS currently conducts training sessions with all field coordinators and management to discuss expectations of the fraud program, how schemes are being perpetrated and to share best practices for coordinating fraud prevention efforts with correctional facilities.

Field offices are increasing their coordination efforts with correctional institutions, especially those with emerging or existing refund fraud issues. This coordination will include routine liaison contacts to discuss indications of fraud schemes, possible

prevention techniques, and to obtain information pertaining to criminal investigations involving prisoners.

FDC's will have procedures in place to coordinate fraud prevention efforts with the prisons in the states that the FDCs service. This will include the establishment of procedures for the FDCs to review IRS correspondence sent by prisoners.

Question: For years, it was Federal law that prisoners should not receive SSI disability benefits while behind bars, for obvious reasons. Yet Federal law left it to the inmate to report their change of address to the jail so their benefits would be cut off. Not surprisingly, few did. There is now a procedure in place between the Social Security Administration and prisons to encourage prisons to provide up-to-date information to SSA about prison inmates, so that their SSI benefits can be cut off. Under this program, prisons receive a portion of any money that is saved by cutting off an inmate's benefits. Could something similar be considered to encourage prisons to provide information to the IRS to help it catch tax fraud?

Answer: The possibility could be explored. The above addresses benefits that an individual is entitled to receive unless they reside in a jail, prison or certain other public institution. These benefits are disrupted until after their incarceration. This would result in a savings of benefits being distributed if the prisons notify SSA about the inmate's incarceration.

Refund fraud is theft of Treasury funds. The inmate is not entitled to any portion of the fraudulent claimed refund.

The incentive for prisons would be to restrict these illegal gained funds from coming into the prison which are then utilized by prisoners to engage in illegal activities within the prison for example purchase of drugs.

Question: How many cases of prisoner refund fraud were referred by the IRS to the U.S. Justice Department for prosecution each year between 2000 and 2005?

Answer: QRP Subject Criminal Investigations Recommended for Prosecution—FY2000, 95; FY2001, 113; FY2002, 144; FY2003, 223; FY2004, 232; FY2005*, 147

Please note that the above figures are QRP. We do not keep statistics on prisoner prosecution recommendations.

Question: Does the IRS maintain a database of prison addresses? Does the IRS have a policy against sending refund checks directly to prisons?

Answer: Yes, the IRS maintains a database of prison addresses. The IRS requests every possible address including P.O. Boxes and the physical address for each of the institution's facilities. Generally only one or two addresses are provided for each institution although the current database can hold up to six addresses for each institution.

The IRS does not have a policy against sending refund checks directly to prisons. Some prisoners have a legitimate need to file tax returns, including filing a joint return with their spouse or filing a return including income earned while not incarcerated for that particular year.

[Submissions for the record follow:]

Statement of Cynthia Payne, Largo, Florida

Back in September, 2003 my husband made me aware of the tax fraud. My husband was approached by an inmate by the name of Michael Shores. Mr. Shores made this "scam" sound very pleasing. "FREE MONEY FROM THE IRS", who wouldn't want it? However, my husband and I CHOSE to turn the information over to the officials. We knew we couldn't go directly to the prison with the information because too many of their staff were involved. I contacted Gov. Bush's office and was told to contact the IRS fraud hotline. When I contacted the hotline I was told there was nothing they could do. So I went to the Hardee County States Attorney's Office and spoke to Gary Ellis. After speaking with Mr. Ellis, he contacted Sgt. Jimmy Harrison of the Hardee County Sheriff's Office and set up a meeting for Sgt. Harrison and myself for later that day. Mr. Ellis and Sgt. Harrison were both at awe with the information they heard. I was continuously asked "but, how?". Sgt. Harrison then put me in contact with William Miles of the FDLE. I spoke to Mr. Miles and he agreed to go to Hardee C.I. and speak with my husband. Mr. Miles and his partner, whom I know only as Lisa, went and spoke to my husband. They agreed to try and get some fake bank accounts set up so that the FDLE could intercept the money. The next thing I know, I was being contacted by an IRS Special Agent. Spe-

* As of 5/31/05

cial Agent, Tammy Tomlins. Special Agent Tomlins made an appointment with me to meet at my home. On our first meeting I explained the issue to her. She stated that she knew it was going on but never had an inside contact until us (my husband and I). And now that she had an inside contact it would give her the break she needed. I also explained to Special Agent Tomlins as to what we expected out of us giving her the information. 1) That a request for a sentence modification for my husband be put in and 2) A monetary reward for me. Special Agent Tomlins did explain that she could not make any promises about anything until she new the information was good, and that she would be able to get indictments on those involved. Special Agent Tomlins made several trips to my home over the next few weeks. She did telephone recordings of conversations I had with Michael Shores' girlfriend and outside contact, Tammy Hutchinson. At one point Tammy Hutchinson became so afraid that she was being watched by the Special Agents that she left her home in the Orlando area and went to Hollywood, Florida. While she was gone she called and asked me if I would please go to her home in Orlando and check her mail, in fear that the Special Agent's would try and intercept her mail. I called Special Agent Tomlins and asked her if it was ok for me to do this and she said she could not give me permission to get anyone's mail. However if Tammy Hutchinson gave me permission to get her mail then by all means I was allowed to. And so I did. Once I retrieved Tammy Hutchinson's mail I called her and she asked me to open 2 letters and read them to her. One was from a man giving her names and social security numbers to use for tax refunds, the other was from a man wanting to know where his refund money was. I made copies of these letters and turned them over to Special Agent Tomlins. Then I sent the originals back to Tammy Hutchinson once she was back home. In December 2003 Special Agent Tomlins wrote a letter to Michael Marr, the prosecuting attorney in Pinellas County, for my husbands case requesting a sentence reduction. Michael Marr refused the request for sentence reduction. Special Agent Tomlins then sent me the paper work to fill out for a monetary reward. She asked that I sign and date these blank forms and send them back to her. I did so. A few weeks later I received the same papers from a Tennessee Office requesting that I complete the paper work and send it back to them. I called Special Agent Tomlins and she ordered me to send them back to her. At this point I became very suspicious as to what was going on. I filled out the papers and sent them back to Tennessee as told by the Tennessee Office. I have sent the same paper work to Tennessee 3 times and they have still not been received. I was also informed by B. Manuel at the Tennessee Office that the requested reward from Special Agent Tomlins was for a percentage of what she actually recovered from me, not from my information. Our information led to the IRS intercepting \$53 million dollars in tax fraud money as well as indictments. Therefor as I see it, I am due a monetary reward of \$7,950,000. That would be 15% of what the IRS recovered from our information. I have also expressed my fear with this whole situation. My name and my husband's name are being made public whether we wanted them to or not! This whole thing has caused severe concern about our safety. The monetary reward would be used to relocate my family for our safety. I have spoken with several Congressmen's Office's and my husband has sent letters to them as well. With our testimonies are we going to be safe? We don't know and noone is able to assure us of our safety. I go to bed every night praying for my families safety. This is a very big issue. Alot of people have had their financial lives messed up because of our information to the IRS Special Agent. But that is obviously obvious with the IRS intercepting \$53 million dollars in fraudulent tax monies. We just want we feel we deserve for our part in this investigation. We have both agreed to testify if necessary.

Statement of Kenneth Ryesky, Esq., East Northport, New York

I. INTRODUCTION:

Per Hearing Advisory OV-3 (22 June 2005), the Subcommittee on Oversight, in conjunction with its Hearing that was held on 29 June 2005, has solicited additional written comments from the public in connection with its examination of tax fraud committed by prison inmates. This Commentary is accordingly submitted.

II. COMMENTATOR'S BACKGROUND & CONTACT INFORMATION:

Background: The Commentator, Kenneth H. Ryesky, Esq., is a member of the Bars of New York, New Jersey and Pennsylvania, and is an Adjunct Assistant Professor, Department of Accounting and Information Systems, Queens College of the

City University of New York. Prior to entering into the private practice of law, Mr. Ryesky served as an Attorney with the Internal Revenue Service ("IRS"), Manhattan District. In addition to his law degree, Mr. Ryesky holds BBA and MBA degrees in Management. He has authored several scholarly articles on taxation.

Disclaimer: This Commentary reflects the Commentator's personal views, is not written or submitted on behalf of any other person or entity, and does not necessarily represent the official position of any person, entity, organization or institution with which the Commentator is or has been associated, employed or retained.

III. COMMENTS ON THE ISSUES:

A. THE AMERICAN SYSTEM OF VOLUNTARY TAX COMPLIANCE:

The American taxation system is based upon voluntary tax compliance, which means "that taxpayers are expected to comply with the law without being compelled to do so by action of a federal agent; it does not mean that the taxpayer is free to decide whether or not to comply with the law." IRS, Pub. 1273, Guide to the Internal Revenue Service for Congressional Staff at 4 (January 1996) (SuDoc No. T22.44/2: 1273/996). The voluntary compliance system is based upon self-assessment in the initial filing of the return and calculation of the tax, and the payment of the proper amount of the tax. For all of its displeasures, the American system of voluntary compliance has long proven to be a far, far preferable alternative to the more coercive taxation systems employed in other societies of now and yore. Nothing less than American freedom is at stake when Congress legislates its policies for tax administration.

Certain conditions must be met in order for the American voluntary compliance system to continue to work. For one thing, it is necessary that individual members of the public perceive and believe that others are also complying with the laws.

Moreover, it has long been recognized that the taxpayers need definitive and meaningful assurances that information they voluntarily disclose on their filed tax returns will be safeguarded in confidence by the taxation authority; else they will harbor justifiable misgivings about the practical wisdom of frankly and forthrightly complying with the tax laws, to the detriment of the public weal and fisc. *Boske v. Comingore*, 177 U.S. 459, 469—470 (1900); *United States v. Tucker*, 316 F. Supp. 822, 825 (Dist. Conn. 1970); *FSLIC v. Krueger*, 55 F.R.D. 512, 514 (N.D. Ill. 1972); *Webb v. Standard Oil Co. of California*, 49 Cal. 2d 509, 513, 319 P.2d 621, 624 (1957); *New York State Dept. of Taxation & Finance v. New York State Dept. of Law*, 44 N.Y.2d 575, 378 N.E.2d 110, 406 N.Y.S.2d 747 (N.Y. 1978).

The confidentiality privilege, however, is not absolute. There are situations where the public good is best served by the selective, measured and controlled disclosure of various items of information reported on tax returns. Exceptions to the general policy against disclosure of tax returns and tax return information must be made very cautiously, upon good cause clearly articulated, with due regard of the need to balance the often conflicting public policies involved, and in a manner which protects, to the greatest extent practicable under the circumstances, the taxpaying public's expectations of confidentiality. Moreover, the public must know that such a meaningful deliberative process necessarily accompanies, and is a prerequisite for, those instances when tax return information is so disclosed. Any disclosures so made must inspire and facilitate public confidence in the tax administration process.

In balancing the strong public policy of tax return confidentiality against what often is an equally strong imperative to promote law enforcement, sound governmental function and/or societal order, a disclosure mechanism has been established by Congress in I.R.C. § 6103. The provision necessarily is one of the more complex and verbose sections of the Internal Revenue Code, and has commensurately spawned a large, complex and robust body of rules, regulations and case law. I.R.C. § 6103 is a key provision in facilitating tax administration, and while revisions and updates to the statute are periodically warranted, any tinkering with the statute or its implementing regulations must be done with great care in order to maintain the delicate balance between taxpayer confidentiality and need for disclosure.

B. THE PROBLEMS IN THE PRISONS:

As amply recounted in further detail by the various witnesses at the Subcommittee's 29 June 2005 hearing, the tax fraud practiced by prison inmates is a growing problem that has collective effects well beyond the plundering of the United States Treasury. The often significant sums of ill-gotten money placed at the disposal of prison inmates and others fuel the engines of contraband, chaos and corruption, thereby threatening order within the prison walls, and endangering the health, safety and lives of inmates and law-abiding citizens alike.

Moreover, the public morale also suffers when the citizenry sees the inability of their officials and civil servants to deal with the problem, as the dollars flow into

the pockets of dishonest criminals who hold the law in contempt. Neither law enforcement nor tax administration can benefit from such public perceptions.

That which nominally is a tax administration issue has thus expanded well beyond the purview of managing the public fisc, becoming a general law enforcement problem that tax administration alone cannot adequately address without the aid and cooperation of other competent law enforcement professionals. As Messrs. Davis, Keller and Feeney indicated in their respective testimony at the hearing, the law enforcement officials in their State of Florida (which has no state personal income tax) seek closer cooperation with the IRS in addressing the problem. Mr. Moriarity from the Texas Department of Criminal Justice has expressed similar sentiment (Texas likewise has no state personal income tax). The problem clearly cannot be successfully addressed as merely one of tax administration.

C. APPROACHES TO ADDRESSING THE PROBLEM:

There is no single simple solution to the prison inmate tax fraud problem. In addition to the legislative approaches, which clearly are necessary, there also need to be administrative efforts on the part of the cognizant Federal and state agencies.

Every bureaucracy has its own culture. Given the aforesaid need for confidentiality of tax returns, the IRS has developed an internal culture in which secrecy plays a significant role. Though this culture of secrecy generally serves the IRS quite well, it has been known to have dysfunctional aspects when one organizational element within the IRS must cooperate with another. *See, e.g., Berg v. Commissioner*, T.C. Memo 1993-77. Therefore, IRS cooperation with other agencies, as is clearly needed with respect to the instant problem, can only come about through the strong guidance and direction from the upper echelons of the IRS and the Treasury (though the respective testimonies of Ms. Jardini and Mr. George indicate that such guidance and direction would likely be forthcoming from the IRS and Treasury leadership if the appropriate statutory framework were in place).

Administrative matters aside, there are several approaches and issues that the Congress ought to explore. These include, but are not necessarily limited to, the following:

1. *Amendments to I.R.C. § 6103*: Ms. Jardini and Mr. Moriarity each indicated that the current statutory limitations on the IRS's disclosure of information have impeded cooperation between the IRS and the prison and law enforcement bureaucracies. I.R.C. § 6103(d) is couched in terms of limitation to tax enforcement and administration, and provides precious little leeway for disclosure in matters of more general law enforcement. The traditional and typical application of I.R.C. § 6103(d) would be to provide Federal Income Tax information to the states so that they can enforce their own personal income taxes. This would hardly apply to states such as Florida or Texas, which, as previously mentioned, have no personal income tax to enforce. Accordingly, the statutory provision that enables Federal-State coordination of analogous tax administration is often useless for coordinating efforts to control prisoner tax fraud.

Expanding the scope of I.R.C. § 6103 to encompass investigation and prosecution of tax fraud by incarcerated prisoners and their confederates is a *sine qua non* to addressing the problem. As emphasized by Mr. Moriarity, the statutes need to permit not only disclosure of information, but also ongoing feedback, so as to facilitate "a team approach of IRS and criminal investigators who are familiar with working informants in a correctional setting."

Indeed, in a non-taxation context, Congress enacted analogous legislation in 1992 when it amended the Child Abuse Prevention and Treatment Act to remove restrictions upon information sharing between and among cognizant state and Federal agencies, *see* Congressional Findings, P.L. 102-586, § 9(a), 106 Stat. 5036 (4 November 1992).

[N.B. This Commentator has already written on the problems and confusion caused whenever Congress redesignates paragraphs and subparagraphs of the Internal Revenue Code, Kenneth H. Ryesky, *Tax Simplification: So Necessary and So Elusive*, 2 *Pierce L. Rev.* 93, 100-101 (2004), and beseeches the Congress to avoid the renumbering of existing paragraphs and subparagraphs at such time as it amends I.R.C. § 6103 (or any other statutory section).]

2. *Enhanced penalties for tax fraud by or in connection with incarcerated prisoners*: Certain classes of illegal activities are already subject to enhanced penalties.

7 U.S.C. § 111 (b) provides an enhanced penalty for using a deadly weapon in assaulting, resisting, or impeding certain Federal officers or employees. 15 U.S.C. § 6823 prescribes an enhanced penalty for fraudulently accessing customer information of financial institutions when the harm exceeds a certain dollar threshold. Under 31 U.S.C. § 5324, an enhanced penalty is warranted for illegally structured money transactions when the amount involved exceeds certain dollar thresholds.

Moreover, Congress has previously made findings that certain species of criminal activity are especially detrimental to the public welfare and interest. These include, for example, harassment, intimidation and violence committed against foreign officials, P. L. 92-539, § 2, 86 Stat. 1070 (24 October 1972).

Given the disproportionately broad sweep of the harm inflicted on account of tax fraud by incarcerated prisoners and their confederates, there is ample precedent for the Congress to make specific findings that prisoner tax fraud is an especially nefarious offense for which enhanced penalties are appropriate. Such penalty enhancements can be prescribed by statute, and/or provided for in the United States Sentencing Guidelines [this Commentary will not expound upon the issues induced by the United States Supreme Court decision in *Booker v. United States*, — U.S. —, 125 S. Ct. 738; 160 L. Ed. 2d 621 (2005) regarding the Sentencing Guidelines.].

The sweep of the enhanced penalties should encompass not only the prison inmates, but also others who cash checks or otherwise participate in the schemes of the inmates to defraud the Treasury. Many prison tax fraud schemes involve outside confederates, *see, e.g. United States v. Hicks*, 1999 U.S. App. LEXIS 32146 (10th Cir. 1999). Moreover, prison corrections officers and other prison employees are often complicit in diverse illegal schemes of prisoners, including the smuggling of contraband, *see, e.g. United States v. Torok*, 2000 U.S. Dist. LEXIS 11054 (E.D.Pa. 2000), *Martinez v. Cardwell*, 542 P.2d 1133 (Ariz.App. 1975); *State v. Guerra*, 151 Conn. 159, 195 A.2d 50; (Conn. 1963); *Commonwealth v. Booth*, 291 Pa Super 278, 435 A.2d 1220 (1981); *People v. Strickland*, 342 Ill. App. 3d 566; 795 N.E.2d 793 (2003), *appeal denied* 206 Ill. 2d 641; 806 N.E.2d 1071 (2003); *see also Dept. of Corrections v. Drayton*, New York City Office of Admin. Trials & Hrgs. Index No. OATH 1901/99 (28 December 1999) (reciting testimony that civilian employees constitute approximately 40% of the arrests for drug smuggling in NYC prisons.).

3. *Diminished right of tax return confidentiality*: As discussed above, the confidentiality of tax returns and the information contained therein is a vital component of the American system of voluntary tax compliance. Nevertheless, certain individuals under certain circumstances may have a diminished right to and expectation of confidentiality with respect to their tax returns.

Those who in bad faith abuse the legal system can lose the full enjoyment of their legal rights. For example, criminal defendants who willfully misbehave at their trials and/or fail to appear may waive their right to trial, *see, e.g. Taylor v. United States*, 414 U.S. 17 (1973); *People v. Aiken*, 45 N.Y.2d 394, 397, 380 N.E.2d 272, 274, 408 N.Y.S.2d 444 (1978). Those who abuse the legal system with repeated and vexatious litigation may have limits placed upon their access to the courts, *see, e.g., Demos v. Storrie*, 507 U.S. 290 (1993); *In re Sassower*, 20 F.3d 42 (2d Cir. 1994); *Feathers v. Chevron, USA, Inc.*, 141 F.3d 264 (6th Cir. 1998); *Duffy v. Holt-Harris*, 260 A.D.2d 595, 687 N.Y.S.2d 265 (2d Dept. 1999), *appeal dismissed* 93 N.Y.2d 1033, 719 N.E.2d 915, 697 N.Y.S.2d 555; 1999 (1999). This includes prison inmates who have engaged in vexatious litigation in the courts, *Richard v. Cuyahoga County Bd. of Commissioners*, 654 N.E.2d 443 (Ohio App. 1995), *appeal dismissed*, 89 Ohio St. 3d 205, 2000 Ohio 135, 729 N.E.2d 755 (2000).

Moreover, incarcerated inmates who have abused the system have been properly curtailed in their access to prison law libraries, *Wilkie v. State*, 644 P.2d 508 (Nev. 1982).

The American system is based upon self-assessment in the initial and timely filing of the tax return by the honest taxpayer. *Estate of Ashman v. Commissioner*, 231 F.3d 541, 544 (9th Cir. 2000); *Cowarde v. Commissioner*, T.C. Memo 1976-246. There is no reason why individuals who, in bad faith, abuse and flout the system must be given its full benefits of confidentiality to the detriment of law enforcement and public order interests. This is especially so in the cases of incarcerated inmates.

IV. CONCLUSION:

As made plain by the testimony at the Subcommittee's 29 June 2005 hearing, the problem of prisoners defrauding the tax system is serious and growing. Reining in the problem will take the joint and concerted efforts of the IRS and other Federal and State law enforcement agencies, who must be given the statutory authority to meaningfully cooperate, interact and share relevant information and feedback.

Any intrusions by the prison authorities into the affairs of inmates must be engineered and calculated to facilitate good faith compliance with the tax laws, and not to impede such compliance, *cf. Curry v. Commissioner*, 571 F.2d 1306 (4th Cir. 1978).

In making adjustments to I.R.C. § 6103 to facilitate the sharing of information, appropriate regard must be given to the privacy rights of prison inmates who, not-

withstanding their status as such, do in fact make good faith efforts to comply with the tax laws.

The IRS and the various state and Federal law enforcement authorities all desire to cooperate with one another to address the problem of tax fraud by prison inmates, but are currently hobbled by the restrictive statutory provisions now in force. They, along with the law-abiding citizenry of America, await Congressional action, so that the statutes that currently impede law enforcement can facilitate sound enforcement practices.

Regardless of any administrative measures that need to be taken by the IRS and the other relevant agencies, prompt action by Congress is necessary before any meaningful strategies to address the matter can be implemented.

