WRITTEN TESTIMONY OF
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BEFORE THE
HOUSE COMMITTEE ON THE JUDICIARY
SUBCOMMITEE ON CRIME, TERRORISM AND HOMELAND SECURITY
ON IDENTITY THEFT AND RETURN PREPARER FRAUD
JUNE 28, 2012

INTRODUCTION AND SUMMARY

Chairman Sensenbrenner, Ranking Member Scott and Members of the Subcommittee on Crime, Terrorism and Homeland Security, my name is Rebecca Sparkman and I am the director of operations, policy and support in the Criminal Investigation division of the Internal Revenue Service. I appreciate the opportunity to testify on the important issue of identity theft and also discuss actions that the IRS is taking in the area of return preparer fraud.

Over the past few years, the IRS has seen a significant increase in refund fraud schemes in general and schemes involving identity theft in particular. Identity theft and the harm that it inflicts on innocent taxpayers is a problem that we take very seriously. The IRS has a comprehensive identity theft strategy comprised of a two-pronged effort, focusing both on fraud prevention and victim assistance.

Identity theft is the use of another person's identifying information stolen from a wide variety of places and through a wide variety of means. With respect to the IRS, identity theft manifests itself in several ways. First, it is used to defraud the government of funds through the filing of fraudulent refund claims. Second, in many instances it victimizes an innocent taxpayer by impeding his or her ability to get a refund from us. Fraudulent filings may also cause us to initiate an adverse enforcement action against the innocent taxpayer. There are also many instances where the identity stolen is not of an active filer so there is less immediate impact on the real taxpayer. In these instances, the identity may belong to a deceased individual or an individual without a filing requirement. In this category, the IRS is faced with fraud, but there is less immediacy in the need to assist the correct taxpayer because there is no return filed or other IRS activity underway with respect to that individual.

At the start let me say quite plainly that the IRS is confronted with the same challenges as every major financial institution in preventing and detecting identity theft. The IRS cannot stop all identity theft. However, we have improved and we are committed to continuing to improve our programs. We can and will continue to work to prevent the issuance of fraudulent refunds and we can and will continue to work with innocent taxpayers to clear their accounts and/or get them their money faster in a courteous and professional manner.

The IRS has also taken actions to be better prepared in both fraud prevention and victim assistance. On the prevention side, this means implementing new processes for handling returns, new filters to detect fraud, new initiatives to partner with stakeholders and a continued commitment to investigate the criminals who perpetrate these crimes. The work being done by our Criminal Investigation division is a key component of our overall refund fraud and identity theft strategy. We have been increasing our investigations of fraud related to identity theft, and expanding our efforts to work with other divisions within the IRS as well as with local law enforcement and other federal agencies in this area.

As for victim assistance, the IRS is working to speed up case resolution, provide more training for our employees who assist victims of identity theft, and step up outreach to and education of taxpayers so they can prevent and resolve tax-related identity theft issues quickly.

The improvements that the IRS is making would not be possible without the additional resources that we have directed toward these programs. We have substantially increased our resources devoted to both prevention and assistance. Even in a declining budget environment, we are hiring and training additional staff to address the growing challenge of identity theft.

Fighting identity theft will be an ongoing battle for the IRS and one where we cannot afford to let up. The identity theft landscape is constantly changing, as identity thieves continue to create new ways of stealing personal information and using it for their gain. We at the IRS must continually review our processes and policies to ensure that we are doing everything possible to minimize the incidence of identity theft, to help those who find themselves victimized by it, and to investigate those who are committing the crimes.

And yet there is a delicate balance here. We cannot manually inspect 100 million refunds to ensure all are correct – nor is there any justification for doing so. That is neither practical nor in keeping with Congressional intent. The IRS has a dual mission when it comes to refunds, particularly when they are generated in whole or in part by tax credits. Refundable and other tax credits are provided to achieve important policy goals, such as relieving poverty, encouraging work, or boosting the economy. The IRS must deliver refunds in the intended time frame, while ensuring that appropriate controls are in place to minimize errors and fraud. We must balance the need to make payments in a timely manner with the need to ensure that claims are proper and taxpayer rights are protected.

So it is indeed a difficult challenge to strike the right balance. The IRS' approach to tackling identity theft must be multi-faceted. We are improving processes to prevent fraudulent filings from being processed as well as identifying promoters and other schemes. We are aggressively pursuing perpetrators of tax fraud from identity theft to bring them to justice. We are also taking actions to improve handling of identity theft cases and to better serve taxpayers whose identities have been stolen for tax purposes. All of this is being done within a very difficult budget environment. The Administration's FY 2013 Budget request includes important funding for additional enforcement initiatives focused specifically on addressing refund fraud, including identity theft. Let me walk through our work to prevent the fraud up front and how we hope to improve our service to the victims of identity theft.

PREVENTING FRAUD FROM IDENTITY THEFT

Tax filings can be affected by identity theft in various ways. For example, an identity thief steals a legitimate taxpayer's personal information in order to file a fake tax return and attempt to obtain a fraudulent refund. There are also instances where the identity stolen is of an individual who is deceased or has no filing requirement.

Overall, IRS identified and prevented the issuance of over $14 billion in fraudulent refunds in 2011. Identity theft is a subset of this overall refund fraud. From 2008 through May 2012, the IRS identified approximately 550,000 taxpayers who have been affected by identity theft. The IRS is committed to improving its approaches to blocking these fraudulent refund claims. To that end, we strive to process returns in such a way that potentially false returns are screened out at the earliest possible stage.

Catching the Refund at the Door -- Enhanced Return Processing

Identity theft is a key focus of an IRS program launched in 2011. Under this program, the following improvements have been made:

- Various new identity theft screening filters are in place to improve our ability to spot false returns before they are processed and before a refund is issued. For example, new filters were designed and launched that flag returns if certain changes in taxpayer circumstances are detected.

- Moreover, this filing season, we have expanded our work on several fraud filters which catch not only identity but other fraud. In this area we have already stopped more returns this filing season than we stopped all last calendar year.

- We have implemented new procedures for handling returns that we suspect were filed by identity thieves. Once a return has been flagged, we will correspond with the sender before continuing to process the return.

- We are issuing special identification numbers (Identity Protection Personal Identification Numbers or IP PINs) to taxpayers whose identities are known to have been stolen, to facilitate the filing of their returns and prevent others from utilizing their identities.

- We have accelerated the availability of information returns in order to identify mismatches earlier, further enhancing our ability to spot fraudulent tax returns before they are processed.

- We are leveraging mechanisms to stop the growing trend of fraudulent tax returns being filed under deceased taxpayers' identities. We are also working with the Social Security Administration in order to more timely utilize the information SSA makes available to us.

- We have also developed procedures for handling lists of taxpayers' personal information that law enforcement officials discover in the course of investigating identity theft schemes or other criminal activity. This is extremely valuable data that can be used to flag taxpayer accounts and help us block returns filed by identity thieves who have used the personal information of these taxpayers. The Criminal Investigation (CI) division will utilize this data to ensure linkages are identified between criminal schemes and will also ensure that the information is shared appropriately to affect victim account adjustment and protection activity.

- We expanded the use of our list of prisoners to better utilize the list to stop problematic returns. We have collaborated with the Bureau of Prisons for many years to help identify Federal prisoners who may be engaged in tax fraud, and we received additional help under the United States-Korea Free Trade Agreement Implementation Act passed in 2011 that requires federal and state prisons to provide information on the current prison population. Unfortunately, the authority allowing us to share return information with prisons expired at the end of 2011. The Administration's FY 2013 Budget proposal would reinstate the provision authorizing the IRS to disclose return information with respect to individuals incarcerated in Federal or State prisons whom the IRS determines may have filed or facilitated the filing of a false return.

- We are also collaborating with software developers, banks, and other industries to determine how we can better partner to prevent theft.

Stopping It Before It Starts -- Criminal Investigation Work

The investigative work done by the Criminal Investigation (CI) division is a major component of our efforts to combat tax-related identity theft. CI investigates and detects tax fraud and other financial fraud, including fraud related to identity theft, and coordinates with other IRS divisions to ensure that false refunds involving identity theft are addressed quickly and that the IRS accounts of identity theft victims are marked to help prevent any future problems. CI recommends prosecution of refund fraud cases, including cases involving identity theft, to the Department of Justice.

CI works closely with the other IRS divisions to improve processes and procedures related to identity theft refund fraud prevention. For example, CI provides regular updates to the IRS' Wage and Investment division regarding emerging scheme trends so that processes and filters can be enhanced to prevent refund loss. These collaborative efforts have been instrumental in helping the IRS stop more refund fraud.

In response to this growing threat to tax administration, CI established the Identity Theft Clearinghouse (ITC), a specialized unit that became operational in January, to work on identity theft leads. The ITC receives all refund fraud-related identity theft leads from IRS-CI field offices. The ITC's primary responsibility is to develop and refer identity theft schemes to the field offices, facilitate discussions between field offices with multi-jurisdictional issues, and provide support to on-going criminal investigations involving identity theft.

CI investigations of tax fraud related to identity theft have increased significantly over the past two fiscal years and the trend is continuing in FY 2012. In FY 2011, 276 investigations were initiated, compared with 224 in FY 2010 and 187 in FY 2009. CI recommended 218 cases for prosecution in 2011, compared with 147 the previous year and 91 in 2009. Indictments in identity-theft related cases totaled 165 in 2011, with 80 individuals' sentenced and average time to be served at 44 months. This compares with 94 indictments, 45 individuals sentenced and a 41 month average sentence in 2010.

Already in FY 2012 – through May 31 – CI has initiated 576 cases and recommended 342 cases for prosecution. Indictments in identity theft cases total 316, with 107 individuals sentenced and average time to be served at 49 months. The direct investigative time spent on identity theft in FY 2011 was 225,000 hours and CI is on pace to double this in FY 2012, as we have already reached 304,053 hours through the end of May.

The IRS conducted a coordinated identity theft enforcement sweep during the week of January 23. It was an outstanding success. Working with the Justice Department's Tax Division and local U.S. Attorneys' offices, the nationwide effort targeted 105 people in 23 states. The coast-to-coast effort that took place included indictments, arrests and the execution of search warrants involving the potential theft of thousands of identities. In all, 939 criminal charges are included in the 69 indictments and information related to identity theft.

In addition, in that same week IRS auditors and investigators conducted extensive compliance visits to check cashing businesses in nine locations across the country. The approximately 150 visits occurred to help ensure that these check-cashing facilities aren't facilitating refund fraud and identity theft.

These efforts send an unmistakable message to anyone considering participating in a refund fraud scheme that we are aggressively pursuing cases across the nation with the Justice Department, and people will be going to jail.

Identity theft has been designated as a priority in 2012. We also will be piloting dedicated cross-functional teams with other parts of the IRS that will allow us to create a greater footprint in one or more geographic locales.

Local law enforcement and other federal agencies play a critical role in combating identity theft. Thus, an important part of our effort to stop identity thieves involves partnering with law enforcement agencies. We collaborate on these issues and this effort will only increase going forward**.** It should be noted that the existing rules for protecting taxpayer privacy often make it difficult for us to provide easy access to information that may be useful for local law enforcement. Despite these difficulties, in April 2012 we implemented a new law enforcement assistance pilot program designed to aid law enforcement in obtaining tax return data vital to their local efforts in investigating and prosecuting specific cases of identity theft. The IRS will carefully assess the results and performance of the pilot program before deciding on how to proceed.

We will continue to search for other innovative ways to partner with local law enforcement. Furthermore, CI special agents throughout the country participate in at least 35 task forces and working groups with federal, state, and local law enforcement that target tax-related identity theft crimes. CI personnel also coordinate with these agencies in an effort to ensure that victims are aware of the steps they need to take to resolve their affected tax accounts. We will continue to develop new partnerships with law enforcement agencies.

Some of the recent successes involving identity theft include the following cases in which sentences were handed down in just the last couple of months:

- A Florida man was sentenced to 22 years in prison and ordered to pay approximately $3.5 million in restitution on charges that included wire fraud, making false statements against the U.S. and aggravated identity theft. This individual and four accomplices perpetrated a scheme in which taxpayers' identities were stolen from state databases and used to file hundreds of fraudulent tax returns. The four accomplices were sentenced to a total of 117 months in prison and ordered to pay restitution totaling more than $1.6 million.

- A South Carolina woman was sentenced to 75 months in prison and ordered to pay more than $289,000 in restitution after she was convicted on 18 counts of filing false, fictitious and fraudulent claims, and one count of aggravated identity theft. This individual, who operated a tax preparation service out of her home, filed false returns using identifying information stolen from a former employer, relatives, prisoners and others. She attempted to obtain approximately $437,000 in bogus refunds.

- Three Texas women were sentenced to a total of more than 70 months in prison for conspiring over a four-year period to steal taxpayer identities and use the information to file false returns and attempt to claim approximately $200,000 in bogus refunds. These individuals used their positions in Texas state agencies governing child support and low-income housing to steal the identities of agency clients and claim the false refunds.

- Two Alabama women were sentenced to 115 months in prison apiece and ordered to pay more than $500,000 in restitution for their involvement in a conspiracy to file false returns using stolen identities. One of these individuals operated a tax return preparation business and prepared the fraudulent returns, while the other gathered stolen personal information and also recruited customers, coaching them to provide false information in order to obtain the bogus refunds.

- Five Georgia men were sentenced to a total of more than 280 months in prison and ordered to pay a total of more than $3 million in restitution for participating in a scheme in which they prepared more than 150 false tax returns using the identifying information of prison inmates or persons living in their community.

- A Tennessee woman was sentenced to 168 months in prison, three years of supervised release, and ordered to pay more than $200,000 in restitution on charges that included aggravated identity theft, smuggling and mail fraud. This individual and an accomplice filed more than 500 false returns over a three-year period using stolen identifying information, and she attempted to collect more than $2 million in bogus refunds.

- A Montana man was sentenced to 33 months in prison, three years of supervised release, and ordered to pay more than $85,000 in restitution on charges of submitting false claims and identity theft. Over a two-year period this individual filed numerous fraudulent returns using information of deceased taxpayers, and he attempted to obtain more than $125,000 in bogus refunds.

ASSISTING TAXPAYERS VICTIMIZED BY IDENTITY THEFT

Along with prevention, the other key component of the IRS' efforts to combat identity theft involves providing assistance to taxpayers whose personal information has been stolen and used by a perpetrator in the tax filing process. This situation is complicated by the fact that identity theft victims' data has already been compromised outside the filing process by the time we detect and stop perpetrators from using their information.

We have taken a number of actions, including those described below, to restore the account of the innocent taxpayer. We have had difficulty keeping pace with the number of cases, but we are determined to bring to bear new resources and streamline existing processes. Thus, we have committed additional resources, even in this tough budget climate, trained our people, developed an IP PIN program, and expanded our external outreach.

Improving our work on Identity Theft Cases

We realize the importance of resolving cases involving identity theft quickly and efficiently so that identity theft victims who are owed their refunds can receive them as soon as possible and so that we do not take adverse enforcement actions against such individuals.

We are implementing new procedures designed to resolve cases faster and minimize the disruption to innocent taxpayers. For example, every division within the IRS is making identity theft cases a higher priority in their work. As indicated above, new procedures and additional staff are being put in place to work cases faster where a refund has been stopped. We increased staffing last year and this year, and have plans to dedicate additional resources following the filing season.

Along with taking steps toward faster resolution of identity theft cases, we are continuously improving the way we track and report on the status of all identity theft cases. We believe these improvements will reduce the time to work identity theft cases in coming filing seasons so that honest taxpayers will receive their refunds sooner. Additionally, better tracking and reporting means that we can spot – and correct – any flaws in the system more quickly.

Identity Protection PIN Program

In addition to helping identity theft victims clear up problems with their IRS accounts, the IRS works proactively to help ensure that these taxpayers do not encounter delays in processing their future returns. In 2011, we launched a pilot program for Identity Protection Personal Identification Numbers (IP PIN). The IP PIN is a unique identifier that establishes that a particular taxpayer is the rightful filer of the return. The pilot program showed us that this is a very promising innovation that can dramatically reduce the number of taxpayers caught up in delays. Therefore, we have expanded the program for the new filing season, and have issued IP PINs to approximately 250,000 taxpayers who have suffered identity theft in the past.

Employee Training

The IRS runs one of the largest phone centers in the world, and is dedicated to providing quality service with a high degree of accuracy to every taxpayer who contacts us. Having said that, we realize that taxpayers who call the IRS with identity theft problems present unique challenges to our telephone representatives and we need to ensure taxpayers receive quality, courteous service.

Therefore, last year we conducted a thorough review of the training we provide our employees to make sure that they have the tools and sensitivity they need to respond in an appropriate manner to those who have been victimized by identity theft. As a result, we updated the training course for our telephone assistors to maintain the proper level of sensitivity when dealing with identity theft victims, and we broadened the scope of our training to include other IRS employees who interact with identity theft victims or work identity theft cases.

Taxpayer Outreach and Education

The IRS continues to undertake outreach initiatives to provide taxpayers, return preparers and other stakeholders with the information they need to prevent tax-related identity theft and, when identity theft does occur, to resolve issues as quickly and efficiently as possible. Recent actions in this area include the following: overhauling the identity protection training provided to tax practitioners at last year's Tax Forums; updating the identity theft information provided in the IRS.gov website; and continuing a far-reaching communications effort through traditional and social media in both English and Spanish, including producing new identity theft awareness videos for the IRS YouTube channel in English, Spanish and American Sign Language, and making identity theft the top item in this year's "Dirty Dozen" annual list of taxpayer scams.

RETURN PREPARER FRAUD

I would like to turn now to the subject of tax return preparer fraud and describe for you the efforts that the IRS has made in recent years to ensure a basic competency level for tax return preparers and focus our enforcement efforts on rooting out unscrupulous preparers.

The role of third party assistance in tax preparation in the U.S. has become increasingly important, particularly in light of growing tax law complexity and growing confusion among taxpayers over how to comply with the tax code and meet their responsibilities. Today, most federal individual income tax returns are prepared by paid return preparers or by taxpayers using consumer tax preparation software.

The IRS' Return Preparer Initiative

As the importance of the practitioner's role in tax preparation increased, the IRS determined that it was necessary to address a gap in oversight involving return preparers who are not certified public accountants (CPAs), enrolled agents (EAs) or attorneys. Our research suggested that our tax system and a large number of taxpayers may be poorly served by some return preparers who engage in fraud.

It was within this context that the IRS in 2009 launched its Return Preparer Initiative, one of the most important initiatives that the IRS has taken in recent years. This initiative has strengthened partnerships with tax practitioners who are already regulated and tested, while at the same time ensuring that all return preparers are serving taxpayers well.

In 2009, the IRS launched a six-month review focusing on the competency and conduct of paid return preparers. That review spawned a series of recommendations to extend oversight to certain areas of the preparer industry to enhance tax compliance and service to taxpayers. The IRS began implementing these recommendations in 2010 and is now well into the process of putting in place the main components of the initiative, which include a registration requirement for preparers, and a competency test and continuing education requirement for preparers who are not CPAs, EAs or attorneys.

Criminal Investigations of Preparers

About 60 percent of taxpayers use tax professionals to prepare and file their tax returns. Most return preparers provide honest service to their clients. But as in any other business, there are also some who prey on unsuspecting taxpayers.

Unfortunately, some unscrupulous return preparers have been known to promise clients guaranteed or inflated refunds, skim off part or all of their clients' refunds, or charge inflated fees for return preparation services. Frequently, return preparer fraud involves the orchestrated preparation and filing of false income tax returns (in either paper or electronic form) which claim inflated personal or business expenses, false deductions, excessive exemptions, and/or unallowable credits that result in a refund. In many instances, the preparers' clients may not have knowledge of the false nature of the entries on their tax returns.

A new aspect of return preparer fraud is the highjacking of client returns – taking personal information of former or potential clients and filing falsified returns when the client did not intend for that preparer to submit a return. This may occur in instances where the client no longer has a filing requirement, has decided to retain a different return preparer or has met with a preparer to obtain an estimate for preparation of a return.

A second new aspect of this type of fraud is participation by return preparers in the identity theft schemes initiated by other third-parties. These individuals seek out unscrupulous return preparers due to their access to, and familiarity with, the IRS' filing systems. Identity thieves are continually searching for accomplices, either to create and file the fraudulent returns or to collect and convert the tax refunds into usable forms, i.e. cash or bank accounts they control. Willing return preparers that participate in identity theft schemes also offer an important incentive for identity thieves – the ability to commingle fraudulent returns with legitimate ones in order to make pattern recognition harder for IRS systems and personnel.

CI investigations of tax fraud related to return preparer fraud have increased significantly over the past two fiscal years and the trend is continuing in FY 2012. In FY 2011, 371 investigations were initiated, compared with 397 in FY 2010 and 224 in FY 2009. CI recommended 233 cases for prosecution in 2011, compared with 202 the previous year and 129 in 2009. Indictments in return preparer fraud related cases totaled 176 in 2011, with 163 individuals sentenced with an average time to be served at 25 months. This compares with 182 indictments, with 132 individuals sentenced and a 24-month average sentence in 2010. Already in FY 2012 – through May 31 – CI has initiated 317 cases and recommended 181 cases for prosecution. Indictments in return preparer fraud cases total 149, with 103 individuals sentenced and average time to be served at 30 months.

CONCLUSION

Mr. Chairman, thank you for the opportunity to appear before the Subcommittee and describe the steps that the IRS is taking to prevent identity theft and assist taxpayers who have been victims of this crime, and to discuss the actions we have been taking in the area of return preparer fraud. These two areas are major challenges for the IRS, and, while we have had some success of late, we are committed to improving our efforts in regard to both. The Criminal Investigation division has played and continues to play a key role in our efforts both on identity theft and return preparer fraud. We will continue to be aggressive in investigating fraud schemes perpetrated by identity thieves and unscrupulous preparers. We want to make certain that the message gets through that those participating in such schemes do so at their peril, because we will do everything we can to make sure that they are caught and sent to jail. I would be happy to answer any questions that you may have.