

GAO

Report to the Chairman and Ranking  
Minority Member, Committee on  
Finance, U.S. Senate

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November 2003

# INTERNAL REVENUE SERVICE

## Challenges Remain in Combating Abusive Tax Schemes



G A O

Accountability \* Integrity \* Reliability

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Highlights of GAO-04-50, a report to the Chairman and Ranking Minority Member, Committee on Finance, U.S. Senate

# INTERNAL REVENUE SERVICE

## Challenges Remain in Combating Abusive Tax Schemes

### Why GAO Did This Study

Abusive tax avoidance schemes could threaten our tax system's integrity and fairness if honest taxpayers believe that significant numbers of individuals are not paying their fair share of taxes. Abusive schemes encompass such distortions of the tax system as falsely describing the law (saying, for example, that the income tax is unconstitutional), misrepresenting facts (for instance, promoting the deduction of personal expenses as business expenses), or using trusts or offshore bank accounts to hide income.

As agreed, this report focuses on three objectives. They are to (1) describe the nature and scope of abusive tax avoidance schemes as determined by the Internal Revenue Service (IRS), (2) describe IRS's strategy to combat these schemes and the performance goals and measures IRS uses to track its major effort related to them, and (3) describe how IRS determined the amount and source of staff resources to be devoted to these schemes in the IRS operating division most directly affected.

### What GAO Recommends

GAO recommends that when IRS prepares future estimates of the size of the abusive scheme problem, the Commissioner of Internal Revenue document the support underlying the estimates. In written comments on a draft of this report, the Commissioner agreed with this recommendation.

[www.gao.gov/cgi-bin/getrpt?GAO-04-50](http://www.gao.gov/cgi-bin/getrpt?GAO-04-50).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or [brostekm@gao.gov](mailto:brostekm@gao.gov).

### What GAO Found

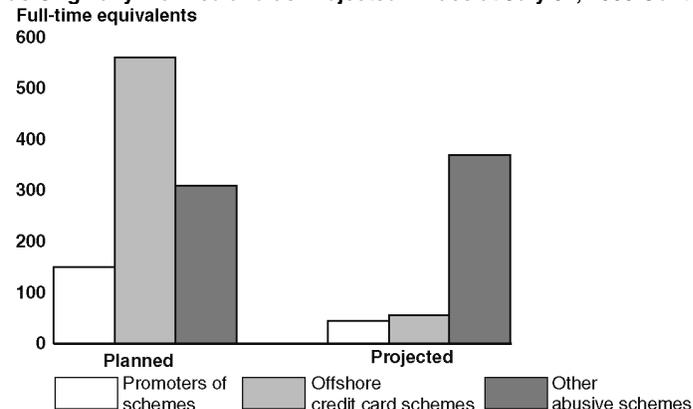
Abusive schemes vary in nature, and new ones continually emerge, making it very difficult to measure their extent. IRS has been gathering information to better define the scope of abusive schemes. In addition to 131,000 participants linked to abusive schemes between October 1, 2001, and mid-August 2003, IRS officials estimated that several hundred thousand others likely are engaged in abusive schemes. However, IRS documented this estimate only when GAO asked. Documentation can help policymakers judge the appropriateness of IRS resources and strategy in combating the high-priority abusive scheme problem.

IRS's broad-based strategy for addressing abusive schemes included:

- targeting promoters to head off the proliferation of abusive schemes and to identify taxpayers taking advantage of them;
- offering inducements to taxpayers to come forth and disclose their use of questionable offshore tax practices; and
- using performance indicators to measure outputs and intending to continue down the path it has started and develop long-term process and results-oriented performance goals and measures linked to those goals. The lack of these latter elements impedes gauging IRS's progress in combating abusive schemes.

Using a systematic agencywide decision-making process, IRS planned to shift significant resources to support its strategy, but the level of resources likely to be used in fiscal year 2003 was less than expected due to overly optimistic workload forecasts caused by inexperience with the types of cases involved. Future resource usage remains to be seen, given uncertainty about how much abusive scheme work IRS will have and how long it will take to close cases. IRS's understanding of how many staff will be needed to address the problem over what period will continue to evolve as IRS gains a better understanding of the problem's scope.

**Fiscal Year 2003 Examination Full-Time Equivalent Resources Devoted to Abusive Schemes, as Originally Planned and as Projected If Pace at July 31, 2003 Continued**



Source: Compiled by GAO from IRS data.

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United States General Accounting Office  
Washington, D.C. 20548

November 19, 2003

The Honorable Charles E. Grassley  
Chairman  
The Honorable Max Baucus  
Ranking Minority Member  
Committee on Finance  
United States Senate

Abusive tax schemes encompass such distortions of the tax system as falsely describing the law (saying, for example, that the income tax is unconstitutional), misrepresenting facts (for instance, promoting the deduction of personal expenses as business expenses), or using trusts or offshore bank accounts to hide income. During an April 2002 hearing before the Senate Committee on Finance, we testified about the inexact process for estimating the extent of abusive schemes used by individual taxpayers.<sup>1</sup> We pointed to Internal Revenue Service (IRS) estimates that about 740,000 taxpayers had used certain types of abusive schemes in tax year 2000, and that \$20 billion to \$40 billion in improper tax avoidance or tax credit and refund claims had occurred that IRS had not yet been able to identify and address. We noted that abusive schemes could threaten our tax system's integrity and fairness if honest taxpayers believe that significant numbers of individuals are not paying their fair share of taxes.

The estimated 740,000 taxpayers consisted of estimates of the number of taxpayers in four major scheme areas—about 62,000 with frivolous returns, 105,000 with frivolous refunds, 65,000 using abusive domestic trusts, and 505,000 using offshore schemes. Of the 505,000 taxpayers estimated to use offshore schemes, IRS estimated 500,000 were abusing offshore credit cards. In our testimony, we discussed how IRS arrived at its estimates. We also understand that some of the estimates reflected high-end numbers, for example, the numbers of taxpayers who were associated with a particular abusive promoter, but not necessarily reflecting an abusive scheme on their tax returns.

The \$20 billion to \$40 billion estimate of taxes not identified and addressed related to offshore schemes. Saying there were no reliable data to predict

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<sup>1</sup>U.S. General Accounting Office, *Internal Revenue Service: Enhanced Efforts to Combat Abusive Tax Schemes—Challenges Remain*, [GAO-02-618T](#) (Washington, D.C.: Apr. 11, 2002).

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tax implications, IRS derived its estimate based on average dollars in other parts of the abusive tax scheme program.

As agreed, this report focuses on three objectives. They are to (1) describe the nature and scope of abusive tax avoidance schemes as determined by IRS, (2) describe IRS's strategy to combat these schemes and the performance goals and measures IRS uses to track its major effort related to them, and (3) describe how IRS determined the amount and source of staff resources to be devoted to these schemes in the IRS operating division most directly affected. To do our work, we (1) analyzed IRS and other scheme reports, publications, data, and other documentation providing insight into the characteristics, complexity, size, and type of the problem, (2) reviewed IRS planning documents with information on IRS strategies, measures, milestones, and resources, (3) compared the contents of IRS planning documents to Government Performance and Results Act of 1993<sup>2</sup> (GPRA) criteria on what elements strategic planning should include, and (4) interviewed agency officials about their views on, among other things, the problem's nature and scope and IRS's strategy. We did our work from September 2002 through September 2003 in accordance with generally accepted government auditing standards.

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## Results in Brief

Abusive schemes vary in nature, and new ones continually emerge, making it very difficult to measure their extent. IRS has been gathering information to better define the scope of abusive schemes. In addition to 131,000 participants who were linked to abusive schemes between October 1, 2001, and mid-August 2003, IRS officials estimated that several hundred thousand additional taxpayers likely are engaged in abusive schemes. Officials have not estimated how many tax dollars might be involved overall. IRS's estimate of those involved is primarily based on promoter-related information developed in the past year and includes only those offshore credit card cases where IRS believes individuals' names are likely to be identified. Although they did not originally have documentation supporting this estimate, upon request, IRS officials prepared documentation for us showing the estimate's derivation. Documenting the basis for key program-related numbers ensures that others can judge their reliability and better understand what may account for differences in such key numbers over time. IRS continues to believe abusive schemes

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<sup>2</sup>P.L. 103-62.

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represent a significant compliance problem that deserves considerable attention, and schemes remain a top enforcement priority.

IRS's broad-based strategy for addressing abusive schemes included the following:

- targeting promoters to head off the proliferation of abusive schemes and to identify taxpayers taking advantage of them;
- offering inducements to taxpayers to come forth and disclose their use of questionable offshore tax practices;
- focusing attention on identifying schemes, alerting the public, and enforcing the law, including partnering with states to share information on abusive schemes;
- promoting the coordination of efforts throughout IRS; and
- using performance indicators to measure outputs and intending to continue down the path it has started and develop long-term process and results-oriented performance goals and measures linked to those goals. The lack of these latter elements impedes gauging IRS's progress in combating abusive schemes.

IRS is in the midst of its efforts to implement its abusive scheme strategy and has had to make decisions about staff allocations and what can be accomplished on the basis of available information. Using a systematic agencywide decision-making process, IRS planned to shift resources, significantly in the case of examination resources, to support its strategy, but the level of resources used in fiscal year 2003 through July 31 and likely to be used in fiscal year 2003 as a whole was less than expected due to overly optimistic workload forecasts caused by inexperience with the types of cases involved. The extent to which the caseload and resources will match each other in the future remains to be seen, given the uncertainty about the volume of additional work and the rate at which IRS can close abusive scheme examinations. IRS's understanding of how many staff will be needed to address the program and how long staff will take to work through the cases will continue to evolve as IRS gains a better understanding of the scope of abusive schemes.

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To ensure that support for future IRS estimates of the size of the abusive scheme problem exists, we are recommending that IRS document the support when preparing the estimates.

In written comments, the Commissioner of Internal Revenue agreed with a draft of this report. He specifically agreed with the recommendation and said that IRS would establish a methodology for documenting the basis for the estimates. He also affirmed IRS's intention to establish measurable process and results-oriented goals and said that developing these measures is an operational priority for fiscal year 2004.

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## Background

In a June 2002 letter, the Secretary of the Treasury addressed various questions posed by the then Ranking Member of the Committee on Finance on IRS actions to address abusive schemes. Treasury's letter pointed to IRS's Small Business/Self-Employed (SB/SE) Division as having primary responsibility for abusive schemes marketed to individuals and small businesses.

Within SB/SE, several units have established combating abusive schemes as a top priority. The Office of Reporting Enforcement was established in 2002 to increase program oversight and to help information flow among programs that address abusive schemes. SB/SE's collection component is to work closely with the examination function to ensure coordination. Its Taxpayer Education and Communication unit has launched a countermarketing strategy against abusive tax schemes and their promoters. Its Communications and Liaison unit is responsible for developing communication messages and strategies to maintain and enhance ongoing IRS interaction with internal and external stakeholders.

Other IRS organizations are also involved with abusive schemes. For instance, Criminal Investigation (CI) works closely with SB/SE and investigates and pursues promoters and individuals using schemes. The Office of Chief Counsel provides legal services, such as publishing guidance, working with examination and collection activities, and pursuing litigation.

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## Nature of Abusive Schemes Varies and Their Scope Is Unknown

The nature of abusive tax schemes is both varied and evolving. We testified last year that as schemes are often hidden, estimates presented in 2002 of the extent of abusive tax avoidance were inexact at best. IRS efforts underway to more definitively identify the scope of the problem revealed that, for the period from October 1, 2001, until mid-August 2003, 131,000 participants were involved in abusive schemes. For the 72,600 of these participants identified by February 28, 2003, IRS estimated that about \$1.6 billion in taxes were or might be recaptured, with more to be determined. In addition, on the basis of the number of promoters identified and the amount of information not yet received or processed, IRS officials estimated that hundreds of thousands of other taxpayers were involved in abusive schemes, but they did not prepare supporting documentation when making the estimate. According to IRS, recent estimates resulted from knowledge gained over the last year focusing on more specific information than previously used.

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## Abusive Schemes Vary and New Ones Continually Emerge

Abusive schemes include various kinds of arrangements designed to circumvent tax laws or evade taxes. As we testified last year, they can run from very simple to very complex, from clearly illegal to those carefully constructed to disguise the illegality of the scheme. Users of schemes can range from those believing their position is correct to those who knowingly but willfully file incorrect tax returns.

As shown in table 1, SB/SE sorts abusive schemes into seven categories. They range from trust arrangements to those claiming no legal basis for federal income taxes to tax shelters bought by taxpayers that are under SB/SE's auspices. In the case of the latter, SB/SE is responsible for investigating abusive shelters used by high-wealth individuals with complex tax returns and by businesses with assets of less than \$10 million.

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**Table 1: Descriptions of Abusive Scheme Categories**

<b>Category of scheme</b>	<b>Description of the category</b>
Abusive trust schemes	Arrangements featuring layers of trusts, with each trust distributing income to the next layer to fraudulently reduce taxable income to nominal amounts
Deduction/expense schemes	False representations of facts to claim improper deductions
Refund/credit schemes	Schemes involving the creation of credits to substantially reduce tax or create refunds
Antitax arguments	Arguments that entice people to believe collecting federal income taxes has no legal basis
Exempt organization schemes	Schemes using a tax-exempt entity to obtain unallowable benefits
Tax shelters	Very complicated transactions that sophisticated tax professionals promote, exploiting tax loopholes and reaping large and unintended tax benefits
Offshore compliance schemes	Schemes in which the true ownership of income streams and assets is hidden to improperly shield financial activity from the U.S. tax system

Source: IRS data compiled by GAO.

According to IRS officials, the popularity of schemes can also vary. Officials have seen a decline in slavery reparation schemes over time, and they have also become aware of new schemes that abuse corporate “soles” (one-member religious entities used to claim that income is tax free) and the disabled access credit (used to reduce taxes or create refunds). One SB/SE official explained that scheme promoters try to stay in the business of tax avoidance; when one type of scheme is discovered and addressed, another scheme will take its place.

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## Scope of Abusive Schemes Is Unknown

The full scope of the abusive tax scheme problem is unknown because estimates are difficult to make based on imperfect data. As we testified last year, estimating the extent of abusive schemes used by individual taxpayers is at best an inexact process because these schemes are often hidden.

In fiscal year 2003, SB/SE tried a new approach to improve its information about the problem and help with its work planning process. The new approach differed from prior efforts in that it focused on what IRS had actually found. The effort’s aim was to develop an inventory of abusive schemes and related data in order to develop an overall strategy for

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addressing abusive schemes and to enhance the work planning process. In this context, SB/SE developed a template for organizing information about known schemes and known investors. The template took the form of a matrix to be used to compare the risks presented by various schemes along the lines of factors such as the number of cases available for IRS staff to review but as yet unstated, the number of promoters, the amount of money involved, and the number of taxpayers participating. The matrix organizes abusive schemes within the seven categories shown above in table 1.

According to a summary of items in the matrix categories and IRS's work with offshore credit cards covering October 2001 through mid-August 2003, IRS identified about 131,000 participants in abusive schemes. This number included 22,000 participants in the offshore credit card area and, according to SB/SE, reflected the best available data, but not a potential universe. It updated a previous summary covering October 1, 2001, through February 2003 that showed 72,600 potential participants. In that summary, SB/SE noted that recaptured or potentially recaptured taxes from closed or identified reviews totaled almost \$1.6 billion, excluding undetermined amounts from the credit card work. That summary also included the 22,000 participants in the offshore area, but IRS was not able to update this figure for its later summary because new credit card information had just arrived.

IRS used an estimate in its fiscal year 2005 budget presentation of the number of taxpayers it believes are involved in abusive schemes who are likely to be identified through its various efforts. IRS estimated that more than 400,000 taxpayers fall into this category, generally including the approximately 131,000 participants it had identified as of mid-August 2003. According to IRS officials, this estimate was included in materials provided to the Department of the Treasury and the Office of Management and Budget during budget discussions. It was used not as a basis for requesting resources sufficient to examine the taxpayers, but to show that the abusive scheme problem was large relative to current resources. According to IRS officials, this estimate was developed during a series of meetings, but documentation showing the basis for the estimate was not prepared at that time.

We are unaware of a specific IRS or other policy that requires contemporaneous documentation of a figure like the 400,000 estimate of taxpayers IRS expects to identify as engaged in abusive schemes. Nevertheless, documenting the basis for key numbers related to an agency's programmatic efforts is in line with the thrust of management

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legislation and IRS's own policies. For example, GPRA stresses not only that agencies develop measures of program performance, but also that the measures be valid and reliable. IRS too stresses that program managers have valid and reliable measures of program performance in its Strategic Planning, Budgeting, and Performance Management Process. Although the 400,000 estimate is not an IRS program performance measure, it is a measure that IRS has used in discussions on its fiscal year 2005 budget needs. Further, Congress has expressed interest in the specific issue of abusive schemes, including through this review, which has focused in part on the nature and scope of abusive tax schemes. Documenting the basis for key program-related numbers ensures that others can judge their reliability and better understand what may account for differences in such key numbers over time.

At our request, IRS prepared a document showing how the estimate of over 400,000 was derived. IRS based this estimate to a great extent on the promoters it had identified, but for which it had not yet received investor lists. If each investor list contained only the average number of names identified on the very few lists considered so far, a conservative assumption according to SB/SE's Deputy Director, Compliance Policy, more than 300,000 taxpayers would be involved. In addition, although IRS had not yet processed most of the offshore credit card information it had received, staff projected that tens of thousands of abusive credit card users were likely to be identified. According to the same official, IRS now believes more taxpayers are engaged in various abusive schemes not involving offshore credit cards than it did last year but fewer than it believed last year are engaged in schemes involving offshore credit cards and likely to be identified. Not wanting to overstate the total number of taxpayers likely to be identified as involved in abusive schemes, IRS adopted a conservative estimate of more than 400,000, emphasizing to us that its program is still in the developmental stage and the number is probably higher. Table 2 compares how the 400,000 relates to the numbers used in our testimony from last year. Because some of the numbers are estimates based on limited information and because the specific types of cases included in the different categories are not always identical, the comparisons are only a general indication of changes in the potential size of the scheme categories and the total number of taxpayers involved.

**Table 2: Comparison of Different Estimates of the Number of Taxpayers Involved in Abusive Schemes**

<b>Scheme area<sup>a</sup></b>	<b>February 2002 estimate</b>	<b>October 2003 estimate</b>
Offshore credit cards and other schemes	570,000	More than 400,000
Frivolous returns	62,000	21,000 <sup>b</sup>
Frivolous refunds	105,000	127,000 <sup>b</sup>
<b>Total</b>	<b>737,000</b>	<b>More than 548,000</b>

Source: Derived by GAO from IRS data.

<sup>a</sup>The types of schemes included in the different categories in the two periods were not consistent, but the differences were small relative to the total number of taxpayers involved.

<sup>b</sup>These numbers are for fiscal year 2002.

IRS has not associated a dollar amount with its estimate of more than 400,000 taxpayers, although it believes the amount is substantial. According to SB/SE's Deputy Director, Compliance Policy, IRS is trying to be more data-driven in this area and is not tracking dollars associated with its projection.

In addition to the estimate of more than 400,000 taxpayers, some IRS units collected other information regarding abusive schemes that identified the scope of other pieces of the problem. These pieces are not part of SB/SE's examination workload planning effort because they do not involve examinations. IRS's Frivolous Return Program identifies returns and refunds for taxpayers whose returns either state an argument that IRS can readily identify as frivolous or have characteristics IRS has identified as reflecting a frivolous argument. The program stopped about 21,000 frivolous returns (as shown in table 2) and refunds resulting in about \$619 million in protected tax dollars in fiscal year 2002. CI identified about 127,000 fraudulent refund claims in fiscal year 2002 and stopped about \$379 million in fraudulent refunds.

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## IRS Strategy to Combat Abusive Schemes Is Broad-Based, but Has No Long-term Performance Goals or Measures Linked to Goals

IRS's abusive scheme strategy takes a multipart approach to focus resources on the most egregious promoters of, and participants in, offshore credit card and other schemes. It entails identifying schemes and their participants, alerting the public, enforcing the law, and coordinating efforts internally and throughout IRS. Although IRS planning documents outline an overall strategy for combating abusive schemes, IRS has not yet defined long-term performance goals for the effort and the measures it would use to track progress in achieving those goals. However, although establishing such goals and measures will be challenging, IRS intends to establish process and results-oriented goals in the future.<sup>3</sup>

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## SB/SE's Strategy Includes Pursuing Egregious Promoters As Well As Offshore Credit Card and Other Abusers

As outlined in planning documents, the SB/SE strategy to combat abusive tax schemes focuses on attacking the source of what IRS considers to be the most egregious abusive noncompliance. The strategy requires using scarce resources to address three high-priority areas—promoters, offshore credit card schemes, and other abusive schemes (including offshore schemes other than credit card schemes)—all under the jurisdiction of a position established in 2002, the Director of Reporting Enforcement.

Because promoters generate noncompliance by selling tax avoidance schemes to others, they represent a top priority in the strategy. By pursuing promoters, IRS may leverage its resources and gain access to lists of clients who bought the promoters' products. An SB/SE official stated that the focus is to pursue promoters first to stop the growth of abusive schemes. IRS can then take enforcement actions against participants in abusive schemes.

IRS especially targeted abusive schemes involving credit cards issued by offshore banks. Credit cards allow easy access to income hidden in accounts in tax haven countries. In October 2000, IRS issued summonses to two credit card companies to obtain limited information about U.S. citizens holding credit cards issued by banks in three offshore financial centers.

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<sup>3</sup>Guidance related to GPRA can provide a framework in developing measurable goals and outcome-oriented measures. Although GPRA is generally applied to agencywide strategic plans, its framework is useful to guide any type of planning. GPRA requires long-term strategic and annual performance goals and associated measures, preferring measures relating to outcomes (results) versus outputs (activities). Office of Management and Budget guidance says that strategic plans set out long-term goals, outlining planned accomplishments and their implementation schedule.

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After lengthy negotiations to address one of the company's concerns and reach a compromise for compliance, that company provided information in April 2002. In March and August 2002, IRS issued a second round of summonses to credit card companies seeking records on cards issued by banks in 31 offshore financial centers. The scope of records to be produced under these summonses had to be negotiated, with consideration given to the burden of requiring full compliance, the balance between the amount of information to be produced and the time needed to produce it, and the need to focus as much as possible on probable U.S. taxpayers.

Because IRS could not always identify individuals based on credit card company information, it also issued summonses to 123 merchants for additional information that could be used in examinations and criminal investigations. Analyzing merchant responses was very time consuming, requiring follow-up for more information, and IRS still needed to work beyond the merchant information provided to identify taxpayers.

On July 30, 2003, IRS announced that as a result of its credit card project, it had continuing or completed audits on 2,800 returns, and it had assessed more than \$3 million in taxes. As of early August 2003, IRS had received records from both rounds of credit card company summonses and from almost all of the merchant summonses. It needed to go through these records before it would begin to have a better idea of the size of the credit card problem, keeping in mind that the merchant summonses related only to merchants identified by analyzing data produced by one credit card company responding to the first summons.

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In January 2003, IRS began a voluntary compliance initiative to identify promoters and to return to tax law compliance taxpayers who use offshore payment cards to hide income. Under the initiative, eligible taxpayers stepping forward before April 16, 2003, would not pay certain penalties and would not face criminal prosecution, pending acceptance into the program. However, they would agree to provide full details on promoters of offshore arrangements. They would also pay previously owed taxes, interest, and certain other penalties. In addition to this voluntary compliance initiative and to the summonses, the Department of the Treasury has entered into tax information exchange agreements with offshore financial centers to further improve the federal government's information collection.<sup>4</sup>

On July 30, 2003, IRS announced that 1,299 taxpayers stepped forward to participate in the voluntary compliance initiative, and that analyzing cases to date revealed 214 new offshore promoters. According to SB/SE's Deputy Director, Compliance Policy, as of mid-September 2003, the initiative had led to collecting more than \$100 million in tax, a figure that continues to grow. The 1,299 taxpayers who volunteered is a small number compared to early reports of the scope of the problem. However, according to IRS officials, the reality of promoters being identified by taxpayers gives IRS data on the source of the problem and a wealth of information that can be used to further investigate abusive schemes. They said IRS was in the early stages of receiving and following up on completed packages of information, but it had already received valuable information on how promoted schemes worked. In addition, instead of stepping forward, IRS officials say some taxpayers seem to have filed amended tax returns, bringing themselves into compliance in a different way. IRS did not yet know the number of amended returns that arrived as a result of the initiative.

For the abusive schemes shown in table 1, SB/SE's fiscal year 2003 plans called for developing an inventory of schemes and their status, working out a more detailed overall strategy, and developing and implementing a process to oversee and manage IRS's efforts to combat abusive schemes and promoters. In general, SB/SE officials saw fiscal year 2003 as a transition year in which to build an infrastructure for full implementation of a strategy in fiscal year 2004. To develop inventory information, SB/SE

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<sup>4</sup>Between November 2001 and November 2002, Treasury entered into agreements with the Cayman Islands, Antigua and Barbuda, The Bahamas, the British Virgin Islands, the Netherlands Antilles, Guernsey, the Isle of Man, and Jersey.

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has been devising a matrix to assess the risk associated with various abusive schemes. Although it will not identify the full scope of the problem, the matrix is intended to help SB/SE management prioritize the various schemes it encounters and decide how much in resources to allocate to combat each one.

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**SB/SE's Strategy Includes Identifying Schemes, Alerting the Public, and Enforcing the Law**

SB/SE's strategy to combat abusive schemes includes actions to identify schemes, alert the public, and identify and take enforcement action against promoters and participants. SB/SE identifies promoters and participants through disclosure initiatives, Internet research, investigations, and examinations. IRS is also partnering with state tax agencies to combat abusive schemes. On September 16, 2003, IRS announced agreements to, among other things, exchange information about abusive schemes identified at the federal and state levels, have IRS provide leads on participants in abusive schemes to states for investigation, and partner on training and other educational activities.

SB/SE's strategy to alert the public includes targeting educational outreach and countermarketing strategies to address abusive schemes and their promoters. The division's Taxpayer Education and Communication (TEC) unit, in conjunction with the Communications and Liaison and Reporting Enforcement units and others, created toolkits for abusive scheme outreach and education. The toolkits are for external stakeholders, such as professional organizations, to educate their members and clients and also for use as internal guidance.

Enforcement action against promoters and participants can take many forms. For example, IRS criminal investigations can lead to indictments and convictions. Similarly, IRS conclusions that injunctions are warranted can lead to promoters being enjoined from continuing with their promotions. As of May 2, 2003, IRS had 464 ongoing criminal investigations of scheme promoters and investors, as opposed to 125 in 2001, and 27 promoter injunctions granted, compared to 1 about a year earlier. IRS can also assert civil penalties or use summonses.

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**SB/SE's Strategy Is Coordinated within SB/SE and throughout IRS**

Internal coordination is key to SB/SE's approach for addressing abusive schemes. Last year we testified that SB/SE was reorganizing to place its key efforts to combat abusive schemes under one executive and better integrate them. Now SB/SE's Deputy Director, Compliance Policy, is charged with coordinating the division's strategy for combating abusive

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schemes and working closely with other IRS operating divisions. IRS has also established coordination groups, namely the Abusive Tax Evasion, Avoidance Schemes, and Devices Executive Steering Committee and the Offshore Credit Card Project Oversight Board, both of which include members from different parts of IRS and operate under the auspices of IRS's Enforcement Committee chartered in July 2003. Chaired by the Deputy Commissioner for Services and Enforcement, the Enforcement Committee is to guide IRS-wide enforcement strategies, focusing on high visibility issues involving many divisions or potentially having significant compliance impact.

IRS units coordinate with each other in various ways in planning and implementing actions to combat abusive schemes. For example, in April 2002, SB/SE established the Lead Development Center (LDC) to centralize the nationwide receipt of leads on promoters of abusive schemes. Once the LDC organizes promoter information from both agencywide and external sources, it coordinates with CI to determine who takes the lead in promoter cases of interest to SB/SE and CI and at times to work in parallel investigations. Another example of two divisions partnering with each other was the plan for SB/SE and the Large and Mid-Size Business Division to jointly find ways to identify entities used to mask questionable transactions and address their abuse. As part of this effort, the two divisions planned to develop and implement a strategy to focus on high-income taxpayers investing in flow-through entities used to hide taxable income. The planning documents of different IRS divisions had cross-references to the plans and work of other divisions.

SB/SE also coordinates internally and with other units in its efforts to alert the public. TEC and the SB/SE Communications and Liaison unit coordinate with SB/SE Compliance and with CI and the Office of Chief Counsel when doing outreach and education. For instance, Counsel provides legal assistance with language to try to ensure that public messages are legally accurate. As another example, Communications and Liaison, Compliance, CI, and Counsel personnel all provided TEC with input on components of the toolkits TEC developed.

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### SB/SE Has No Long-term Performance Goals or Measures Linked to Goals

Although IRS has outlined and begun to implement a strategy for combating abusive schemes, it has not yet defined performance goals for the effort and established the measures it would use to track progress in achieving those goals. Performance goals define what an organization is trying to achieve over time, preferably focusing on the outcome desired

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rather than on activities or outputs. IRS officials recognize that developing performance goals and associated measures to track progress is desirable. Although given the substantial difficulty in assessing the scope of the abusive scheme problem, establishing performance goals and associated measures will be challenging, IRS intends to establish process or results-oriented performance goals in the future.

Using business plans and status reports, SB/SE established some short-term goals and measures to track its abusive scheme activity. It established short-term goals, such as developing alternative treatments and/or a settlement strategy for offshore credit card cases by November 1, 2002. (As mentioned earlier, IRS actually began its offshore voluntary compliance initiative in January 2003.) SB/SE also used measures, such as the number of approved investigations. Although establishing these goals and measures represents progress, IRS has not developed long-term process and results-oriented performance goals or measures associated with them.

SB/SE officials acknowledged the importance of goals and measures and are working on improving. As mentioned earlier, one of SB/SE's fiscal year 2003 efforts was to develop a detailed overall strategy for addressing the abusive schemes described in table 1, including a process to oversee and manage the area. SB/SE officials said they would devise measures of compliance success once they have their process in hand and gain experience. Because the extent of abusive scheme activity is unknown and success in addressing it is hard to define, efforts to develop long-term performance goals and associated measures are difficult. However, consistent with their ongoing efforts to build an infrastructure to address abusive schemes, SB/SE management officials expressed their intention to establish process and results-oriented goals and measures in the future. Progress in developing these elements is crucial to being able to communicate progress made in combating abusive schemes.

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## IRS Planned Resource Shifts Are Significant, but Resource Use Started Slowly and Future Use Remains to Be Seen

IRS has begun shifting, although more slowly than expected, and plans to continue shifting, significant resources into addressing abusive schemes, but the potential volume of additional work that may be identified and inexperience with the rate at which staff can close cases make it unclear whether the additional resources and the caseloads will match each other. At the agencywide level, IRS used a systematic decision-making process in deciding to make these shifts. At the SB/SE level, executives considered resources available and program priorities in significantly increasing SB/SE examination staff resources devoted to abusive schemes. In doing so, they

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planned to shift resources out of examining areas such as small corporations and nonabusive flow-through entities.

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## Overall Budget Trade-offs

IRS decided staffing resource levels to be devoted to addressing abusive schemes through a systematic planning and budgeting process, albeit one that used participants' experience and judgment in the absence of definitive measures of the problem's size. Early in calendar year 2002, IRS's divisions, including SB/SE, conducted strategic assessments in which they studied trends, issues, and priorities affecting their operations. In April 2002, IRS's senior management team, including the Commissioner, Deputy Commissioner, division heads, and others, went through two rounds of considering IRS's programs to prioritize the needs for new or redirected funding for fiscal year 2004. Of 33 programs considered, abusive schemes received the second most votes. According to an IRS official, this process also informed how funds already requested for fiscal year 2003 would actually be spent.

After the senior management team reached consensus, the Commissioner issued overall planning guidance for fiscal years 2003 and 2004 to reflect the jointly set strategic direction, and the divisions wrote fiscal year 2003 and 2004 "strategy and program plans" outlining staff resources needed. Showing its intent to focus resources on detecting noncompliance, SB/SE's plan cited an increasing number of abusive schemes, an abusive scheme estimate of up to \$40 billion, promoters using the Internet as their primary way of operating, and the potential for abusive schemes eroding taxpayers' confidence in the tax system's fairness.

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## SB/SE Used Priorities to Plan for Significant Resource Shift

For fiscal years 2003 and 2004, SB/SE significantly increased the examination resources it planned to allocate to new priorities, including three of its highest: (1) promoters of abusive schemes, (2) offshore credit card schemes, and (3) other abusive schemes. As shown in table 3, the planned level of resources for these three areas almost quadrupled from 267 full-time equivalents (FTE) in fiscal year 2002 to 1,020 FTEs the next year, and it increased slightly from there to 1,154 FTEs for fiscal year 2004.

**Table 3: Planned Shift in Revenue Agent and Tax Compliance Officer FTE Positions Devoted to Abusive Scheme Priority Areas, Fiscal Years 2002-2004**

Priority area	FY 2002	FY 2003	FY 2004	Percentage increase from FY 2002 to 2004
Promoters of abusive schemes	16	150	154	863%
Offshore credit card schemes	0	561	367	-
Other abusive schemes	251	309	633	152%
<b>Total</b>	<b>267</b>	<b>1,020</b>	<b>1,154</b>	<b>332%</b>

Source: IRS data compiled by GAO.

Note: These FTEs include revenue agents and tax compliance officers, but not tax examiners who conduct examinations through correspondence. Revenue agents and tax compliance officers usually have accounting experience and meet directly with taxpayers during the audit. Correspondence examinations do not require tax examiners to meet with the taxpayer in person.

SB/SE arrived at its fiscal year 2003 budget estimates for different categories of abusive schemes in different ways. To estimate the number of examiner FTEs needed for promoters, it started with the number of approved promoter investigations and assumed another 35 investigations would be added each month. It also assumed that each investigation would take 37.5 hours per month for 8 months, for a total of 300 hours.

For offshore credit card schemes, SB/SE estimated a potential number of participants by extrapolating data from October 2000 summonses to find potential credit card abusers. It decided how many participants it could actually examine, which was significantly less than the number of participants extrapolated, based on the estimated availability of FTEs.

For other abusive schemes, SB/SE estimated a potential number of participants by using available data on identified schemes and investor lists. It determined how many hours examining relevant returns would take by assuming that closing other abusive cases would take certain percentages of the time needed for nonabusive returns. Although other abusive schemes evolve and past experience will not necessarily bear out for the future, for its staff year estimates for other abusive schemes IRS officials generally had more relevant experience from prior work on abusive schemes to draw upon than they did for promoter and offshore credit card staff year estimates.

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In determining its budget estimates for all these areas, SB/SE considered the allocation to other programs. It did this using input from SB/SE executives and examiners in an iterative process. Given the shifts to abusive schemes, SB/SE planned to limit the numbers of its traditional examinations, such as those of small corporations and nonabusive flow-through entities. For instance, it scheduled the number of revenue agent FTEs devoted to nonabusive flow-through entities to decline from 485 to 176 between fiscal years 2002 and 2003, translating to a decrease in the number of returns examined by revenue agents from 12,318 to 1,078.<sup>5</sup> Further, for fiscal year 2003, SB/SE also began directing its most skilled examination resources away from national programs, such as claims for refunds and cases with tax returns identified as being most likely to have their taxes increased upon audit. To cope with this shift in resources away from certain areas, IRS planned various mitigating efforts, such as first examining individuals for abusive schemes and then pinpointing related flow-through and other entities to be audited, rather than first selecting the entities to audit. We did not assess how the shifts in resources would affect examination coverage in the areas losing staff or IRS's plans to mitigate that effect.

In addition to the increased resources for IRS examination priority areas reflected in table 3, other parts of SB/SE and IRS also used or planned to use FTEs to address abusive schemes. For instance, within SB/SE, although the TEC unit did not specifically allocate FTEs for abusive schemes in fiscal year 2002, it planned to devote 54 FTEs to addressing abusive schemes in fiscal year 2003 (about 13 had been used as of July 26, 2003) and asked for another 125 for fiscal year 2004. Similarly, the collection function went from 0 FTEs in fiscal year 2002 to planning for 73 and 81 FTEs in fiscal years 2003 and 2004, respectively. According to an SB/SE official in early August 2003, SB/SE did not have reliable information on how many FTEs the collection function had used to date to address abusive schemes in fiscal year 2003.

Outside SB/SE, although CI did not budget staff resources specifically for abusive schemes, it used 120 FTEs in fiscal year 2002 just on abusive domestic and foreign trusts and expected significant cascading effects on its scheme work in the form of referrals from other units. For fiscal year

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<sup>5</sup>Nonabusive flow-through entities are entities such as trusts and partnerships that IRS examines as part of its broad coverage of taxpayers, even though it has no specific reason to think they are abusive.

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2004, it also requested 185 FTEs in addition to the 441 already used to identify, develop, and analyze potentially fraudulent schemes in its Questionable Refund Program and its Return Preparer Program. Other SB/SE and IRS areas devoting FTEs to abusive schemes include the Frivolous Return Program, SB/SE Communications and Liaison, and the Office of Chief Counsel.

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### Resource Use Differed from Expectations, and Future Use Remains to Be Seen

As of July 31, 2003, IRS had used fewer examination resources combating abusive schemes than it had expected. Although IRS intends to significantly shift resources to address abusive schemes, how future resources will actually be used remains to be seen. The future volume of cases IRS will need to examine and the rate at which IRS will be able to close examinations are unclear. Instead of using examination resources to the extent intended to address abusive schemes, it has been able to apply them to other high-priority programs, such as its Unreported Income Discriminant Function effort, and if circumstances warranted, it could do so again in the future.

As shown in table 4, through July 31, 2003, SB/SE was on track to use less than half of the 1,020 fiscal year 2003 FTEs designated for abusive scheme priority areas. It was on track to use 10 percent of the revenue agent FTEs to be devoted to offshore credit card schemes and 30 percent of those to be devoted to promoters. IRS officials stated that fiscal year 2003 was a transition year and attributed the slower than expected start to overly optimistic forecasts for delivering a high level of workable cases to revenue agents—forecasts made without the experience needed in the promoter and offshore credit card areas to gain insight into how slowly or quickly inventory develops. Recent trends of more cases starting per month indicate that the available workload is growing.

**Table 4: Planned and Projected Revenue Agent and Tax Compliance Officer FTEs Devoted to Abusive Scheme Priority Areas, Fiscal Year 2003**

Priority area	Planned FTEs	Projected FTEs if the pace at July 31, 2003 was maintained	Projected FTEs as a percentage of those planned
Promoters of abusive schemes	150	45	30
Offshore credit card schemes	561	56	10
Other abusive schemes worked by revenue agents	275	352	128
Other abusive schemes worked by tax compliance officers	34	17	51
<b>Total</b>	<b>1,020</b>	<b>470</b>	<b>46</b>

Source: IRS data compiled by GAO.

Other data illustrate how difficult it is for IRS to reliably estimate the resources that may be needed to work abusive schemes due to uncertainty about the volume of cases that it will need to examine and the rate at which IRS will be able to close examinations. The data indicate that, at times, the actual number of cases identified and the rate at which cases were being closed diverged significantly from the estimates used to plan for fiscal year 2003 FTEs. For example, as shown in table 5, by July 31, 2003, SB/SE did not yet have offshore credit card cases lined up for examination that would approach the number the budget was intended to cover, and it had closed only 18 percent of the cases it had anticipated closing. On the other hand, SB/SE had more cases involving other abusive schemes in its queue for revenue agents to handle than it had estimated it could work in fiscal year 2003, but it was closing almost twice as many cases as expected. Having budgeted FTEs to work 9,060 complete cases involving other abusive schemes, it had enough resources to begin and/or complete work in fiscal year 2003 on many of the 20,810 cases it identified by July 31, 2003. It could complete many of the unfinished cases in fiscal year 2004, and by that time, have identified new cases to work.

**Table 5: Comparisons of Inventory Developments with Inventory Expectations**

Priority area	Number of cases identified by July 31, 2003 <sup>a</sup>	Number of equivalent cases SB/SE estimated it could cover in FY 2003	Rate at which cases expected to be closed by July 31, 2003 actually were closed by that time
Promoters	535	569	Not available
Offshore credit card schemes	2,208 <sup>b</sup>	9,455	18%
Other abusive schemes worked by revenue agents	20,810	9,060	193%
Other abusive schemes worked by tax compliance officers	2,607	4,570	44%

Source: Calculated by GAO from IRS data.

<sup>a</sup>This calculation entailed adding the number of cases that either started in fiscal year 2003 or were identified to be started but had not yet begun by July 31, 2003. To this total, we added cases carried over from fiscal year 2002 into 2003, but adjusted the total to reflect that a portion of the casework had been completed. For example, if two cases carried into 2003 were half completed, we counted them as one case. We relied on IRS estimates of case status to make these adjustments. The resulting totals do not represent cases that IRS could necessarily complete in fiscal year 2003 because, we were told, many cases could take 2 or 3 years.

<sup>b</sup>SB/SE officials explained that over time IRS would identify additional tax returns related to the 2,208 offshore credit card cases that had been identified as of July 31, 2003. SB/SE projected that each offshore credit card case originally identified would eventually include four tax returns, on average.

SB/SE officials told us that they accommodated shortfalls in cases or in budgeted examination resources by shifting examination FTEs among different types of abusive scheme examinations and to other priority programs. According to them, the offshore credit card cases did not start as quickly as anticipated because dealing with the summons process took longer than expected. However, this delay allowed more SB/SE resources to be used for other abusive schemes.

Although to date SB/SE officials have acted to accommodate unexpected differences in the volume of cases and the time needed to work them, uncertainties affecting future resource levels are perhaps even greater. There is the potential that the volume of cases could grow significantly, but it is not clear how much the caseload will grow or how quickly. For example, in the offshore credit card scheme area, IRS has not yet assessed how many new cases may be identified from the 214 new offshore promoters found in its voluntary compliance initiative that closed on April

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15, 2003. Also, by early August 2003, IRS had received records from its second round of credit card summonses, which covered credit card company records on cards issued by banks in 31 offshore financial centers. Efforts like these may potentially expand the caseload but by an unknown amount.

To the extent the potential cases expand, IRS's experience so far, as alluded to earlier, has been that it is taking longer than originally expected to obtain all of the information needed to actually identify individuals for potential examination and to make informed choices about which cases merit examination. IRS found, for example, that the information from credit card summonses often was insufficient to identify individuals, and, therefore, it had to issue summonses to merchants as well to obtain identifying information. Therefore, IRS would be more likely to be able to handle the examination caseload if the universe of potential examination cases expands, even fairly significantly, but developing those cases to the point they can actually be examined stretches out over time, than if a "workable" caseload materializes quickly.

The fiscal year 2003 statistics in table 5 also illustrate that the rate at which identified cases may be closed is highly uncertain. According to an SB/SE official, SB/SE took its time estimates for working on abusive scheme cases from its most complex abusive case examinations. SB/SE officials explained that IRS had very little history to use in estimating the time needed to process promoter, offshore credit card, and other abusive scheme cases. The matrix being developed in fiscal year 2003 was designed to collect information that will help executives assess resources needed. As SB/SE gains experience with current cases, officials said, the planning process would become more refined.

Across the spectrum of IRS's responsibilities, IRS works varying amounts of the identified workload. It has pointed to gaps between what it should be doing and what it has the capacity to do in areas ranging from individuals to small and large corporations. IRS will make future decisions about the portion of abusive scheme cases that it will work as part of its overall processes for allocating resources among its many competing priorities.

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We have previously raised questions about IRS's ability to shift compliance resources as planned. We recently testified that many parties have expressed concern about declining IRS compliance—especially audit—and collection trends for their potential to undermine taxpayers' motivation to fulfill their tax obligations.<sup>6</sup> Concerned about these trends, IRS has sought more resources, including increased staffing for compliance and collections, since fiscal year 2001. Despite receiving requested budget increases, staffing levels in key occupations were lower in 2002 than in 2000. These declines occurred for reasons such as unbudgeted expenses consuming budget increases and other operational workload increases.

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## Conclusions

Having designated abusive schemes as a priority enforcement area, IRS has made progress in developing an agencywide effort to address schemes. To ensure that these efforts are focused and to support both congressional and IRS assessments of progress in combating abusive schemes, IRS officials must follow through on their intention to develop long-term process and results-oriented performance goals and associated measures.

Fiscal year 2003 experience, however, illustrates that IRS likely will need to continually adjust its efforts. Although IRS identified many more of some types of abusive schemes than it expected it could handle in fiscal year 2003, the development of a workable inventory of offshore credit card scheme cases progressed much more slowly than anticipated. On balance, this likely led to IRS using substantially fewer resources for abusive scheme work in fiscal year 2003 than anticipated. As with developing long-term goals and measures, officials recognize that they must build a better analytic basis for judging the appropriate resources to assign to pursuing abusive schemes and intend to do so as they better identify the potential workload and how quickly they can close cases. Given that abusive schemes are a top priority for IRS and have been the focus of congressional attention, the potential size of the problem is a key reference point for policymakers in judging whether IRS has appropriate resources and an effective strategy over time for combating the schemes. Although estimating the potential size of the problem is inherently difficult and must rely on assumptions and officials' judgment, documenting the basis for the

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<sup>6</sup>U.S. General Accounting Office, *Compliance and Collection: Challenges for IRS in Reversing Trends and Implementing New Initiatives*, [GAO-03-732T](#) (Washington, D.C.: May 7, 2003).

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estimates can help others judge how to interpret the numbers and use them to make decisions.

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## Recommendation to the Commissioner of Internal Revenue

We recommend that the Commissioner of Internal Revenue document the support underlying future IRS estimates of the size of the abusive scheme problem when IRS prepares the estimates.

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## Agency Comments

In written comments, the Commissioner of Internal Revenue agreed with a draft of this report. He specifically agreed with the recommendation and said that IRS would establish a methodology for documenting the basis for the estimates. He noted that the other information we provided would also help IRS improve its abusive scheme program for fiscal year 2004 and beyond. In addition, he affirmed IRS's intention to establish measurable process and results-oriented goals and said that developing these measures is an operational priority for fiscal year 2004.

The Commissioner also provided other general comments on our draft report and an update of activities since the time of our review. For instance, he said that as a result of LDC improvements, expedited procedures with the Department of Justice, and many other efforts, IRS recently identified significant numbers of abusive scheme promoters and participants and refined its methods to deal with them. In addition, he noted, a key part of the ongoing, infrastructure-building efforts that we describe was forming and training 12 cross-functional teams in 2003 to identify traditional or alternative strategies for addressing individual schemes. Also, he stated that, as of October 2003, 42 states and the District of Columbia had signed a memorandum of understanding focusing on exchanging information with IRS relating to abusive tax avoidance transactions. Finally, he pointed out that given IRS's inability in 2003 to consistently identify and deliver abusive scheme cases to be worked in IRS field offices, IRS policy is to focus on other strategic priorities when it does not have an abusive scheme case to work.

The full text of the Commissioner's comments is reprinted in appendix I.

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As agreed, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report.

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At that time, we will send copies to the Commissioner of Internal Revenue, the Secretary of the Treasury, and other interested parties. The report will also be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact Signora May on (404) 679-1920 or me on (202) 512-9110. Melissa Hinton and Lawrence Korb were key contributors to this report.

A handwritten signature in black ink that reads "Michael Brostek". The signature is written in a cursive style with a large initial "M".

Michael Brostek  
Director, Tax Issues

# Comments from the Internal Revenue Service



COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

November 12, 2003

Mr. Michael Brostek  
Director, Tax Issues  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Brostek:

I reviewed your draft report entitled, "Challenges Remain in Combating Abusive Tax Schemes" (GAO-04-05). We agree with your recommendation that we need to document the basis for the underlying estimates of the Abusive Scheme problem and will establish a methodology to do so. The other information you provided will also help us improve the program for FY 2004 and beyond. In addition to providing general comments on your report, we would also like to give you an update on relevant activities since the date of your audit.

As the report acknowledges, we are making strides in our ability to identify abusive scheme promoters as well as their participants. Given the magnitude of the scheme problem today – that there are over 400,000 taxpayers involved and billions of dollars potentially escaping taxation, we are focused on meeting the challenges raised in your report. Our Lead Development Center continues to improve its investigation methods as well as reducing its cycle time for processing these cases. We have also developed integrated approaches with other divisions as well as expedited procedures with the Department of Justice. As a result of these and many other efforts, we have identified significant numbers of promoters and participants since your audit, as well as refined our methods to deal with them.

Your report also recognizes our ongoing efforts to build an infrastructure to address abusive schemes. One key step was the formation of issue management teams. In 2003, we formed and trained twelve teams, each headed by an executive or territory manager. These teams are charged with identifying an overall strategy for their assigned issue or scheme. Strategies may include traditional approaches such as examination or alternative resolution strategies which may resolve large numbers of taxpayer cases more quickly. Team members include representatives from Small Business/Self-Employed (SB/SE) Compliance and Taxpayer Education and Communication (TEC) offices and SBSE Division Counsel. When appropriate, other operating units such as Large and Mid-Size Business (LMSB), Tax Exempt/Government Entities (TE/GE) and Criminal Investigation participate.

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In September 2003, we announced the establishment of a nationwide partnership to combat abusive tax avoidance. Under agreements with individual states, the IRS will share information on abusive tax avoidance transactions and those taxpayers who participate in them. The agreements creating this partnership are designed to enable States and the IRS to move more aggressively in addressing this tax compliance problem. As of October 2003, 42 states and the District of Columbia have signed the Memorandum of Understanding focusing on the exchange of information relating solely to abusive tax avoidance transactions. The partnership also includes joint public outreach activities to more effectively counter the claims of those marketing tax schemes and scams.

As pointed out in your report, we began shifting examination resources to support our strategic priorities in FY 2003. 2003 was a transition year, because we did not have an established inventory selection and delivery system for the new type of work our strategies required. Our work plan had to rely on limited data given that we had not done this type of work previously to any great extent. As a consequence we over-estimated our ability to deliver inventory to the field. While the total planned Full Time Equivalents for the Abusive Schemes Program were not delivered, we used the resources for other priority work, such as the Unreported Income Discriminate Function Program. Given the inability in 2003 to identify and deliver abusive scheme inventory consistently, our policy is to focus on other strategic priorities if we do not have an abusive scheme case to work.

We will establish measurable program goals during Fiscal Year 2004 which will be process and results-oriented. The FY 2004 Business Plan includes the development of these measures as an operational priority.

We believe we are making progress combating these pervasive attacks against our tax administration system. We are: (1) better warning taxpayers about the dangers of the schemes and scams; (2) better identifying the promoters and participants in them; (3) using our enforcement powers more effectively; (4) better coordinating our actions with the Justice Department to shut down the schemes before they do more damage; (5) bringing taxpayers back into compliance; and, (6) helping to restore public confidence in the fairness of our tax administration system.

If you have any questions, please contact me or Joseph R. Brimacombe, Deputy Director, Compliance Policy, at (202) 283-2200.

Sincerely,

  
Mark W. Everson

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