



*The Parallel Investigations Process
Needs Improvement*

September 23, 2013

Reference Number: 2013-30-114

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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HIGHLIGHTS

THE PARALLEL INVESTIGATIONS PROCESS NEEDS IMPROVEMENT

Highlights

**Final Report issued on
September 23, 2013**

Highlights of Reference Number: 2013-30-114 to the Internal Revenue Service Office of the Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

In Calendar Year 2005, the IRS Commissioner established a policy that encourages civil enforcement actions in collaboration with criminal investigations when abusive tax promotions are ongoing and harm to the Government is significant. If communication and coordination are not thorough and consistent, the full range of criminal and civil remedies available may not always be explored, resulting in missed opportunities to 1) seek injunctions to prevent further harm to the Government and 2) assess civil penalties for abusive tax preparer/promoter behavior.

WHY TIGTA DID THE AUDIT

This audit was requested by the IRS's Small Business/Self-Employed Division. The overall objectives of this review were to determine whether parallel investigations are being conducted in accordance with IRS procedures and guidelines and whether there may be opportunities to improve the process.

WHAT TIGTA FOUND

Processes for communication and coordination of parallel investigations between the applicable IRS's civil compliance functions and its Criminal Investigation (CI) could be improved. The civil compliance functions are generally following the procedures that require them to communicate with CI their intent to conduct a civil investigation of an abusive tax preparer/promoter. However, CI does not always coordinate with the civil compliance functions when it becomes aware of an abusive tax preparer/promoter. Improved communication would allow the IRS to further

explore all potential civil and criminal remedies in these cases.

IRS procedures require that quarterly coordination meetings be held for ongoing parallel investigations. However, there is no consistent requirement to document these meetings. Therefore, there is no assurance that the meetings took place and that all required attendees were present. When required meetings are not held, the civil compliance functions may be unaware that CI concluded an investigation, possibly preventing the appropriate civil actions from being taken.

In addition, reconciliation of investigation case inventories among the various civil compliance functions and CI could be improved to provide IRS management with the ability to better monitor the progress of parallel investigations and ensure that the program is effective.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) revise the memorandum used for the civil compliance function notification process to clearly identify that the criminal investigation being initiated has abusive tax preparer/promoter characteristics; 2) revise procedures to ensure that all quarterly coordination meetings are conducted and documented and ensure that all procedures are consistent; 3) improve awareness of the purpose of parallel investigations through the periodic dissemination of information and training; and 4) conduct periodic reconciliations of the various investigation inventory systems used to track parallel investigations.

In their response to the report, IRS officials agreed with all four recommendations. The IRS plans to revise the memorandum used to notify the civil compliance functions, develop a standardized check sheet to document quarterly coordination meetings, and update procedures relevant to parallel investigations to ensure consistency across functions. IRS officials also plan to improve awareness by creating a training course on parallel investigations for use by civil examiners and special agents. Finally, the IRS plans to conduct a monthly reconciliation of the various inventory systems to help ensure that parallel investigations are properly tracked and monitored.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 23, 2013

MEMORANDUM FOR OFFICE OF THE DEPUTY COMMISSIONER FOR SERVICES
AND ENFORCEMENT

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Parallel Investigations Process Needs
Improvement (Audit #201230031)

This report presents the results of our review to determine whether parallel investigations are being conducted in accordance with Internal Revenue Service (IRS) procedures and guidelines and whether there may be opportunities to improve the process. This audit was requested by the Small Business/Self-Employed Division. It was conducted as part of our Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have questions, please contact me or Nancy Nakamura, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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Abbreviations

CI	Criminal Investigation
IRS	Internal Revenue Service
LB&I	Large Business and International
SB/SE	Small Business/Self-Employed



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Background

One of the Internal Revenue Service's (IRS) top priorities is to combat abusive tax avoidance schemes¹ and the individuals who promote them. During the 1990s, the IRS witnessed a proliferation of abusive tax avoidance schemes. To address the threat those schemes posed to the integrity of the Federal tax system, in Calendar Year 2001, the IRS and the Department of Justice formed a joint task force to examine how to successfully use parallel civil and criminal proceedings to stop abusive tax promotions. The task force report,² published in Calendar Year 2003, made several recommendations including:

- Bringing civil injunctions in cases where abusive tax promotion schemes or tax return preparation is ongoing and harm to the Government is significant, even when a criminal investigation has commenced.
- Civil and criminal compliance functions of the IRS should consider taking appropriate action(s) against tax return preparers or scheme promoters. This may be accomplished by pursuing solely a criminal investigation, solely a civil investigation, or parallel civil and criminal investigations.
- If it is decided that the scheme should be investigated for both civil and criminal actions, the IRS should conduct parallel civil and criminal investigations.
- Specific parallel procedures should be developed by the IRS and the Department of Justice as guidance for agents and attorneys who are conducting parallel proceedings.
- To enhance the Government's ability to pursue parallel civil and criminal proceedings, training should be provided to inform employees of the policies favoring the use of parallel investigations against abusive tax return preparers and scheme promoters.

In response to the task force's recommendations, in Calendar Year 2005, the IRS Commissioner approved Policy Statement 4-26, which encourages civil enforcement actions in collaboration with criminal investigations when abusive tax promotions are ongoing and harm to the Government is significant. The policy statement provides guidance on conducting simultaneous but

Policy Statement 4-26 provides guidance on conducting simultaneous but separate "parallel investigations" by the IRS's Criminal Investigation and the applicable IRS civil compliance function.

¹ See Appendix IV for a glossary of terms.

² IRS, *Using Parallel Civil and Criminal Proceedings to Stop Abusive Tax Schemes – A Report Prepared by an IRS/Department of Justice Task Force* (July 30, 2003).



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separate “parallel investigations” by the IRS’s Criminal Investigation (CI) and the applicable IRS civil compliance functions (hereafter referred to as “civil functions”) working authorized abusive tax promoter and preparer investigations. The goal of a parallel investigation is to achieve maximum compliance by effectively balancing criminal and civil enforcement actions to stop the promotion of abusive tax avoidance schemes. Policy Statement 4-26 also provides guidance to identify the best alternative enforcement actions from a range of civil and criminal sanctions available, prevent additional tax revenue loss, and encourage voluntary compliance.

The IRS has various civil remedies such as penalties and injunctions at its disposal to combat abuses of the tax laws. The Internal Revenue Code allows the IRS to bring civil action in district court against abusive tax scheme promoters and tax return preparers to prevent them from further engaging in illegal actions.

The Internal Revenue Code authorizes the Federal Government to take specific action against a paid tax return preparer who engages in certain practices, such as participating in any fraudulent or deceptive conduct that substantially interferes with tax law administration. If the Government establishes that the preparer’s misconduct has been continual or repeated, the court can permanently enjoin the person from further acting as a tax return preparer.

The IRS also uses criminal investigations to combat abusive tax promotions and abusive tax return preparers. In parallel investigations, CI focuses on identifying and investigating tax scheme promoters as well as those who play a substantial or integral role in facilitating, aiding, assisting, or furthering the abusive tax scheme. Furthermore, CI has implemented efforts to foster compliance by identifying, investigating, and prosecuting abusive tax return preparers.

The IRS civil functions involved in parallel investigations

The Small Business/Self-Employed (SB/SE) Division and the Large Business and International (LB&I) Division are the IRS’s two primary civil functions that participate with CI in conducting parallel investigations of abusive tax preparers/promoters. Both divisions investigate abusive tax preparers/promoters and seek civil penalties and injunctions when necessary.

- **Lead Development Center:** The SB/SE Division established the Lead Development Center to centralize receipt and development of abusive tax preparer/promoter leads, conduct research, and authorize the initiation of abusive tax preparer/promoter investigations in coordination with the IRS’s Office of the Chief Counsel, CI, and other operating divisions.
- **Office of Tax Shelter Analysis:** The LB&I Division Office of Tax Shelter Analysis serves as a centralized collection point for all its leads involving abusive tax shelters and other reportable transactions, while its Technical Tax Shelter Promoter Committee is responsible for authorizing the LB&I Division’s civil investigations. The LB&I Division Financial Services Industry function has oversight of the Technical Tax Shelter Promoter program.



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In December 2009, the SB/SE Division created the Parallel Resolution Group to discuss parallel investigations with the other stakeholders

The Parallel Resolution Group originally included stakeholders from the Lead Development Center, SB/SE Division Counsel, Criminal Tax Counsel, CI, and the Department of Justice. In December 2012, representatives from the LB&I Division were invited to join the group. These stakeholders now meet quarterly with the overall objective of discussing strategy and future actions related to parallel investigations. Among the topics discussed are:

- Awareness of the parallel process among civil examiners and CI special agents.
- Guidelines to determine when it is appropriate to proceed with civil and criminal parallel investigations.
- Improvements in the process which ensures that lines of communication remain open throughout the life cycle of a parallel investigation.

In addition, meeting participants use this opportunity to update each other on events occurring in their respective divisions and to discuss any trends identified.

This review was performed with information obtained from CI's National Headquarters Office in Washington, D.C., the SB/SE Division Lead Development Center, and the LB&I Division during the period September 2012 through June 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Communication Between Criminal Investigation and the Civil Functions Could Be Improved

The civil functions are generally following the requirement to notify CI of all proposed civil abusive tax preparer/promoter investigations. Due to the sensitive nature of criminal

Deconfliction reduces the risk of conflict in investigations.

The IRS's civil functions are required to send a memorandum to CI advising of their intent to authorize a civil investigation.

CI determines if there is:

- 1) No CI Activity.
- 2) CI Activity – No Conflict.
- 3) CI Activity – Conflict.

CI also indicates whether a civil investigation will conflict with the criminal investigation.

investigations, the IRS has established formal procedures designed to minimize the risks that simultaneous civil and criminal processes might pose to the criminal case. IRS guidelines³ require that CI be notified of all proposed abusive tax preparer and promoter investigations prior to either the SB/SE Division or the LB&I Division authorizing a civil investigation. The civil function sends a memorandum to CI of a proposed abusive tax preparer or promoter investigation (known as a deconfliction memorandum), and CI responds in writing by indicating whether the commencement of a civil investigation would likely conflict with a criminal investigation. This process is known as “deconfliction.”

A review of a judgmental sample⁴ of 31 parallel investigations closed by CI during Fiscal Years 2010 through 2012 showed that the civil functions generally deconflicted with CI as required. However, of the 31 closed cases reviewed, we were unable to locate deconfliction memorandums for four (13 percent) cases. For these four cases:

- Three were initiated by the SB/SE Division. We found evidence of deconfliction for these cases in the SB/SE Division's investigation inventory system but could not locate a memorandum.
- One was initiated by the LB&I Division. Its investigation inventory system does not include a field to annotate deconfliction. We requested that LB&I Division officials provide documentation that a deconfliction occurred. They attempted to locate the

³ Internal Revenue Manual 9.5.1.5.2 (Sep. 27, 2011).

⁴ A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.



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documentation, but were unable to do so. *****1*****
*****1*****.

CI does not always coordinate with the civil functions when it first becomes aware of a potential abusive tax preparer or promoter

While the civil functions generally followed the process to deconflict with CI, there were instances where the civil functions were not aware of ongoing criminal investigations that may have benefited from the parallel investigation process. Results of comparing civil and criminal investigation inventories showed the following situations that could have resulted in missed opportunities to seek injunctions or civil penalties.

- Analysis of a list of 2,342 nongrand jury CI investigations with ongoing abusive tax preparer/promoter characteristics active in Fiscal Year 2012 showed instances where the civil functions were not always aware that CI was conducting abusive tax preparer/promoter investigations. Of the 2,342 CI investigations, 1,585 (68 percent) had no corresponding case in the SB/SE Division's investigation inventory system, indicating that there was no referral from CI or ongoing civil investigation or lead.⁵
- Analysis of a judgmental sample of 75 adjudicated abusive tax return preparer cases publicized by CI on the IRS.gov public website for Fiscal Year 2012 showed that 39 (52 percent) cases were not on the civil functions' investigation inventory systems. We provided these names and case descriptions to the respective civil function officials to inquire about the injunction or civil penalty potential had they been notified of the abusive preparer. They responded that of the 39 cases, nine had injunction potential while 22 could have been potentially enjoined as part of a plea agreement. Although not all of the individuals identified in our analysis would necessarily warrant a full civil investigation, there may have been missed opportunities for exploring possible civil actions.

The pursuit of an injunction is time sensitive

Pursuing civil injunctions has multiple benefits for the Government. Generally, civil litigation:

- Proceeds more quickly than criminal investigations and prosecutions. Civil litigation can stop the abusive tax preparer/promoter sooner with fewer Government resources expended.
- Presents the opportunity to obtain a consent injunction during the plea agreement phase of a trial. For example, Department of Justice guidance encourages prosecutors to include a provision in the plea agreement by which the defendant agrees to be

⁵ We limited the analysis to the SB/SE Division's investigation lead list because the majority of parallel investigations occur in that division.



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permanently enjoined from preparing or filing Federal tax returns on behalf of third parties.

- Allows the Government to publicize its position on, and create awareness of, a particular abusive tax preparer/promoter or information about an abusive scheme.
- Facilitates the opening or advancement of a criminal investigation using information gathered during the injunction investigation.

An SB/SE Division official stressed the importance of CI notifying the appropriate civil function at the earliest possible opportunity. Currently, the decision to coordinate with the civil functions when CI first becomes aware of an abusive tax preparer/promoter is at the discretion of CI. Not coordinating with the civil functions could result in missed opportunities to seek injunctions to prevent further harm to the Government or assess civil penalties for abusive tax preparer/promoter behavior.

Potential exists for criminal investigations to be compromised if CI does not follow notification procedures

Analysis of the sample of the 31 parallel investigations' deconfliction memorandums showed three instances where CI had originally responded to the civil function that there was "no CI activity" on these tax preparers/promoters. However, CI subsequently opened criminal investigations on these individuals. Guidance states that if CI decides to conduct a criminal investigation after the civil investigation has been authorized, CI is responsible for coordinating with the civil function and organizing the initial coordination meeting.

In these three instances, CI did not advise the Lead Development Center when it initiated the criminal investigation. Additionally, the CI special agents did not conduct the required coordination meetings with the appropriate civil function. *****1*****
*****1*****.

Procedures require that when any tax-related investigation is opened, the special agent is to issue a notification memorandum to the SB/SE Division Technical Services unit to inform the civil function of the criminal investigation and request that any ongoing civil examination activity be suspended. The Technical Services unit determines whether it is an SB/SE or LB&I Division case and forwards the notification to the appropriate division.

However, civil function officials stated that these notifications often do not get routed appropriately. Although the notification memorandum was originally designed for traditional individual tax evasion investigations, such as individual income tax evasion where civil activity should cease while CI conducts its investigation, civil investigations that involve abusive tax preparers/promoters could continue in parallel while CI conducts its criminal investigation.

The notifications may not be forwarded to the proper civil function contacts because there is no identifying information in it to alert the Technical Services unit that the investigation is an



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abusive tax preparer/promoter and that it should be forwarded to the Lead Development Center or Office of Tax Shelter Analysis for the evaluation of civil penalty or injunction potential. Civil function officials stated that it would be beneficial if CI would notify them when it found instances of abusive tax preparers/promoters. This would facilitate communication and allow both the civil functions and CI to determine the best approach in stopping the abusive actions and curtailing further harm to the Government.

In addition, timely notification would provide civil examiners with opportunities to begin casework against abusive tax preparers/promoters so that, if appropriate, they can seek an initial injunction and be prepared to enjoin taxpayers with consent injunctions by the time any plea bargaining begins. By failing to notify the appropriate civil functions, CI risks jeopardizing its criminal investigations and the civil functions miss opportunities to permanently enjoin abusive tax preparers and promoters, if warranted.

Recommendation

The Chief, CI, and the Commissioners, LB&I and SB/SE Divisions, should coordinate efforts to:

Recommendation 1: Revise the memorandum used for the civil function notification process to clearly identify that the criminal investigation being initiated has abusive tax preparer/promoter characteristics and that the memorandum is to be forwarded to the Lead Development Center or the Office of Tax Shelter Analysis for consideration of civil actions.

Management's Response: The IRS agreed with this recommendation. Currently, there are procedures in place that require CI to notify the civil functions of all tax-related investigations including investigations against abusive tax preparers and promoters. CI is revising the notification memorandum to include: 1) specific notification to the SB/SE Division Lead Development Center or the LB&I Division Office of Tax Shelter Analysis, as appropriate, of the existence of a CI promoter/preparer investigation; 2) a list of the statutory violations that relate to abusive promoter/preparer investigations; and 3) a checkbox to indicate whether CI has determined that the investigation has potential to be worked as a parallel investigation with a civil function.

Required Quarterly Meetings May Not Have Been Held

Although guidelines require⁶ that quarterly coordination meetings be held and include the civil examiner, civil group/team manager, Area Counsel, CI special agent, CI supervisory special agent, and Criminal Tax Counsel, we could not verify that the meetings took place and that all required attendees were present. Guidance on documenting these meetings is inconsistent. Additionally, CI and the LB&I Division's investigation inventory systems do not track these

⁶ Internal Revenue Manual 4.32.2.6.4 (June 8, 2012) and Internal Revenue Manual 9.5.1.5.4 (Sept. 27, 2011).



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quarterly meetings. The SB/SE Division's investigation inventory system is only capable of tracking the most recent reported quarterly meeting date.

We found evidence of 71 (22 percent) required meetings documented in meeting minutes, e-mails about coordination meetings, and examiner activity logs for our sample of 31 parallel investigations closed by CI during Fiscal Years 2010 through 2012. Of the 71 meetings, 49 were substantiated by written meeting minutes, 17 were noted in examiner activity logs, and five were identified in e-mail exchanges. However, approximately 319 quarterly coordination meetings⁷ should have been held for the 31 parallel investigations.

To determine their understanding of the quarterly meeting requirements, we interviewed 21 special agents, civil examiners, and their managers, many of whom were involved in the investigations in our sample. IRS personnel stated that there were various reasons that conducting quarterly coordination meetings was not required or documenting these meetings was not advisable. For example:

- Frequent informal communication between civil examiners and special agents during the investigation eliminated the need for formal quarterly coordination meetings. While frequent contact between the civil examiner and special agent may have occurred, we could not determine if all participants required by the procedures were involved in or were aware of the discussions or decisions that took place.
- Some special agents were reluctant to document what was discussed during the meetings because of concerns that meeting notes would be an additional burden in ensuring that all available documents are turned over to the defense when the cases go through the discovery phase. Nevertheless, appropriate documentation that a meeting was held along with a list of attendees should be maintained.
- Some special agents believe that cases classified as "grand jury" preclude the special agents and civil examiners from conducting coordination meetings. However, a grand jury investigation does not prohibit a civil investigation. Federal Rule of Criminal Procedure 6(e) limits the use of grand jury materials to the enforcement of criminal law. Special agents cannot share information presented or that might be presented to a grand jury, but this should not prevent a quarterly coordination meeting to share information that could be used in a civil examination.
- Participants in parallel investigations often cited the postponement of the civil case as negating the need to conduct coordination meetings. Generally, the resolution of a civil case occurs more quickly than the resolution of a criminal case. Should a civil examiner determine a civil penalty is warranted, CI or the Department of Justice often requests that

⁷ The estimate of 319 is based on the duration of each parallel investigation in days divided by 90 days (which represents a quarter) to determine the number of quarterly meetings required for our sample of 31 parallel investigations.



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the civil examiner postpone assessing the penalty until the criminal case is completed. However, quarterly coordination meetings should continue until the civil proceedings are complete.

- Some special agents, especially those who have never been involved in a parallel investigation, were confused about what constituted a parallel investigation or were unfamiliar with the parallel investigation process. CI officials stated that most special agents never work a parallel investigation during their career, and that those who do may work only one or two. Some civil examiners commented that special agents sometimes view their role in parallel investigations as cooperating civil examiners who are to provide technical tax assistance to the criminal case, which would be a civil examiner's role in a joint investigation. These civil examiners further explained that typical CI actions on cases not involving an abusive tax promoter/preparer are to stop or suspend indefinitely civil investigation activity pending a criminal resolution, which is what some special agents instinctively try to do during approved parallel investigations.

Training and guidance are not consistent

The assumptions made for not conducting required coordination meetings are due to a lack of awareness of the parallel investigation procedures and conflicting guidance in the Internal Revenue Manual. Proper awareness and training that informs employees of the policies favoring the use of parallel investigations would improve the Government's ability to pursue parallel civil and criminal proceedings. When asked about training related to parallel investigations, IRS officials stated the following:

- CI: Other than the CI section of the Internal Revenue Manual, no additional guidance or specific training is provided on how to coordinate and conduct a parallel investigation.
- LB&I Division: Training was provided to LB&I Division examiners several years ago, but no significant training has been provided recently.
- SB/SE Division: Initial training that includes a section on parallel investigations is provided to new civil examiners. Parallel investigation training workshops, which include review of the relevant Internal Revenue Manual sections and Department of Justice policies, are provided to civil examination groups when requested. Further, the SB/SE Division has planned additional training centering on advanced promoter investigation techniques to be given by the end of Calendar Year 2013.

In addition, the Internal Revenue Manual is not clear on who should attend the meetings and at what point in the investigation the meetings are no longer required as well as documentation requirements. For example:



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- Internal Revenue Manual 4.32.2.6.4 (Civil) states:
Civil and criminal examiners must regularly communicate regarding their investigative efforts, but CI should not direct civil actions. Investigation status meetings are required to be held every quarter until the civil proceedings are complete.
- An additional SB/SE Division civil function guideline for the coordination of parallel investigations states:
Coordination between civil and criminal is crucial. The examiner, special agent, and IRS attorneys should advise each other of their respective actions during the required quarterly six-way conferences. These conferences continue until the civil or criminal investigation is closed. Examiners must document the results of these conferences, including any agreements reached concerning examinations or interviews of specific participants.
- Internal Revenue Manual 9.5.1.5.4 (CI) states:
Civil examiners, special agents and their respective Area Counsels must continually coordinate their efforts. Investigation status meetings are required to be held, at a minimum, every quarter until the civil proceedings are complete or the civil investigation is placed in fraud suspense.

We reviewed the civil functions' investigation inventory systems and related case files to determine whether the civil functions were aware that CI had completed its investigations for each of the cases in our sample of 31 parallel investigations. Seventeen (55 percent) of the 31 investigations were still in suspended status in the civil function's Examination Returns Control System. This suspended status indicates that civil work is not progressing because the civil examiner was requested to postpone assessing the penalty until the criminal case was completed.

In six (35 percent) of the 17 civil investigations, civil examiners appeared to have been unaware that the criminal investigations were complete and therefore did not follow up timely on seeking civil remedies. As of March 1, 2013, these six civil investigations had been suspended for an average of 612 days after CI closed its related criminal investigation. *****1*****
*****1*****
*****1*****

If quarterly meetings had been conducted as required, the maximum time a civil examiner would not be aware of the closure of a criminal investigation would be no more than about 90 days. Civil investigations remaining in suspended status after the criminal investigations are closed indicate that there is little management oversight to ensure that coordination meetings take place, thereby unnecessarily preventing the appropriate civil procedures from being concluded.



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Recommendations

The Chief, CI, and the Commissioners, LB&I and SB/SE Divisions, should coordinate efforts to:

Recommendation 2: Revise procedures to ensure that all quarterly coordination meetings are conducted and appropriately documented. Procedures should include: 1) developing a standardized format that would provide sufficient information for management oversight but would not compromise any future legal proceedings; and 2) establishing consistent time frames for conducting periodic coordination meetings or specifying when other types of contact between CI and the civil functions are sufficient. Once procedures are established, a review of the various Internal Revenue Manual sections should be completed to ensure that all guidance is consistent.

Management's Response: The IRS agreed with this recommendation. The IRS will continue with the current process in which the civil function prepares the six-way meeting memorandum; however, the civil functions and CI will work together to develop a standardized check sheet to document quarterly coordination meetings in a manner which would not include information that could compromise any legal proceedings. CI and the SB/SE and LB&I Divisions will each issue a reminder to the field to conduct quarterly meetings. CI and the SB/SE and LB&I Divisions will work together to develop time frames for conducting any other necessary coordination meetings between CI and the civil functions. The IRS will also ensure that the Internal Revenue Manual sections relevant to parallel investigations are consistent across functions.

Recommendation 3: Improve awareness of the purpose of parallel investigations by providing periodic information or training on the use of and procedures required for parallel investigations.

Management's Response: The IRS agreed with this recommendation. The civil functions will discuss the quarterly six-way meeting and associated requirements with front-line managers. The Lead Development Center will edit the Promoter Action Plan to include a statement about the requirement to conduct quarterly coordination meetings and to include links to the Internal Revenue Manual and the Parallel Investigations web pages. The Lead Development Center will also continue to include periodic articles on various aspects of parallel investigations, *e.g.*, reminders regarding available training and resources, discussions of the Promoter Action Plan, and investigation requirements such as quarterly six-way meetings. The Lead Development Center and CI will work together to create a training course on parallel investigations for use by civil examiners and special agents.

Reconciliation of Investigation Case Inventories Could Be Improved

An analysis of 298 parallel investigations identified by CI as being closed during Fiscal Years 2010 through 2012 showed that 50 (17 percent) were not on the civil functions'



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investigation inventory systems. Reasons for the discrepancy in the inventories may be attributed to:

- The civil Examination function considers parallel investigations to be SB/SE Division or LB&I Division authorized abusive tax preparer/promoter investigations where a criminal investigation is also active during the deconfliction process. However, the Collection function considers any collection activity occurring while CI is conducting an investigation to be a parallel investigation, regardless of whether it involves an abusive tax preparer/promoter.
- CI designated some internal fraud referrals and some criminal investigations worked with other Federal agencies as parallel investigations, although those did not meet Policy Statement 4-26 criteria.
- The civil functions may consider a parallel investigation to be occurring when they are conducting an examination on a taxpayer that CI considers an associate of an abusive tax preparer/promoter, such as an investor or client. CI may not necessarily consider those to be parallel investigations.

While there is no parallel investigation inventory reconciliation process between CI and the LB&I Division Financial Services Industry function, there is some attempt to reconcile parallel investigation inventory between CI and the Lead Development Center. The Lead Development Center's goal is to provide CI a monthly report of all its open investigations, but the frequency of the reconciliation process has not been formalized. When CI receives the Lead Development Center's report, CI compares the report to its data to determine the status of the criminal investigation. CI reports this back to the Lead Development Center, but does not ask that the Center reconcile what CI considers to be a parallel investigation. Without an appropriate method of tracking parallel investigation cases, IRS management may not be able to identify all parallel investigations and monitor their progress to ensure that their program is effective and that the IRS obtains the full range of enforcement options available to the Government.

Recommendation

The Chief, CI, and the Commissioners, LB&I and SB/SE Divisions, should coordinate efforts to:

Recommendation 4: Conduct a periodic, standardized reconciliation of the civil functions' investigation inventory systems to CI's investigation inventory system to ensure that all parallel investigations are correctly designated in the systems and are properly tracked and monitored.

Management's Response: The IRS agreed with this recommendation. On a monthly basis, the civil functions will provide CI with a list of active promoter and preparer investigations. CI will advise that the civil inventory is correctly reflected in CI's inventory system.



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Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to determine whether parallel investigations are being conducted in accordance with IRS procedures and guidelines and whether there may be opportunities to improve the process. To achieve these objectives, we:

- I. Determined whether the IRS's policies and procedures ensured that parallel investigations were effectively used to coordinate criminal and civil actions to stop abusive tax avoidance scheme promotions¹ and abusive tax return preparers by reviewing guidance issued by CI, the applicable civil functions, and IRS Counsel for consistency with Policy Statement 4-26, inclusion of relevant/emerging issues, proper coordination protocol, and appropriate information sharing procedures upon the commencement of a parallel investigation.
 - A. Evaluated IRS employees' interpretation of the use of parallel investigations by determining their understanding of the process and the criteria under which such investigations are pursued.
 1. Surveyed each of the 25 CI field office special agents in charge.
 2. Interviewed CI's Global Financial Crimes management; nine judgmentally² selected CI supervisory special agents and special agents; 10 judgmentally selected civil function group managers and civil examiners; the SB/SE Division Lead Development Center and the LB&I Division Office of Tax Shelter Analysis and Financial Services Industry function program managers; the SB/SE Division Lead Development Center parallel investigation coordinator; officials in the SB/SE Division Collection function; officials in SB/SE Division Counsel; Criminal Tax Counsel; and officials at the Department of Justice.
 - B. Discussed CI's and the civil functions' training material used to inform employees of policies regarding the use of and procedures for parallel investigations.
 - C. Reviewed data from the inventory tracking systems used by CI, the SB/SE Division Lead Development Center, and the LB&I Division Office of Tax Shelter Analysis and Financial Services Industry function to determine if the systems would enable each group to identify and monitor the status or progress of parallel investigations.

¹ See Appendix IV for a glossary of terms.

² A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population. Judgmental samples were used throughout because we did not intend to project the results to the entire population.



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- D. Reviewed meeting minutes from eight Parallel Investigation Working Group quarterly meetings held between July 2011 and March 2013 to determine the issues and concerns raised by each function.
- II. Determined whether IRS actions ensured that parallel investigations were effectively used to coordinate criminal and civil actions to stop abusive scheme promoters and tax return preparers.
 - A. Reconciled SB/SE Division abusive tax preparer/promoter cases designated as parallel with CI cases also designated as parallel to determine whether CI's and the civil functions' monitoring data on parallel investigations were in agreement.
 - B. Selected a judgmental sample of 30 open SB/SE Division cases from a population of 56 investigations and one closed LB&I Division case from a population of five investigations that were designated as "closed parallel" by CI during Fiscal Years 2010 through 2012. We analyzed each case to determine whether the deconfliction process was followed and whether the required quarterly coordination meetings were held.
 - C. From the judgmental sample of 30 open SB/SE Division cases selected in Step II.B, determined that 17 were in suspended status in the civil functions but were considered closed by CI. We discussed these cases with the civil functions to determine whether civil action should have resumed.
 - D. Analyzed a list of 2,342 nongrand jury criminal investigations with ongoing abusive tax preparer/promoter characteristics active in Fiscal Year 2012 provided by CI to determine if the civil functions were aware of the cases.
 - E. Analyzed all 75 adjudicated abusive tax return preparer cases that were publicized by CI on the IRS.gov public website to determine if the civil functions were aware of the criminal investigations. We provided the cases to the SB/SE Division Lead Development Center for a determination of whether the cases might have had injunction or penalty potential had the civil functions been aware of the criminal investigations.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objectives: IRS policies, procedures, and practices for determining whether parallel investigations are conducted in accordance with stated policy. We evaluated these controls by reviewing source materials, interviewing management and



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front-line employees, and reviewing a judgmentally selected sample of 31 parallel investigation cases during Fiscal Years 2010 through 2012.



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Appendix II

Major Contributors to This Report

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Bryce Kisler, Director
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Frank O'Connor, Lead Audit Evaluator
Margaret Filippelli, Senior Auditor
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Appendix III

Report Distribution List

Acting Commissioner
Office of the Commissioner – Attn: Chief of Staff C
Chief, Criminal Investigation SE:CI
Commissioner, Large Business and International Division SE:LB
Commissioner, Small Business/Self-Employed Division SE:S
Deputy Chief, Criminal Investigation SE:CI
Deputy Commissioner (Domestic), Large Business and International Division SE:LB
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
 Deputy Commissioner for Services and Enforcement SE
 Chief, Criminal Investigation SE:CI
 Commissioner, Large Business and International Division SE:LB
 Commissioner, Small Business/Self-Employed Division SE:S



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Appendix IV

Glossary of Terms

Term	Definition
Abusive Tax Avoidance Schemes	A specific tax transaction or promotion that reduces tax liability by taking a tax position that is not supported by tax law or manipulates the law in a way that is not consistent with the intent of the law (tax evasion). Abusive tax avoidance schemes may be applicable to either a large number of taxpayers or a limited number of taxpayers. These strategies may be organized and marketed and, if so, are often referred to as an abusive tax shelter.
Calendar Year	The 12-consecutive-month period ending on December 31.
Civil Enforcement Action	Civil promoter penalty examinations and injunctions against promoters of abusive tax avoidance transactions and tax return preparers.
Civil Examiner	In the context of this report, an employee of the Examination function who is trained to work civil investigations of abusive promoters or preparers. However, the examiner position is also used for many other types of positions located in various IRS offices.
Consent Injunction	An offer by a preparer or promoter whereby he or she voluntarily agrees to a permanent injunction.
Deconfliction	The process by which the SB/SE Division Lead Development Center and the LB&I Division Office of Tax Shelter Analysis send a memorandum to CI of a proposed abusive tax preparer or promoter investigation (known as a deconfliction memorandum), and CI responds in writing by indicating whether the commencement of a civil investigation would likely conflict with a criminal investigation.



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Term	Definition
Discovery	The efforts of a party to a lawsuit and the party's attorney(s) to obtain information before trial through demands for production of documents, depositions of parties and potential witnesses, written interrogatories (questions and answers written under oath), written requests for admissions of fact, examination of the scene, and the petitions and motions employed to enforce discovery rights.
Enjoin	To prohibit by a judicial order.
Fiscal Year	A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Grand Jury	A grand jury is established to hear testimony to determine whether there is probable cause to believe that the person to be indicted committed the crime in question. The grand jury adheres to the strictest of secrecy, and violators are subject to severe penalties.
Injunction	A judicial process or order requiring the person(s) to whom it is directed to do a particular act or to refrain from doing a particular act.
Internal Revenue Code	The codified collection of United States laws on income, estate and gift, employment, and excise taxes, plus administrative and procedural provisions.
Internal Revenue Manual	A manual containing the procedures and controls for IRS employees to follow.
Joint Investigation	A method used by CI to combat tax fraud in which a cooperating civil examiner assists the CI special agent on the technical tax aspects of a criminal investigation.
Plea Agreement	Agreements between defendants and prosecutors in which defendants agree to plead guilty to some or all of the charges against them in exchange for concessions from the prosecutors.
Special Agent	A law enforcement employee who investigates potential criminal violations of the tax laws and related financial crimes.
Special Agent in Charge	A law enforcement employee responsible for directing, monitoring, and coordinating the criminal investigation activities within a field office's area of responsibility.



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Term	Definition
Supervisory Special Agent	A supervisory law enforcement employee who oversees special agents and the overall criminal investigation.



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Appendix V

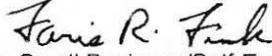
Management's Response to the Draft Report



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

September 4, 2013

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Parallel Investigations Process Needs
Improvements (Audit # 201230031)

Thank you for the opportunity to review the subject draft report. We appreciate your acknowledgement that the Internal Revenue Service is generally following the established procedures to ensure that commencement of a civil investigation will not conflict with a criminal investigation.

Parallel investigations achieve maximum compliance by effectively balancing criminal and civil enforcement actions to stop the promotion of abusive tax avoidance schemes. As your report states, due to the inherent risks involved and the rules and regulations governing both criminal and civil processes, additional procedures and increased oversight are necessary when considering the use of parallel proceedings. Our planned corrective actions based on your recommendations will help to strengthen our current procedures. We would note, however, that the findings in your report regarding parallel investigations and abusive tax return preparers and promoter cases cannot be projected to the respective case populations because the results were derived from judgment samples and are therefore not representative of the entire population.

Attached is a detailed response outlining our corrective actions.

If you have any questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self-Employed Division at 202-283-2659.

Attachment



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Attachment

RECOMMENDATION 1:

The Chief, CI, and the Commissioners, LB&I and SB/SE Divisions, should coordinate efforts to revise the memorandum used for the civil function notification process to clearly identify that the criminal investigation being initiated has abusive tax preparer/promoter characteristics and that the memorandum is to be forwarded to the Lead Development Center or the Office of Tax Shelter Analysis for consideration of civil actions.

CORRECTIVE ACTION:

We agree with this recommendation. Currently there are procedures in place that require Criminal Investigation (CI) to notify the civil functions of all tax-related investigations including investigations against abusive tax preparers and promoters. CI is revising the notification memorandum to include (1) specific notification to the Small Business/Self-Employed (SB/SE) Lead Development Center (LDC) or Large Business & International (LB&I) Office of Tax Shelter Analysis, as appropriate, of the existence of a CI promoter/preparer investigation; (2) a listing of the statutory violations that relate to abusive promoter/preparer investigations; and (3) a checkbox to indicate whether CI has determined that the investigation has potential to be worked as a parallel investigation with a civil function.

IMPLEMENTATION DATE:

May 15, 2014

RESPONSIBLE OFFICIAL(S):

Director, Operations Policy and Support, CI

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:

The Chief, CI, and the Commissioners, LB&I and SB/SE Divisions, should coordinate efforts to revise procedures to ensure that all quarterly coordination meetings are conducted and appropriately documented. Procedures should include: 1) developing a standardized format that would provide sufficient information for management oversight but would not compromise any future legal proceedings; 2) establishing consistent time frames for conducting periodic coordination meetings or specifying when other types of contact between CI and the civil functions are sufficient. Once procedures are established, a review of the various Internal Revenue Manual (IRM) sections should be completed to ensure that all guidance is consistent.



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CORRECTIVE ACTION:

We agree with this recommendation. We will continue with the current process in which the civil function prepares the six-way meeting memorandum; however, the civil functions and CI will work together to develop a standardized check sheet to document quarterly coordination meetings in a manner which would not include information that could compromise any legal proceedings. CI, SB/SE and LB&I will each issue a reminder to the field to conduct quarterly meetings. CI, SB/SE and LB&I will work together to develop time frames for conducting any other necessary coordination meetings between CI and the civil functions. We will ensure that the IRM sections relevant to parallel investigations are consistent across functions.

IMPLEMENTATION DATE:

June 15, 2015

RESPONSIBLE OFFICIAL(S):

Director, Operations Policy and Support, CI
Director, Abusive Transactions and Technical Issues, SB/SE
Director, Pre-Filing & Technical Guidance, LB&I

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:

The Chief, CI, and the Commissioners, LB&I and SB/SE Divisions, should coordinate efforts to improve awareness of the purpose of parallel investigations by providing periodic information or training on the use of and procedures required for parallel investigations.

CORRECTIVE ACTION:

We agree with this recommendation. The civil functions will discuss the quarterly six-way meeting and associated requirements with front-line managers. The LDC will edit the Promoter Action Plan to include a statement about the requirement to conduct six-way meetings quarterly and to include links to the IRM and Parallel Investigations web pages and will continue to include periodic articles on various aspects of parallel investigations (e.g. reminders regarding available training and resources, discussions of Promoter Action Plan and investigation requirement such as quarterly six-way meetings). The LDC and CI will work together to create a CENTRA or web-based training course on parallel investigations for use by civil and criminal agents.

IMPLEMENTATION DATE:

June 15, 2015



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RESPONSIBLE OFFICIAL(S):

Director, Operations Policy and Support, CI
Director, Abusive Transactions and Technical Issues, SB/SE
Director, Pre-Filing & Technical Guidance, LB&I

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls

RECOMMENDATION 4:

The Chief, CI, and the Commissioners, LB&I and SB/SE Divisions, should coordinate efforts to conduct a periodic, standardized reconciliation of the civil functions' investigation inventory systems to the CI's investigation inventory system to ensure that all parallel investigations are correctly designated in their respective systems and are properly tracked and monitored.

CORRECTIVE ACTION:

We agree with this recommendation. On a monthly basis the civil functions will provide CI with a list of active promoter and preparer investigations. CI will advise that the civil inventory is correctly reflected in CI's inventory system.

IMPLEMENTATION DATE:

June 15, 2014

RESPONSIBLE OFFICIAL(S):

Director, Operations Policy and Support, CI
Director, Abusive Transactions and Technical Issues, SB/SE
Director, Financial Services, LB&I

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.