

INMATE TAX SCAMS

© Monica Haven, E.A. 072106

Advanced Criminal Topics Seminar
Professor Laurie Levenson
Loyola Law School
Summer 2006

Monica Haven
mhaven@pobox.com

Table of Contents

| | | |
|-------------|---|-----------|
| I. | INTRODUCTION..... | 1 |
| II. | TAX SCAMS IDENTIFIED | |
| | A. Scope of the Problem | 5 |
| | B. Creative Cons | 7 |
| | 1. Refund Claims | |
| | 2. Social Security Fraud | |
| | 3. FEMA Fraud | |
| | 4. From the Outside In | |
| | C. Accomplices | 13 |
| | D. The Perfect Con..... | 15 |
| III. | CASE LAW | |
| | A. Scams Exposed and Prosecuted..... | 18 |
| | B. Penalties | 20 |
| | 1. Sentences and Restitution | |
| | 2. Sentencing Guidelines | |
| IV. | ATTACKING THE PROBLEM | |
| | A. Current IRS Strategy | 25 |
| | 1. Computer Enhancements | |
| | 2. Fraud Alerts | |
| | 3. Additional Steps | |
| | B. Congressional Action | 28 |
| | C. Information Sharing | 29 |
| | D. Prison Policies..... | 32 |
| | 1. Procedures for Legitimate Filings | |
| | a. Sources of Inmate Earnings | |
| | b. Filing Requirements | |
| | 2. Prophylactic Measures | |
| | 3. Increased Criminal Activity | |

| | | |
|------------|---|-----------|
| V. | INMATE RIGHTS..... | 38 |
| VI. | CONCLUSION | |
| | A. Radical Solutions..... | 40 |
| | B. Voluntary Compliance..... | 43 |
| | APPENDICES | 45 |
| | A. Refund Returns Filed and Refunds Claimed | |
| | B. False Prisoner Returns versus Total False Returns | |
| | C. Scam Schematic | |
| | D. Table of Base Level Offenses | |
| | E. Sentencing Table | |
| | F. Top Five Reasons Why Refunds Were Issued | |
| | G. Percentage ELF and Paper Prisoner Returns | |
| | H. Incidence of Refund Fraud at Prisons | |
| | I. Schemes with the Largest Number of Prisoner Returns | |
| | LISTING OF ACRONYMS USED THROUGHOUT THIS PAPER..... | 54 |

INMATE TAX SCAMS

I. INTRODUCTION

96 INT -- PRISON LIBRARY/ANDY'S OFFICE -- DAY (1950)
Andy is doing taxes. Mert Entwhistle is seated across from him.
Other off-duty guards are waiting their turn.

RED (Voice-over)

The following April, Andy did tax returns
for half the guards at Shawshank.

97 INT -- PRISON LIBRARY -- ONE YEAR LATER (1951)
Tax time again. Even more guards are waiting.

RED (Voice-over)

Year after that, he did them all... including the warden's.

99 INT -- PRISON LIBRARY/ANDY'S OFFICE -- DAY (1952)

RED (Voice-over)

Yes sir, Andy was a regular H&R Block.

In fact, he got so busy at tax time, he was allowed a staff.¹

¹ Excerpts from the script of *The Shawshank Redemption* (Columbia Pictures 1994), available at <http://www.angelfire.com/movies/moviefreak/shawshank.html> (last accessed July 16, 2006).

Andy's tax scam as portrayed in the movie *The Shawshank Redemption* was perpetrated from behind prison walls by an inmate sentenced to two consecutive life terms in 1946 for the murder of his wife and her lover. And when Andy escaped nineteen years later he "visited nearly a dozen banks in the Portland area... [and] blew town with better than 370 thousand dollars."

The stuff of Hollywood fiction? Hardly! Prison tax fraud occurs with relative ease and great frequency in real prisons every day and is committed by real inmates demanding tax refunds in real dollars. The problem is neither isolated nor inconsequential. In fact, fraudulent refund claims are not only significant in terms of federal tax dollars lost, but also because the pervasiveness of the fraud threatens the continued viability of the American tax system.

Prison inmates are uniquely suited to the crime: Often bright, always bored, and generally pre-disposed negatively toward a government they hold responsible for their incarceration, inmates have the necessary wherewithal to develop and commit a variety of tax scams. Part II of this paper will examine the scope of the problem, the methodologies employed by the inmates, and the assistance required from accomplices outside the prisons to successfully bilk the government of millions of dollars.

Unfortunately many of the schemes remain undetected; even fewer are prosecuted. Neither the tax authorities nor federal prosecutors are particularly motivated to pursue these scams since prosecution and eventual sentencing appear to have no deterrent effect on either inmates already behind bars or would-be offenders still living freely. Prosecutions are costly, sentences are relatively light, and restitution is near impossible. Nevertheless, there is a strong sense that inmates should not simply be allowed to escape the consequences. Part III provides a sampling of cases selected for prosecution due to the likelihood of

obtaining convictions. Typically these cases involve conspiracies which are punishable by enhanced sentences based on federal guidelines.

The problem of inmate tax scams is fixable. Part IV outlines what is currently being and what still can be done to combat the abuses. Tax authorities, for example, have instituted policies to better detect fraudulent claims once filed, whereas prison authorities have developed rules in an attempt to stem the flow of fraudulent returns before they even leave the penitentiaries. But the biggest problem that remains is one of poor communications between tax and prison authorities.

Where mutual disclosure is prohibited by the existing tax code, the Legislature must amend the rules. All proposed solutions must consider inmate rights. Constitutional guarantees, for instance, prohibit the total denial of tax publications to inmates as well as unrestricted mail censorship. However, prisoner telephone calls made may be monitored. Part V discusses these limitations and illustrates the fine line that regulatory authorities must walk in an effort to curtail the tax fraud problem.

In conclusion, inmate tax scams abound and because they are perpetrated by those who have already taken something from society, they are exceptionally odious. Actual and potential tax losses are great, but the true threat posed by these scams runs deeper. If left unchecked, ordinary citizens may rebel by cheating in similar fashion, thereby jeopardizing a tax system based upon voluntary compliance.

[See page 54 for Listing of Acronyms used throughout this Paper.]

II. TAX SCAMS IDENTIFIED

“Honest taxpaying Americans are being defrauded to an alarming extent,” warns U.S. Representative J.D. Hayworth (D-AZ).² While processing an estimated 130 million tax returns during 2004, the Internal Revenue Service (IRS) detected \$2.2 billion worth of false refund claims some of which were made on the 455,000 returns that were filed by prison inmates in federal, state, and local correctional institutions.^{3,4} [See Appendix A: Refund Returns Filed and Refunds Claimed.] These numbers are as staggering as they are outrageous.

While the 16th Amendment, ratified in 1913, grants Congress the “power to lay and collect taxes on incomes, from whatever source derived,”⁵ the U.S. income tax system is based on voluntary compliance. Taxpayers are asked to report all sources of revenue to the federal government and self-assess the resulting tax liability. To ensure compliance, the U.S. Treasury has granted enforcement powers to the IRS which audits a sampling of filed returns. These examinations ensure that those taxpayers who have filed incorrect information can make necessary corrections and pay the proper tax due, and also serve as a general deterrent to a public fearful of close scrutiny and collection activities.

In general, the system works: Compliance is reasonably high, although the IRS reports that the tax gap—the difference between the tax that should be paid

² Hayworth Dubs Jailhouse Tax Fraud Scheme (June 29, 2005), as quoted at <http://www.jdhayworth.com/cgi-data/press/files/27.shtml> (last accessed July 7, 2006) [hereinafter *Hayworth Dubs*].

³ Dennis Wagner, *Inmates Scam IRS Big Time: Prisoners rake in refunds from phony tax forms; few ever caught, punished* (December 25, 2005), available at <http://img.azcentral.com/specials/special21/articles/1225inmatescam.html> (last accessed July 7, 2006) [hereinafter *Inmates Scam IRS*].

⁴ Ken Rankin, *H & R cell block? Jailbirds scam IRS* (Jul 25, 2005), available at <http://www.webcpa.com/article.cfm?articleid=13783&pg=acctoday&print=yes> (last accessed July 8, 2006) [hereinafter *H & R cell block?*].

⁵ U.S. Const. amend. XVI.

and the actual tax collected—is currently \$290 billion.⁶ Due only in part to the complexity of the tax laws, the bulk of the tax gap is attributable to under-reported income, while the remainder is caused by non-filers and those who have not paid their liabilities. Nevertheless, the IRS reports that 224 million business and individual returns were filed in 2004 (the last complete year for which data is available)⁷ and that more than \$2 trillion was collected by the federal government.⁸ Hence, the supposed tax gap totals about 15% of collections, and of that gap less than 1% is attributable to fraudulent refund claims. [See Appendix B: False Prisoner Returns versus Total False Returns.] Still, taxpayers who do comply are rightfully angered by those who do not and are particularly incensed by those who intentionally cheat.

A. Scope of the Problem

Prison inmates, whether incarcerated in federal or state penitentiaries, are presumed to have been removed from society and disenfranchised. For example, convicted felons forfeit their right to vote. But the public further assumes that inmates have also relinquished their right to earn a living and hence, any need to file a tax return. Whether this presumption is correct will be explored in Part IV, Section D but for now, readers may presuppose that inmates do not have a federal tax filing requirement and yet...

⁶ *IRS Updates Tax Gap Estimates*, I.R.S. News Rel.2006-28 (February 14, 2006), available at <http://www.irs.gov/newsroom/article/0,,id=154496,00.html> (last accessed July 7, 2006).

⁷ *Number of Returns Filed, by Type of Return and State, Fiscal Year 2004*, SOURCE: IRS Data Book, FY 2004, Publication 55b, available at <http://www.irs.gov/taxstats/compliancestats/article/0,,id=97168,00.html> (last accessed July 7, 2006).

⁸ *Internal Revenue Collections and Refunds, by Type of Tax, Fiscal Years 2004 and 2005*, SOURCE: IRS Data Book, FY 2005, Publication 55b, available at <http://www.irs.gov/taxstats/compliancestats/article/0,,id=97168,00.html> (last accessed July 7, 2006).

- ◆ A 37-year old inmate serving a 25-year term for burglary, grand larceny, and arson testified before the House Ways and Means Committee that he filed approximately 700 tax forms claiming refunds on behalf of fellow inmates totaling approximately \$3.5 million.⁹
- ◆ An inmate of the Marana Community Correctional Treatment Facility near Tucson, Arizona filed refund claims totaling more than \$200,000.¹⁰
- ◆ A Florida inmate serving time for murder listed 35 fellow inmates who recently received tax refund checks for thousands of dollars and stated that similar scams are employed “all over the place.” Based on this information, WESH News Channel 2 investigative reporters estimate that the 500 fraudulent forms filed from one prison (as well as from each of another five institutions identified by the inmate) cost the IRS and taxpayers nearly \$2.5 million.¹¹
- ◆ The *Arizona Republic* reports that IRS officials detected \$68 million in false refund applications filed by 18,000 U.S. prisoners during 2004.¹²
- ◆ Treasury Department officials estimate that the number of fraudulently filed inmate tax returns quadrupled last year.¹³
- ◆ Nancy Jardini, Chief of the IRS Criminal Investigations Division (CID) estimates that while prisoner returns represent less than 1% of all tax returns filed, more than 15% of all false refund claims are attributable to inmates, an increase of 700% in three years.¹⁴

⁹ Hayworth Dubs, *supra* n. 2.

¹⁰ *Inmates Scam IRS*, *supra* n. 3.

¹¹ Stephen Stock, *Inmate: 'It's Been Going On For Years'* (November 16, 2005), available at <http://www.wesh.com/news/3923526/detail.html> (last accessed July 7, 2006) [hereinafter *Going On*].

¹² Dennis Wagner as quoted on January 9, 2006 at <http://www.sniggle.net/Experiment/index.php?entry=09Jan06&showyear=2006> (last accessed July 7, 2006).

¹³ Brett Witt, *SC Prisoner Details Tax Fraud Scheme Worth Millions* (June 29, 2005), available at <http://www.wistv.com/Global/story.asp?S=3539062&nav=0RaPbckH> (last accessed July 7, 2006).

¹⁴ *Inmates Scam IRS*, *supra* n. 3.

Alarmed by the wide-spread nature of the problem and its tremendous fiscal costs, the U.S. House of Representatives convened a subcommittee hearing to identify potential curative and preventative measures which could be implemented to put “Operation H & R (Cell) Block”¹⁵ out of business. The June 29, 2005 hearing began, as does this paper, with a summary of various methods used by inmates to defraud the tax system.

B. Creative Cons

Testifying anonymously behind a partition during the House Ways and Means subcommittee hearing, prison inmate John Doe said that he “started out by filing phony returns for ten inmates in 1991, which netted \$4,200 to \$5,400.” In the ensuing years he filed “six to seven hundred returns” and kept a \$1,000 commission on each.¹⁶ Doe explained how he did it:

“In 1991 I saw a television commercial made by the IRS promoting early filing of tax returns to avoid the spring tax rush. I decided to file ten returns using fellow inmates’ information just to see what would happen. The tax forms were readily available at the institution through the library... All ten refunds went through... When nothing happened behind those returns, I started filing

¹⁵ J.D. Hayworth (R-AZ) created this clever moniker after listening to an inmate’s description of fraudulent tax schemes employed by prison inmates.

¹⁶ Frederic J. Frommer, *Prisoner Details Bogus Tax-Return Scheme* (June 29, 2005), available at <http://beta.abc3340.com/news/stories/0605/239521.html> (last accessed July 8, 2006) [hereinafter *Bogus Tax-Return Scheme*].

every year for whatever groups of inmates I was friends with.”¹⁷

News of successful scams spreads rapidly through the prison grapevine, encouraging others to make similar attempts. In fact, a Florida prisoner serving a life sentence even “prepared a self-help manual instructing others on how to prepare fraudulent returns”!¹⁸ However, due to the sheer size of the government bureaucracy and the complexity of the Internal Revenue Code (IRC), creative cons have developed myriad schemes that, while akin in purpose, vary in technique. [See Appendix C: Scam Schematic.]

1. Refund Claims

Whether preparing fictitious W-2 forms using the names and Social Security numbers of fellow inmates to report wages never earned or creating Employee Identification numbers for deceased individuals and collecting refunds for the EITC, the schemes are always creative and evolve with tenacious regularity. Often developed by enterprising felons with too much time on their hands and already serving lifelong sentences, the inventiveness of the scams is boundless.¹⁹

In one instance, an inmate prepared a false W-2 Wage and Tax Statement which was photocopied and attached to sixty-six returns filed by other

¹⁷ Excerpt from transcript of John Doe’s testimony given before H.R. Ways and Means Comm., *Hearing to Examine Tax Fraud Committed by Prison Inmates*, 109th Cong. (June 29, 2005), at 15, available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=4523> (last accessed July 17, 2006) [hereinafter *House Hearing*].

¹⁸ Ken Rankin, *Prisoner tax fraud: How they did it* (Jul 25, 2005) available at <http://www.webcpa.com/article.cfm?articleid=13783&pg=acctoday&print=yes> (last accessed July 8, 2006) [hereinafter *How they did it*].

¹⁹ The German proverb “Ein ausgeruhter Kopf lernt gut” seems particularly apropos [Translation: “A well-rested head learns well”].

inmates claiming refunds.²⁰ But if W-2 forms are unavailable, the IRS has allowed the use of Form 4852 Substitute for Form W-2, Wage and Tax Statement, 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. Indeed, IRS instructions for this form specifically state that it should be used “as a substitute for Forms W-2, W-2c and 1099-R when an employer or payer does not issue a Form W-2 or Form 1099-R or when an employer or payer has issued an incorrect Form W-2 or Form 1099-R.”²¹ Used most commonly by individuals who have worked for employers who have since discontinued operations, prison inmates use this form to fraudulently report wages that were never paid by employers that never existed.

A Louisiana woman filed fictitious tax returns on behalf of eleven inmates using Schedule C Profit and Loss from Business (Sole Proprietorship) to falsely claim business income allegedly (but impossibly) earned by the prisoners while incarcerated.²² WESH investigative news reporters uncovered an outside middleman who was paid to file false tax returns claiming refunds of excess tax withholdings on behalf of inmates for work they never performed.²³

Nancy Jardini of the IRS testified during the Ways and Means Hearing that “[n]umerous tax credits to which prisoners were not entitled were also claimed, including the EITC, the Advanced Earned Income Credit, the Child and Dependent Care Credit, the Education Credit, the Child Tax Credit, and the Adoption Credit.”²⁴ Available to qualified taxpayers, instructions for claiming these credits specifically prohibit inclusion of wages “for work done while an

²⁰ *How they did it*, supra n. 18.

²¹ I.R.S. Form 4852 (Rev. 12-2005).

²² *How they did it*, supra n. 18.

²³ *Inmates Receive Hundreds of Thousands of Dollars in Refunds* (March 2, 2005), available at <http://www.wesh.com/news/4247557/detail.html> (last accessed July 8, 2006) [hereinafter *Inmates Receive Hundreds*].

²⁴ *H & R cell block?*, supra n. 4.

inmate in a penal institution,”²⁵ thereby explicitly precluding prisoners from eligibility. Nevertheless, such claims have been filed (and refund checks have been issued by the tax authority).²⁶

2. Social Security Fraud

While the focus of this paper is on tax scams, it is worth noting that other fraudulent schemes abound. For example, California inmates at the Pelican Bay State Prison gained unlawful access to Social Security numbers and other personal data about prison employees while working in a warehouse.²⁷ Prison guards have filed suit against the state corrections department for granting access to such information “to people already convicted of felonies” by carelessly storing boxes of personal data on shelves next to a weight bench in the gym.²⁸

An Ohio cancer patient was denied his Social Security checks when an inmate in a North Carolina federal prison used the victim’s identity to claim disability benefits.²⁹ In other cases, such information is used to amass fraudulent charges on credit cards or transfer money via Western Union. Law enforcement officials are warning citizens to guard their identities ferociously and to “never give personal information to ANYONE over the telephone, internet, or

²⁵ *Child Tax Credit for Use in Preparing 2005 Returns*, I.R.S. Publication 972 (Cat. No. 26584R), at 8, Line 4b: Taxable Earned Income Worksheet and I.R.S Form 1040 Instructions (2005) (Cat. No. 11325E), at 47, Line 2: Earned Income Credit Worksheet.

²⁶ In its publication *2005 Energy Rebate Information for New Mexico’s Senior Citizens* the Revenue and Taxation Department expressly states that refundable rebates and credits may only be claimed if “you were not an inmate of a public institution for more than six months of the tax year” (page 1 of Instructions for 2005 PIT-1-RC New Mexico Rebate and Credit Schedule).

²⁷ Robert Douglas, *Privacy & Information Security News*, blog available at <http://www.privacytoday.com/> (last accessed July 8, 2006).

²⁸ Christina Jewett, *Inmates got guards’ ID in prison, suit says*, The Sacramento Bee (June 1, 2006), available at <http://www.sacbee.com/content/news/california/story/14262655p-15075864c.html> (last accessed July 8, 2006).

²⁹ *Local Man’s Social Security Checks Halted* (February 16, 2006), available at http://www.wkrc.com/heyhoward/story.aspx?content_id=A389A8BD-8016-4845-8CC8-B8466C2AEB66 (last accessed July 8, 2006).

by any other means unless” the caller can be verified.³⁰ Although many would-be criminals have concocted schemes by which they glean this information from unsuspecting victims, prison inmates with access to telephones have often perpetrated this deception.

In its review of inmate telephone abuse, the U.S. Office of the Inspector General reports that while “all calls made by inmates are recorded[,] less than three and a half percent of all inmate calls are listened to by BOP [Bureau of Prisons] staff” and that these limited efforts are virtually useless in preventing inmates from committing crimes using the telephones.”³¹ Attributed to a lack of sufficiently trained manpower, inadequate equipment, language barriers, and concerns regarding privacy issues, most federal institutions have done little to curtail the problem or are even aware of its extent.

3. FEMA Fraud

Sadly, identity theft is not the only white collar crime committed by inmates from behind prison walls. Two Louisiana inmates were recently indicted for mail fraud and theft of public money stemming from their fraudulent applications for FEMA disaster relief funds. They claimed that their *primary* residences in New Orleans had suffered hurricane damage, when in fact they were housed at a correctional facility during the storm.³² In this case, the

³⁰ Media Release from the Pima County Sheriff’s Department—*Scam of the Week* (October 17, 2005), available at <http://www.pimasheriff.org/MR2005/101705scamoftheweek.htm> (last accessed July 9, 2006) reports that a woman was contacted by a supposed representative of a cellular phone company requesting her Social Security number. Two days later “Paul,” ostensibly from Wells Fargo Bank, sought to verify personal information.

³¹ USDOJ/OIG Special Report, *Criminal Calls: A Review of the Bureau of Prisons’ Management of Inmate Telephone Privileges* (August, 1999), available at <http://www.usdoj.gov/oig/special/9908/callsp4.htm> (last accessed July 9, 2006).

³² *Two Prison Inmates Indicted on FEMA Fraud Charges*, The New York Jewish Times, available at <http://nyjtimes.com/Stories/2005/InmatesIndictedOnFEMAFraud.htm> (last accessed July 9, 2006).

deception was uncovered when the FEMA checks arrived in the prison mail and were intercepted. However, had the inmates more cleverly requested that the relief funds be directly deposited into bank accounts, the scheme might have remained undetected. A General Accounting Office study has found that FEMA paid millions of dollars to applicants who “used names and Social Security numbers belonging to state and federal prisoners.”³³ One inmate collected \$20,000 using a post office box address.³⁴

4. From the Outside In

Finally, it should be noted that inmate tax scams, when not actually perpetrated by the incarcerated individual, may nevertheless involve him. A taxpayer who provided \$1,300 of support to her son while housed in the Missouri Eastern Correction Center was denied a dependency exemption since the amounts provided “by the State prison system where he was incarcerated far exceeded the monetary amounts provided by his mother.”³⁵ To qualify as a dependent, an individual must satisfy certain eligibility criteria as well as receive more than one-half of his support from the taxpayer seeking to claim the dependent.³⁶

In this same case, the Court held that the taxpayer could not claim the Earned Income Tax Credit (EITC) since her son was also not a

³³ *FEMA fraud debated: Congress, agency spar over extent of hurricane cases*, Detroit Free Press (June 15, 2006), available at <http://freep.com/apps/pbcs.dll/article?AID=/20060615/NEWS07/606150346/1009> (last accessed July 9, 2006).

³⁴ *A Vacation, Sex Change and 'Girls Gone Wild'—Thanks FEMA*, The Los Angeles Times (June 15, 2006), available at <http://www.latimes.com/news/nationworld/nation/la-na-fema15jun15,0,1306432.story?coll=la-home-headlines> (last accessed June 18, 2006).

³⁵ *Haywood v. Commr.*, 84 T.C.M. (CCH) 442 (2002).

³⁶ I.R.C. § 152(a)(1) (West 2006).

“qualifying child” who must share the same principal abode with the taxpayer for more than one-half of the taxable year in which the credit is claimed.³⁷

C. Accomplices

Whether the schemes originate from within or outside of prison walls, they rarely lack ingenuity and almost always require the assistance of accomplices. Typically prisoners receive help from family and friends, but “in at least one case, from an IRS employee.”³⁸ When outgoing prison mail is screened, visitors often smuggle fraudulent tax returns out and mail them on behalf of jailed inmates. If incoming mail is censored, inmates arrange to have refund checks mailed to accomplices or deposited into bank accounts of intermediaries who then earn a fee. One such middleman was unearthed by a WESH News Channel 2 investigation and stated that she was “allowed to keep half” of whatever was deposited in her bank account.³⁹

The wife of a Florida prisoner pled guilty to charges of conspiracy, accused of preparing false W-2 forms and fraudulent tax returns based on information provided by her jailed husband. Forty-three refund checks totaling \$138,242 were sent to the wife, who withheld a \$1,000 fee from each check and forwarded the balance to designated friends and relatives of inmates.⁴⁰ Similarly, a mother and two sons have been charged with conspiracy to defraud the IRS in a scheme whereby the incarcerated son provided inmate names and Social Security

³⁷ I.R.C. § 32(c)(3)(A)(ii) (West 2006).

³⁸ *H & R cell block?*, *supra* n. 4.

³⁹ *Inmates Receive Hundreds*, *supra* n. 23.

⁴⁰ U.S. Department of Justice Press Release: *Co-Defendant Wife Pleads Guilty to Tax Scam from Prison Facility* (November 18, 2005), available at <http://www.usdoj.gov/usao/fls/051118-02.html> (last accessed July 9, 2006).

numbers to his outside family members who then filed fraudulent tax returns claiming nearly \$100,000 in refunds.⁴¹

One taxpayer became suspicious when she found ten tax returns stuffed into two large packets in her mailbox. She noted that the returns were quite similar; each requesting a refund between \$4,300 and \$5,100 based on income earned from employers whose addresses didn't even exist. An investigator reported that "one address took us to an empty lot."⁴² Often clever ploys are required to smuggle the returns to the outside. Correction officers intercepted a greeting card that had been fabricated in a prison craft shop wherein the inmate had concealed six W-2s and fraudulent tax returns in a hidden pocket.⁴³

In other cases, inmates employ forgery. In prison serving a life sentence for murder, one inmate did not deny that it was his signature at the bottom of a fraudulent tax return, however he maintained that "someone had copied it off another form and pasted it" onto the illegally filed return. The refund check resulting from this return totaled \$5,146 and was to have been mailed to the inmate's sister. A fellow inmate had told her "to expect a big check from the IRS this year."⁴⁴

Two inmates of the Moberly Correctional Center in Missouri charged fellow inmates \$100 a piece to participate in a tax scam whereby one conspirator used Forms 1040EZ to falsely report that twenty-seven inmates had each earned \$4,000 of wage income on which no tax was withheld. However, because these wages represented earned income which was below the threshold amount, each

⁴¹ Stanley H. Block, *Mother and Son Charged in Tax Refund Scheme*, IRS Times & Inquirer, VIII, 5, available at <http://www.mdtaxattorney.com/newsletter/may-2005.html> (last accessed July 9, 2006).

⁴² *Going On*, *supra* n. 11.

⁴³ *H & R cell block?*, *supra* n. 4.

⁴⁴ *Who's Helping Inmates Steal Tax Dollars? Prisoners Serving Life Sentences Request Thousands in Tax Return* (November 17, 2004), available at <http://www.wesh.com/news/3927312/detail.html> (last accessed July 9, 2006).

purported taxpayer claimed that he was entitled to the EITC.⁴⁵ [See Footnote 98.] While one of the two co-conspirators prepared the false returns, the other acted as the enforcer to collect the fee from the participants in the scam.⁴⁶

D. The Perfect Con

Tax crimes can be lucrative. With the stroke of a pen, hundreds and even thousands of dollars can be “earned.” With multiple strokes, millions can be scammed from government coffers, thereby providing great incentive to scammers who feel the need to “stick it to the man.” Many taxpayers share the viewpoint that “taxation is theft” and that the “government is truly nothing more than a gang of deadly propagandists” who deserve to be cheated.⁴⁷

Nowhere is this attitude more prevalent than within the inmate community which is comprised of individuals who believe they have been victimized by the government. Furthermore, inmates have an abundance of time during which to concoct schemes that suffer only from the bounds of boredom and ingenuity of the criminal mind. Characterized by a lack of moral compunctions, unafraid of consequences that have historically been insignificant, and motivated by greed, inmates are ideally suited as perpetrators of tax scams. Potential rewards

⁴⁵ The maximum allowable credit for the tax years for which the Moberly inmates filed their fraudulent returns was \$3,816 in 1999 and \$3,888 in 2000. To be eligible for the credit, a taxpayer must be a U.S. citizen with a valid Social Security number, may not file Married-Filing-Separately, must have earned income but only a limited amount of investment income, and depending upon the number of qualifying children claimed may not have an Adjusted Gross Income (AGI) in excess of certain threshold amounts that have been indexed for inflation: \$10,200 if no child in 1999 (\$10,380 in 2000), \$26,928 if one child in 1999 (\$27,413 in 2000), and \$ 30,580 if two or more children in 1999 (\$31,152 in 2000). *Earned Income Credit (EIC)*, I.R.S. Publication 596 (Cat. No. 15173A).

⁴⁶ *Lexington, Independence Men Sentenced for Role in Tax Refund Scheme*, News Release, Office of the U.S. Attorney, Western District of Missouri (April 22, 2005), available at <http://www.usdoj.gov/usao/mow/news2005/schuster.sen.pdf> (last accessed July 9, 2006).

⁴⁷ Paul Crider, *Why you should cheat on your taxes*, The Collegian—an independent student newspaper of the University of Tulsa (April 9, 2002), available at <http://www.utulsa.edu/collegian/article.asp?article=1222> (last accessed July 15, 2006).

are great, ranging from financial to status enhancements. Within the prison code, an inmate capable of enriching others gains automatic prestige that ultimately may yield more practical benefit behind prison walls than even ill-gotten money can, much like Andy Dufresne whose cachet built the prison library and “helped a dozen guys get their high school diplomas.”⁴⁸

III. CASE LAW

Although tax scams spread like wildfire amongst inmates from prison to prison, few are prosecuted. In part, this woeful lack of enforcement is because some scams have only relatively recently come to light, creating an indignant uproar amongst politicians. And when our representatives took notice, so did the media and the public. Angered that inmates—of all people (!)—seem to be getting away with something worse than murder, selective cases are being prosecuted.

Nevertheless, federal prosecutors are less than suitably motivated since the perpetrators of these scams are already behind bars and likely will neither be deterred nor suitably punished by the imposition of comparatively nominal sentences added on to the lengthy terms that they are already serving. Nor does prosecution of inmates serve to put the general public on adequate notice as most citizens give little thought to those behind bars. After all, inmates are often considered non-entities; a sub-class of society that hardly warrants a second thought.⁴⁹ And even if their existence is considered, the public at large typically disassociates itself from those serving time. There is such a strong disconnect that

⁴⁸ “Andy” (Tim Robbins) as quoted in *The Shawshank Redemption* (Columbia Pictures 1994).

⁴⁹ “Napoleon saw inmates as a “sub-class” undeserving of equal care.” *Prison Doctor’s License Revoked for Contempt Towards Inmates* (November 14, 2002) available at http://talkleft.com/new_archives/000925.html (last accessed July 15, 2006).

punishment of *those* kind of people hardly serves as a deterrent for the rest of *us good guys*.⁵⁰

Finally, the scope of the problem must be placed into perspective. While inmates indeed bilk the government of considerable dollars, the tax loss due to prison scams remains reasonably small in comparison to dollars refunded to non-prisoners filing fraudulent claims. In 2004, only \$68 million of the total \$440 million false refund claims filed were attributable to inmates and of this amount, only \$15 million was erroneously refunded when the IRS did not identify the scam.⁵¹ Given budgetary constraints, enforcement dollars must be directed toward those activities which can yield the greatest return, if successfully prosecuted.

Indeed, precisely because inmates have few assets and limited earnings potential while incarcerated, the government cannot realistically hope to recoup dollars lost to tax scams. While restitution may be court-ordered, it is less likely that an inmate convicted of tax fraud will repay his financial obligations than an individual who, until he was convicted of a tax crime, lived on the outside, maintained a job, and accumulated assets. And because those convicted of only tax crimes can rejoin society sooner than inmates serving sentences for other crimes in addition to their tax convictions, non-prisoner perpetrators are more appealing to prosecutors hoping for some restitution in the future.

But because there is a strong sense that “we simply cannot let them get away with it,” the most egregious inmate scams are indeed prosecuted. The following cases are a sampling of those that have been successfully pursued.

⁵⁰ “[P]risoners are sub-human, should be punished in prison, and deserve whatever they get...” Mickey W. as quoted on Stop Prisoner Rape website, Letters to SPR (December 13, 2000), available at <http://www.spr.org/en/comments.html> (last accessed July 15, 2006).

⁵¹ *H & R cell block?*, *supra* n. 4.

A. Scams Exposed and Prosecuted

An inmate of the Oahu Community Correctional Facility filed his 1982 and 1984 tax returns prepared by various fellow inmates on his behalf. The earlier return, prepared by an inmate who had previously been an accountant, claimed that the taxpayer was the sole proprietor of a general store and therefore entitled to a variety of deductions, including cost of goods sold, advertising expenses, and bad debts. The return further stated that the taxpayer was filing as Head of Household and that he had dependent children living at home. The later return was prepared by an inmate with no formal tax training who relied on the information provided in the earlier return.

The Court found that although the inmate taxpayer did have a minor child, that child did “not live with him in prison” as required by IRS rules. Furthermore, the inmate was “not authorized to operate a store” while incarcerated as per Hawaii statute. Although the taxpayer claimed to have relied upon the expert advice of his tax practitioners in good faith, the Court convicted the inmate because he had filed his returns knowing that they were false.⁵²

Upon pleading guilty to five counts of filing false tax claims and one count of conspiracy, the Court sentenced an inmate to fifty-seven months in prison and ordered him to pay restitution to the IRS. This scheme involved the creation of five fictitious businesses for which the inmate obtained tax identification numbers. The inmate then added himself, as well as various other prisoners and deceased individuals to the payrolls of these fictitious companies so that he could file twenty-three false Forms 941 Employer’s Quarterly Federal Tax Return claiming refunds totaling \$130,000 for the EITC paid in advance to non-existent employees.

⁵² *United States v. Dorotich*, 900 F.2d 192 (9th Cir. 1990).

Based upon his plea agreement which conclusively established that the inmate had instructed others “how to file false tax returns to profit from the scam,” he was deemed to be an organizer of a criminal activity and therefore subject to a mandatory four-level sentence enhancement under U.S. sentencing guidelines. Categorizing the IRS as a “victim” of the inmate’s scheme, the government agency was entitled to restitution totaling \$71,611 under the Mandatory Victims Restitution Act of 1996.⁵³

Three Oklahoma inmates conspired to defraud the government: Hart had previously participated in a tax scam at another prison and now had access to the prison print shop; Webb possessed the requisite financial and accounting expertise; and Ward recruited his mother and girlfriend on the outside to handle the false returns and refund checks. Proving that criminals may develop inspired and complex plans but then deserve the Darwin Award for stupidity,⁵⁴ these co-conspirators were caught when Webb shipped the fraudulent tax returns to Hart’s mother using the prison address and his inmate number as the return address. When Hart’s mother refused delivery, the packet was returned to the prison where it was opened by officials.

Although the scheme was initially proposed by Hart, the Court found that “Webb had the intelligence to create the formula and see that the returns were properly filled out.” By recruiting others, Webb took on a leadership role and thereby became eligible for the four-level sentence enhancement imposed on “organizers.”⁵⁵

Three years after a grand jury indicted a former inmate of the Marana Community Correctional Treatment Facility, he was sentenced for submitting false claims to the IRS. Using a Form W-2G to report fictitious gambling winnings in

⁵³ *United States v. Senty-Haugen*, 449 F.3d 862 (8th Cir. 2006).

⁵⁴ <http://www.darwinawards.com/> (last accessed July 9, 2006).

⁵⁵ *United States v. Webb*, 1999 U.S. App. LEXIS 30756 (10th Cir. 1999).

the amount of \$947,836, the inmate claimed that he was due a refund of \$207,686 for excess taxes purportedly withheld from his winnings.⁵⁶

In January 2006, an inmate of the Ohio Mansfield Correctional Institution serving fifteen years to life for murder was indicted on a tax refund scheme whereby he stole the identity of his fellow inmates, as well as “the refunds they were never entitled to.” The refunds were mailed to a post office box rented by the inmate’s girlfriend who forged endorsements on at least ten checks totaling \$11,367 and then sent much of the money to the inmate in prison.⁵⁷ Similarly, an inmate of the West Tennessee State Penitentiary was charged with twenty-one counts of filing false claims totaling over \$48,100 between 2001 and 2002 when he filed tax returns for taxpayers he knew were not entitled to tax refunds.⁵⁸

B. Penalties

Each of the aforementioned defendants were indeed sentenced, albeit to relatively minimal terms, and ordered to pay restitution. Schuster, for example, was sentenced to two and one half years in federal prison without parole to run consecutively with his existing state sentence. His prison co-conspirator was sentenced to one year and nine months.⁵⁹ A convicted car thief who collected hundreds of thousands of dollars from the IRS was sentenced to six years and

⁵⁶ *Former Marana Inmate Sentenced for False Income Tax Returns while in Prison*, Office of the United States Attorney, District of Arizona (June 29, 2006), available at [http://www.usdoj.gov/usao/az/press_releases/2006/2006-115\(Johnson\).pdf](http://www.usdoj.gov/usao/az/press_releases/2006/2006-115(Johnson).pdf) (last accessed July 9, 2006).

⁵⁷ Jim Nichols, *Inmate accused of tax-refund scheme*, The Plain Dealer (January 6, 2006), available at <http://www.cleveland.com/crime/plaindealer/index.ssf?/base/iscr/1136543531224530.xml&coll=2> (last accessed July 9, 2006).

⁵⁸ *Memphis Inmate Indicted for Tax Fraud*, U.S. Department of Justice, U.S. Attorney’s Office Western District of Tennessee Press Release (January 13, 2006) available at <http://www.usdoj.gov/usao/tnw/pressreleases/2006/2006JAN20InmateIndictedTaxFraud.htm> (last accessed July 9, 2006).

⁵⁹ *Lexington, Independence Men Sentenced for Role in Tax Refund Scheme*, News Release, Office of the U.S. Attorney, Western District of Missouri (April 22, 2005), available at <http://www.usdoj.gov/usao/mow/news2005/schuster.sen.pdf> (last accessed July 9, 2006).

ordered to pay \$57,000 in restitution.⁶⁰ The inmate-husband who conspired with his wife was sentenced to four years in federal prison in addition to the fifteen years he was already serving in state prison for his manslaughter conviction.⁶¹ Finally, the mother who conspired with her inmate son is now serving a 42-month probationary sentence.⁶²

1. Sentences and Restitution

These wrong-doers were indeed punished, but sentences are often haphazardly and inconsistently imposed, and seem to be almost inconsequential in comparison to those sentences inmates already serve for their past crimes. Hence, inmates are not effectively deterred from engaging in tax scams, nor are law enforcement officials suitably motivated to pursue these cases since sentencing is so lax. During the House subcommittee hearings, the IRS Chief of CID admitted that inmate cases “are not terribly attractive for criminal prosecution” since limited enforcement dollars can be better spent pursuing counterterrorism, corporate fraud, narcotics, and violent crimes, rather than directed toward inmates already sitting in jail for lengthy terms.⁶³

Restitution, while it may be court-ordered, is typically impossible to collect. In fact, the money collected by accomplices on the outside is often “smuggled back into the institutions through visitation” and may actually never come back as cash, but instead be used to purchase drugs or other

⁶⁰ Brian Ross, *Income Tax Scams from Behind Bars—Prison Inmates File False Claims* (April 14, 2005), available at <http://abcnews.go.com/WNT/Investigation/story?id=671324&page=1> (last accessed July 10, 2006).

⁶¹ *Inmate gets four years for tax scam* (March 21, 2006), available at <http://www.ocala.com/apps/pbcs.dll/article?AID=/20060321/NEWS/203210335/1002/news02> (last accessed July 10, 2006).

⁶² *United States v. Webb*, 1999 U.S. App. LEXIS 30756 (10th Cir. 1999).

⁶³ Nancy Jardini’s response to Chairman Jim Ramstad’s inquiry at *House Hearing*, *supra* n. 17, at 42.

contraband. Cell phones are a common form of contraband, used to operate illicit activities in- and outside of prison, to contact inmates housed at other institutions, or even to call the IRS to check on the status of returns that have been filed.⁶⁴

Sentences are usually meted out to punish the perpetrator for his bad act, to rehabilitate the victim, and to deter others from committing similar crimes. If, however, the perpetrators are inmates who are serving time for other crimes, a short sentence added to or required to be served consecutively with an already long one deters neither inmates nor others. Indeed, because the sentences are reasonably benign, potential tax scammers find that the upside potential of large-scale refunds far outweighs the minimal time they may be required to serve. And because the scam's profits can be hidden in off-shore accounts or spent long before law enforcement has an opportunity to hold an individual accountable, there is little risk that a judgment requiring restitution can be effectively enforced.

2. Sentencing Guidelines

Guided by the Sentencing Reform Act of 1984 (Title II of the Comprehensive Crime Control Act of 1984), the calculation of sentences for tax fraud begins by establishing the base level offense based on the tax loss involved—defined as “the total amount of tax that the taxpayer owed and did not pay.” [See Appendix D: Table of Base Level Offenses.] The “guidelines also contain ‘specific offense characteristics’ which require the base offense level to be increased based on certain aggravating facts,” such as a two-level enhancement if the defendant used sophisticated means to impede discovery of the offense, or a four-level increase if the defendant played a leadership role in the scheme.

⁶⁴ Statement of Jeff Bentley, Criminal Investigator, South Carolina Department of Corrections, given during *House Hearing*, *supra* n. 17, at 40.

Conversely, if the defendant can show that he is “substantially less culpable than the average participant,” he may qualify for an offense level reduction.⁶⁵

Once the applicable level of offense is determined, sentence guidelines require the judge to select an appropriate term of imprisonment from the U.S. Sentencing Table. [See Appendix E: Sentencing Table.] Since base tax offense levels range from 6 to 32, the guidelines dictate sentences that may range from no jail time to as much as about 12 years; the precise amount depends upon the facts and circumstances of the particular case.

While the Department of Justice (DOJ) claims that “[i]t has long been a priority of the Tax Division to pursue vigorous prosecution of a wide range of tax crimes to deter taxpayer fraud and to foster voluntary compliance,” in fact most cases involving offenses committed prior to November 1, 1987 were disposed of by guilty plea.⁶⁶ Once a case was referred by the DOJ to the U.S. Attorney’s office, policy dictated that a guilty plea could be accepted with regard to any major tax count without approval of the Tax Division. Felonies involving tax evasion or conspiracy were designated as major counts.⁶⁷

Cases involving offenses committed after November 1, 1987 may be similarly discharged by plea arrangements; however, the Tax Division’s “bluesheet” issued on December 17, 1990 now stipulates that major counts may only be dismissed pursuant to a plea bargain if “the prosecutor has a good faith doubt as to the government's ability to prove” the charges. And provable counts

⁶⁵ U.S. Dept. of Justice Tax Division, Criminal Tax Manual 1 (1994 Ed.), § 4: *Pleas And Sentencing: Tax Division Policy And Guidelines*, available at <http://www.usdoj.gov/Tax/Readingroom/Criminal/Taxc05.Htm#5.00> (Last Accessed July 10, 2006) [hereinafter *USDOJ Manual*].

⁶⁶ *Id.* at § 5.10: *Tax Division Policy*

⁶⁷ U.S. Attorney’s Manual, Title 6, § 6-4.310: *Major Count Policy/Plea Agreements* available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title6/4mtax.htm#6-4.310 (last accessed July 15, 2006).

may only be dropped in certain circumstances with the specific approval of the U.S. Attorney.⁶⁸

Unless aggravating or mitigating circumstances demand otherwise, courts must impose sentences within the range of guidelines specified. DOJ attorneys, may recommend up- or downward departures from the guidelines if consistent with the policies of the U.S. Attorney's office, but may never "recommend that there be no period of incarceration."⁶⁹

Regardless of the potential sentence, prosecution will not be authorized unless a conviction can be anticipated. To promote efficient use of resources and protect individuals from multiple prosecutions and punishments arising from the same act(s), the DOJ must evaluate whether prosecution of an inmate charged with a tax crime might violate the prohibition against dual and successive prosecutions.⁷⁰ As per the U.S. Attorney's Manual (USAM), the decision whether to prosecute an incarcerated individual must weigh the following factors: 1. federal law enforcement priorities; 2. the nature and seriousness of the offense; 3. the deterrent effect of prosecution; 4. the person's culpability in connection with the offense; 5. the person's history with respect to criminal activity; 6. the person's willingness to cooperate in the investigation or prosecution of others; and 7. the probable sentence or other consequences if the person is convicted.

This list is not all-inclusive and other factors may be considered as well. Particular weight is given to the probable sentence, the likelihood that it will be imposed "and whether such a sentence or other consequence would justify the

⁶⁸ *USDOJ Manual, supra n. 6, at § 5.11: Plea Agreements and Major Count Policy for Offenses Committed After November 1, 1987.*

⁶⁹ *Id. at § 5.13: Departures from the Guidelines.*

⁷⁰ *Id. at § 4.03: Incarcerated Persons.*

time and effort of prosecution.”⁷¹ If, for example, the offender is already incarcerated for another crime, the prosecutor must weigh whether a conviction for a tax crime will meaningfully add to the existing sentence. On the other hand, if the offender is on parole, the prosecutor must consider whether it might not be better to institute parole violation proceedings rather than initiate a new prosecution for tax fraud. Additional consideration must be given to statute of limitation issues on the tax crime, as well as potential reversals of the offender’s other conviction. In all cases, the decision to prosecute must be made on a case-by-case basis since the DOJ does not have any formal policy requiring the institution of proceedings simply because the accused is already in prison on another charge.

IV. ATTACKING THE PROBLEM

Given the scope and scale of the problem, inmate tax scams cannot be ignored and indeed have garnered Congressional attention, as well as become the focus of IRS enforcement activity.

A. Current IRS Strategy

More than one million returns have been filed by incarcerated individuals between 2002 and 2005. Recognizing that more than four percent of all prisoner refund claims are fraudulent,⁷² the IRS has recently devoted additional resources to the matter. However, in the past the “IRS let its ten Fraud Detection

⁷¹ *Id.*

⁷² As stated by Nancy Jardini, Chief of IRS Criminal Investigations *House Hearing, supra* n. 17, at 30.

Centers (FDCs), which are the front line for detecting fraudulent refund schemes, establish their own policies and procedures for working with prison authorities in their region.”⁷³ In fact, only 36,000 of the approximately 455,000 refund returns identified as filed by prisoners were physically screened by the FDCs.

1. Computer Enhancements

In an effort to improve coordination between federal and state prison officials, CID has requested computer programming modifications to help flag common characteristics of prisoner refund schemes. Current operating procedures require that the FDCs input freeze codes whenever a fraudulent return is identified to prevent automatic issuance of a refund in future years. However, the IRS failed to input these codes on nearly 3,000 accounts involving 18,000 fraudulent returns filed by prisoners in 2004, allowing nearly \$600,000 of erroneous refunds to be processed.⁷⁴

2. Fraud Alerts

The IRS and prison officials routinely issue fraud alerts regarding various scams (including those perpetrated by inmates) to the public, the media, and other law enforcement agencies. One such alert warns that prison inmates might seek to solicit funds from pen pals by asking them to deposit money into their inmate accounts to pay for prison services that are already provided to

⁷³ Excerpt from Statement by Russell George, Treasury Inspector General for Tax Administration, U.S. Department of Treasury, given during *House Hearing*, *supra* n. 17, at 35.

⁷⁴ *Final Audit Report – The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (Audit # 200510019) issued by J. Gardiner, Deputy Inspector General for Audit (September 28, 2005), at 9, available at http://www.ustreas.gov/tigta/auditreports/2005reports/200510164fr.html#_ftnref15 (last accessed July 10, 2006) [hereinafter *Final Audit Report*].

inmates at no charge.⁷⁵ In 2002, the IRS *Tax Scams* page debuted on the agency's website. It is used to alert taxpayers to actively promoted tax schemes and assure them that "unscrupulous taxpayers are [not] allowed to get away with not paying."⁷⁶

3. Additional Steps

In September 2005, the Treasury Inspector General for Tax Administration (Inspector General) issued a report evaluating the effectiveness of current procedures employed by the IRS to detect fraudulent prisoner refund returns and concluded that the additional efforts must be taken. While the Internal Revenue Manual (IRM) outlines criminal investigation strategies that allow the IRS to employ certain investigative techniques for refund fraud investigations,⁷⁷ the report offered additional suggestions that ranged from better coordination and information exchange with prison authorities to notification of parole authorities and updating prisoner files.

But IRS enforcement efforts remain stymied by a lack of funds and the reality that lost revenues cannot be recouped, even from those inmates who are successfully prosecuted. Furthermore, the government must balance its efforts to stop the relatively few illegitimate refunds against its mandate to process an overwhelming majority of legitimate refunds to deserving taxpayers as expeditiously as possible. Typically, the IRS has three weeks to evaluate tax returns for indicators of fraud, to verify wage and withholding information, and to

⁷⁵ *Inmate Fraud Alert*, available at <http://www.doc.mo.gov/> (last accessed July 10, 2006).

⁷⁶ Charles Rossotti, former IRS Commissioner, as quoted in I.R.S. News Release 2002-61 (May 8, 2002), available at <http://www.irs.treas.gov/pub/irs-news/ir-02-61.pdf> (last accessed July 10, 2006).

⁷⁷ I.R.M. 9.5.3: *Criminal Investigation Strategies* (April 19, 2006) outlines investigative techniques such as handwriting identification, decoy refund check procedures, and multiple refund identification by the Electronic Fraud Detection System.

compare potentially fraudulent returns to others with similar characteristics. Electronic filing helps the IRS to accomplish this task more efficiently and effectively. However, seventy-five percent of all fraudulent returns filed by prisoners are submitted on paper rather than electronically and are thus more likely to remain undetected. [See Appendix F: Top Five Reasons Why Refunds Were Issued.]

In response to the Inspector General’s report, CID replied that it had increased the staffing of the ten FDCs to “600 skilled investigative analysts and special agents,” as well as sought to educate electronic return originators and practitioners about attempts made by inmates to engage the professional community to file false returns. In coordination with prison officials, the IRS now publishes deterrent messages on prison websites. Finally, the IRS hopes that the President’s request earmarking \$10.7 million to combat refund fraud in the 2006 federal budget will be approved⁷⁸ and will enable access to the National Directory of New Hires database maintained by the Department of Health and Human Services to streamline the employment verification process.⁷⁹

B. Congressional Action

Dissatisfied with the spotty enforcement record of the IRS, “demands for action are being made from Central Florida all the way to Washington, D.C.”⁸⁰ James Maule—a tax professor at Villanova’s Law School—recently challenged

⁷⁸ On July 20, 2006, the Senate Appropriations Committee passed the FY 2007 Treasury Appropriations Bill, which includes \$10.7 billion for the IRS and earmarks \$4.7 billion for enforcement activities. *NAEA e@alert*, National Association of Enrolled Agents (July 21, 2006).

⁷⁹ *Management’s Response to the Draft Report*, Nancy Jardini, Chief of IRS Criminal Investigation Division (September 19, 2005) attached as Appendix IV to *Final Audit Report*, *supra* n. 74.

⁸⁰ *Members of Congress Look into Inmate Tax Scam—Local Members of Congress Demand Action from IRS* (November 20, 2004), available at <http://www.wesh.com/news/3936142/detail.html> (last accessed July 10, 2006).

Congress to amend privacy statutes that currently preclude the sharing of tax information between the IRS and prison officials. He wonders “if Congress can muster up the courage to invest \$10 or \$20 million to prevent the payment to prisoners of five or ten times that amount in falsely claimed refunds.”⁸¹

On December 15, 2005 Congressman James Ramstad (R-MN) introduced a bill entitled Prison Inmate Tax Fraud Reduction Act which would amend the IRC to allow for disclosure of certain prisoner return information to prison officials, including the taxpayer’s identity and whether he has claimed or received a federal tax refund on the basis of a return which the IRS has determined to be fraudulent. Any information disclosed could be used only to take administrative action to prevent the filing of additional fraudulent returns.⁸² While such measures are limited, those charged with enforcing the tax law eagerly anticipate passage of the proposed legislation.

Interestingly, Congress as early as 1998 noted that the Social Security Administration (SSA) had “just uncovered a very expensive scam” whereby prison inmates were receiving as much as \$3.46 billion in improper Social Security checks each year—money that could be used to “save Social Security and clean up the IRS.”⁸³ That was five years ago—apparently the wheels of the Legislature turn very slowly!

C. Information Sharing

Indeed, the biggest problem facing the law enforcement community originates from a statute designed to protect the public from privacy intrusions by

⁸¹ *A New Year’s Resolution for Congress: Help Stop Inmate Tax Fraud* (January 6, 2006), available at http://mauledagain.blogspot.com/2006_01_01_mauledagain_archive.html (last accessed July 10, 2006).

⁸² H.R. 4549 IH, 109th Congress (December 15, 2005), available at <http://www.theorator.com/bills109/hr4549.html> (last accessed July 10, 2006).

⁸³ 144 Cong. Rec. S3117-01 (1998), *Congress Should Pass IRS Reform by April 15*.

an overly zealous tax bureaucracy. IRC § 6103 requires that “return information shall be kept confidential” and may generally only be disclosed to the extent that “such disclosure would [not] identify a confidential informant or seriously impair any civil or criminal tax investigation.”⁸⁴ As a result, prison authorities have complained that vast amounts of information are given to the IRS, but that virtually nothing is given back in return since the IRS is prohibited from informing prison officials if an inmate is engaging in tax-related criminal activity.

Although IRC § 6103 does allow the IRS to share information pursuant to federal-state agreements, coordination between CID, the FDCs, and state agencies is sorely lacking. In the Inspector General’s report only two of ten FDCs indicated that they participated in data sharing programs. And six of ten FDCs did not have “procedures for checking the accounts of prisoners filing fraudulent refund returns to determine if they were on probation.”⁸⁵

Conversely, information received from prison authorities by the IRS, while not restricted by statute, may be outdated and incomplete. Ostensibly, CID contacts all prisons in February or March of each year to update prison mailing lists. Much of the information is not received until August and September, leaving little time for the IRS to enter the information into the Electronic Fraud Detection System before the start of the next tax season. For example, 134,000 prisoners incarcerated between September 1 and December 31, 2003 were not included in the data file for 2004.⁸⁶

⁸⁴ I.R.C. § 6103: *Confidentiality and Disclosure of Returns and Return Information* (West 2006).

⁸⁵ *Final Audit Report*, *supra* n. 74, at 16.

⁸⁶ In his report, the Inspector General estimates that almost nineteen percent of all prisoner data files (about 550,000 records) are missing or inaccurate due to:

| Problem | Number of Records |
|--|-------------------|
| Using 000-00-0000 as Social Security Number | 252,000 |
| Using duplicate Social Security Numbers | 118,000 |
| Other Social Security Number issues | 46,000 |
| Information submitted after reporting deadline | 134,000 |

During the House subcommittee hearings, Representative Tom Feeney (R-FL) found that “officials with some state penal systems are refusing to help the IRS crack down on inmate tax scammers” and urged Congress to consider legislation that would provide incentives encouraging states to cooperate with federal authorities. He recommended that inmate identities, as well as data about prison employment and bank routing numbers for prison bank accounts, be shared with the IRS.⁸⁷

Furthermore, the federal government complains that data received from state authorities is not only tardy, but also inaccurate and that it is provided in disparate formats that are “difficult and time-consuming to reconfigure to upload into” IRS systems.⁸⁸ Inmates may not provide truthful information when they enter the prison system and prison officials may not have an immediate need or the time to verify what is told to them. And in at least one case, the IRS has found that “members of the correctional staff were corrupted and had been actively participating in the [tax] schemes.”⁸⁹

Such backbiting and sniping is of course counter-productive. At the suggestion of Congress, the IRS is now exploring the possibility of instituting a similar arrangement with prisons as is currently in effect between prisons and the SSA. Under this program, prisons must provide up-to-date information about their inmates to the SSA and in exchange receive a portion of any money that is saved by cutting off an inmate’s benefits to which he is not entitled.⁹⁰ But the IRS notes

⁸⁷ *H & R cell block?*, *supra* n. 4.

⁸⁸ *Final Audit Report*, *supra* n. 74, at 33.

⁸⁹ *Id.* at 37.

⁹⁰ However, even this program is not without its faults. Based on a review of 250 sample cases, the Inspector General estimates that 86,131 payments issued between March 1997 and August 2003 (totaling almost \$19 million) should not have been made and that these incorrect payments were due to the untimely receipt of information and clerical errors. *The Social Security Administration’s Prisoner Incentive Payment Program Audit Report #A-01-04-24067*, Office of the Inspector General, Social Security Administration (July 2004), at 2, available at <http://www.ssa.gov/oig/ADOBEPDF/A-01-04-24067.pdf> (last accessed July 11, 2006).

that refund fraud is theft of U.S. Treasury funds to which the inmate is not, and never was entitled unlike Social Security benefits to which he may have been entitled prior to imprisonment.

D. Prison Policies

An obvious and overly simplistic solution to the problem of inmate tax scams would be to categorically prohibit prisoners from filing any tax returns while incarcerated based on the assumption that no reportable income is earned while locked behind bars. However, the IRS has conceded that “some prisoners have a legitimate need to file tax returns, including a joint return with their spouse or filing a return including income earned while not incarcerated for that particular year.”⁹¹ Hence, one must first look at procedures put in place to allow inmates to file properly and only then determine what policies might be implemented to ensure that inmates filing improperly cannot do so.

1. Procedures for Legitimate Filings

Martha Stewart surely had a filing requirement during her internment, and yet it can be safely assumed that her accountants filed for an extension and awaited her release to allow her to personally sign her income tax return. Similarly, most high profile and celebrity inmates continue to earn large sums while imprisoned, but likely maintain their established relationships with tax professionals who compile the tax returns and bring them to the inmate during visitation.

⁹¹ *Id.* at 58.

But average criminals do not employ an accounting staff and must prepare their own tax returns to report income earned during any part of the year prior to imprisonment, income earned by an unincarcerated spouse if filing jointly, wages earned from a prison work program, investment income from unconfiscated assets still owned by the inmate, or business income from an ongoing venture managed by others while the inmate is serving time. While taxes may be the last thing on the minds of many blue collar or violent criminals—if only because they had not complied with their filing requirements even while still on the outside—many convicts may seek to file legitimate tax returns to avoid running further afoul.

a. Sources of Inmate Earnings

While there are many potential sources of revenue such as support provided by friends and family on the outside, many prisoners actually earn wages while incarcerated. For instance, the Prison Industry Enhancement Certification Program created by Congress in 1979, encourages “state and local governments to establish employment opportunities for prisoners that approximate private sector opportunities.”⁹² By placing the inmates into realistic work environments, they may acquire marketable skills that can later be used to obtain employment upon release from prison. And by paying these inmates a prevailing wage, the program can turn otherwise idle prisoners into taxpayers.

Regulations mandate that these wages (as well as other sources of income) may be used to meet the inmate’s financial obligations, such as court-ordered child support, student loan debts, victim reimbursements, and unpaid

⁹² *Incentives for PIE Programs*, Florida Corrections Commission 1997 Annual Report, Ch. 2, available at <http://www.fcc.state.fl.us/fcc/reports/final97/97pie.html> (last accessed July 11, 2006) [hereinafter *Florida Corrections Report*].

income tax.⁹³ Florida, for example, employs the following distribution formula: Of each wage dollar earned by the inmate, the Department of Corrections (DOC) will automatically allocate 15% to the Crimes Compensation Trust Fund, 15% for taxes, 40% to the DOC for room and board, 10% to family or child support if applicable, 5% to restitution, fines or court costs, and 5% to an inmate savings account that is held in abeyance until the prisoner is released. Only 10% of his wage earnings are available to the inmate for discretionary expenditures while incarcerated.⁹⁴

b. Filing Requirements

Although wages include “all remuneration for employment” and employment means “any service, of whatever nature, performed,”⁹⁵ the federal tax code specifically exempts services performed by an inmate of a penal institution. Hence, prison wages are not subject to FICA and FUTA taxes,⁹⁶ although some states may levy payroll taxes.⁹⁷ Nevertheless, these wages are subject to income taxes and are reportable on the inmate’s personal tax return.⁹⁸

⁹³ *The Federal Bureau of Prisons' Inmate Financial Responsibility Program*, Report # I-2000-023 (September 2000), available at <http://www.usdoj.gov/oig/reports/BOP/e0023/results.htm> (last accessed July 11, 2006).

⁹⁴ *Florida Corrections Report*, *supra* n.94.

⁹⁵ I.R.C. § 3121(a) and (b) (West 2006).

⁹⁶ I.R.S. Instructions for Form 940-EZ: *Employer's Annual Federal Unemployment (FUTA) Tax Return* (2005), at 5.

⁹⁷ Stephen Dresch and Michael LaFaive, *Michigan State Industries Needs Competitive Contracting* (July 15, 2002), available at <http://www.mackinac.org/depts/ecodevo/article.asp?ID=4476> (last accessed July 11, 2006). NOTE: California does not levy UI, ETT, or SDI taxes on wages earned by inmates of a penal institution, although they are subject to Personal Income Tax (PIT) withholding. (See Employment Development Department, Employment Tax, Frequently Asked Questions at <http://www.edd.ca.gov/taxrep/taxfaq.htm>, last accessed July 17, 2006).

⁹⁸ However, in yet another example of statutory inconsistency, “[a]mounts received for work performed while an inmate in a penal institution are not earned income for the earned income credit. This includes amounts received for work performed while in a work release program or while in a halfway house.” I.R.S. Publication 596: *Earned Income Credit (EIC) (2005)* (Cat. No. 15173A).

It is for these individuals that prisons must develop policies to allow inmates to comply with federal and state tax filing requirements. In fact, only 18,000 of the more than 455,000 prisoner returns filed during 2004 were identified as fraudulent. [See Appendix G: Percentage of ELF and Paper Prisoner Returns.] This statistic proves that not only are most inmate-filed tax returns legitimate, but that a significant number of returns are actually filed.

Hence, it is not surprising to learn that inmates of some institutions have ready access to tax forms in prison libraries and on the internet. Nevertheless, a properly instituted policy directive could diminish the incidence of abuse. The Los Angeles Men's Central Jail, for instance, does not allow an inmate to sign any document (including a tax return) unless duly authorized by court order. Although inmates may freely receive mail while in custody, all incoming items are opened and perfunctorily screened. Hence, an unsigned tax return would be questioned. Furthermore, visitors may not pass any papers to inmates. And inmates do not have access to anything but "penal codes and crotch novels" in the prison library.⁹⁹

But the county jail merely houses individuals on a temporary basis, typically for no more than one year prior to release or transfer to the state prison system. As a result, inmates of this local institution typically do not face the problem of missing an extended tax filing deadline that might otherwise be encountered in facilities housing inmates for extended terms.

⁹⁹ As stated by Los Angeles County Sheriff's Department Custody Assistant Andrea Soffa during a telephone interview conducted on June 29, 2006 (Interview notes on file).

2. Prophylactic Measures

To preclude potential inmate access to tax forms they should not have, the BOP has developed program statements that mandate that all incoming mail be inspected prior to distribution.¹⁰⁰ While state prisons have instituted similar policies, much of the inmate tax scam's success is attributable to the simple fact that the IRS on occasion simply mails the requested refund directly to the inmate's prison address. "The IRS issued twenty-eight refund checks in the amount of \$722 to the inmates at [their] prison address."¹⁰¹ When pointedly asked by Representative Earl Pomeroy (D-ND) during the House subcommittee hearing whether refund checks are sent to prison addresses, CID Chief Nancy Jardini responded that the IRS does its best not to do so but that it is possible a check "might get out."¹⁰²

Correctional facilities have instituted numerous measures in an effort to combat the problem at the state level. South Carolina, for example, considers all tax forms and related materials—whether blank or filled out—to be contraband, thereby exposing inmates found in possession of these items to various forms of punishments. Administrative actions may include segregation, loss of good time earned, and forfeiture of privileges.¹⁰³

¹⁰⁰ The Federal Bureau of Prisons Program Statement 5265.11 and Mail Management Manual 5800.10 available at <http://www.bop.gov/DataSource/execute/dsPolicyLoc> (last accessed July 10, 2006).

¹⁰¹ *United States v. Jackson*, 155 F.3d 562 (4th Cir. 1998).

¹⁰² *Final Audit Report*, *supra* n. 74, at 50.

¹⁰³ As stated by Jeff Bentley, Criminal Investigator, South Carolina Department of Corrections during *House Hearing*, *supra* n. 17, at 40.

3. Increased Criminal Activity

Tax scams are costly for all involved: The federal government obviously suffers the loss of tax revenues to which it is legitimately entitled and the public loses its faith in a system which depends upon voluntary compliance. But local institutions suffer as well. State tax authorities also sometimes forfeit revenues where inmates file similarly fraudulent tax returns. For example, the Franchise Tax Board (FTB) recently charged three Southern Californians with filing false state income tax returns, tax refund fraud, grand theft, and burglary. Each felony charge carries a maximum sentence of three years in state prison.¹⁰⁴

But other problems abound as well. “Most of the ill-gotten tax money [is used] to buy illegal drugs”¹⁰⁵ which in turn leads to beatings, stabbings, and extortion behind prison walls. During the House subcommittee hearings, an investigator from the South Carolina DOC complained that “[a]lthough the total costs of inmate tax fraud [will] never be completely known, there have been measurable costs... In late 2004, Evans Correctional Institution was placed on total lockdown due to rampant criminal behavior... For a period of approximately 2 months, Evans Correctional Institution staffing was at least doubled, and at times more, in an effort to bring the situation under control.”¹⁰⁶

Interestingly, the IRS maintains records of those correctional facilities from which the greatest numbers of fraudulent tax returns are filed, but then does not share that information with prison officials. [See Appendix H: Incidence of Refund Fraud at Prisons.] The Inspector General’s report espouses

¹⁰⁴ *FTB arrests three in tax refund fraud sweep*, Franchise Tax Board Tax News 06-2 (March/April 2006), at 6, available at http://www.ftb.ca.gov/professionals/taxnews/tn_06/03_04.pdf (last accessed July 11, 2006).

¹⁰⁵ *Bogus Tax-Return Scheme*, *supra* n. 16.

¹⁰⁶ As stated by Jeff Bentley, Criminal Investigator, South Carolina Department of Corrections during *House Hearing*, *supra* n. 17, at 40.

inter-agency cooperation whereby the IRS would provide prisons with statistical information regarding fraudulent activity without running afoul of any IRC § 6103 prohibitions. In this manner, prison authorities would be alerted and could take proactive measures to uncover tax scams as well as prevent potential internal violence.¹⁰⁷

V. INMATE RIGHTS

The U.S. Supreme Court has traditionally adopted a hands-off approach to prison administration, giving prison officials “as much latitude as could be justified” to maintain internal order and discipline.¹⁰⁸ Nevertheless, federal courts have begun to intervene and now frequently mandate operating changes in an effort to protect the Constitutional rights of prisoners. As a result, prison officials must look to the totality of conditions to ensure “that a multitude of prison conditions and practices which might not be unconstitutional if viewed individually could, when viewed as a whole, make confinement a cruel and unusual punishment.”¹⁰⁹

For instance, while inmates are not guaranteed unfettered access to all publications, courts have held that the First Amendment¹¹⁰ requires that prison officials must show a compelling interest to justify the regulation of inmate access to reading material. Hence, it would not be possible to categorically deny inmate access to tax publications.

¹⁰⁷ *Final Audit Report, supra* n.74, at 21.

¹⁰⁸ Instructor guide to *Inmate Rights and Privileges*, Course Number 3502, available at <http://www.tcleose.state.tx.us/tcleosehome/GuideInst/HTML/3502.htm> (last accessed July 15, 2006).

¹⁰⁹ Excerpt from *Criminal Law Reporter*, op. cit., p. 4 (1978), as quoted in the instructor guide to *Inmate Rights and Privileges*, Course Number 3502, available at

<http://www.tcleose.state.tx.us/tcleosehome/GuideInst/HTML/3502.htm> (last accessed July 15, 2006).

¹¹⁰ “Congress shall make no law ... abridging the freedom of speech, or of the press.”

Similarly, prisoners are entitled to receive incoming mail from attorneys, courts and public officials which may, however, be opened and inspected for contraband.¹¹¹ In some cases, incoming mail may be censored or rejected but courts have imposed a heavy burden upon prison officials to prove that such measures are warranted to ensure prison security and that less restrictive means would be insufficient. Outgoing mail must also remain as unfettered as possible.¹¹²

While prison officials may reasonably regulate prison visitation, a balance must be struck between the legitimate needs of inmates and the security of the institution.¹¹³ However, courts have held that because inmates have no expectation of privacy, prison officials may monitor inmate telephone calls without violating Fourth Amendment protections¹¹⁴.

Given these limitations, prison officials cannot readily preclude inmate access to tax forms that may ultimately be misused. As noted previously, inmates often have ready access to such forms in the prison library, or can accept delivery in their cells when the forms are mailed by outside accomplices, or can receive them surreptitiously when smuggled by visitors. Prison policies may indeed dictate that mail and telephone calls be monitored, but the reality is that such monitoring is limited due to Constitutional protections and because prison staff cannot adequately screen each item. Consequently, inmates are able to maintain their contact with the outside world and thereby exploit available avenues when conducting their tax scams.

¹¹¹ *Frye v. Henderson*, 474 F.2d 1263 (5th Cir.-OLD 1973).

¹¹² *McDonnell v. Wolff*, 483 F.2d 1059 (8th Cir. 1973).

¹¹³ *Block v. Rutherford*, 468 U.S. 576 (U.S. 1984).

¹¹⁴ "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated..."

VI. CONCLUSION

Tax crimes—while seemingly victimless—are particularly vile in that they offend the ordinary sensibilities of the public. Law-abiding citizens who diligently, albeit reluctantly, comply with the Tax Code are outraged when others do not adhere to the rules. But the indignation is especially acute when inmates commit fraud that not only allows them to send fewer tax dollars *to* the government, but in fact actually grants them the opportunity to cash checks *from* the government. And to add insult to injury, these same perpetrators live in federal and state penal institutions supported by tax dollars!

So, while the problem may not loom large in terms of the ultimate tax loss sustained by the U.S. Treasury or meaningfully affect the federal budget deficit [See Appendix I: Schemes with the Largest Number of Prisoner Returns], inmate tax scams must be controlled if only to assuage public opinion. The U.S. tax system is based upon voluntary compliance. If the public perceives that undeserving individuals can successfully escape their financial obligations, others will surely follow in their footsteps. This must be prevented at all costs.

A. Radical Solutions

Many of the remedies proposed by the IRS, prison officials, and legislators should of course be implemented. [See Part IV: Attacking the Problem.] But more could be done, not the least of which might be to stiffen penalties. While those already incarcerated may not be influenced by such measures, outside accomplices might well think twice about becoming involved in a tax scam. Of course, it can be argued that increased sentences for tax crimes might appear disproportionate in relation to sentences currently mandated for

violent crimes and that such sentences would only serve to further crowd prisons. Nevertheless, if increased penalties were applied only to tax crimes involving conspiracies with prison inmates, such punishments may serve to effectively deter accomplices and sever the necessary link inmates require to perpetrate their scams.

Should inmates persist in their endeavors, they might be more effectively dissuaded if their punishments were significantly enhanced: Long-term sentences could be automatically converted to life sentences; life sentences with parole could be automatically converted to life without parole. In the hopes that such harsh enhancements would deter even the most hardened criminal, the overcrowding effect resulting from these new sentencing guidelines would hopefully be irrelevant. Inmate behavior might be further modified with the denial of specified prison privileges. For inmates dependent upon minute perks to make their lives palatable behind bars, such a threat may prove far more useful than even enhanced sentencing.

But the problem might best be addressed from the other end, long before an inmate even has the opportunity to develop his scheme and perfect its execution. The IRS has already assigned some of its agents “specifically to prison refund scams” and asked them to focus on inmate ringleaders and outside accomplices with the help of prison officials.¹¹⁵ The tax authority could also institute a program similar to its Volunteer Income Tax Assistance (VITA) program which offers free tax help for low- to moderate-income people who cannot prepare their own tax returns. VITA sites throughout the country are staffed by volunteers who have received training to help prepare basic tax returns. Similarly, the Tax Counseling for the Elderly (TCE) program uses trained

¹¹⁵ *Inmates Scam IRS, supra* n. 3.

volunteers to provide free tax counseling and basic income tax return preparation for senior citizens.¹¹⁶

While it may not be safe to allow volunteers from the general public to interact directly with violent felons, the IRS could nevertheless sponsor a training program whereby select prison employees would learn rudimentary tax law. These individuals could then serve as designated tax practitioners for each penal institution. And professional tax practitioners could be called upon to serve inmates housed in low- and medium-security facilities on a pro bono basis. Inmates would only be allowed to submit returns prepared by these designees.¹¹⁷

Inmate tax fraud is not unique to the U.S. Sentenced to an additional two years behind bars, an Australian inmate helped fellow prisoners file \$1.8 million fraudulent tax refund claims for work-related expenses. After tax authorities managed to recover \$1.4 million, they instituted a new policy that requires prisoners to use specially designated forms that differ from those used by the public.¹¹⁸ The IRS could similarly design a Form 1040-I that would only be available to inmates from prison officials and that could be readily flagged for additional scrutiny when processed by the tax authority.

Finally, numerous proposals mandate public disclosure of tax returns. While IRS Commissioner Mark Everson has stated that “it’s worth thinking about,” he was referring to corporate rather than individual returns, aware that taxpayers might be less inclined to voluntarily comply with tax laws if “neighbors and competitors could peek at their financial secrets.”¹¹⁹

¹¹⁶ Information about these programs is available at <http://www.irs.gov/individuals/article/0,,id=119845,00.html> (last accessed July 15, 2006).

¹¹⁷ The author of this paper has titled this proposed program DEPRIVE™ to emphasize that by engaging **DE**signated **PR**eparers for **IN**mate **VE**eracity, prisoners would be less likely to make untruthful tax claims.

¹¹⁸ *Govt cracks down on inmate tax fraud* (April 26, 2004), available at <http://www.abc.net.au/news/australia/wa/bunbury/200404/s1094825.htm> (last accessed July 16, 2006).

¹¹⁹ *Going Public with Tax Returns?*, Roth & Company Tax Updates (March 15, 2006), available at <http://www.rothcpa.com/archives/001753.php> (last accessed July 15, 2006).

But despite fears that taxpayers will elect to simply drop out of the system, selective disclosure might help to resolve the problem of prisoner-run tax scams. Presuming that inmates have forfeited certain privacy rights, publication of tax returns and sharing of information with prison authorities might not only be allowable but would provide prison and tax authorities with a powerful tool helpful in their endeavors to curtail the scam problem.

B. Voluntary Compliance

In a system dependent upon voluntary compliance, where taxpayers are expected to truthfully report income earned so that the proper tax may be assessed, it is particularly critical that participants in the system are assured of its integrity and fairness. “Taxpayer belief in the IRS' ability to meet their expectations is essential... [to] maintaining the integrity of a tax system founded on voluntary compliance.”¹²⁰

Therefore, the problem of inmate tax scams is not merely about preventing the loss of tax dollars due to fraudulent refund claims, but it is also about the continued success of our voluntary system and maintaining the confidence of the tax-paying public who might otherwise cease to comply willingly. For the moment, “folks pay their taxes. They know it is part of their citizenship, and they expect others to pay as well, and they don’t expect people to be cheating the government.”¹²¹

No one likes a cheater. Deeply ingrained at an early age, children chant “Cheater, cheater, pumpkin eater!” and taunt those who skirt the rules. But as cheating by some is perceived by all to have become more pervasive or is left

¹²⁰ I.R.M. 4.22.1.1: *National Research Program Overview* (October 1, 2002) available at <http://www.irs.gov/irm/part4/ch22s01.html> (last accessed July 16, 2006).

¹²¹ Statement of Jim Davis (D-FL) during *House Hearing*, *supra* n. 17, at 6.

unchecked “more and more Americans regard paying their fair share of taxes as an act of stupidity.” In 1999, eighty-seven percent of those surveyed responded that cheating on their taxes was unacceptable, but the percentage of disapprovals dropped to only seventy-six percent a few short years later.¹²²

An IRS agent recently conceded, “It’s a problem. I’m not going to sit here and deny that there’s a hole in the system.”¹²³ That hole must be plugged. And so like the hero of Haarlem who saved his country by putting his finger into a leaking dike, regulatory authorities must do what they can to stem this putrid flow of fraudulent refunds.¹²⁴

¹²² Robert Reno, *Incite Cheats, Give the Rich New Tax Cuts* (January 22, 2002), available at <http://www.commondreams.org/views02/0122-04.htm> (last accessed July 16, 2006).

¹²³ Brad Palmer as quoted in *Inmate Tax Refund Scams on the Rise* (December 29, 2005), available at <http://www.tscpa.org/accountingweb/weeklynews.asp#6> (last accessed July 16, 2006).

¹²⁴ Mary Maples Dodge, *Hans Brinker* (1865).

APPENDIX A

Refund Returns Filed and Refunds Claimed By All Individuals and By Prisoners during Processing Year 2004¹²⁵

| Number of Returns | Total | Prisoner | Percentage |
|--|-----------------------|---------------------|------------|
| Total Returns Filed | 130,459,600 | Not Available | |
| Refund Returns Filed | 106,420,200 | 455,097 | 0.43% |
| Returns Reviewed for Potential Fraud | 463,222 | 36,126 | 7.80% |
| Fraudulent Refund Returns | 118,075 | 18,159 | 15.38% |
| Fraudulent Refunds Stopped | <u>81,922</u> | <u>14,033</u> | 17.13% |
| Fraudulent Refunds Issued | <u>36,153</u> | <u>4,126</u> | 11.41% |
| Amount of Refunds | | | |
| Refunds Requested | \$227,573,835,000 | \$758,951,862 | 0.33% |
| Fraudulent Refunds | \$440,773,403* | \$68,179,070 | 15.47% |
| Fraudulent Refunds Stopped | <u>\$309,961,554*</u> | <u>\$53,456,963</u> | 17.25% |
| Fraudulent Refunds Issued | <u>\$130,811,849</u> | <u>\$14,722,107</u> | 11.25% |
| Average Fraudulent Refund | \$3,733 | \$3,755 | |
| Average Fraudulent Refund Stopped | \$3,784 | \$3,809 | |
| Average Fraudulent Refund Issued | \$3,618 | \$3,568 | |
| * Does not include 1 scheme with 2 returns claiming \$1.8 billion. | | | |

Source: The CID function's data dated April 1, 2005.

As shown in the table, a disproportionately higher percentage of fraudulent returns are filed by incarcerated individuals. Although prisoner returns account for only 0.43 percent of all refund returns, they account for over 15 percent of the fraudulent returns identified by the IRS. Refund fraud committed by prisoners is growing at an alarming rate. The number of fraudulent prisoner returns identified by the CID function grew from about 4,300 during PY 2002 to over 18,000 during PY 2004 (a 318 percent increase). During the same period, all fraudulent returns identified grew by 45 percent, from about 81,000 to about 118,000. The percentage of fraudulent returns identified as prisoners grew from 5 percent to 15 percent.

¹²⁵ *Final Audit Report, supra* n. 74, at 3.

APPENDIX B

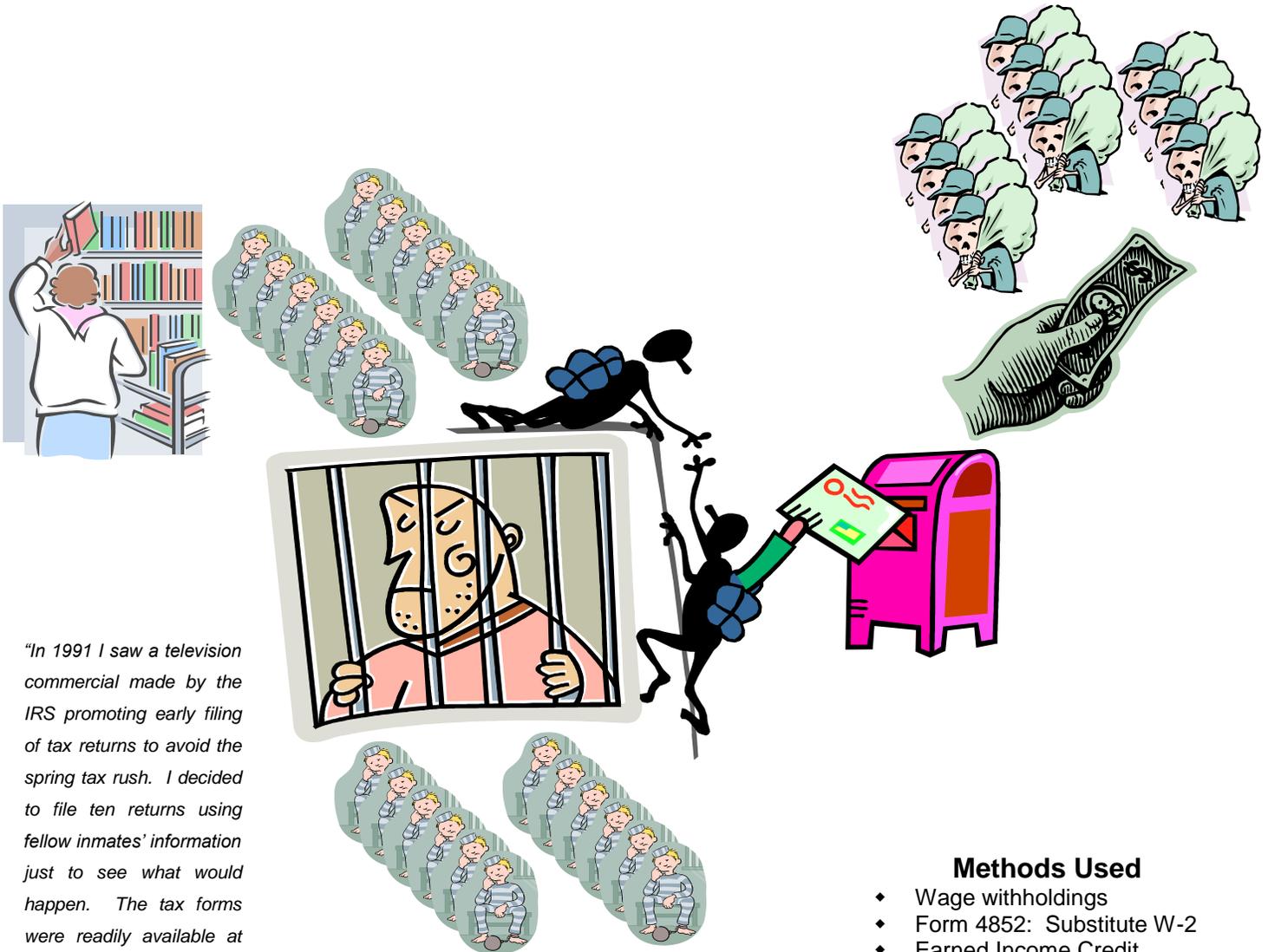


Final Audit Report – The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners (Audit # 200510019) issued by J. Gardiner, Deputy Inspector General for Audit (September 28, 2005), p. 32.

APPENDIX C

Scam Schematic

© Monica Haven, E.A. 071706



"In 1991 I saw a television commercial made by the IRS promoting early filing of tax returns to avoid the spring tax rush. I decided to file ten returns using fellow inmates' information just to see what would happen. The tax forms were readily available at the institution through the library... All ten refunds went through... When nothing happened behind those returns, I started filing every year for whatever groups of inmates I was friends with."¹

--John Doe, Inmate
 Testimony before the
 House Ways & Means
 Committee
 June 29, 2005

- Methods Used**
- ◆ Wage withholdings
 - ◆ Form 4852: Substitute W-2
 - ◆ Earned Income Credit
 - ◆ Business deductions
 - ◆ Child Tax Credit
 - ◆ Advanced Earned Income Credit for fictitious employers

Potential Solutions

Prisons

- ◆ Share inmate information with IRS
- ◆ Inspect in- and out-going mail
- ◆ Assign designated tax preparers

Congress

- ◆ Amend IRC § 6103 to allow data-sharing
- ◆ Increase penalties

IRS

- ◆ Share fraud information with prisons
- ◆ Increase number of investigators
- ◆ Standardize Fraud Detection Center process
- ◆ Develop Form 1040-I
- ◆ Screen prison addresses
- ◆ Verify refund claims
- ◆ DEPRIVE™ Program: DEsignated PReparers for Inmate VERacity

APPENDIX D

Table of Base Level Tax Offenses¹²⁶

| <u>Tax Loss (Apply the Greatest)</u> | <u>Offense Level</u> |
|--------------------------------------|----------------------|
| (A) \$2,000 or less | 6 |
| (B) More than \$2,000 | 8 |
| (C) More than \$5,000 | 10 |
| (D) More than \$12,500 | 12 |
| (E) More than \$30,000 | 14 |
| (F) More than \$80,000 | 16 |
| (G) More than \$200,000 | 18 |
| (H) More than \$400,000 | 20 |
| (I) More than \$1,000,000 | 22 |
| (J) More than \$2,500,000 | 24 |
| (K) More than \$7,000,000 | 26 |
| (L) More than \$20,000,000 | 28 |
| (M) More than \$50,000,000 | 30 |
| (N) More than \$100,000,000 | 32 |

¹²⁶ Excerpted from *Sentencing Guideline Excerpts for Tax Fraud Examination*, University of Houston (April 30, 2003), available at <http://www.tjtaxlaw.com/2003TFExamSGExcerptps.pdf> (last accessed July 10, 2006).

APPENDIX E

Sentencing Table (in months of imprisonment)¹²⁷

| Offense Level | Criminal History Category (Criminal History Points) | | | | | |
|---------------|---|-------------|---------------|--------------|----------------|-----------------|
| | I (0 or 1) | II (2 or 3) | III (4, 5, 6) | IV (7, 8, 9) | V (10, 11, 12) | VI (13 or more) |
| 1 | 0-6 | 0-6 | 0-6 | 0-6 | 0-6 | 0-6 |
| 2 | 0-6 | 0-6 | 0-6 | 0-6 | 0-6 | 1-7 |
| 3 | 0-6 | 0-6 | 0-6 | 0-6 | 2-8 | 3-9 |
| 4 | 0-6 | 0-6 | 0-6 | 2-8 | 4-10 | 6-12 |
| 5 | 0-6 | 0-6 | 1-7 | 4-10 | 6-12 | 9-15 |
| 6 | 0-6 | 1-7 | 2-8 | 6-12 | 9-15 | 12-18 |
| 7 | 0-6 | 2-8 | 4-10 | 8-14 | 12-18 | 15-21 |
| 8 | 0-6 | 4-10 | 6-12 | 10-16 | 15-21 | 18-24 |
| 9 | 4-10 | 6-12 | 8-14 | 12-18 | 18-24 | 21-27 |
| 10 | 6-12 | 8-14 | 10-16 | 15-21 | 21-27 | 24-30 |
| 11 | 8-14 | 10-16 | 12-18 | 18-24 | 24-30 | 27-33 |
| 12 | 10-16 | 12-18 | 15-21 | 21-27 | 27-33 | 30-37 |
| 13 | 12-18 | 15-21 | 18-24 | 24-30 | 30-37 | 33-41 |
| 14 | 15-21 | 18-24 | 21-27 | 27-33 | 33-41 | 37-46 |
| 15 | 18-24 | 21-27 | 24-30 | 30-37 | 37-46 | 41-51 |
| 16 | 21-27 | 24-30 | 27-33 | 33-41 | 41-51 | 46-57 |
| 17 | 24-30 | 27-33 | 30-37 | 37-46 | 46-57 | 51-63 |
| 18 | 27-33 | 30-37 | 33-41 | 41-51 | 51-63 | 57-71 |
| 19 | 30-37 | 33-41 | 37-46 | 46-57 | 57-71 | 63-78 |
| 20 | 33-41 | 37-46 | 41-51 | 51-63 | 63-78 | 70-87 |
| 21 | 37-46 | 41-51 | 46-57 | 57-71 | 70-87 | 77-96 |
| 22 | 41-51 | 46-57 | 51-63 | 63-78 | 77-96 | 84-105 |
| 23 | 46-57 | 51-63 | 57-71 | 70-87 | 84-105 | 92-115 |
| 24 | 51-63 | 57-71 | 63-78 | 77-96 | 92-115 | 100-125 |
| 25 | 57-71 | 63-78 | 70-87 | 84-105 | 100-125 | 110-137 |
| 26 | 63-78 | 70-87 | 78-97 | 92-115 | 110-137 | 120-150 |
| 27 | 70-87 | 78-97 | 87-108 | 100-125 | 120-150 | 130-162 |
| 28 | 78-97 | 87-108 | 97-121 | 110-137 | 130-162 | 140-175 |
| 29 | 87-108 | 97-121 | 108-135 | 121-151 | 140-175 | 151-188 |
| 30 | 97-121 | 108-135 | 121-151 | 135-168 | 151-188 | 168-210 |
| 31 | 108-135 | 121-151 | 135-168 | 151-188 | 168-210 | 188-235 |
| 32 | 121-151 | 135-168 | 151-188 | 168-210 | 188-235 | 210-262 |
| 33 | 135-168 | 151-188 | 168-210 | 188-235 | 210-262 | 235-293 |
| 34 | 151-188 | 168-210 | 188-235 | 210-262 | 235-293 | 262-327 |
| 35 | 168-210 | 188-235 | 210-262 | 235-293 | 262-327 | 292-365 |
| 36 | 188-235 | 210-262 | 235-293 | 262-327 | 292-365 | 324-405 |
| 37 | 210-262 | 235-293 | 262-327 | 292-365 | 324-405 | 360-life |
| 38 | 235-293 | 262-327 | 292-365 | 324-405 | 360-life | 360-life |
| 39 | 262-327 | 292-365 | 324-405 | 360-life | 360-life | 360-life |
| 40 | 292-365 | 324-405 | 360-life | 360-life | 360-life | 360-life |
| 41 | 324-405 | 360-life | 360-life | 360-life | 360-life | 360-life |
| 42 | 360-life | 360-life | 360-life | 360-life | 360-life | 360-life |
| 43 | life | life | life | life | life | life |

- The Offense Level (1-43) forms the vertical axis of the Sentencing Table. The Criminal History Category (I-VI) forms the horizontal axis of the Table. The intersection of the Offense Level and Criminal History Category displays the Guideline Range in months of imprisonment. "Life" means life imprisonment. For example, the guideline range applicable to a defendant with an Offense Level of 15 and a Criminal History Category of III is 24-30 months of imprisonment.
- In rare cases, a total offense level of less than 1 or more than 43 may result from application of the guidelines. A total offense level of less than 1 is to be treated as an offense level of 1. An offense level of more than 43 is to be treated as an offense level of 43.

¹²⁷ U.S. Sentencing Guidelines Manual §3E1.1 (2004), at 376, available at <http://www.criminaldefenselawyer.com/federal-sentencing-guidelines/federal-sentencing-guidelines-2004.pdf> (July 10, 2006).

APPENDIX F

Top Five Reasons Why Refunds Were Issued (Which represent 91.3% of all fraudulent prisoner refunds issued)¹²⁸

| Reason Refund Issued | Total Refunds Issued | Electronic Return | Paper Return |
|-------------------------------|----------------------|-------------------|--------------|
| Identified After Cycle Cutoff | 2,196 | 600 | 1,596 |
| Other | 786 | 192 | 594 |
| No Selection | 462 | 79 | 383 |
| Tax Examiner Error | 320 | 108 | 212 |
| Prior Year Return | 128 | 31 | 97 |
| Totals | 3,892 | 1,010 | 2,882 |

Source: TIGTA analysis of the Scheme Tracking and Referral System (STARS).

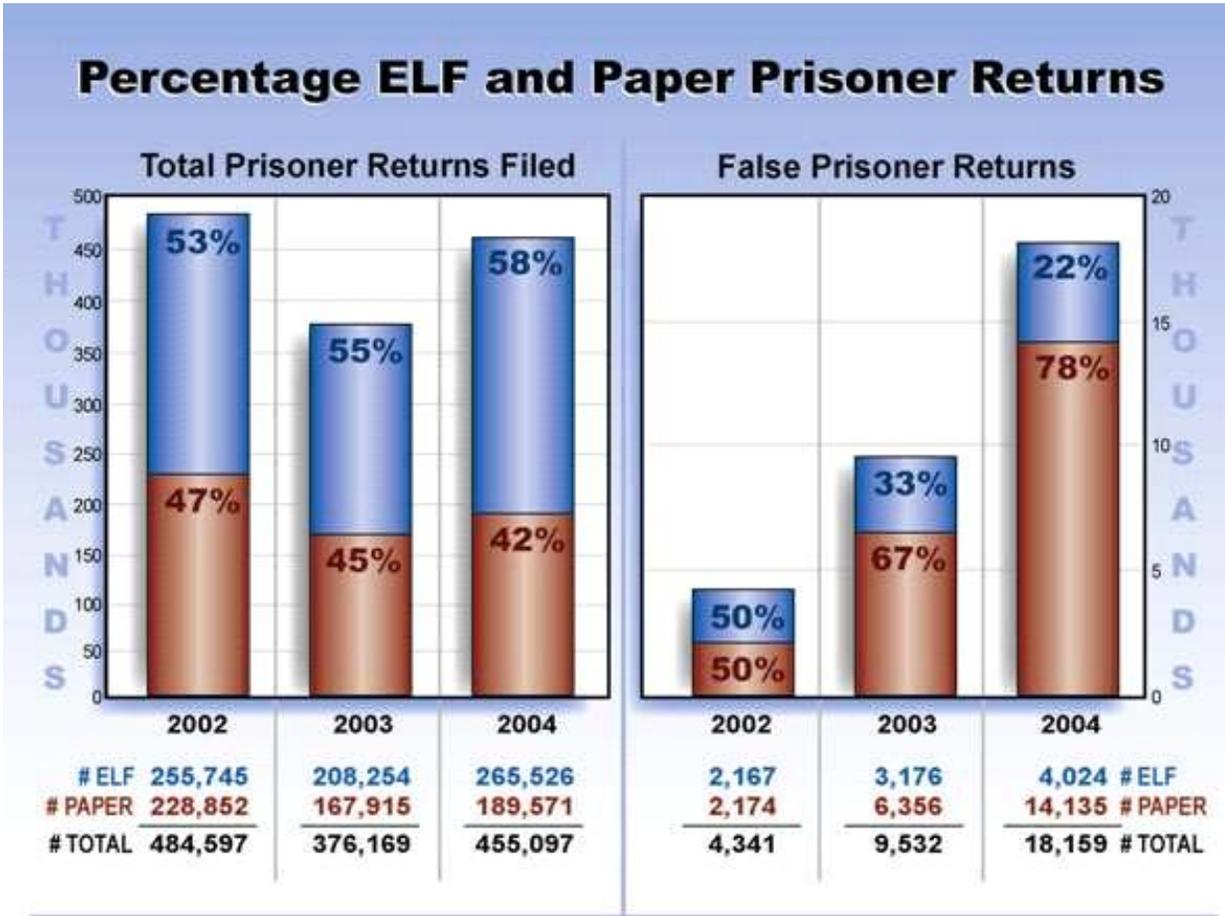
Cycle Cutoff: Tax returns entering the Submission Processing function go through various computer routines to perfect the data for processing. Various dates during the processing cycle have been established for certain routines to be completed so returns, and any resulting refunds, can be processed timely.

Other or No Selection: The CID function selected these two reasons why refunds were issued in over 29 percent of the cases. While these are legitimate reasons, they should be used sparingly. Using generic reasons could make it more difficult to identify the real reason refunds are issued and to make improvements to better identify and stop the refunds. The CID function indicated time constraints during processing may have led to the high use of these categories.

Prior Year Return: These are returns that were processed in the prior year but were detected during the current processing year. For example, these returns could have been identified as a result of an informant or by their association with a current-year scheme.

¹²⁸ Final Audit Report, *supra* n.74, at 7.

APPENDIX G



Final Audit Report – The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners (Audit # 200510019) issued by J. Gardiner, Deputy Inspector General for Audit (September 28, 2005), p. 31.

APPENDIX H

Incidence of Refund Fraud at Prisons¹²⁹

| Number of Fraudulent Returns Filed | Fraudulent Returns Filed While Incarcerated | State or Federal | Prison Name |
|------------------------------------|---|------------------|---|
| 499 | 489 | CA | CALIFORNIA SUBSTANCE ABUSE TREATMENT FACILITY |
| 474 | 429 | SC | EVANS CORRECTIONAL INSTITUTION (C.I.) |
| 353 | 320 | FL | DESOTO C.I. – ANNEX |
| 303 | 268 | FL | JACKSON C.I. |
| 292 | 269 | SC | MCCORMICK C.I. |
| 240 | 228 | FL | JEFFERSON C.I. |
| 236 | 194 | FEDERAL | FORT DIX FEDERAL C.I. (FCI) |
| 203 | 166 | FL | CENTURY C.I. |
| 201 | 177 | FL | HARDEE C.I. |

Source: TIGTA analysis of the STARS and the 2004 prisoner data file.

¹²⁹ Final Audit Report, *supra* n. 74, at 19.

APPENDIX I

Schemes with the Largest Number of Prisoner Returns (Comparing Numbers of Returns Filed by Prisoners versus Non-Prisoners)¹³⁰

| 2004 Scheme Numbers | Number of Fraudulent Prisoner Returns | Refunds Claimed on Fraudulent Prisoner Returns | Number of Fraudulent Nonprisoner Returns | Refunds Claimed on Fraudulent Nonprisoner Returns | Number of Total Fraudulent Returns | Refunds Claimed on All Fraudulent Returns |
|---------------------|---------------------------------------|--|--|---|------------------------------------|---|
| 0720040020* | 4,259 | \$18,494,308 | 1,689 | \$7,601,259 | 5,948 | \$26,095,567 |
| 0920040058 | 1,546 | \$9,191,419 | 624 | \$3,182,618 | 2,170 | \$12,374,037 |
| 8920040022 | 1,103 | \$1,858,806 | 71 | \$80,966 | 1,174 | \$1,939,772 |
| 0720040317* | 1,041 | \$5,671,747 | 209 | \$1,156,713 | 1,250 | \$6,828,460 |
| 0720040019* | 774 | \$2,185,222 | 84 | \$202,829 | 858 | \$2,388,051 |
| 1820040018* | 651 | \$1,849,262 | 730 | \$2,637,717 | 1,381 | \$4,486,979 |
| 0720040146 | 310 | \$1,756,224 | 203 | \$1,256,461 | 513 | \$3,012,685 |
| 0920040434 | 240 | \$104,017 | 78 | \$32,929 | 318 | \$136,946 |
| 8920040273 | 237 | \$310,418 | 149 | \$192,729 | 386 | \$503,147 |
| 1820040238 | 200 | \$113,174 | 21 | \$12,119 | 221 | \$125,293 |

Source: TIGTA analysis of the STARS.

- * This is a “dump” scheme. Each FDC places fraudulent returns into the category of a dump scheme if the FDC cannot associate the return with a larger, individual scheme. Some FDCs also had a dump scheme for prisoner returns.

¹³⁰ *Final Audit Report, supra n. 74, at 18.*

**ALPHABETICAL LISTING OF ACRONYMS
USED THROUGHOUT THIS PAPER**

| Acronym | Unabbreviated Description |
|----------------|--|
| AGI | Adjusted Gross Income |
| BOP | Federal Bureau of Prisons |
| CID | IRS Criminal Investigations Division |
| DEPRIVE™ | DEsignated PReparers for Inmate VEracity |
| DOC | Department of Corrections |
| DOJ | Department of Justice |
| EITC | Earned Income Tax Credit |
| ELF | Electronically-filed Returns |
| FDC | Fraud Detection Center |
| FEMA | Federal Emergency Management Agency |
| FTB | California Franchise Tax Board |
| FY | Fiscal Year |
| IRC | Internal Revenue Code |
| IRM | Internal Revenue Manual |
| IRS | Internal Revenue Service |
| SSA | Social Security Administration |
| TCE | Tax Counseling for the Elderly |
| USAM | U.S. Attorney's Manual |
| VITA | Volunteer Income Tax Program |
| W-2 | IRS form used to report wage earnings |