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Introduction

Chairman Baucus, Ranking Minority Senator Grassley, members of the Committee, I am pleased to appear before the Committee on Finance as you investigate the problem created by criminals who promote and market tax evasion schemes that defraud the United States Treasury. The cases that the Internal Revenue Service forwards to the Tax Division of the United States Department of Justice for criminal investigation or prosecution represent a growing challenge to federal tax enforcement. Tax fraud schemes cheat all American taxpayers. The Tax Division of the United States Department of Justice is responsible for ensuring that people who commit tax crimes are prosecuted to the fullest extent of the law.

As a Section Chief of one of the three regional criminal trial sections of the Tax Division, I have seen an increasing number of cases in which unscrupulous promoters claim not only that they can eliminate all federal income taxes prospectively, but also that they can arrange for the refund of taxes already paid. Many people who join these schemes willingly become co-conspirators in tax evasion. Their greed leads them to risk their future liberty. Sometimes, people who negligently or foolishly listen to these tax scam artists and follow their promises of a tax free world become the latest victims of the modern day equivalent of the alchemist who promises to turn base metal into gold. When these schemes are uncovered, even participants who are not criminally prosecuted often face substantial tax bills, interest and penalties.

There are many types of tax fraud scams. Some claim that all tax laws are unconstitutional and no one need pay taxes. Others claim a secret understanding of our tax laws that converts ordinary personal daily living expenses into fully deductible business expenses. Some claim that people can avoid taxes by pretending to transfer all of their assets to a series of trusts.

Criminals who promote tax fraud schemes generally share one thing in common. For a fee, they promise to eliminate almost all taxes without any real change in the manner a person lives or earns income. They accomplish that by concealing critical facts from the Internal Revenue Service. Sometimes accountants and lawyers are also criminally involved in marketing these illegal scams.

One way to better understand this growing problem, its impact on those who join in the schemes and the manner in which the Internal Revenue Service and the Department of Justice investigate and prosecute these schemes, is to discuss a case recently prosecuted in the District of Montana against Donald Fletcher, William Webber and Steven Heimbichner.

The Scheme

This scheme first came to the government's attention when a confidential informant notified the IRS in Billings, Montana, that individuals were holding suspicious seminars about the use of trusts to eliminate the need to pay taxes. The presenters at the seminars reportedly were spouting anti-government rhetoric. After the seminars, Fletcher, Webber or Heimbichner met with people to review their previously filed tax returns. During the meetings, the defendants told the taxpayers that non-deductible personal items actually could be deducted. The defendants claimed that there were legitimate deductions that were not known to most CPAs and attorneys because the IRS did not publicly disclose this supposed secret information to tax professionals.

If a taxpayer agreed to become a client of the defendants, the taxpayer was then told to amend prior year tax returns in order to obtain refunds of most, if not all, taxes paid. These amended returns contained “additional business expenses” that the defendants claimed were legitimate, but actually had no basis in law or fact. For example, the defendants advised a taxpayer that he could deduct expenses for his cat, such as veterinarian bills and pet food, on the ground that a cat was a “rodent control device.” In another instance, the defendants advised a separate client that he could deduct personal expenses for his family dog as a mobile security device. The defendants also regularly claimed that deductions could be taken for meals and entertainment so long as the taxpayer's business was discussed, no matter how insignificant the discussion.

The defendants arranged for the amended returns to be signed by the clients and filed with the Internal Revenue Service. The amended tax returns did not contain the signature of the paid preparer, as required by law. When some taxpayers asked the defendants why they did not sign the returns, the defendants stated that it was not necessary. These amended returns claimed refunds as high as $38,877.

In exchange for their "work," the Defendants charged a fee of approximately 5.5% of the client's gross income for the year. One-half of this fee was to be paid when the return was prepared and the other half was to be paid upon receipt of the tax refund.

In addition to amending returns for prior years, the defendants advised taxpayers to purchase two trusts at a cost of approximately $3,500 each. The stated purpose of the trusts was to protect assets from loss due to frivolous lawsuits, inheritance taxes and unnecessary income taxes. During and after the seminars, however, the defendants claimed that the trusts would allow taxpayers to legally deduct all of their personal expenses. Essentially, they claimed that the "trust entities" could take deductions which individuals could not take. The defendants also implied during their seminars that members of Congress use the very same trusts and don't pay any taxes.

In addition to the trust scheme, the defendants also offered to prepare current years tax returns and charged a monthly fee that ranged from $100 to $1,300 a month for this service. These fees were electronically transferred to them from the clients' checking accounts. For this fee, the defendants also promised to represent the clients at any IRS audit.

The defendants continued to prepare annual returns for clients who paid these monthly fees and, in some cases, the false returns understated the taxpayer's true tax liability by as much as $30,000 per year. On those tax returns, the defendants did not provide accurate information about the preparer of the tax return, which made it difficult for the IRS to determine who was involved in the scheme.

The defendants secured clients to attend their seminars in many ways. We have provided the Committee with an example of a brochure or advertising flyer that the defendants used to market their program and charts that help explain the manner in which the scheme functioned.

Investigative Techniques

The IRS began its investigation by auditing amended returns filed by Montana taxpayers. After the IRS received information about the trust promoters from a confidential informant, the IRS requested and received permission to conduct undercover surveillance. Based on evidence gathered during the undercover operation, the IRS secured a search warrant for the defendants' offices in Montana. After executing the search warrant the IRS identified additional clients of the defendants and began to appreciate the full extent of this scheme, in terms of the number of people involved and the revenue loss to the United States Treasury.

Based on the information obtained from the search warrant, the IRS conducted a financial investigation and identified the perpetrators. The IRS then referred the matter to the Department of Justice and requested that the Tax Division authorize prosecution. The Tax Division authorized prosecution of Donald Fletcher, William Webber and Steven Heimbichner in Montana. The Tax Division referred the matter to the United States Attorney for the District of Montana, but continued to provide assistance as needed.

Prosecution

____In June of 1999, a federal grand jury in the District of Montana returned an indictment charging Donald Fletcher, William Webber and Steven Heimbichner with Conspiring to Defraud the United States, in violation of Title 18 U.S.C. § 371; Mail Fraud, in violation of Title 18 U.S.C. § 1341; and numerous counts of Aiding and Assisting in the Preparation of False Tax Returns, in violation of Title 26 U.S.C. § 7206(2).

After prolonged pre-trial motions and several hearings, the trial was scheduled to begin in August of 2001. On July 5, 2001, William Webber agreed to plead guilty and cooperate with the United States in this case and another pending criminal case in another jurisdiction. Mr. Webber's case was then severed and transferred to another jurisdiction for disposition. On July 20, 2001, Steven Heimbichner pleaded guilty to Conspiring to Defraud the United States. Finally, on August 7, 2001, on the eve of trial, Donald S. Fletcher pleaded guilty to mail fraud and conspiracy to defraud the United States.

Donald Fletcher was sentenced in the District of Montana on January 3, 2002. United States District Judge Richard F. Cebull found that the demonstrable tax loss to the United States was $861,402. That is, had this scheme succeeded, the defendants would have prevented the United States from collecting $861,402 in taxes. Judge Cebull also found that the Montana clients, numbering close to fifty, had paid in excess of

$440,000 to the defendants for their alleged tax and trust services. The clients may never be able to recover their money from the defendants. In addition, the clients were audited by the Internal Revenue Service and many were required to pay back taxes and interest.

At Mr. Fletcher's sentencing, Judge Cebull found that the facts warranted an upward departure from the sentencing guidelines, because the defendant's criminal history did not adequately represent the scope of his criminal conduct. The judge also noted that the defendant had been previously found liable in civil cases for fraud and civil RICO involving similar schemes with false tax returns and various insurance companies. Judge Cebull also found that the defendant engaged in activities to conceal his involvement and role in these crimes by using fictitious entities and nominees. Finally, the judge determined that Fletcher was a leader of the conspiracy. Based on those findings, Judge Cebull imposed a sentence of 78 months imprisonment, three years of supervised release, a $100,000 fine and restitution of $10,000.

Steven Heimbichner was sentenced on February 12, 2002, and is cooperating with the United States in ongoing aspects of this and a related investigation.

William Webber has not yet been sentenced.

This investigation and prosecution were successful because of the joint efforts and close cooperation of prosecutors in the Office of United States Attorney William W. Mercer and the Justice Department's Tax Division, as well as the invaluable assistance of the IRS Special Agents assigned to the criminal investigation.

Conclusion

The Fletcher case demonstrates the considerable investigative effort and time required to successfully prosecute complex tax fraud schemes. This case is just one of many similar cases that involve promoters who make a living offering the illusory promise of a tax free world.

Hearings such as this one, combined with the publicity generated by successful criminal prosecutions and civil enforcement actions, should help deter taxpayers from participating in fraudulent tax schemes. As stated recently by Eileen J. O'Connor, Assistant Attorney General for the Tax Division, "Taxpayers should be extremely wary of promoters who market schemes they claim eliminate the obligation to file tax returns and pay taxes. The Department of Justice will prosecute the promoters of fraudulent tax schemes and their clients, and the person who claims to be liberating you from your taxes might in fact be leading you to prison."

The Department of Justice is committed to working with the Treasury Department to ensure that everyone complies with the tax laws and to stop unscrupulous schemers from defrauding honest taxpayers. The Justice Department greatly appreciates this Committee's support in our important work.

I would welcome any questions you may have at this time.