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USAID'S LEADERSHIP IN PUBLIC FINANCIAL MANAGEMENT
**Detailed Guidelines for Effective Tax Administration in Latin
America and the Caribbean**
Chapter 9. Fraud Investigations

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Detailed Guidelines for Effective Tax Administration in Latin America and the Caribbean

Chapter 9. Fraud Investigations

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List of Acronyms and Abbreviations

Acronym	Definition
CCECC	Center for Combating Economic Crimes and Corruption
CIAT	Inter-American Center of Tax Administrations
CITP	Criminal Investigation Training Program
FLETC	Federal Law Enforcement Training Center (United States)
ILEA	International Law Enforcement Academy
IRS	Internal Revenue Service (United States)
LAC	Latin America and the Caribbean
LTO	Large Taxpayer Office
VAT	Value added tax

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Chapter 9. Fraud Investigations

The term "tax fraud" refers to cases involving taxpayers who knowingly underreport substantial amounts of taxable income and/or overstate substantial amounts of deductions in their tax declarations to fraudulently minimize tax payments. "Tax evasion" refers to the premeditated failure to register with the tax authorities, as required by law, or failure to pay owed taxes. The tax administration's fraud investigation department or division investigates both types of violations.

The purpose of this chapter is to describe tax fraud investigations in tax administrations around the world and to discuss the vital role tax fraud investigation staff play in promoting voluntary compliance with the country's tax laws. The following aspects of fraud investigation work are addressed in this chapter:

- The main mission and organization of the fraud investigation function;
- The key legal provisions for effective fraud investigation work;
- Staff qualifications, training, and differences between fraud investigations and audit;
- The role of the audit and collection functions in detecting potential tax fraud and evasion and in developing fraud cases jointly with the fraud investigations staff;
- The importance of communications from third-party informants as sources of potential tax fraud/evasion cases;
- The criteria that should be considered when selecting cases for full-scale fraud investigation, based on international leading practice;
- The importance of information technology for case development and management;
- The role of the legal staff of the tax administration in fraud investigations;
- The relationships between fraud investigators and the police, other law enforcement agencies, and members of the judiciary before whom fraud and evasion cases are prosecuted; and
- The fraud deterrent role of widespread publicity about convictions, particularly those convictions with sentences of incarceration and/or substantial civil fraud penalties.

9.1. Leading Practice

By international leading practice, the fraud investigation function is an integral part of the compliance and enforcement "tools" of the tax administration, alongside the collection of delinquent tax accounts, securing delinquent tax returns, fiscal inspections, and fiscal audits. In other words, fraud investigations are a vital feature of the overall risk-driven compliance strategy of a tax administration. **Tax fraud investigators** are the financial experts that identify and investigate complex financial crimes by taxpayers.

The primary mission of the fraud investigations division is to identify, target, investigate, and recommend for prosecution significant perpetrators of tax fraud and evasion. The division's highly trained and skilled investigators conduct in-depth investigations of tax fraud and evasion cases, gather all necessary evidence, select and forward those cases deemed worthy to the legal staff of the tax

administration for review, and participate as expert witnesses in judicial proceedings on cases that the legal staff of the tax administration submit for prosecution. The focus of the fraud investigation division is on the selection of the most serious cases, where the tax administration can pursue the most severe punishment, for investigation and possible prosecution. If successful, the tax administration can publicize these cases to give taxpayers a clear understanding of the high risks and consequences for non-compliance.

Although the role of tax auditors and fraud investigators may seem similar, there are substantial differences. In effect, tax auditors use accounting and business skills in examining financial records, transactions, assets, etc. to detect irregularities by taxpayers. Fraud investigators' skills include accounting as well, but fraud investigators also rely heavily on investigative techniques, information gathering, use of direct and indirect methods of proof, and detection and gathering of evidence to prove criminal violations of tax laws.

9.1.1. Key Legal Provisions Required

To discourage tax fraud and evasion, a country's tax laws must first contain provisions with serious consequences for violations, including substantial civil fraud penalties and possible incarceration. Second, legal provisions must grant fraud investigators sufficient power to conduct their investigations effectively and efficiently. Among the most important legal provisions, already discussed in Chapter 3 are:

- Provisions that require banks or other third parties to regularly provide information on payments to taxpayers to the tax administration for matching with its master file;
- Provisions for sanctions, including possible imprisonment, for tax fraud and evasion and the authority to publicize convictions and prison sentences; and
- Provisions that give administrative authority to the compliance staff of the tax administration to legally summons persons and any case-related documents necessary.

For fraud investigators, the legal authority to administratively subpoena or summons persons and documents, compel persons to testify, and record all questioning are indispensable investigative tools. Fraud investigators also require the use of various kinds of investigative equipment, including firearms and the authority to enter premises that contain books and records, or that are otherwise deemed pertinent to their investigations.

Perhaps, however, one of the most important legal provisions of fraud and evasion investigators is the authority to use circumstantial evidence to determine the proper tax due when books and records are absent. Circumstantial evidence enables the fraud investigator to develop presumptive assessments and includes the type and nature of the business activities of the taxpayer, analysis of businesses similarly situated, the movement of funds through the taxpayer's accounts with a bank or other financial institution, the comparison of the taxpayer's expenditures with the taxpayer's income, and other information.

9.1.2. Qualifications and Training for Fraud Investigators

To qualify for fraud investigator positions in the tax administration, candidates should be required to have a graduate degree in accounting, or at least some post-secondary schooling on accounting, because much of their work involves investigating and/or reconstructing financial records to prove that taxpayers have committed financial crimes. Candidates should also have excellent physical health and fitness, because their assignments include rigorous undercover and surveillance work that requires physical stamina. Candidates also are required to have firearms training and must qualify periodically in the proper use of firearms. Generally, training courses for fraud investigators include the following topics:

- Accounting principles and techniques;
- Applicable criminal laws, rules of criminal procedure, and relevant constitutional and statutory laws;
- Revenue administration functions and jurisdictions of the Ministry of Finance, and other governmental ministries and their subdivisions;
- Investigative policies and prescribed investigative techniques, such as undercover, surveillance, and interrogations;
- The use of investigative equipment authorized by statutes, including firearms;
- Relevant computer applications to assist in conducting criminal investigations, information gathering, and case development activities;
- Information gathering and the detection and gathering of evidence;
- The use of direct and indirect methods of proof;
- Investigative report writing;
- Interviewing techniques;
- Money laundering statutes; and
- Domestic and international banking.

The training program goals are to give the fraud investigator the knowledge and a basis to acquire the skills to:

- Conduct interviews and interrogations effectively;
- Identify, explore, and exploit leads;
- Reconstruct books and records from incomplete data;
- Analyze and interpret available evidence;
- Prepare fair, accurate, complete, uniform, concise, and logical reports; and
- Testify in legal, quasi-legal, or administrative proceedings.

Fraud investigator training is highly specialized. For many years now, all new fraud investigators of the U.S. Internal Revenue Service (IRS) have attended the Department of Homeland Security's Federal Law Enforcement Training Center's (FLETC) Criminal Investigation Training Program (CITP) – an interagency law enforcement training organization for 91 Federal agencies. The training topics include interviewing,

surveillance, criminal case management, legal provisions, physical techniques and conditioning, tactical training, firearms, vehicle handling skills, physical evidence, and other courses that provide the essential knowledge, skills, and abilities needed by the Federal criminal investigator. The FLETC provides services to international law enforcement agencies as well, including to fraud investigation divisions in LAC. In fact, the FLETC has oversight and program management responsibilities at the International Law Enforcement Academies (ILEA) in Gaborone, Botswana and Bangkok, Thailand. The FLETC also supports training at other ILEAs in Hungary and El Salvador.

9.1.3. Implementing a Fraud Referral Program

One of the best sources of fraud investigations is referral of potential fraud cases from tax auditors or staff of the collection function. Many suspected fraud cases are initially detected with the use of accounting and collection skills during the examination of financial records, transactions, etc., while performing what start out as routine audits or other compliance activities.

Fraud Referral

To develop a robust fraud referral program, staff of the audit and collection functions should be trained to recognize the so-called "badges of fraud"¹ in the cases they handle. Classroom and on-the-job, "badges-of-fraud" training courses focus on indirect methods, such as examining wealth, high value assets, and business transactions observed or uncovered during routine audit and collection activities and not reflected on tax declarations, and other methods. "Badges of fraud" for VAT/consumption tax cases include the nature of the business, such as enterprises which conduct a substantial volume of cash business and taxpayers who claim repeated, large refunds. It is the responsibility of the headquarters office staff of the fraud investigation function, in coordination with their audit and collection counterparts at headquarters, to develop internal policies and procedures for the referral of such cases from the audit and collection divisions to the fraud investigation division.

If, during the course of a routine tax audit or other compliance activity, a tax auditor or other enforcement official detects "badges of fraud", the compliance officer should immediately notify his or her manager. The facts and circumstances should be further reviewed, with management involvement, to a point where there is a reasonable indication that tax fraud exists. At that point, and without going any further, the case should be referred to the fraud investigation division, whose investigators are specially trained in criminal laws and in techniques to conduct criminal investigations. Auditors and other compliance staff, who continue their activities beyond this point in such cases, often unknowingly take actions that harm the government's cases in subsequent criminal court proceedings, because they are not trained in criminal laws and criminal investigation techniques.

A criminal offense referral report is usually completed when the tax auditor or other compliance officer is reasonably certain that "badges of fraud" exist and when his or her supervisor concurs. This report contains a narrative summary of the facts and circumstances that is reviewed, along with all tax returns,

¹ "Badges of fraud" are the facts or circumstances that indicate the intent to hinder or defraud. Badges of fraud can include excessive false or fraudulent expenses, unreported income, or returns not filed.

schedules, and documentation, for approval by the referring officer's supervisor and, ultimately, by the respective head of the audit or collection division, prior to its referral to the fraud investigation division and its intelligence branch head.

Communications from Informants

Communications from informants are very important sources of fraud investigations. Many third parties, particularly former or current business partners, accountants, and spouses, often have "inside" information not readily obvious and/or available to others about tax fraud and evasion schemes and associated details. They may even have documents/records to substantiate their allegations. The staff of the information and analysis section should develop, widely publicize, and maintain an effective informant communication program. Generally, a direct telephone line is dedicated to receiving communications from informants, and a special address is provided for anyone wishing to submit information about possible tax fraud and evasion. The telephone number and address are widely and continually publicized. Anonymity, for those who wish it, is guaranteed. Furthermore, a financial reward based on the amount of tax, penalties, and interest recovered is given to the informant, as provided by law.

Box 9.1. Informant cases in the United States

In the United States, by law, the IRS must pay 15 to 30 percent of the amount of taxes, penalties and interest collected to informants, as a result of the information that they provide. An informant case in the United States that received much publicity around the world in 2012 involved Bradley Birkenfeld, a former insider at Swiss Bank UBS. Mr. Birkenfeld provided valuable information to the IRS regarding a tax fraud scheme of his former employer, Swiss Bank UBS. He received a record-setting \$104 million reward from the IRS, after UBS paid \$780 million to settle civil fraud charges, and turned over records to help the IRS pursue many others, who participated in the tax fraud scheme. Other Swiss financial institutions, formerly in a bank secrecy jurisdiction, also turned over names and bank account numbers to the IRS. As negotiations with Switzerland for disclosure of information were ongoing, the IRS also implemented and publicized a "voluntary disclosure program" for unreported income in tax haven countries, resulting in \$ 5.5 billion in collections from 2009-2011, according to various media reports. The media also reported that the large awards granted in 2012 prompted an avalanche of calls to the IRS from potential informants.

In 2012, public media also reported that two awards for \$38 million and \$2 million were paid by the IRS to anonymous informants. No details were provided about the \$38 million award. As reported by the media, the \$2 million award was the third seven-figure reward for the same informant, a Wall-Street insider, who wanted to remain anonymous.

9.1.4. Organizational Makeup and Placement of the Fraud Investigations Component

In a large tax administration, with headquarters, regional, and district/field levels, and a substantial volume of ongoing and potential cases, fraud investigations are typically conducted by investigators assigned to various district/field offices. In medium and small tax administrations, with only headquarters and district/field offices, and only a small volume of fraud cases, the fraud investigations operations may be centralized in one or two key district/field offices, in a division under a District Director, who reports to the Deputy Director General (Operations), as discussed in Chapter 3. In several developing countries, where the fraud investigation function is relatively new in the tax administration,

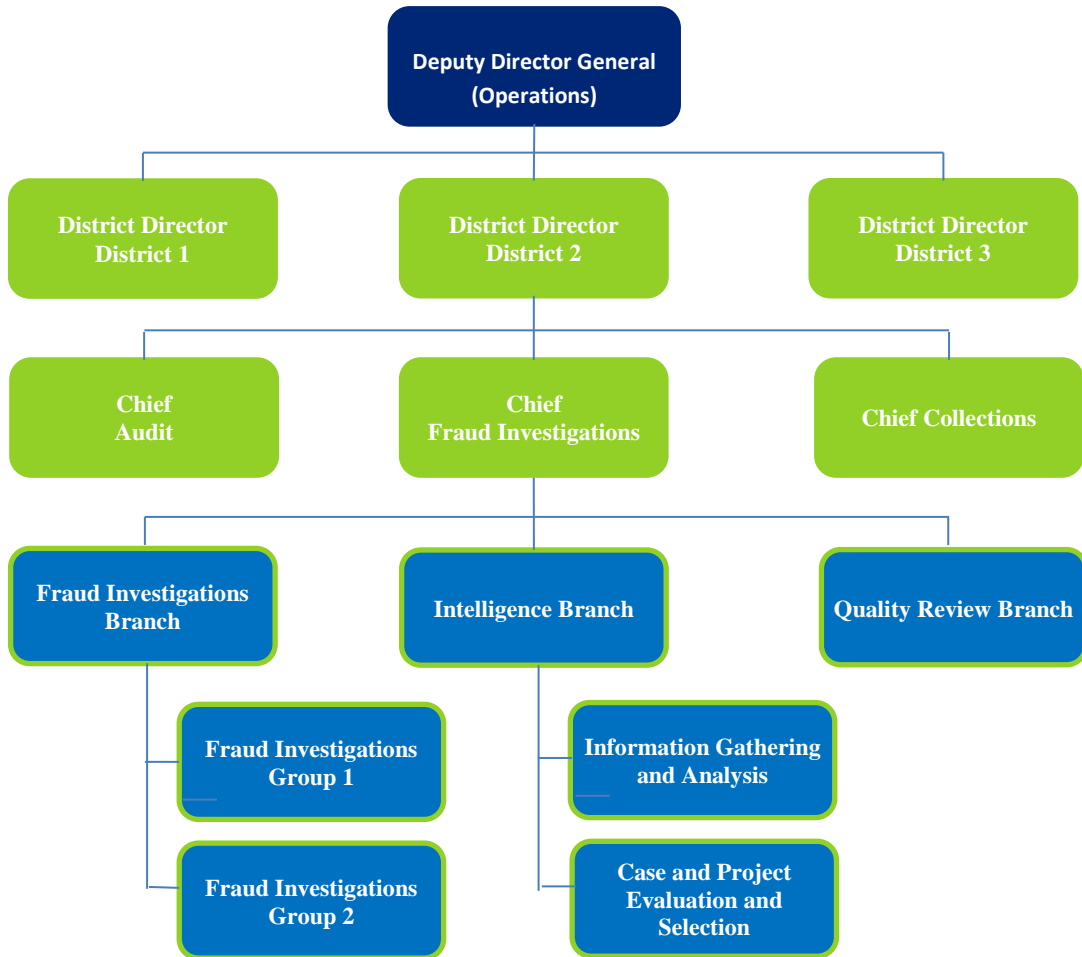
the function can be conducted from the headquarters level, under the Deputy Director for Operations. This way, top-level officials can monitor the fraud investigation function, given that it embodies considerable powers and can be a conduit for abuse and corruption.

As discussed in Chapter 4, the normative, planning, monitoring, and evaluation roles of headquarters and the operational role of regional, district, and local offices, respectively, must be practiced. The staff of the fraud investigation division at headquarters should perform the following roles:

- Develop an objective case/project selection system with a uniform method to select cases for investigation;
- Develop annual work plans and objectives in line with strategic plans;
- Establish policies, procedures, and guidelines regarding coordination with prosecutors on prosecution cases;
- Monitor and provide functional guidance to the tax fraud investigation divisions in field offices;
- Develop and maintain information regarding taxpayer fraud and evasion by occupational, business, and geographic sectors;
- Develop guidelines and procedures for the referral of potential fraud cases by the audit and collection functions;
- Develop guidelines and procedures for the joint investigation of cases referred by the audit or collection functions and accepted for fraud investigations; and
- Coordinate with other law enforcement agencies at the national level in the development of information regarding tax fraud and evasion.

At the operations level in the field, there should be three main organizational units in the functional structure of a fraud investigation division: (1) intelligence, (2) investigations, and (3) quality review. The role of the intelligence unit is covered in the next subsection. The work of the fraud investigation staff is self-explanatory. The quality review staff should consist of highly trained, skilled, and experienced investigators, who review completed fraud investigation cases to ensure that all evidentiary standards are met before these cases are referred to the legal services division of the tax administration for prosecution. The following organizational chart depicts the structure at the district/field office level.

Figure 9.1. Typical structure of a fraud investigation division in the field



Role of the Intelligence Branch

Potential fraud cases arise mainly from three sources –communications from informants, referrals from the audit and collection functions, and cases developed from information gathering. The intelligence branch plays a key role in all three scenarios. Referrals of potential fraud cases from the audit or collection divisions, and from third-party informants, are assigned to the intelligence branch for further analysis. The intelligence branch provides a recommendation for full-scale investigation or a recommendation for discontinuance if further development determines the case does not meet selection criteria and standards. Through its own information gathering, supplemented with information shared by its counterpart headquarters office staff, the intelligence branch not only identifies and develops individual targets for investigation, but also looks at groups of taxpayers for analysis of potential compliance. There are two staff sections that perform the work of the intelligence branch: (1) an information and analysis section, and (2) a case evaluation and selection section, as shown in the organization chart above.

Roles of the Information and Analysis Section: The information and analysis section of the intelligence branch is responsible for gathering and matching data from all possible sources for the preliminary analysis and classification of possible cases for investigation starting with any related tax returns, including cases referred by audit and collection staff or by informants. To do their jobs effectively, the staff of the section must have access to the computerized systems of the tax administration that accurately collect information on all payments and liabilities, land and building ownership and taxation, customs transactions, motor vehicle registration, etc. Experiences in many countries that have the ability to make such queries and compare such data continually confirm or reveal many incidences of potential tax fraud and evasion. For example, audits of taxpayers who paid relatively little income tax, but were identified in related computerized systems by the information and analysis staff as owners of several profitable companies and one or more expensive automobiles, often revealed substantial underreporting of income and led to prosecution.

To secure other pertinent data for comparative purposes, other activities of the information and analysis section can include the scanning of information in industry and trade registrations, electric company lists of high wattage users, lists of passport holders, data on membership in professional associations (doctors, lawyers, etc.), publications for new business announcements, import/export documents, and other sources. Even aerial photography to locate large houses and unregistered businesses can be explored. With these matching exercises, the staff of the information and analysis section fully develops and analyzes potential fraud and evasion cases to determine those that should be discontinued and those that should be recommended for full-scale investigation. Either recommendation is fully documented.

However, the cross-checking of information can only be effective with the complete storage of accurate information on most or all taxes for each taxpayer, which is impossible to accomplish with manual systems. As taxpayers become aware that the tax authority has the ability to cross-check information with computerized systems on a routine basis, there is a positive and significant impact on controlling tax evasion.

Roles of the Case Evaluation and Selection Section: The staff of the case evaluation and selection section is responsible for evaluating referrals from the information and analysis section and recommending for criminal investigation only those cases where there is a strong likelihood that the evidence required for prosecution can be assembled through investigative means. "Case selection criteria" in international leading practice include some, if not all, of the following considerations:

- The amount of tax evasion;
- Broad geographical and occupational coverage;
- Type of industry;
- Flagrancy of the violation (to prove intent, willfulness);
- Establishment of a criminal pattern over time;
- Notoriety of the taxpayer or enterprise;
- Collusion with others;
- Education level of the taxpayer and/or his/her presumed knowledge of tax laws;

- Whether the taxpayer is in an industry or geographic area identified in strategic and/or annual work plans where non-compliance is particularly high;
- Availability of records or evidence;
- Associations of the taxpayers involved; and
- Lifestyle and/or wealth.

The cases selected for fraud investigation should have both geographical and occupational coverage based on market segment analysis. By analyzing geographical areas of the country and occupational groups, the staff determines pockets of non-compliance by comparing return information (or the lack of tax returns filed) with other forms of financial information. Once a group has been analyzed, the few individual targets with the greatest criminal prosecution potential are selected for full-scale investigations by fraud investigators in the investigations branch. The most promising targets follow the developmental and selection processes described above.

A fraud investigator with the case evaluation and selection section ultimately writes an intelligence referral report recommending full-scale investigation, or a criminal withdrawal report to close files or to refer them to the audit or collection function if there are still civil tax consequences. Intelligence referral reports recommending full-scale investigations are reviewed by the head of the intelligence branch and, if approved, forwarded to the investigations branch for assignment to fraud investigators.

Fraud Investigation Case Development

If the development phase indicates that insufficient criminal prosecution potential exists, the appropriate fraud investigator will write a criminal withdrawal report outlining the reasons for the discontinuance. The investigation, after concurrence by the head of the intelligence branch and the head of the fraud investigations division, is closed and referred back to audit or collection functions, along with the criminal withdrawal report, for resolution of the civil issues (e.g., additional tax assessments, interest, penalties). As the person responsible for inter-division relationships, the head of the division reviews rejection of referral cases to insure that rejection is the proper decision. Referrals are a very important source of fraud cases and future referrals must be encouraged. If potentially good fraud cases are rejected, inter-division relationships will be negatively affected. On the other hand, if too many referrals are rejected for just cause, the head of the fraud investigations division is required to offer assistance to audit and collection counterparts for refresher training on "badges of fraud" for auditors and compliance staff.

If the development phase indicates sufficient potential for criminal prosecution, the fraud investigator prepares an intelligence referral report outlining the findings of the case development effort and recommending full-scale investigation. After review by the head of the intelligence branch the case is transferred to the fraud investigation branch for assignment to a fraud investigator.

Income tax cases recommended for full-scale investigation may include those cases, in which indirect methods have shown substantial changes in the taxpayer's net worth each year for the last three years; total expenditures substantially exceed gross income for the last two years; there are unidentified sources of income, as alleged in an informant's communication; the quality and accuracy of the

taxpayer's books and records are poor; the taxpayer principal business is cash-based; or combinations of all the above. VAT cases recommended for full-scale investigation may include taxpayers with unexpected large or repeated refund claims; large deficiencies in prior audits; owner-operated cash businesses, service industries, or businesses with a low ratio of input tax to output tax, such as restaurants; informant's communications; history of late filing and late payment; or combinations of all of the above.

Roles of Fraud Investigations Branch

When a full-scale investigation is opened, the tax auditor or collection officer who referred the case is automatically included as part of the investigation. Furthermore, the tax auditor or collection officer stays involved in the examination of the taxpayer for civil settlement purposes – the assessment and collection of additional taxes, penalties, and interest – long after the criminal aspects of the case – are completed.

Early in any criminal investigation – whether the source of referral is an audit case, a collection case, an informant's communication, or information gathering by the intelligence branch - the taxpayer and/or representative is contacted by the fraud investigator and advised of the investigation. Cooperation for both testimony and documentation is solicited. At the conclusion of the investigative phase, the taxpayer and/or representative is also invited to an investigation closing conference (a meeting), where the case and recommendation are summarized. At this meeting, the taxpayer is given an opportunity to present any final information or testimony prior to submission of the case for prosecution or final resolution.

The combination of options and tools used to reconstruct a taxpayer's taxable income are referred to as indirect methods, and generally fall into the following six categories:

1. **Cash transactions** – matching cash expenditures to cash receipts. Also known as the "T" Account method, this is the simplest of the indirect methods. It is usually performed as a quick test of the reasonableness of reported income.
2. **Source and application of funds** – a more advanced computation of the above method. The key aspect is the fraud investigator's or auditor's ability to trace the use of money by the taxpayer. This requires competent investigative and analytic skills to identify, corroborate, and document each expense.
3. **Net worth** – compares the increase in a taxpayer's net worth from year to year. This method requires examination of more than one consecutive tax year.
4. **Bank deposit** – monitors the flow of funds through bank accounts. This method is applicable only if the taxpayer's income and expenditures are primarily transacted through bank accounts.
5. **Percentage computation** – determination of gross income using percentages or ratios considered typical to the business or item under inspection.
6. **Markup/unit volume** – estimation of gross income based on specific business transactions and the normal volume and average prices of the items or services sold. Generally, this method is the most difficult for the taxpayer to refute.

Indirect methods, done correctly, have been recognized by courts in developed countries throughout the world as sustainable, legal assessments by tax administration officials, where the taxpayer has few or no records or refuses to cooperate with tax officials. Assessments using indirect methods have been upheld as admissible evidence, not only in civil court proceedings, but also as proof of fraud and evasion in criminal proceedings.

Closing Fraud Investigations

Once all of the facts and circumstances of the tax crime have been fully documented, it is the responsibility of the assigned fraud investigator to prepare the final investigation report summarizing the evidence. The report will contain, for example, identification, location, sources and amount of unreported income uncovered during the investigation, location and legal description of real estate purchased for cash at prices, which greatly exceed gross income reported for tax purposes, and similar items. At the conclusion of the investigation, the head of the investigation branch, the quality review staff, and the head of the fraud investigation division perform formal reviews of the fraud investigation report, with related exhibits, prior to submission for legal counsel's review. Even though the fraud investigator participates in the pre-court proceedings, the head of the fraud investigation division is the official representative of the division with the Legal Services Division and should therefore be familiar with the technical aspects of the case.

As is readily obvious from all the above steps, fraud investigations consume a lot of resources. Therefore, only the most egregious cases which have the best potential for prosecution, conviction, and publicity should be selected for investigation to serve as clear examples for all taxpayers that there are significant consequences for non-compliance.

9.1.5. The Role of the Legal Services Division

The legal services staff of the tax administration is involved in the investigation process by performing legal reviews of cases in progress with the assigned investigators at least quarterly. Upon the completion of the investigation, the legal staff also perform an in-depth, formal legal review of the final investigation report and related exhibits. The Legal Services Division submits a brief report in writing to the Deputy Director General (Operations) concerning the review and legal recommendations for prosecution. If the Deputy Director General (Operations) concurs, the case is forwarded to the Director General for review and approval. If approved, the Director General refers the case for prosecution to the litigation unit of the tax administration's legal services division.

The main responsibilities of the attorneys of the criminal litigation section are to:

- Prepare the final legal reports for cases which will involve criminal litigation, with assistance from those members of the advisory services unit staff already involved with the investigation;
- Provide legal advocacy during judicial proceedings for the tax administration's criminal cases in judicial venues of the Ministry of Justice; and
- Liaise with counterparts of the Ministry of Justice, Ministry of National Security, the national police agency, and other national officials involved with public prosecutions in all aspects of duties requiring criminal litigation.

9.1.6. Relationships with the Ministry of Justice, Police Agencies, and Others

Fraud investigators, auditors, and other compliance staff involved in the development and investigation of cases serve as expert witnesses in the judicial proceedings, as required by attorneys of the criminal litigation section. It is important that representatives of the fraud investigation function and legal services staff demonstrate high levels of courtesy, professionalism, and expertise on such occasions. In fact, it is the responsibility of all the staff, particularly top-level staff of the fraud investigation division, to develop and maintain positive relationships with the judiciary and other Ministry officials involved in the prosecution of tax fraud and evasion cases. Coordination and collaboration with these officials is essential to insure that all tax cases referred for prosecution are handled timely and effectively. In its efforts to develop positive relationships, in some cases, the tax administration is able to offer and provide tax law training and other services to judges and other Ministry officials.

There are other public institutions with which the fraud investigations function must develop and maintain positive relationships. National and local police agencies are examples. In some cases, when information summoned from the taxpayer and/or representative is not forthcoming, fraud investigators may be required to enter business premises to seize documents, computer equipment, and other materials necessary for the ongoing investigation. In these cases, the presence and collaboration of police officers is often necessary. Occasionally, fraud investigators, who are authorized to carry firearms, are required to assist in the protection of auditors and other compliance officers in cases where there is the threat or risk of assault. Often, the presence and collaboration of police officers is also sought in these cases. In some countries, fraud investigators and the police collaborate to conduct joint vehicle searches periodically for evidence or contraband at checkpoints on roads, highways, and railways in cases that involve known or potential violations of laws, including tax laws.

Furthermore, many countries are establishing law enforcement entities with broad authority to prevent, investigate, and prosecute "economic crimes," such as corruption, money laundering, and even terrorist financing. For example, the Center for Combating Economic Crimes and Corruption (CCECC), established recently in Moldova, is a law enforcement entity aimed primarily at detecting and investigating economic crimes, including tax evasion. A similar institution was also established in Jordan very recently.

It is generally agreed that, in many countries, the various government agencies involved in one way or another with tax fraud and evasion issues typically have difficulty communicating and coordinating, and often even have competing interests. This is an international problem that must be solved through forced collaboration. It is essential that the fraud investigation division of the tax administration take the lead on a regular basis in bringing these parties together to share mutual interests and problems that relate to legislation, work processing, common procedures, overlapping authorities, information sharing, etc. After all, one of the significant differences between the fraud investigation and other tax compliance components of the tax administration is that the ultimate results of prosecutions, convictions, and fines are dependent on a multitude of governmental bodies working cooperatively to achieve a high degree of voluntary compliance with the country's tax laws and higher tax revenues.

9.2. Common Trends

9.2.1. Large Taxpayer Tax Fraud

There seems to be a general perception in the tax administrations of many developing countries that tax fraud should not be a major concern with large taxpayers, because they invariably have effective accounting controls, skilled legal assistance, sound management practices, and internal and external, independent auditors. Experience indicates otherwise. International tax administration experts in the field of tax fraud and evasion quickly point out that some large enterprises frequently employ tax lawyers, skilled accountants, and information technology experts to avoid paying taxes. Oftentimes, these businesses intentionally create complex accounting systems and transactions so that it is difficult, if not impossible, for less sophisticated auditors and investigators to detect tax evasion. For example, transfer pricing² creates issues that are extremely difficult to unravel.

Global automation by businesses has created tremendous opportunities for enterprises to hide financial transactions. Undoubtedly, tax administrations need to develop strategies to combat international tax evasion. Tax administrations around the world now train their large case auditors and fraud investigators in industry specialized courses, such as telecommunications, banking, energy, and mining, to be able to perform effectively in the large enterprise world.

Box 9.2. The case of Enron

In the international arena, many large corporations have been involved in multi-million dollar tax evasion schemes. Enron Corporation, the seventh largest U.S. corporation in 2000, is an example of this trend. More than 30 people were charged with various crimes as a result of their illegal business practices. More than 20 people, including Enron's chairman, president, and chief financial officer, were convicted of or pleaded guilty to fraud, conspiracy, and other crimes. Arthur Andersen, a top accounting firm and provider of accounting services to Enron, came under investigation for its role in Enron's collapse and received a conviction for obstruction of justice in 2001.

9.2.2. Computerization

Large taxpayers are not the only ones that use technology. International estimates suggest that 70 percent to 80 percent of taxpayers use computers to document and store financial data once maintained in manual ledgers. Tax administration officials, who seek to recover critical financial information for their audit or investigative work, face difficult challenges. The employment of skilled programmers by some involved in tax fraud and evasion schemes to create programs designed to hide and, in some cases, destroy information when outsiders attempt to access their computers or networks compounds the problem.

There is a strong trend in tax administrations of developed countries to hire and train computer forensic experts, provide them with equipment for forensic data mining, and enable them to clone hard drives,

² Transfer pricing is the practice by which divisions of a company set prices for transactions with each other. These transactions can be between a parent company and a subsidiary, or two subsidiaries controlled by a common parent.

retrieve required accounting data, and analyze such information. This is particularly true if tax authorities agree to investigate major enterprises to prove tax evasion by recreating critical information for the presentation of evidence in court.

Many developed countries now use automated, risk-based techniques to select those taxpayers for audit cases that have the highest probability to produce audit assessments. The collection division is also embracing computerized formulae for priority selection of the cases with the highest risk to revenue. The latest trend is for the fraud investigation division to also design computerized systems for case selection with the input of numerous external and internal databases. The output of these systems, with the application of automated ratios and mathematical formulae, targets cases with high potential for fraud, of which, those with the highest potential are selected for investigation. The remaining cases, which always constitute the majority of cases, do not meet the case selection standards, but may reveal civil tax violations, in which case they are referred to the audit or collection divisions for necessary action.

Adding skilled information technology staff to the traditional fraud investigation division is a recent trend in tax administrations around the world. These staff help develop computerized systems unique to the fraud and evasion function, such as automated case tracking systems and automated management information systems, and assist in case investigations that involve computer seizures and forensic analysis. Information technology staff is usually placed in the intelligence branch and/or as staff to the head of the fraud investigation division to serve all fraud investigation functions.

9.2.3. Tax Fraud Investigation of Corruption, Money Laundering, and Narcotics Trafficking

In collaboration with drug enforcement agencies in various countries, the fraud investigation functions of many tax administrations have been dedicating significant time and effort in recent years to the tax fraud and evasion implications of narcotics traffickers. While the tax administration does not enforce drug laws, the enormous, untaxed profits of those engaged in these illegal activities are definitely within the scope of the tax administration's jurisdiction. Through circumstantial evidence and indirect methods, fraud investigators of some tax administrations have been able to prove tax fraud and evasion of very large sums by narcotics traffickers and have seized impressive amounts of cash and valuable property on many occasions through presumptive tax assessments.

However, narcotics trafficking cases are very time consuming and require extensive surveillance activities, joint activities with other law enforcement agencies, and evidentiary challenges in judicial proceedings. While publicity about prosecutions, convictions, and funds and property seized by the tax administration is certainly worthwhile, taxpayers do not associate such cases with the consequences of non-compliance with the tax laws, which is one of the primary objectives of fraud investigations. Therefore, to avoid taking too much time from the main missions of the tax fraud and evasion function, the number of narcotics trafficking cases selected and ongoing at any given time should be small.

9.3. Tax Administration Maturity

Maturity levels of tax administrations with respect to the investigation of tax fraud and evasion are described below.

Fraud Investigations: Maturity Level 1

Key word: "Absent"

- The country's separate tax laws for the various types of taxes either have no provisions for tax crimes or have only vague provisions about civil fraud penalties for tax fraud and evasion.
- There are no provisions in the tax laws that require financial and other institutions to report to the tax administration on any of the various payments made by taxpayers through these institutions or that give tax officials the authority to subpoena or summon persons or documents or to use circumstantial evidence for presumptive assessments to determine unreported tax.
- The Ministry of Justice is in charge of investigating and prosecuting all economic crimes, is understaffed, doesn't have the capacity to discuss tax, and rarely handles even the civil fraud violations referred directly to them by informants.
- Without statutory authority, a fraud investigation component is totally absent from any of the organizational structures of the various tax administrations.
- The various tax administrations are in the business of collecting as much revenue as possible and are not interested in making examples of tax evaders other than for the large amounts of taxes, penalties, and interest collected from them.
- There is no coordination among the various tax administrations, and each tax administration is passive in developing positive relationships with other institutions involved with law enforcement.

Fraud Investigations: Maturity Level 2

Key word: "Junior Partner"

- The country's separate tax laws for the various types of taxes have a few provisions for tax fraud and evasion, particularly for VAT – civil fraud penalties, especially for repeat violations, and even incarceration for egregious repeat offenders – that give limited authority to tax administrators to investigate tax fraud and evasion.
- There is one tax administration for all taxes, and the audit and collection divisions in the organizational structure have a junior partner – a small fraud investigation component at the headquarters level reporting to the Director General, consisting of a somewhat isolated supervisor, administrative staff, a few investigators, and using little information technology.
- Fraud Investigators and their supervisor in the new unit are former, experienced auditors, but most do not have post-secondary schooling in accounting, none has special fraud-investigation training, and they are not skilled in the basic skills required to conduct professional tax fraud

investigations, such as indirect methods, investigative techniques, evidentiary requirements, etc.

- Under the tax laws, fraud investigators have limited authority to subpoena and summon persons or documents and to use circumstantial evidence for presumptive assessments to determine unreported tax, mostly in the legal VAT framework, and have limited access to financial information of taxpayers from third parties.
- Fraud investigators concentrate wholly on cases of fraud and evasion of VAT by small and a few medium taxpayers, which are much easier to determine and prove than cases of income tax fraud and evasion. Investigators select these cases manually, and there are no defined criteria for the selection of VAT or income tax cases and no written manuals, policies, or procedures for investigators developed by headquarters.
- VAT fraud and evasion cases are successful in producing revenue from civil fraud penalties, including substantial revenue from repeat second and third-time offenders, but no one has ever been sentenced to prison for tax fraud or evasion.
- The tax administration's legal services staff has minimal involvement in the review of completed tax fraud and evasion cases, except in cases where the taxpayer does not agree with the findings of investigators.
- There is an informal, word-of-mouth fraud referral program for audit and collection staff, which has very limited success.
- Most of the cases selected for full-scale investigation by the fraud investigation division come from informal informant communications received throughout the tax administration, of which only some are referred to the fraud investigation unit. Others are either erroneously referred directly to the audit division, or are ignored.
- The fraud investigation staff has good relationships with Customs and police agencies, but is making no effort to cultivate positive relationships with the judiciary or with Ministry of Justice officials.

Fraud Investigations: Maturity Level 3

Key word: "Partner"

- The country's tax code or tax procedures code has strong provisions and sanctions for tax fraud and evasion, including substantial civil fraud penalties and possible incarceration.
- The legal framework provides for a functional organizational structure for the single tax administration, including a fraud investigation component, and gives specific authority to the tax administration to investigate tax fraud and evasion.
- The tax administration's fraud investigation component is now a partner and an integral part of the compliance and enforcement "toolbox," along with audit and collections.
- The fraud investigations function in headquarters and the district/field divisions is organized and performed according to international leading practice, with intelligence, investigations, and quality review branches, and all are equipped with fairly modern computerization equipment and systems.

- Fraud investigators and their supervisors, mostly former, experienced auditors, have post-secondary degrees in accounting and most, except for those recruited in the last two to three years, have attended a locally designed criminal investigation training course and have adequate skills in the application of indirect methods, investigative techniques, evidentiary requirements, etc.
- Under the law, fraud investigators have full authority to subpoena and summon persons or documents and to use circumstantial evidence for presumptive assessments to determine unreported tax. Investigators also have access to taxpayer financial information, in documents received periodically from financial institutions and others, and good computerized equipment and systems for matching data.
- A written, formal fraud referral program designed for the audit and collection divisions produces many good cases accepted for full-scale investigation. However, too many other referred cases are rejected, because work on civil issues by audit or collection staff, who have no key fraud indicator training, compromised the investigation.
- A well-designed and administered informant communication program, managed by the intelligence staff of the fraud investigation function, yields notable fraud prosecution cases, including convictions and prison sentences that are widely publicized.
- With defined case selection criteria for the manual selection of cases, and policy and procedural manuals for case investigations, fraud investigators successfully prosecute medium and a few large taxpayers for VAT fraud and evasion, leading to convictions and prison sentences that are widely publicized.
- Although lesser in number, there are successes with prosecuting medium taxpayers for individual and corporate income tax fraud and evasion, including convictions and prison sentences that are widely publicized. However, investigators have never developed similar cases against large taxpayers.
- The tax administration's legal services staff has full involvement in tax fraud and evasion cases during the investigation phase and also after completion.
- The fraud investigation staff has good relationships with the Ministry of Justice, the judiciary, Customs, and police agencies, and participates actively with other agencies on some important investigations of economic crimes, including drug trafficking. Occasionally, however, there is confusion about jurisdiction.

Fraud Investigations: Maturity Level 4

Key word: "Key Partner"

- The country's tax code or tax procedures code has strong provisions and sanctions for tax fraud and evasion, including substantial civil fraud penalties and possible incarceration.
- The legal framework provides for a functional organizational structure for the single tax administration, including a fraud investigation component, and gives specific authority to the tax administration to investigate tax fraud and evasion.

- For several years, the tax administration's fraud investigation component has been a full partner and an integral component of the compliance and enforcement "toolbox," along with the audit and collections. In fact, fraud investigation is now considered the key partner, due to its success in investigating and prosecuting income tax and VAT fraud and evasion by many medium and large taxpayers throughout the country, including securing convictions and prison sentences that have been widely publicized.
- The fraud investigations function in headquarters and the district/field divisions is organized and performed according to international leading practice, with intelligence, investigations, and quality review branches, all of which are well equipped with the latest computerization equipment and systems. Additionally, information technology staff are present as staff assistants at the division-head level to assist the entire division on IT needs.
- The fraud investigation function counts on computerized systems unique to the function, such as automated case tracking systems and automated management information systems, to assist in case investigations that involve computer seizures and forensic analysis.
- Fraud investigators and their supervisors, mostly former, experienced auditors, have post-secondary degrees in accounting and have all attended an excellent criminal investigation training course, designed on one of the international models for criminal investigators. This course is updated periodically, and fraud investigators also attend continuing professional education training courses periodically. All but the newest recruits have expert skills in the application of indirect methods, investigative techniques, evidentiary requirements, etc.
- Under the law, fraud investigators have full authority to subpoena and summon persons or documents and to use circumstantial evidence for presumptive assessments to determine unreported tax. Investigators also have access to taxpayer financial information, in documents received periodically from financial institutions and others, and modern computerized equipment and systems for matching data.
- Most experienced auditors and collection staff have attended a "badges-of-fraud" course, designed and conducted by staff of the fraud investigation function, and a written, formal fraud referral program, designed for the audit and collection functions, continually produces many good cases accepted for full-scale investigation.
- A well-designed and administered informant communications program, managed by the intelligence staff of the fraud investigation function, has yielded several notable fraud prosecution cases, including convictions and prison sentences that have been widely publicized. The tax administration has paid all informants timely awards based on the recovery of tax, penalties, and interest that stems from the information they provide.
- With defined case selection criteria for the computerized selection of cases, and policy and procedural manuals for case investigations, fraud investigators successfully prosecute many medium and several large taxpayers for both income tax and VAT fraud and evasion, including convictions and prison sentences that are widely publicized.
- The tax administration's legal services staff has full involvement in tax fraud and evasion cases during the investigation phase, and also after completion.

- The fraud investigation staff has excellent relationships with the Ministry of Justice, the judiciary, Customs, and police agencies, and participates actively with other agencies, all acting within their respective jurisdictional boundaries, on important investigations of economic crimes, including drug trafficking.

9.4. Latin America and the Caribbean

As noted above, one of the most important legal provisions underpinning an effective fraud investigations function is the authority for tax investigators to access taxpayers' bank information in the conduct of their investigations. A second set of indispensable legal provisions to discourage tax fraud and evasion provides serious consequences for violations, including substantial civil fraud penalties and possible incarceration.

Generally, in LAC countries, tax administrations do not benefit from either of these legal provisions. According to a recent report, "practically all countries (in Latin America) affirm that they have bank secrecy laws which limit their access to information necessary to perform their responsibilities."³ Furthermore, "the information...shows that sanctions and penalties for tax violations imposed by Tax Administrations of Latin America are very low.....in general it can be affirmed that the Tax Administrations do not apply sanctions/penalties frequently nor vigorously and therefore sanctions/penalties are not disincentives to taxpayers for noncompliance."⁴

In fact, a very recent study confirms that tax evasion in Latin America is very high.⁵ VAT evasion rates from 2001-2006 ranged from 11 percent in Chile to 38.1 percent in Nicaragua and averaged around 27 percent. Rates of non-compliance with the income tax ranged from 41.6 percent in Mexico and 47.4 percent in Chile to 63.8 percent in Ecuador for an average of 51.4 percent. Evasion of the corporate income tax was more extensive in most of the countries than evasion of taxes on income of physical persons, ranging from 48.4 percent in Chile to 65.3 percent in Ecuador for an average of 54.1 percent for the six countries with estimates available.⁶

The majority of LAC countries are in the second level of maturity described above, with a fraud investigation function that is only a "junior partner" of the audit and collection functions in their respective tax administrations and very high VAT and income tax evasion rates.

External weaknesses in the execution of effective fraud investigation activities and operations include:

- A few countries still have separate tax laws which have very few provisions for investigation of tax fraud and evasion, except perhaps for VAT, and the laws in those countries provide few, if any serious sanctions – definitely no incarceration - for fraud;

³ Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 33.

⁴ Ibid., p. 36

⁵ Gómez Sabaini et al. (2012), p. 7.

⁶ Ibid., p. 34.

- In countries that do have serious sanctions, including incarceration, they are rarely, if ever applied;
- Lawmakers are not usually inclined to enact provisions that give powerful investigative authority to the tax administration, which they think can be abused;
- Under some countries' laws, tax fraud and evasion are not investigated and prosecuted by the tax administration, but are the responsibility of other government institutions, such as agencies under the Ministry of Justice;
- Lawmakers often establish multiple national commissions or agencies to investigate financial crimes with authorities and jurisdictions which conflict with existing bodies or agencies;
- Bank and other financial secrecy laws prevail, so there is no third-party information available to the tax administration for matching documents for possible unreported or underreported income or overstated expenses;
- What little authority fraud investigators may have under the law to summon persons or documents is rarely, if ever, enforced with legal proceedings in cases of non-compliance; and
- Prosecution cases that rely on circumstantial evidence or indirect methods are seldom, if ever, successful in the courts because of the vagueness of laws and the inexperience of judges.

Internal weaknesses in the execution of effective fraud investigation activities and operations include:

- Many fraud investigators do not have post-secondary schooling in accounting, which itself is not a required qualification for the job, and so the cadres of fraud investigators throughout LAC countries are generally not well qualified;
- Training courses specifically for fraud investigators are non-existent or inadequate, and so cadres of fraud investigators throughout LAC countries are not well trained;
- The exclusive normative and program execution roles of the headquarters and field offices, respectively, are neither clearly defined nor practiced, and there is always some degree of confusion of roles at both levels. There is also confusion amongst the taxpayers involved in fraud investigations and/or their representatives;
- There are few, if any, procedural manuals and few clear, written policies for fraud investigators to follow. Case selection criteria are not well defined, so case selection is usually a manual, ad-hoc process;
- The organizational structures of the fraud investigation function and the roles of staff do not follow international leading practice. For example, there is a lack of units dedicated to intelligence gathering, case development, and quality control;
- There is no formal fraud referral program, and there is no "badges of fraud" training offered to auditors or other compliance staff;
- Within the Large Taxpayer Offices (LTOs), the audit function is understaffed, and both auditors and fraud investigators lack expertise on issues related to multinational corporations, such as transfer pricing, and on other issues related to complex industries. As a result, potential fraud and evasion cases involving large taxpayers are often neither referred nor developed;

- There is no formal informant communications program and such communications are treated on an ad-hoc basis;
- There is a strong focus on VAT fraud prosecution cases, with little focus on income tax, and cases referred to courts languish interminably. No one is sentenced to prison for tax fraud and evasion, even if the tax laws provide for it;
- Annual budgets consistently prove inadequate to finance much needed computer equipment and systems or the hiring of increased numbers of qualified fraud investigators and legal service attorneys, who review and prosecute fraud cases;
- Relationships with Customs and police agencies are fair, but relationships with the Ministry of Justice and other institutions or commissions also involved with financial crimes are poor or non-existent; and
- The overall results of the tax administrations' fraud and evasion operations are mediocre.

Box 9.3. Tax fraud and evasion investigation Guatemala

Guatemala's situation with regard to tax fraud and evasion about 10 years ago is a good example of the situation in many LAC countries. In 2000, it was estimated that tax evasion of VAT in Guatemala was 33.9 percent, and that the rate of income tax fraud and evasion was even higher.⁷ Yet, Guatemala's tax administration, the Superintendent of Tax Administration (SAT), had no legal authority to investigate tax fraud and evasion. Instead, auditors and other compliance staff of the SAT who suspected fraud and evasion by any taxpayer they were auditing, or on whom they were conducting other compliance checks, were required to submit an information/complaint report through their Legal Services Department to the Ministry of Justice's Prosecutor of Corruption Cases (Fiscalía Contra la Corrupción), which had received 2,350 cases from April 2000 through July 2001 (including 890 Customs and 123 tax cases). Unfortunately, the office of the Prosecutor was severely understaffed, and its small staff of attorneys was unfamiliar with tax laws and issues. The majority of tax fraud cases were invariably discontinued or ignored and lapsed. Of those actually processed and discontinued, the main cause cited was that the SAT's auditors had gone too far on civil tax issues to introduce criminal charges. As noted by Gallagher in his benchmarking methodology study in 2004, Guatemala's tax fraud law enacted in the mid 1990's had not been applied even once.⁸

The jurisdictions of national agencies became even more complicated and confusing, when lawmakers established a National Commission to Combat Fraud and Smuggling in 2000. In many other LAC countries there are usually multiple national commissions or national institutions with jurisdiction over financial crimes, which always causes confusion about "turf," and often results in inaction, clashes between agencies, and minimal prosecutions and convictions.

The lack of effective tax fraud and evasion detection, investigations, prosecutions, convictions, and publicity contributes to a situation whereby taxpayers realize that there are no serious consequences for non-compliance, even in cases of egregious tax fraud or evasion. As a result, tax administrations in many LAC countries are faced with low levels of voluntary compliance among taxpayers. The threat is that even the current, mediocre levels of voluntary compliance will erode further, leading to increased leakage of tax revenue, which countries can ill afford.

⁷ Jacobs (2002), p. 3.

⁸ Gallagher (2004), p. 18.

The greatest threats, however, are with the large taxpayer segment. With chronic understaffing, auditors that lack expertise on complex multinational tax issues, and insufficient or inadequate information technology equipment and systems, LTO auditors in most LAC countries are likely to have an annual audit rate of 5 percent or less of all taxpayers, which is not even close to the international audit norm of 30 percent. Given this inexperience and low audit rate, coupled with ambiguous or no fraud referral programs and training, fraud detections and referrals by LTO auditors for investigation are unlikely to reach a meaningful number. Therefore, there are ever-increasing opportunities for large taxpayers in LAC countries to underreport their tax liabilities, with less risk of detection and investigation. With impunity over the long term, large taxpayers are likely to become bolder. If so, the threat of serious, persistent revenue leakage from this taxpayer segment, which now contributes 60-75 percent of the governments' tax revenues, would be catastrophic.

There are some encouraging trends in the LAC region. For example, in Jamaica, a Fraud Investigation Unit was established as part of the Tax Administration Jamaica's (TAJ) Audit function more than 10 years ago. An IMF report of April 2010 states that "25 fraud investigations were conducted and 10 cases were referred for prosecution to the courts."⁹ Unfortunately one top level official under the Ministry of Finance also "observed that fraud cases referred for prosecution stay in the courts for years and that no one has ever been incarcerated in Jamaica for tax or customs fraud."¹⁰ In April of 2012, TAJ was considering proposing to the MOF and Parliament a tax procedures code, which had already been drafted, and which contains provisions that would significantly strengthen sanctions against fraud and evasion. Tax administrations in most LAC countries recognize the need to have tax legislation that gives sufficient authorities for effective fraud and evasion investigation and are currently exploring options.

As members of the Inter-American Center of Tax Administrations (CIAT), tax administrations in LAC have opportunities to provide modern training, based on international leading practice, to their fraud investigators that may not be available to tax administrations of other developing countries. The U.S. IRS is a member of CIAT as well, and through the U.S. Treasury's Office of Technical Assistance (OTA) and CIAT sponsorship, IRS experts have conducted numerous technical training courses over the years for LAC countries' tax administration staff. Another opportunity for professional fraud investigation training might be the Criminal Investigation Training Program of the Federal Law Enforcement Training Center's (FLETC) International Law Enforcement Academy (ILEA) in El Salvador.

9.5. Key Benchmarks and Guidelines

Any attempt by tax administration officials to measure criminal tax fraud or evasion results in terms of tax assessed or collected will destroy the primary focus on the identification and investigation of major offenders. Rather than dedicating significant time and expertise to complicated and significant tax offenses, fraud investigators will be focused on the generation of revenue, which includes components beyond just tax (e.g., penalties and interest).

⁹ Jacobs et al. (2012), p. 32.

¹⁰ Ibid., p. 32.

The amount of staffing devoted to the fraud investigation function varies. It is not unusual to see as much as 5 percent of the total tax administration's total staff dedicated to this function, as long as the function is both efficient and effective in controlling overall tax fraud and evasion activities by applying strict case selection criteria and producing high quality, and widely publicized, prosecutions and convictions, with corresponding consequences. These consequences are most frequently measured by the application of appropriate civil and criminal fines and penalties and criminal convictions, resulting in prison terms for the most flagrant offenders. If the consequences are appropriately applied by the judiciary, overall tax compliance will improve and tax revenues will increase.

Some more specific key indicators of performance of the fraud and evasion function drawn from international leading practice are:

- 60-70 percent of fraud investigators' total time is spent on investigations (the rest is spent on administrative, training, overhead). In the first two years of operation of the division, approximately 60 percent of total time would be a reasonable objective;
- 60-70 percent of total time of the intelligence branch's staff is spent on case development and information gathering activities;
- Discontinued investigations do not exceed 10 percent of investigations initiated;
- The prosecution rate exceeds 90 percent (the number of cases recommended for prosecution divided by the number of cases placed under investigation for the year);
- The conviction rate exceeds 75 percent (the number of cases successfully prosecuted divided by the number of cases recommended for prosecution); and
- Senior investigators complete an average of one complex investigation in the first two years of operations, and an average of two cases per year thereafter. Journeyman investigators complete an average of two, less complex investigations per year in the first two years of operations, and an average of three per year thereafter.

In addition to the benchmarks described above, key questions to measure the performance of the tax administration in its tax fraud and evasion function and to pinpoint areas for improvement are:

1. Is there an effective effort that focuses on the investigation of high-income and/or prominent criminal tax fraud offenders and on achieving meaningful convictions and civil consequences?
2. Are preventive measures effective in reducing overall tax fraud and evasion?
3. Does the performance system measure the number and quality of convictions or civil actions achieved that result in improving overall tax compliance and revenues?
4. Do the country's tax laws and the tax administration allow for maximum publicity when offenders are prosecuted to ensure that the public is well informed of the offense and the resultant punishment?
5. Are indirect methods of proving income authorized by law and applied in the identification of major tax offenders and during the investigation process to provide quality evidence?
6. Are the audit and fraud investigation staff selected, trained, and developed in both financial investigations and tax control (audit) techniques to adequately detect and investigate violators?

7. Are "selective means" (as discussed in section 2.2.1) being applied in identifying the most important targets?

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