

LAW ENFORCEMENT MANAGEMENT INSTITUTE

INCOME TAX FRAUD
FROM BEHIND PRISON WALLS

A LEARNING CONTRACT
SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR
MODULE II

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HUNTSVILLE, TEXAS
JUNE, 1990

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INTRODUCTION

During the past several years citizens have become increasingly more aware and less tolerant of crime in their community.

Citizens are becoming more involved in crime prevention and detection programs. They elect politicians who profess to be tough on crime. They pass bond elections and overwhelmingly insist that more prisons are built and that criminals receive longer prison sentences. It is generally accepted that, although many criminals are not rehabilitated while in prison, at least they are not committing crimes while they are incarcerated. Additionally, if they did commit a crime while in prison, then the victim would usually be another criminal and that is seen by some as a form of justice.

What most people do not realize is that many criminals continue to commit criminal acts of every description. They are very adept at finding ways to continue their criminal activities within the framework of the prison system. One of the major ways of continuing this criminal activity is by utilizing the mail system. They quickly learn how to manipulate the system and what areas are protected by law. They devise ingenious ways to beat the system and defraud

the public and governmental agencies.

The justice system reacts to these frauds by the traditional methods of investigation, prosecution and administrative responses to make the fraud more difficult to accomplish.

The subject of this paper is a discussion of a type of mail fraud committed by inmates throughout the United States. This fraud is immensely successful and results in the loss of millions of dollars annually. The problem is one that is seldom prosecuted because of jurisdictional issues and the reluctance of prosecutors to pursue criminal charges against inmates who are already incarcerated in county jails and state and federal prison systems.

The tremendous amount of money involved and available to inmates from this scheme can create overwhelming problems in the administration of a jail or prison system. An inmate with extensive resources commands a great deal of power within a prison. The proceeds from this fraud have been used to bribe guards, buy narcotics, purchase contraband, and put out contracts on the life of other inmates and investigators who are examining their illegal activities.

Income Tax Fraud

Inmates throughout the United States are receiving millions of dollars each year by filing fraudulent income tax returns and claiming a refund. Hundreds of inmates are involved nationwide and millions of dollars are received

each year. By understanding the system, inmates will file and receive refunds from the federal government and numerous other states. As of this date, thirty-one different states have acknowledged being victims of the fraud. The average return is approximately \$1,000 and is seldom questioned, even though the inmates normally use their own names and social security numbers. They will file returns for fifteen or twenty other inmates, also using their correct names and social security numbers. This action is taken with the IRS and thirty-one different states, then they split the returned checks with the inmates who allow their names to be used. One inmate, using his own name and twenty other inmates' names (filing with IRS and thirty-one different states), theoretically could receive 672 refund checks. If the average check is \$1,000, this would total \$672,000 of fraudulent money received each year. When the scheme is operated nationwide by hundreds of inmates, the annual loss is staggering.

Additionally, the scheme has been in operation for approximately six years and little effort has been expended to impede or halt the practice. When an inmate is identified as having filed a fraudulent return, IRS and most states will simply put a "stop" in their computer to prevent additional checks from being issued in the individual's name or social security number. Surprisingly, this system does not always work and inmates have been issued checks in their

own name and social security number years after they have been identified as filing fraudulent income tax returns. One inmate continues to receive refund checks even after being identified, prosecuted, convicted and sent to a federal institution for filing fraudulent returns.¹

A bank account has been identified for one Texas inmate that is known to be involved in filing fraudulent returns. This account was subpoenaed and records indicate that he deposited in excess of \$35,000 in the account in tax refund checks from fifteen different states within the past year. Although he has been identified and placed on the list of inmates filing fraudulent returns, he continues to receive refund checks. Unfortunately, he has not been investigated or interviewed by any state or federal law enforcement agency. He is assisted on the outside by his mother and she, too, has never been contacted or interviewed by any investigator.²

Another inmate who works closely with this prisoner is also receiving fraudulent refund checks and one of his bank accounts was identified and the records subpoenaed. His records indicate deposits of refund checks in excess of \$27,000 during 1989. He, too, has been on the list of inmates filing fraudulent returns for approximately five years. He also has not been the subject of any state or federal investigation.³

When an inmate has been identified, entered into the

computer and no longer receives the refund checks, prison investigators have determined that the inmate who prepares the returns will simply use another inmate's name and social security number until that inmate has also been identified. It seems that there is no shortage of inmates willing to have their name and social security number used for a percentage of a refund check.

Description of the Offense
and the Mechanics of its Commission

The inmate income tax fraud is surprisingly simple and effective. An inmate who is knowledgeable of how the tax system works can obtain all information and forms necessary through the U.S. mail.

An inmate will select a large company or corporation that does business in all states in which he intends to file a tax return and claim a refund. He will then write the corporation and ask for information on the corporation, explaining that he is considering investing in the company, or he will request a copy of the corporation's annual report. Both items often contain the corporation's permanent address and federal tax identification number. During a search of one inmate's cell who was involved in the scheme, he was found to be in possession of thirty-two different company or corporation tax numbers and addresses.⁴

Once specific company identifying data is received, the inmate will write different IRS offices around the U.S. and

request a quantity of blank W-2 forms, which are the wage and tax statement to be filed with both federal and state tax returns. The inmate will also request numerous blank federal tax forms from IRS and instructions for filing. The inmate will then write various states and request blank tax forms and filing instructions. This individual often will use another inmate's name to request the forms in order to avoid suspicion. Because some prisons and jails have declared blank tax forms as contraband, some inmates have resorted to bribing guards to bring the forms into the institutions.⁵

Once the inmate receives the corporation's name, address and tax number, and the blank forms from IRS, all that remains is to fill out the forms and mail them. The inmate will normally use a return address of a friend or relative throughout the United States so that the refund check does not come to the prison.

There are several schemes used at this point which makes tracking the refund money difficult. Usually, the inmate who is preparing the fraudulent forms will reach an agreement with other inmates so that he can use their names and social security numbers. A frequent agreement is that both inmates will split the money after expenses. The inmate whose name is being used will write to a friend or relative and tell them that he is filing his income tax return and is expecting a refund. Because he is in prison

he needs help and has no one else to whom he can turn. He then asks the relative or friend to please cash the check for him because the prison does not allow inmates to have money. If the friend or relative agrees, the inmate will have his check sent to the friend, or relative, and will pay them (usually a hundred dollars) to cash the check. He assures them that the return is legitimate and that they should hold the money until the refund check clears the bank. He then directs the relative where to send the money. Usually part of the money will be sent to the inmate's trust fund account and part to the trust fund account of the inmate who prepared the return. They may also have them send money to other friends or relatives for narcotics or other illegal transactions. On some occasions the money has been sent to a post office box or to the home of a guard who has been bribed to bring in more forms, narcotics, or to take out completed tax returns and mail them (to avoid detection through the unit mailroom). In order to make the transaction with the friend or relative seem more legitimate, the inmate will often have a power of attorney notarized by the prison law library and mail it to the person cashing the check.

Another check cashing method is to have an accomplice on the outside work with the inmate that prepares the fraudulent returns. The inmate who cannot find a friend or relative to cash his checks will have his check sent to this

outside accomplice who has also been furnished with a power of attorney to cash the checks. The usual split under this arrangement is one-third for the inmate who prepared the returns, one-third for the inmate whose name is being used, and one-third for the outside accomplice. After the first year, the preparer and outside accomplice may continue to use the inmate's name and social security number, but may not include him in the split. The outside, or "free world" accomplice, will funnel the money as directed by the preparer inmate. The preparer inmate usually keeps detailed records, which have been discovered written in code with portions held for safekeeping by several different inmates who may or may not be involved in the refund scheme. To confuse any trail left by transfers of money directly to certain inmates by the "free world" accomplice, the inmate preparer may direct payments from his share of the money received by an accomplice, to the trust fund account of other inmates as their share of the money for checks received in their name. Using this method, the money cannot be traced from the inmate preparer and his "free world" accomplice to incarcerated inmates whose names and social security numbers have been used by the inmate preparer. Additionally, the inmate preparer may have several outside accomplices and by directing transfers of money through several sources, it may be difficult to prove involvement with each individual fraudulent return.⁶

The inmate preparer has many ways to communicate and direct the operations without knowledge of prison administrators. They give verbal instructions to accomplices during visiting days, or they provide instruction through the mail with coded letters. Bribed prison guards may take the letters from the institution and mail them. They often use the institutional legal mail system which cannot be read by prison mailroom personnel. One inmate was discovered to have "free world" attorneys who would transfer money and mail the completed tax returns which they received from the preparer inmate through the legal mail system.⁷ Some inmates are known to direct the operation by telephone in county jails or prisons where they have access to a telephone.⁸

The inmate preparer normally keeps a detailed accounting record in code with dates as to how much and when money is due. If the refund check is not received in a reasonable time, the inmate may have the "free world" accomplice telephone the state or federal tax agency, identify himself as the taxpayer, and complain about not receiving the refund check in a timely manner.

In 1986, a partial record log was obtained from a cell search of one known inmate preparer. This record indicated that he had filed and claimed refunds in the amount of approximately \$134,000, within a year's time. Another inmate's log was obtained and indicated that he had filed

and claimed refunds in the amount of \$233,000 in a period of four months. The logs appeared to be an accurate representation, as many of the entries listed could be verified.⁹

Records seized from one inmate included copies of correspondence to his out-of-state bank directing them to transfer funds in his account to a bank in Zurich, Switzerland. The correspondence included bank account numbers for both accounts. Also seized was correspondence to the inmate's "free world" contact advising him that the inmate was having the funds transferred because he was concerned that the U.S. bank account could be seized, as IRS investigators had talked to one of his contacts. The inmate further advised his "free world" contact that more interest on the money could be earned if he kept it in the U.S. bank because the Swiss account only paid 3% interest. He further advised that he would earn \$1,800 monthly on the money at the 3% rate. Monthly interest income at this level would require an approximate balance of \$720,000.¹⁰

Because of the complexity of these schemes and the limited investigative effort expended, many inmates involved are never identified. Many of the inmates who have been identified were discovered through information received from other prisoners. Texas correctional officials have identified over four hundred names and social security numbers which have been provided to the IRS and officials in

thirty-one states. This list was compiled from information received from inmates known to be involved. The list is limited to present and former Texas prison inmates and associates and does not include any jail, federal or other states' prisons.¹¹

Problems Involved in Investigating
and Prosecuting the Crime

Inmates involved in this income tax scheme could probably not have planned a criminal activity so simple to accomplish, and so difficult to investigate and prosecute.

An inmate who mails a tax return, requesting a refund for over payment, normally will mail one to IRS and one each to any one, or all, of thirty-one states. The tax agency checks several items upon receipt of the return. They may check the name and social security number to make sure that it matches. They then check the employer's identification number to verify that the employer does business in their state. Some computer programs may reject returns if the earning and deduction numbers are not within a reasonable range. The computer may reject the return if the amount withheld and number of deductions are not within a range that would correspond to percentage levels provided to employers. The computer may also reject returns if the inmate's name and social security number have been provided to the IRS or state tax agency as being involved in filing fraudulent returns. However, if these measures do not

identify a return as fraudulent, a check will be processed and mailed to the inmate. Aware of the problem, some states attempt to double-check all returns mailed to Texas. This method has limited impact because many of the returns are mailed to persons in other states.

Additionally, if the computer rejects a refund request, and if the name on the return has not been identified as having filed fraudulent returns, the IRS or state tax agency may go ahead and process the request. If the name, social security number and employer information provided is correct, the agency has few ways to determine if the return is fraudulent. IRS and state tax agencies apparently do not have methods to determine whether an individual actually worked for a specific company unless they contact the company directly. Because companies forward all money withheld in taxes, and a lesser sum is claimed in refunds, there is no present system to balance money received and money claimed. Tax agencies have stated that to change their computer system, and use the time required to enter this data, would greatly exceed the amount lost to fraud.¹²

Another factor that makes investigating the tax fraud difficult is the Federal Privacy Act. Many of the states are unwilling to share tax related data, indicating that they are prohibited under the privacy act from giving out information regarding a taxpayer. A few states have taken the initiative to share and are willing to do so because

they believe the privacy act does not apply in that these returns are fraudulent and the subjects are not taxpayers. Many of the states, however, believe that they cannot even acknowledge that a return has been filed in an individual's name. They will, however, accept investigative information and the return of their state checks when seized by other agencies. IRS will accept information but will not acknowledge or give any information regarding a case under investigation. They will not even provide assistance or share information with state tax agencies.¹³

Other major problems involved in investigating this crime are jurisdictional issues. If IRS or state tax agencies cannot share information, one possible way to investigate these matters would be for each state tax agency and IRS to investigate, individually, each crime in which they are the victim. Several states have used this approach but, in most instances, their prosecutors have been unwilling to bring charges against an inmate serving time in another state. The cost of sending an investigator out-of-state, and the process of indicting and attempting to extradite an inmate from another state, is expensive. State attorneys apparently feel that to prosecute and incarcerate the inmate in their prison system would not be cost effective, considering the effort and expense required.

It is also often the case that only one refund check was issued to the inmate in a current year. Prosecutors may

not consider that the return they discover and prove to be fraudulent, may be only one of several submitted by that inmate. Some may be in the name of other inmates, as part of a greater fraudulent scheme.

Prison officials in Texas have not been successful in prosecuting these inmates, as prosecutors agree that the primary investigation and prosecuting jurisdiction lies with the victim state or federal agency. It is impossible for inmates to be tried in Texas courts when other states will not release a fraudulent return or admit being victims of fraud.

In 1986, the U.S. Postal Inspector's Office worked with IRS and several states on one case and fourteen people participating in these activities were indicted for mail and tax fraud. Most were inmates or former inmates. Since that time, IRS and the Postal Inspector's Office have indicated that the U.S. Attorney does not wish to pursue inmate fraudulent tax cases unless the loss was an extremely large amount of money.¹⁴ IRS and Postal Inspector's Offices have both accepted information regarding inmate tax fraud, but neither seem to be actively investigating any of the continued filing of fraudulent returns.

Another problem involved in investigating these matters in Texas is the fact that no state income tax exists. Because of this, there is no tax investigative agency to receive and share information with other states. Certainly,

prison investigators are not equipped to investigative tax fraud involving numerous states; especially if the victim is out of state and often the refund checks are sent to another state.

How the Fraud Affects the Prison System

In the Texas corrections system, inmates are not allowed to possess money. They are provided with a trust fund account and can use a voucher system to make purchases from the commissary.

This permits the prison administration to control and document purchases and ownership of personal property. All outside purchases must be acquired through department approved sources. This greatly reduces the chances of sending contraband through the mail. In a prison system an inmate who has money is allowed to purchase a maximum amount from the commissary each month; thus, items such as cigarettes, watches, radios, etc., become a means of power for an inmate. An inmate can trade these items for almost anything available. Inmates will trade sexual favors, and even violence or force against other inmates for commissary purchases. Additionally, inmates with large amounts of money available to them will bribe some guards to bring in narcotics and other contraband, and to receive special privileges. Inmates who have a large amount of money have put out contracts on the lives of officials who threaten their illegal activities.¹⁵ They have put out contracts and

have attempted to kill other inmates who have given information about their illegal activities.¹⁶ With money available they are also able to pay attorneys to assist them in fraudulent filing of tax returns.¹⁷ Other inmates become aware of those who have money and do everything possible to assist and befriend these inmates to receive special favors.

Administrative Responses to the Problem

Administrative personnel within the Texas prison system are well aware of the large amount of money being received by inmates that file fraudulent tax returns. As the problem continues, the large sum involved creates a myriad of problems within the system.

In order to combat some of the difficulties, prison administrators have initiated several steps to lessen the impact of this fraud. They attempt to gather information and pass it along to the appropriate states and IRS. The states have established a newsletter to provide known names and social security numbers of persons involved in what they call the Texas Inmate Scam. This, of course, is effective only on the inmates who are known to be involved. As Texas prisons have approximately 46,000 inmates at any one time, it is extremely difficult to identify all those who are involved. Additionally, as some of the major participants distribute written instructions on this tax fraud practice, the scheme extends to other state and federal prisons and even county jails.¹⁸ There is information to suggest that

prisoners who were involved while in prison have been released and have continued the practice in the "free world."

Texas Department of Criminal Justice's Internal Affairs Division investigates allegations of employee involvement in the tax scheme and provides all information to the local District Attorney for prosecution whenever possible. Unit personnel also conduct frequent cell searches and are constantly providing information to IRS and state tax agencies, as appropriate. Numerous state and federal checks have been confiscated and returned to the appropriate agencies; however, percentage-wise, it appears that very few tax checks are actually mailed to the prison system.

Additionally, the TDCJ Institutional Division's director has declared that possession of numerous blank tax forms is contraband. This has had a positive effect by slowing the fraudulent filings. The scheme continues, however, as much of the actual paperwork has moved outside the prison system. As the scheme is operating external to the prison system, it seems that no agency has taken the initiative to investigate or monitor continuation of the practice.

Prison inmates seem to receive a great deal of satisfaction out of "beating the system." They quickly pass the word and brag about their successes. Some are inclined to tell everyone, including correctional authorities, how

inmates (other than themselves) are receiving tax refund checks from numerous states. They often perceive the scheme to be a victimless crime. Experience has taught them that no one is going to get greatly concerned about an inmate receiving a tax refund check. They realize that the states and IRS do not readily share information and officials in other states will not normally come to Texas to investigate a tax fraud committed by an inmate. They believe that the tax agencies are not concerned about the fraud and if they are discovered, the worst thing that could happen would be for the tax agency to ask them to refund their money. Of course, they can't repay the money if they don't have it to repay. Inmates will also tell you that no one will make an issue of the fraud because the tax agencies are embarrassed by being taken so easily for so much by prison inmates. After five years of investigation and observation, this writer is convinced that they may well be correct.

NOTES

1. J.J. Clark, Warden, interviewed by Claude M. Williams, 30 January 1990. U.S. Federal Prison, Nashville, TN.
2. Information obtained from subpoenaed bank account of Texas inmate.
3. Information from subpoenaed bank account of Texas inmate.
4. Items confiscated during an inmate's cell search. 19 November 1987. Texas Department of Criminal Justice Ramsey II Unit, Rosharon, Texas.
5. Texas Department of Criminal Justice Internal Affairs Division investigative report.
6. Information obtained from seized correspondence and interviews with inmate informants.
7. File documents. Approximately two years of cooperation with inmate. Attorney stopped when confronted by investigators. 1988.
8. Documented interview with fraud co-conspirator. 22 January 1988.
9. Letters containing completed tax forms were seized prior to leaving unit. The forms matched master log seized in cell search. Numerous states verified receipt of payment of refund which also matched seized log.
10. Balance computed by Texas Department of Criminal Justice finance supervisor.
11. Many states have confirmed fraudulent filing of tax returns in the names contained on the list.
12. Interview with tax agency investigators investigating the refund fraud.
13. Interviews with state tax agency investigators and IRS investigators.
14. Interview with tax agency investigators.

15. Documented through seized correspondence from inmates. March 1985.

16. Texas Department of Criminal Justice Internal Affairs Division investigative case.

17. Documented through seized correspondence. 1985 through 1989.

18. Seized document containing twenty-one typed pages of instructions describing each step of obtaining, filling out and mailing fraudulent returns.

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