

INTERVIEW WITH STEPHEN HIRONAKA

PART I

February 2013

[Stephen Hironaka](#) is a forensic consultant in Honolulu, Hawaii. For a detailed background and contact information, please see [his LinkedIn profile](#).

Consultant Services

Mr. Hironaka is available to assist legal counsel in criminal and civil legal proceedings to include facilitating counsel's understanding of financial activities and transactions, testifying in court as an expert witness, and preparing visual aids to support trial evidence. He is able to analyze financial evidence and communicate his findings in the form of reports and exhibits. Due to his extensive professional background, Mr. Hironaka is familiar with operative legal concepts and forensic procedures. Criminal defense applications may involve tax crimes, embezzlement, fraud, bribery, Ponzi schemes, money laundering, identity theft and forgery. Civil litigation aspects may involve divorce, child support, alimony, and other issues of a financial nature.

Background

Mr. Hironaka started with the Internal Revenue Service as an examiner in 1972, after four years with an audit agency within the US Army. Mr. Hironaka subsequently became an IRS Criminal Investigation Division ("CID") Special Agent for 9 years, then a CID Group Manager for two years, and subsequently he supervised criminal operations first for the state of Washington and then, as Executive Assistant to the Assistant Regional Commissioner of CID, coordinated operations for the entire Western Region (Alaska, Washington, Oregon, California, Nevada.) Mr. Hironaka at various times had responsibility for special enforcement initiatives and undercover operations by the IRS CID.

In June 1995, Mr. Hironaka became the [first Criminal Investigator for the modern Criminal Investigation Section of the State of Hawaii Department of Taxation](#). He worked as a criminal investigator and head of the Criminal Investigation Section until 2012, directly investigating and supervising the investigation of over 420 cases during that period.

Common investigation recommendations were for failure to file (General Excise Tax, Net Income Tax), theft (failure to pay over employees' withholding tax), and fraud

and false statements (sometimes called “tax perjury.”) Mr. Hironaka spoke at continuing education seminars and responded to media inquiries during his tenure at the Department of Taxation.

In late 2012, Mr. Hironaka started his consulting practice, assisting legal counsel and business owners with forensic analysis.

An Investigator’s Perspective On Criminal Tax Investigations: Part I

I asked Mr. Hironaka for some thoughts on recurring investigatory matters, including **how criminal cases get started**, the relative **importance of whistleblowers**, the **background of targets**, and **common investigation scenarios** including unreported general excise and rental income.

Q. How do **criminal tax cases** get started?

A. The sources of investigations are both internal and external. The internal were from **collection** and **audit** cases. A common scenario is an income tax examination that reveals that taxpayer had failed to file General Excise Tax returns. [For readers unfamiliar with Hawaii’s tax system, “General Excise Tax” is an excise tax applied to virtually all transactions, including sales and services.]

The external cases stemmed from complaints/informants and **referrals from other local agencies** such as the City & County of Honolulu Prosecutor’s Office.

While the investigator should have his/her radar up 24/7, most investigators do not discover cases on their own. I tried to take the initiative when warranted. I identified cases that were successfully prosecuted where their lifestyle was not supported with the information reflected on returns filing. Obvious steps in this regard include checking the ownership of luxury vehicles and verifying the filing of income and general excise tax returns.

Q. Which sources generate the most promising leads?

A. The most promising leads are from within the (State of Hawaii) Department of Taxation, whether it comes from the Collections or the Audit Branch. These cases have been previewed by the collector or field auditor before referral. Tax

department personnel generally have an understanding of conduct that may warrant a referral to criminal investigation.

For collection referrals – a debt already exists. Collectors also have some knowledge of the taxpayer’s business and sometimes other businesses and when reviewed, these other businesses may not be filing their tax returns.

For audit, an audit is ongoing and review of records indicates deposits more than reported for income and general excise. The discrepancy is a red flag.

At the State level, informants are rare because there is no reward or benefit for an individual to come forward, other than one’s civic duty.

Historically, if not for internal referrals, IRS and State, the best source of leads is an informant. An informant may have inside information as to the business practice, knowledge of the principal, where the money is and the method of evasion, fraud, or non-compliance.

**Stephen Hironaka’s
Top Four Sources For Criminal Tax Investigations**

1. Referrals From Within The Tax Department
2. Whistleblowers/Informants
3. Other Law Enforcement
4. Self-Generated By Criminal Investigator

Typical informants are competitors, disgruntled employees, and scorned spouses. For the IRS, typical motivation for an informant is the prospect of a financial reward. At the State of Hawaii level, informants are looking for retribution.

- Q. In your opinion, are **whistleblower rewards** or cash incentives for reporting possible tax irregularities/fraud important or valuable to tax enforcement?
- A. Very important and while it is not the primary source of cases for the feds or the State, it is a good source. I once received a call from an anonymous person who asked about a reward (like the IRS has) from the State and the caller was advised: there is none. The caller hung up. Each case is unique and information is the source of the beginning for the investigator to follow-up and decide if it is good or worthless. My impression is that, historically, for the IRS, less than 10% of these calls or information result in a good case. Likewise for the State. Too many informants have nothing more than a name and a statement that the person is not filing returns. This is not helpful to an investigator. Callers with detailed information on income, occupation, address, are vastly more useful to an investigator.
- Q. Who are **typical targets of criminal tax investigations**?
- A. (For State of Hawaii cases) The typical target is a business person who has taxable gross income and is not filing general excise tax returns. It's an obvious situation where a complaint is received, either internal or external, and basic research of the tax data showed that the taxpayer had a GE license, had filed in the past, stopped filing and continued to receive gross income. There have been some instances where GE history was not available (meaning: the target did not have a license at all) and the investigation showed willfulness and gross income.
- Q. Is the relative public profile of a target a factor?
- A. Yes. One of the goals of a criminal investigation (and prosecution) is to deter future criminal conduct by others. A public profile person would heighten the publicity to address deterrence. For example, Wesley Snipes who failed to file his tax returns and received three one year sentences to be served consecutively. This is a deterrent to others considering tax crimes. If Wesley Snipes (an actor) was not a public figure, the press would have been minimal and the news would have reached fewer persons. If the public profile is a politician, it would generate a lot of press. Remember Senator Ted Stevens in Alaska. This is one example. If Ted Stevens was an Ordinary Joe, there would not be much press. One of the goals of a criminal investigation is to obtain as much press as possible for deterrence.

At the State of Hawaii, one of the first major prosecutions for failure to file general excise returns was a prominent local tourist-related retail business with a high profile on all of the islands. Tax loss was \$950,000 (GE is 4% of gross receipts.) Shortly thereafter, a major tax return preparer and preparation company was prosecuted. Tax loss was \$340,000. I believe those convictions put the potential for a State of Hawaii criminal tax prosecution much higher on the public radar screen.

Q. Can you provide an easy example of how a person might (unwittingly) generate a referral from an internal (within the Department of Taxation) source to Criminal Investigation?

A. Yes. There are instances where taxpayers may file their income tax returns, individual and or corporate, and report gross income of an amount that does not reconcile to the gross income filed on their general excise tax returns. This could easily generate a review by the Department.

For individuals, the tax office has a matching process on individual returns where on page 2 of the net income tax return there is a place for GE number and gross income. (2007 N-11 excerpt below)

51 If you don't need Hawaii income tax forms mailed to you next year, fill in this oval to receive a preprinted label only.

52 Did you file a federal Schedule C? Yes No If yes, enter Hawaii gross receipts _____, your Hawaii Tax I.D. Number for this activity **W** _____ - _____, and main business activity/product: _____ / _____

53 Did you file a federal Schedule E? Yes No If yes, enter Hawaii gross rents received _____ and your Hawaii Tax I.D. Number for this activity **W** _____ - _____

54 Did you file a federal Schedule F? Yes No If yes, enter Hawaii gross receipts _____, your Hawaii Tax I.D. Number for this activity **W** _____ - _____, and main business activity/product: _____ / _____

If the return (otherwise) shows self-employment income from 1040, Schedule C, and there is no GE number or receipts, this is a red flag for an inquiry. The Department is not always looking for red flags, but when they need to generate referrals, to criminal this is an obvious source for failure to file cases.

Q. What about **rental income**?

A. **Unreported rental income** is a problem for the State. Many people rent out a room at their residence and do not report it. The loss is generally small at the individual level but due to the prevalence of the practice the aggregated amount can be significant. I spoke about this problem previously in a [newspaper article](#).

Realistically, the \$700 a month room rental has limited tax loss and would not be pursued by Criminal Investigation absent a specific initiative by the Department.

(Unreported) Vacation rental income is another story and has been successfully investigated and prosecuted by the State.

Q. How do and how should an investigatory department assign priorities to tax investigations?

A. The amount of tax loss is usually the main factor on whether a case should be investigated (further) but my philosophy was a combination of tax loss and occupation. Part of criminal prosecution is to deter criminal conduct through the threat of penal sanctions. Part of this is making all businesses, professions, and occupations aware of the potential for a tax investigation and prosecution. If there was a case with high dollar and another with medium dollar and an occupation that had not been addressed with a criminal prosecution, I would assign the latter for this reason.

At the State level (Hawaii), general excise tax cases are typically easier to prove than most cases. A department with limited staffing cannot easily dedicate time and manpower to complex cases.

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