

INTERVIEW WITH STEPHEN HIRONAKA

PART II

February 2013

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

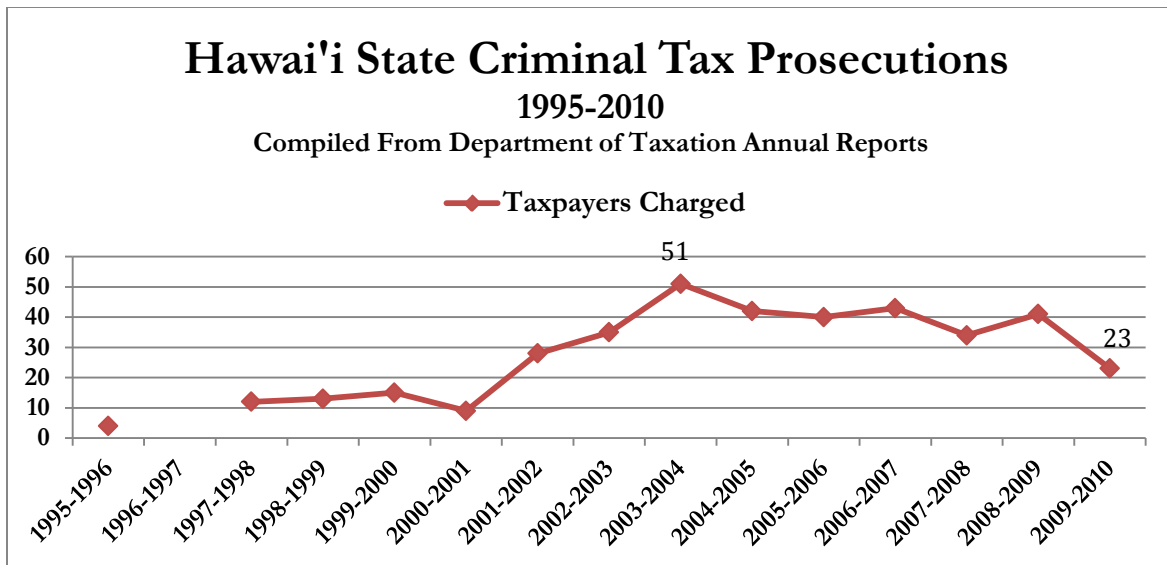
Consultant Services

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 has made numerous presentations at continuing education seminars and responded to media inquiries during his tenure at the Department of Taxation.

After retiring February 1, 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 II

An [earlier interview](#) explored Mr. Hironaka's thoughts on recurring investigatory matters, including how criminal cases get started, the relative importance of whistleblowers, the background of targets, and common investigatory scenarios including unreported general excise and rental income.

This interview focuses upon the **bank deposits method of proof**, the use of cash, and the presence or potential presence of a **cash hoard**. Also discussed is the **role of a forensic consultant** in a typical criminal investigation and trial, and the advantages a forensic consultant can provide the defense team.

- Q. What is the most common investigative technique used to establish the existence of unreported gross receipts or income?
- A. The most common method is the “bank deposits” method. At the State (State of Hawaii, Criminal Investigation Division), we used the **bank deposits method** in more than 80% of the cases.
- Q. Can you describe the **bank deposits method** in a general way?
- A. For a business target, the target’s bank accounts are first identified. Then bank statements are obtained typically via a subpoena or summons. Deposits are then separated into likely categories by the investigator. The investigator attempts to identify non-income items, such as loans, transfers, re-deposits, and separate those transactions from potential income items. The investigator then attempts to corroborate that the potential income items are actually business income. (And that the likely non-income items are actually not taxable income.) For checks, for instance, the maker would be contacted and asked about the nature of the transaction. For most cases, failure to file for instance, the specific amount of income is less important than the fact of taxable income and the absence of tax returns. The criminal tax law for failure to file cases only requires income, it does not require a certain threshold of income. Similarly, for tax fraud cases involving understated income, the law only requires a false statement that is material, not a specific percentage or amount of income.
- Q. What are some limitations of the **bank deposits method**?
- A. From the experience of an experienced investigator, there are not any limitations! Bank deposits is an approved method supported by many federal court cases over decades. The critical point in bank deposits is to corroborate the deposits are gross receipts or income. This can be a problem with the deposit of cash or with items that the investigator just lacks sufficient information about.
- Q. Why do **cash deposits** create a problem for the bank deposits method?
- A. The investigator must establish that the cash deposit is not from a cash hoard (cash savings not kept in the financial institution) and/or that it is from a taxable source. Unlike a check, an investigator looking at deposit items cannot determine the source from the deposit slip alone. In situations where the deposits are cash, the investigator must determine a likely source for the cash to

be treated as taxable income. The identity of the source could come from an insider or could otherwise be identified by the criminal investigator.

Q. What are “**deposit items**”?

A. **Deposit items** are items deposited at the bank. Typically this means the deposit slip filled out by the bank customer, the checks deposited, and an indication by the teller of the cash deposit and anything else, like “cash back.” A bank statement typically will only show the net deposit, while the deposit items will show all the transactions.

Q. How does an investigator get the deposit items?

A. Typically directly from the financial institution via a summons or subpoena.

Q. Do most people understand that criminal investigators can obtain bank records?

A. Most people believe that their records are kept by the bank in confidence. Many targets do not understand that bank records can be obtained through an administrative subpoena by a criminal investigator. A typical reaction by a taxpayer that the government has the ability to obtain their records without their consent is one of amazement and sometimes, a harsh reaction as to the availability of the records to the government. I have had targets say to me “You’ve got my bank records?!!” The perception is that bank records are “safe” from the government.

Q. What is a **cash hoard** or the **cash hoard defense**?

A. A **cash hoard** is a defense that must be accounted for in all the methods of proof, bank deposit, net worth, specific items, etc. Money used to purchase assets and/or deposited into the bank must be determined to have come from a taxable source in the year the asset was purchased or deposited into the bank. For example, if you had a cash hoard of \$100,000 in 2009 and deposited the money or made a down payment on a car in the amount of \$50,000 in 2010, the \$50,000 would not be a taxable item in 2010 because of the cash coming from the prior year.

To disprove the existence of a cash hoard, the investigator will gather evidence to show that the cash hoard was fictitious. Methods to prove the existence or non-existence of a cash hoard include statements by the target, especially on loan applications and financial statements. Most loan applications and financial statements have a line entry for cash on hand and if one leaves that line blank or shows a small amount, it is a statement that will be used by the investigator that a cash hoard was not in existence.

Often the defense would be that the money came from an inheritance or gift. In these type of scenarios, the investigator must obtain statements from those who the taxpayer had claimed they had received the money from. In the event the donor admits to giving the cash, the donor's tax returns and/or financial statements would be reviewed to determine the likelihood that the donor had the stated funds he/she had given.

Q. Why does the presence of a cash hoard complicate the bank deposits method?

A. Cash deposited in a current year from a prior year is not income in the year deposited if it came from a cash hoard.

Q. From your observation, what are the downsides of a business operation using large amounts of cash?

A. The business has to document its reported income and expenses for business reasons. Dealing in cash makes this more difficult, and can make it difficult for owners to understand the profitability of the business and to determine where the business is losing (or making) money.

From a criminal investigator's viewpoint, businesses dealing in cash in a possible attempt to avoid paying tax frequently fail to fully consider the nature of transactions and documented expenditures. Frequently, the business has known and documentable expenses, for example, rent. ***Reported income will have to exceed those expenses over any reasonable period.*** Third party reports in the absence of records provide a basis for establishing income subject to tax. Again, for most purposes a criminal investigator does not have

to establish a specific amount of income, only that income that was not reported, or different (greater) than that reported, was recognized.

Here again an insider can provide specific information on where the criminal investigator should look.

Poor or inadequate record-keeping, whether there are large amounts of cash or not, can make a business vulnerable to employee theft or embezzlement.

Q. What is the role of a forensic consultant for the defense when a criminal investigation is underway?

A. A forensic consultant assists with a “**shadow investigation**” into the target’s business operations and attempts to develop a picture for legal counsel of areas of strength and weakness. How this information is used by the defense is a legal determination. A forensic consultant can help develop “leads” that defense counsel may ultimately provide to the Government in an effort to weaken or cripple the government’s case. A criminal investigator is generally obligated to pursue reasonable “leads” in a tax case. Provision of leads and the criminal investigator’s treatment of those leads can provide fertile ground for cross-examination at trial and reveal assumptions, possibly unfair, built into the investigation.

Aside from leads, a forensic consultant can also help identify weaknesses in the investigator’s approach and conclusions that can ultimately lead to a more effective cross-examination of government witnesses. Under federal rules (of discovery and procedure), this may only happen in a compressed time frame, however. In appropriate cases, a forensic consultant can help develop spreadsheets and charts for use in rebutting the government’s conclusions and presenting the defendant’s version of events.

Oddly enough, in the trials that I have had (as an investigator for the IRS and State of Hawaii), the defense did not hire a forensic accountant or expert. The defense just accepted the relevance and accuracy of the testimony and documents introduced by the government on the taxable income.

While it depends upon the nature of the particular case, in general counsel should be aware that the bank deposits method depends upon certain assumptions and that those assumptions can be subject to effective challenge if they are appropriately identified.

Q. If the government only has to prove an amount of income, as opposed to a specific figure, in a case likely to result in a plea arrangement, does it make any sense for a forensic consultant to be employed to evaluate tax loss?

A. Ultimately, even in a plea situation, a fairly specific figure is going to be used in evaluating the severity of the penalty to be imposed and the restitution figure typically ordered by the court. Getting a lower figure could produce a lower guideline range (federal), a lesser sentence (State proceedings), and a reduced restitution figure.

Also, to the extent the criminal investigation or figures provides a basis for a later civil assessment, the work of a forensic investigator can result in reduced civil tax and penalties and interest thereon.

A forensic consultant's work could also be useful in matters where forfeiture is pending.

Q. Does a forensic consultant have certain advantages over a criminal investigator?

A. The answer is typically yes because a forensic investigator will typically have specific information from legal counsel where to look for problems. Also, the forensic investigator may be supplied with documents and information provided by legal counsel that the criminal investigator has failed to or is unable to obtain.

- Q. What advantages does the criminal investigator have over the forensic consultant?
- A. A criminal investigator has unlimited resources at their disposal. The criminal investigator can summons or subpoena relevant information and review it for discrepancies. Third parties and witness may cooperate more readily with law enforcement than with defense counsel, for a variety of reasons including to curry favor. Due to rules of criminal procedure, a forensic consultant may not have access to prosecution exhibits and conclusions until fairly late in the trial process, which can be a serious disadvantage if appropriate steps have not been taken in the “shadow investigation.”
- Q. Should a target of an investigation contact a forensic consultant directly?
- A. No. Due to rules about privilege and confidentiality, a forensic consultant should be retained by legal counsel.

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