

# INTERVIEW WITH STEPHEN HIRONAKA

## PART III

February 2013

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[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 III**

An [initial 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.

A [second interview](#) focused upon the **bank deposits method of proof**, the use of cash, and the presence or potential presence of a **cash hoard**. Also discussed was the **role of a forensic consultant** in a typical criminal investigation and trial, and the advantages a forensic consultant can provide the defense team.

This conversation discusses the impact of technology, and actions that targets consider or take and their ramifications. Is it effective to destroy records? Pay taxes? File or amend returns? Admit fault? Hire an attorney? Mr. Hironaka provides his perspective on these items and more.

Q. Has technology changed or simplified the job of the criminal investigator? If so, how so?

A. In the 1970’s the investigator had to use 13 column work papers to document the accounting aspects of their case. In a typical **bank deposit** or **net worth** application, a change in a deposit or asset or liability would require an eraser and a messy work paper.

The advent of (computer) spreadsheet simplified the process and this became an effective means for the accounting aspect of the investigation. The IRS has created a process where there the Special Agent report is indexed to exhibits and is practically a fill in the blank type of report. In the modern context, more time can be allocated to the investigation and less to time-consuming presentation of the findings of the investigation.

Modern informational reporting has also changed the investigator's job, particularly at the federal level. For the IRS, **1099s are a very effective means to identify under-reporting** (of income), albeit mostly for civil purposes. However, there have been criminal cases with the under reporting of income via Form 1099's, however, the amounts under reported would have to be significant. The Form 1099 by itself can also be a lead to other sources of income, namely cash payments.

Finally, technology has made third party response to summons or subpoenas quicker and more complete. Previously, records would have to be manually searched and copied. This could take a considerable amount of time, particularly for Hawaii residents with bank records stored in mainland facilities. Frequently, third party record-keepers can print account and payment ledgers almost immediately.

- Q. Speaking of records, and technology, **does destroying records help or hurt targets** in a typical investigation? (Note: destroying records may be a crime in itself)
- A. The **destruction of records** once a subpoena has been served can be used against the taxpayer.

There are situations where records are destroyed by fire or by flood, or natural disasters. In most cases, records can be reconstructed, providing the taxpayer had used conventional methods, i.e., banks and/or third parties, bookkeeper, CPA.

I am sure there have been cases where records were effectively destroyed permanently. I had an undercover case where the original cash register tapes were in fact destroyed once the bookkeeper made an entry of the skimmed receipts. The amount net of the skim matched the bank deposits. Without the undercover agent's information, it would have been impossible to determine the true gross receipts and in this case the records were destroyed. Did it serve a purpose to destroy the original records – absolutely. The cash register tapes would have shown the gross receipts were \$300 to \$600 higher per day than deposited and reported. A typical civil audit would not discover the true gross

and the usual explanation (by a taxpayer) is that the records were too voluminous to keep and once the gross income was recorded, there was no reason to keep the tapes, especially since the bank deposits corroborated the “net” receipts.

Setting aside the criminal ramifications of record destruction, targets put themselves in a difficult position with respect to proving certain items were not taxable. While most records can be reconstructed, many times records in their original condition are more complete and therefore likely to be accepted by an investigator.

My impression, however, is that the destruction of records will be most harmful in any follow-up civil audit due to a different standard of proof.

Q. What do **targets typically misunderstand** about a criminal tax investigation?

A. Targets typically do not understand that a criminal investigation is a criminal investigation: its not an audit. It may culminate in going to jail.

Targets do not recognize that **statements made in non-custodial situations** may be used against them later. Targets typically get a Miranda-like warning before an interview starts, but do not decline to speak to the investigator or request the presence of a lawyer.

Q. In failure to file cases, will **filing delinquent returns end the criminal investigation?**

A. Once the taxpayer is contacted by the criminal investigator and if it is true that returns have not been filed, the subsequent filing will not absolve the crime.

While the mere not filing of a return is a red flag, willfulness must be proven by the government and there must also be tax harm. In other words, if the taxpayer did not have any income subject to tax or the standard deductions or itemized deductions will result in no taxable income, the government in most cases will not continue the criminal investigation.

Q. In false statement or evasion cases, is it a **good idea to file amended returns?**

A. No, it is not a good idea to file an amended return once the taxpayer has been contacted by the criminal investigator. In a criminal investigation, the investigator develops general road map as to where the unreported income is and the filing of an amended return only makes the job of the investigator easier. Besides the income, the investigator needs to prove intent and the filing of an amended return is an indication that the taxpayer had true knowledge of his income and that he filed the original return with intent to evade.

In addition, the filing of an *incorrect* amended return is not a good idea. An incorrect amended return only exaggerates the incident of filing the original false return or attempting to evade the tax.

Q. Will **paying outstanding taxes**, or the taxes that would have been owed, end a criminal tax investigation?

A. If a taxpayer files his return and does not pay the tax, there is no failure to file violation. [Note: there may be other problems] If the return is filed and the tax is not paid and the taxpayer is contacted, *it probably is a result of potential under reporting of income*. Meaning: it's an investigation into potential tax fraud or tax evasion.

If the taxpayer had in fact under reported income, the payment of the taxes for the under reported income **would be an admission** and not in his/her best interest to do so. An investigator would very likely attempt to use the payment amount to shape the inquiry into the omission. There are cases where the taxpayer has filed his returns, but there are outstanding taxes due, payment is not made and the violation would focus on failure to pay.

From the perspective of a criminal investigator, payment of taxes is generally for civil cases to stop the interest and penalties from accruing.

Q. Should a target admit that his/her return is incorrect?

A. A return being incorrect is just one part of an investigation. The government must also prove that the discrepancy was willful, meaning, intentional and deliberate. Admissions help the investigator.

Q. Can an attorney effectively assist targets during a criminal tax investigation?

A. If the taxpayer is knowing that he/she had not filed his/her tax returns and or filed false tax returns and is contacted by a criminal investigator, hiring a lawyer would be in the taxpayer's best interest. The lawyer would be able to assess the situation and provide subsequent guidance as to how to proceed. In most cases, the lawyer would prevent the taxpayer from attending an interview with the criminal investigator unless there is information that would exonerate the taxpayer from the alleged violation.

Q. Is it an effective strategy to try to challenge the investigation, delay production of records, attempt to oppose or quash summons/subpoenas, etc.?

A. Challenging the investigation is in part dependent on the investigator. For some, the challenge becomes a challenge to overcome; to others, it is an impediment that stifles their motivation.

In most cases, a challenge does not make the investigation go away, it just prolongs it. An experienced investigator is going to steer clear of problem areas, for example, shoddy paperwork or “*Tweel*” issues (where a civil audit might have been intentionally used to gather information for a criminal investigation.) Absent investigatory missteps, challenges mostly just delay investigations.

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