Department of Justice

STATEMENT

OF

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PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

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"ILLEGAL DRUG PROFITS"

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Mr. Chairman and distinguished members of this Committee:

I am pleased to have the opportunity today to discuss with you the efforts of the Federal Government to address the financial aspects of the illicit drug trade in this country and some of the means by which we could improve our ability to take the profits and incentives out of this extremely lucrative criminal industry.

It will come as no news to this Committee that illegal drug trafficking is big business, and that the flow of money in this subterranean economy is torrential. Last year alone, the Federal Government seized heroin, cocaine and marijuana which would have retailed on the streets of our country at approximately $3.2 billion. This, of course, represents only a small fraction of the undetected cash flow. The Internal Revenue Service conservatively estimates that the untaxed profits from illegal drug trafficking approaches $25 billion each year. The National Narcotics Intelligence Consumers' Committee estimates that in 1978 retail sales of illegal drugs were about $58 billion, and are rising annually. While we in the Department of Justice have no independent basis for making overall estimates of the dollars involved in the industry, we have and are presently prosecuting large trafficking organizations which we can prove have grossed hundreds of millions of dollars over relatively short periods.

One of the hardest hit areas of drug trafficking is south Florida, which is the principal entry point in this country for cocaine and marijuana shipped from Latin America. The financial figures from Florida banks speak for themselves. Earlier this year the Federal Reserve banks in Florida reported a currency surplus of over $3.2 billion. This represented approximately 77% of the entire Federal Reserve currency surplus at that time. In most other regions, more cash flows out of Federal Reserve banks than into them. Clearly, the major factor for the Florida surplus is the deposit of "narco dollars" -- cash derived from drug sales -- in the banks of south Florida. Also illustrative of the financial picture is the fact that the foreign exchange account of Colombia -- the major transhipment center for cocaine and marijuana destined for this country -- had as of last month a favorable balance of $3.5 billion, up from $405 million in 1975. At least part of this must be a reflection of the amount of American dollars recently received for drugs exported from the country. Indeed, I was recently informed by a Colombian official that marijuana may now have exceeded coffee as that nation's largest export.

Apart from the health risks which this influx of drugs presents to our nation (which I leave to others to assess and describe), the enormous sums of money generated by the sales of these drugs pose grave dangers for our economy in general and for the criminal justice system in

particular. First, of course, the money is almost entirely unreported and untaxed, creating a loss of federal tax revenues estimated by the IRS at between four and six billion dollars each year. Second, the drug trade has an adverse impact on our foreign balance of payments. Third, the normal economy of an area is disrupted when there are such large financial resources in the illegal sector. Drug trafficking is now estimated by some to be south Florida's single largest industry. The work ethic of those citizens who are struggling to make an honest living can only be undermined by the general awareness and ostentatious display of ill-gotten gains. Sound economic planning and development are impossible under such obviously unstable conditions. As recent financial reports from Florida attest, the ready cash available to drug dealers has a direct inflationary impact on the local economy. Moreover, drug dealers, in search of ways to launder their funds, may choose to invest in legitimate businesses, with potentially adverse impact on either those businesses or their competitors. Even worse, money not invested in legitimate businesses is available to finance other, and potentially more dangerous, criminal activities.

The devastating impact on the criminal justice system from this excess cash hoard is direct and immediate. The

large accumulation of money in criminal hands is a readily tapped source to corrupt government authority in order to perpetuate and further the smuggling enterprises. Even if they are identified, captured and charged, drug dealers too often possess the resources to make even the highest bail and flee. They may simply write off the cost of bond as a necessary business expense. Finally, those who are brought to trial -- at tremendous expense to the Government -- may use their vast resources to offer bribes to juries or otherwise finance efforts to impede the proper functioning of the judicial system.

Because of our concern about these disruptive consequences and because we simply must take the financial incentives out of this industry to deter potential entrants, federal narcotics law enforcement is placing increasing emphasis upon cash flow investigations and the forfeiture of illegal profits and the fruits of those profits. Those persons in the highest echelons of the distribution networks who are in a position to accumulate and control millions of dollars may never have actual, direct contact with the drugs themselves. Consequently, the usual tools of interdiction and "buy-bust" investigation are often ineffective against them. We have to be able to trace the flow of money, prosecute and convict the leaders and financiers and obtain forfeiture of their fortunes.

Fortunately, within the last decade Congress has provided some effective legal tools to attack the financial assets of sophisticated drug trafficking organizations, and we are beginning to develop expertise to use them successfully. The Continuing Criminal Enterprise statute (21 U.S.C. §848) is proving one of our most useful weapons, permitting the imposition of a life sentence on a person convicted of being the manager or organizer of a large drug organization and permitting the forfeiture of drug profits. At least 35 such indictments were authorized by the Narcotic and Dangerous Drug Section in the last year. The Racketeer Influenced and Corrupt Organization statute (18 U.S.C. §§1961-64), which has not yet been employed to maximum advantage in the drug area, also represents a potent tool for prosecuting narcotics conspirators and depriving them of their illicit income and assets. In addition to the criminal forfeiture provisions of the Continuing Criminal Enterprise and RICO statutes, the Controlled Substance laws permit the civil seizure and forfeiture of drug-related money and property. Since an amendment last November, the Federal Government is now authorized to seize and forfeit to the general treasury the proceeds of drug dealing as well as the vehicles and other property used in trafficking.

The provisions of the Bank Secrecy Act (12 U.S.C. §1829, 1951 et seq. and 31 U.S.C. §1051 et seq.) could also prove increasingly important in assisting financial investigations and prosecutions, assuming that there is cooperation and compliance from banks and individuals and that there is effective and prompt coordination among federal agencies. These statutes and implementing regulations require banks to maintain written records and file reports of major cash transactions and require individuals to file reports of international currency transportation and details of their foreign bank accounts. These required filings are essential for narcotics investigators to follow a paper trail to the upper levels of trafficking networks. Especially significant is the fact that a violation of the Bank Secrecy Act combined with a narcotics violation subjects the violator to lengthy imprisonment and extremely heavy fines. This was the result in a recent case in Minneapolis, where an Indian hashish smuggling ring was fined over $1.5 million dollars and $750,000 worth of assets were seized. Frankly, the law enforcement potential of the Bank Secrecy Act has not yet been realized, primarily because of compliance delays and lack of an adequate data base. However, we believe the situation is improving. The use of the recently implemented Treasury Enforcement

Communication System (TECS) computer and permanent liaison between the Treasury and other agencies needing the information are important developments.

We are striving to educate prosecutors and investigators concerning the techniques and potential advantages of these tools. Large narcotics trafficking organizations are sophisticated, the nature of financial investigations and prosecutions is technical, and the statutes I have discussed are relatively new and complex. This demands continual educational efforts to upgrade the training of all federal prosecutors and investigators in the drug field. We are carrying on this effort vigorously. Next week in Los Angeles, for example, we will conduct the 11th Major Drug Trafficker Prosecution Conference. Sponsored by the Narcotic and Dangerous Drug Section, the Executive Office for United States Attorneys and DEA, the conference presents lectures and workshops based on actual cases to instruct agents and Assistant United States Attorneys in the use of financial investigation techniques, the Continuing Criminal Enterprise and RICO statutes, lawful electronic surveillance and other technical subjects. Recently, DEA held its Third Financial Investigation Seminar. These seminars are for senior agents who spend a week learning from members of the Department of Justice, the Internal Revenue Service, the

Customs Service, Securities and Exchange Commission and others knowledgeable in the field of financial investigations. The Narcotic and Dangerous Drug Section is now publishing a monthly newsletter as a means of educating all drug prosecutors and other enforcement officials of legal developments and strategies which may improve their performance.

A key to the successful implementation of these statutes is the close coordination of the information, expertise and efforts among a number of federal agencies. In those cases where we have attained success, such coordination has been critical. For example, the recent Minnesota case, which was premised on a combination of Bank Secrecy Act and narcotics violations, resulted from close cooperation between DEA and Customs. In the recently concluded Araujo case -- involving a heroin and cocaine smuggling ring which had funnelled more than $33 million dollars to Mexico -- the investigation coordinated the information and activities of DEA, Customs and the Internal Revenue Service, working closely with an Assistant United States Attorney. The main defendant in that case was convicted of a Continuing Criminal Enterprise violation, sentenced to 35 years' imprisonment and fined more than a million dollars. In another major case recently concluded in Los Angeles, an individual was convicted of a RICO violation and the investments from his drug sales approximating $800,000 have been seized and are awaiting forfeiture.

It is ironic that while Congress has given us the tools to attack the financial dangers posed by drug trafficking, a confidentiality provision in the Tax Reform Act of 1976 has impeded our success in this area somewhat. The Act was enacted in response to concern about access to tax return information. When the Act was passed in 1976, it is noteworthy that there were few, if any, complaints about abuses by prosecutors of tax information which they obtained and used in developing criminal cases. The statute, as enacted and interpreted by the Service, given the penalties to which IRS personnel are subjected for improper disclosure, has made it extremely difficult for law enforcement officials working in such high financial crime areas as narcotics, organized crime, white collar crime and public corruption.

The Administration has recognized the need to achieve greater coordination between law enforcement agencies and the IRS, and has initiated under the auspices of the White House Domestic Policy Staff a process of meetings and communications between the Criminal Division, DEA, Treasury, and IRS to identify specific impediments to cooperation and agree upon necessary legislative and administrative improvements. This process has been facilitated by the March report of the General Accounting Office on the Tax Reform Act and by the interest of this

Committee. As a result of these meetings, the Administration hopes to develop a policy position within six to eight weeks. In the meantime, I can set forth for the Committee the Department of Justice's perspective of the situation.

Under the Tax Reform Act of 1976, the Federal Government's ability to identify and prosecute narcotics financiers and to trace and seek forfeiture of their assets has been severely restricted. Federal prosecutors and investigators from other agencies have been deprived of the opportunity to work closely with the Service and readily to obtain critically important information which it has in its files. This is extremely unfortunate because the Service agents are by training, experience and temperment among the best qualified of any in the Federal Government to assist in conducting financial investigations, and the information available to the Service is among the most important to assist in developing financial cases.

The Tax Reform Act and its implementation by the Service have essentially had four major negative effects on our enforcement efforts in the narcotics area as well as in other large-scale financial crimes:

1. The Service is usually unable to advise us adequately of the cases on which it is working, which precludes us from close coordination with it and leads in some instances to needless duplication of effort.

2. It is unduly difficult for prosecutors and investigators from other agencies to obtain financial information in the hands of the Service which would materially assist in developing prosecutions against major criminals.

3. It is extremely difficult for the Service to provide to prosecutors or other federal investigative agencies evidence concerning non-tax criminal violations which the Service obtains in the normal course of its investigations.

4. In those limited circumstances where prosecutors and other investigative agencies can work with the Service, the time delays involved tend to thwart the benefits that might otherwise by obtained.

The March GAO report, while claiming that the adverse effects had not been fully documented, found that IRS coordination with the Department of Justice and in particular with the Drug Enforcement Administration had been adversely affected and that the IRS was precluded from disclosing, or even alerting agencies to seek, relevant criminal information. The report concluded that "these types of coordination...point up the need for Congress to consider whether the adverse impact on federal law enforcement activities warrants revision of the legislation and whether any revision can be made

without disrupting the balance between criminal law enforcement and individuals' rights." We believe that some documentation is now available and we are conducting a survey to compile additional information.

I will explore below in some detail the precise impediments created by the Tax Reform Act and cite specific examples of the enforcement difficulties these provisions have caused. However, I believe that the major problem with the statute is the signal it has sent to the Service. This message appears to be that the Service is to minimize its role in non-tax law enforcement and devote itself to enhancing the voluntary tax-collection system. From our perspective, we believe this is a critical loss to the Federal Government's law enforcement capacity. The statute unfortunately has also sent a signal to prosecutors. Rather than complying with the elaborate procedures set forth in the statute, prosecutors have frequently gone without obtaining needed financial information already in possession of the IRS. The decline in the number of requests for tax information by Department prosecutors has been precipitious since passage of the Act. In 1975, there were 1,816 such requests; for a six-month period in fiscal 1979, there were only 124.

It is, of course, difficult to quantify a negative -- i.e., the number of cases which would have been made or improved or the amount of fines or forfeitures which we would have obtained if we had the full benefit of the Service, its expertise and information. However, two figures do dramatize the point. First, according to an IRS report, DEA provided IRS with the identity of the 868 alleged Class I (major narcotics) violators to be evaluated for criminal tax potential under a special IRS project. Of this 868, as of a few months ago, 128 investigations had been initiated, 125 investigations completed, 31 prosecutions recommended, nine indictments obtained and only six, or less than 1% of the Class I violators had been convicted of a tax offense. Further graphic evidence of the impact of the statute is provided by the fact that since its effective date in 1977, the Organized Crime Strike Force inventory of joint IRS cases has been cut in half, from well over 600 investigations to slightly more than 300. As we calculate information provided by the Service to a House Committee earlier this year, IRS now devotes less than 5% of its criminal investigative resources to narcotics matters and only 25% of its criminal resources to pursuing illicitly derived unreported income as opposed to unreported income from lawful activities.

I will now turn to the specific problems under the statute. As you know, under Section 6103(i) the only way in which federal law enforcement officials can obtain tax returns or "taxpayer return information" for non-tax cases, such as narcotics violations, is by obtaining a court order. The application for an order must show (1) reasonable cause to believe that a specific crime has been committed; (2) reasonable cause to believe that the information sought constitutes probative evidence of the crime; and (3) the information sought cannot be obtained from any other source or at least that it is the most probative evidence available. The statute defines "taxpayer return information" as that "filed with or furnished to the Secretary by or on behalf of the taxpayer."

Let me give you a few particularly dramatic examples of what has occurred under this provision. Recently, in Philadelphia, DEA and IRS were conducting independent, parallel investigations on a suspected illegal drug chemist. Under the statute IRS could not (and did not) disclose that it was investigating this individual, and hence there could be no coordination with DEA's efforts.

However, DEA became aware that during the course of its investigation, the IRS had obtained information from the chemist's trash can -- including drug precursor formulae, hotel bills and other evidence corroborative of drug dealing. The prosecutor in the drug trial subpoenaed the IRS agent, but the IRS took the position that the agent could not testify about why he was going through the defendant's trash unless the prosecutor obtained a court order, which could not be done prior to conclusion of the trial The prosecutors' inability to present testimony regarding what was found in the defendant's trash by someone unwilling to explain why he was searching the trash made it impossible to use the evidence. Fortunately, the prosecutors managed to secure a conviction without IRS assistance, but were left with serious doubts about the Tax Reform Act.

Another example cited by GAO occurred when IRS' analysis of records submitted by a taxpayer during a criminal tax investigation showed that a union official had accepted gratuities from company officials. IRS could not disclose this apparent violation of the Taft-Hartley Act.

These and other similar stories illustrate the three major problems which prosecutors have had with the court order requirement. First, because IRS cannot provide advance notice that it has useful information, another agency has no reason to request disclosure of taxpayer

information on a particular individual that might be useful to it. Second, even if the agency suspected IRS possessed useful information, the other agency may be in the Catch-22 position of being unable to justify its need for the information -- as required by the disclosure provisions -- before it has the information. Unless the requesting agency has actually seen the material, it is often difficult to certify that it is probative of a material fact or that it is the best possible source of that evidence. In some ways this is a more difficult standard than we impose upon seeking a search warrant to enter the private premises of a suspect to seize personal property. Finally, the requirement of going to court for the interdepartmental transfer of information in the possession of the Government seems unnecessary and inappropriate. The preparation and processing of these court papers not only consume judicial and prosecutorial resources but also often produce delays which can in certain kinds of investigation prove fatal.

A case illustrating the importance of tax information and the danger posed by delays in its disclosure to prosecutors involved the prosecution two years ago of the Nicky Barnes organization in New York City, believed at that time to be one of the largest heroin trafficking networks in the United States. Barnes was charged with a violation of the Continuing Criminal Enterprise statute

which requires proof of substantial amounts of income from narcotics. Six months before trial the prosecutors sought disclosure under 26 U.S.C. §6103(i)(1) of the tax returns of the main defendants. The trial began in October, 1977, without the tax returns. For a number of reasons, most of the returns were not received until midway through the two-month trial; some of the returns were never produced at all. Despite the late date of receipt, the returns we were able to obtain proved extremely valuable to the Government in proving that Barnes and his associates had no legitimate sources for the excessive income they reported (Barnes reported over $250,000 in miscellaneous income in one year alone) and helped prove the substantial income requirement of the Continuing Criminal Enterprise statute. Barnes was convicted and is now serving a life sentence. If the tax returns had been delayed any longer, we might not have been able to secure this conviction.

Under Section 6103(i)(2), a federal agency can obtain information in the possession of the Service other than "taxpayer return information" if the head of the agency certifies that the information sought is material to and will be used solely in connection with an investigation or proceeding. This is in essence information supplied to IRS by a person other than a taxpayer.

Because of the sanctions imposed by the Act, the Service is extraordinarily cautious about making improper disclosures under Section 6103(i)(2). I am advised that on one occasion a DEA agent provided an IRS agent with a list of individuals in whom he thought IRS might be interested. Several days later the DEA agent misplaced the list and called the IRS agent to obtain the names. Because of the Tax Reform Act, the IRS agent refused to disclose the names. Apparently, since the information was provided by a third party, the IRS agent believed that a written request from the Assistant Attorney General was required.

I am also informed of an investigation in Cleveland in which the FBI asked IRS to examine film of documents it had photographed to assist in identifying the material and to join them in the investigation. Upon receipt of the film, IRS advised that because it had become a tax-related matter, IRS could not discuss the case or even return the film.

In an effort to move beyond anecdotal evidence, the Department has recently distributed a questionnaire concerning the impact of the Tax Reform Act to all United States Attorneys' and Strike Force offices throughout the country. After we have obtained and processed the answers to these questionnaires, we will be pleased to supply the

results to this or any other appropriate Congressional committee.

The extreme examples which I have cited today do point up the difficulties which the statute creates for the coordination of IRS with other agencies. It is a fact of life that agencies will not work harmoniously when the information flow is a one-way street. The problem is not confined to narcotics investigations or even to the Organized Crime Strike Forces which are predicated in part on the synergism of several agencies sharing information and working cooperatively. As an example, the United States Attorney in Arizona has recently formed a special investigative task force to focus on white collar fraud. Ideally, such a task force should include IRS participation. However, because of difficulties it has encountered in providing tax information to other participating agencies, the IRS has not even been included in the multi-agency task force.

The statute and IRS procedures have also had an adverse impact on grand jury investigations in which we have attempted to combine both tax and non-tax violations. The principal problem here is delay. In order to obtain approval for a joint grand jury investigation (which would include charges of tax violations as well as other criminal allegations), the Department of Justice must provide justification and seek IRS approval for each specific taxpayer to be investigated by the grand jury. As I understand the procedure, the Department of Justice request must first

be approved by an IRS Special Agent, who passes it on to his manager, who sends it to the Chief of the Criminal Investigation Division, who transmits it to the Chief Counsel of IRS for decision on whether to refer the matter to the Tax Division of the Department of Justice, where the final decision is to be made. As you can imagine, the delays under this kind of multi-layered procedures can be staggering. I am aware of one case in Buffalo, in which approval was obtained 13 months after it was first sought. In the Araujo case, which I mentioned earlier as an example of a successful joint IRS-DEA case, it took 8 months for the Department of Justice to obtain IRS concurrence to conduct the joint investigation. I am aware of another case in which the request was submitted last March and as of this date, it has not yet gotten past the first level of review.

As I noted, even when approval is obtained, it is limited to the individuals then identified as tax violators. As others are identified during the course of the joint investigation, the same involved procedure must be negotiated to secure approval to investigate them. In a fast-breaking investigation, it can be extremely harmful to have to go back to square one of the procedures. As you may imagine, prosecutors often conclude that the attempt to secure approval for joint investigations is

simply not worth the effort.

We recognize that legitimate privacy interests of taxpayers are furthered by the Tax Reform Act. At the same time we question how American society as a whole is benefitted by significantly reducing the ability of the IRS to lend its financial expertise and store of information to the investigation and prosecution of persons engaged in multi-billion dollar criminal conduct. The forthcoming Administration study which I mentioned earlier will address these problems and suggest what legislative changes, if any, should be made to correct the problems which I have identified without unduly disrupting the delicate balance contained in the statute between preserving the legitimate privacy interests of law-abiding taxpayers and permitting the Government to enforce the criminal laws against major offenders.

I should also like to touch briefly on a number of other issues affecting our ability to deal with the financial aspects of large-scale drug trafficking. Foremost among these is the difficulty in tracing funds generated by drug

trafficking after they have left the United States. Money has been traced from drug dealers into and out of U.S. bank accounts, but the trial often disappears when the money is transferred into banks in foreign countries with strict bank secrecy laws. We are trying to address this problem through negotiations with the countries involved, but the prospects are not promising at this time. We believe it essential to have a mutual assistance treaty with each affected country by which we will be able to obtain financial information from that country concerning persons

treaty with Switzerland; and a similar treaty with Turkey has just been ratified by the Senate and awaits implementation. We are also hopeful that we will be able to consummate, and send to the Senate for ratification, a similar treaty with Colombia.

I should note that under the Tax Reform Act the IRS will not provide to any foreign country any information except for tax prosecutions. As a consequence, certain countries, such as the Netherlands, which would otherwise provide us financial information for any prosecutorial use are insisting that as a matter of reciprocity they will not produce the financial infor-

mation to us except for tax prosecutions here. However, the real stumbling block in this area is that those jurisdictions which serve as bank havens -- such as the Bahamas and the Grand Cayman Islands -- have shown no disposition to provide the needed information. We hope to resume discussions with these governments and to demonstrate to them, as we demonstrated to the Swiss Government, that the legitimate economies of all nations are adversely affected by large-scale illegal drug trafficking and that the international community has a responsibility to avoid shielding these bandits. We believe that it can be demonstrated that it is not in the long term interest of any nation to establish havens, financial or otherwise, for these criminals.

At the same time, we should take a closer look at our own banking laws and the compliance with them by our banks. At present, the Bank Secrecy Act requires banks to report cash transactions of $10,000 or more. While there have been a few prosecutions for non-compliance, the Department of Justice cannot solve the problems acting alone. We need more vigorous compliance by the banks and closer supervision by the bank regulatory agencies. Further, it may be that there should be reporting requirements with respect to certain types of wire transfers, which we suspect the narcotics financiers are using.

Congress should also give consideration to proposed amendments to the Currency and Foreign Transaction Reporting Act (31 U.S.C. §1051) which are designed to strengthen the Government's ability to monitor and interdict the movement of illicitly obtained money into and out of the country. For example, H.R. 4071 would provide a reward for information leading to seizures of currency. H.R. 4072 would make it a crime to attempt to violate the requirement to report the movement of currency of $5,000 into or out of the United States. At present while it is a crime to take $5,000 out of the country without reporting it, at least one court has held that under the statute there can be no arrest or prosecution until after the person has left the country without reporting. We believe that once a person is on board an aircraft with more than $5,000 in his possession and has not filed the appropriate report despite notice of the requirement to do so, he should at that point be subject to arrest and prosecution.

Finally, I should note that the Biaggi Bill, or the High Seas Bill, has been passed by the House and is awaiting action by the Senate. The bill would make it a crime for any American or person on an American ship or ship subject to United States jurisdiction to commit on the high seas any

violation of the Controlled Substance Act. At present, it is difficult to prove that a boatload of drugs on the high seas is destined for the United States and hence that its occupants have the intent to distribute those drugs here. This bill would obviate the problem by making it an offense for the covered person to be in possession of the controlled substances on the high seas. We urge enactment of this bill.

These legislative provisions should enhance the tools we presently have to investigate and prosecute major drug trafficking networks. They should improve our ability to ferret out and convict the major offenders and to deprive them of their illicit gains. However, in our view, law enforcement techniques and resources alone will not halt illicit drug traffic and its attendant high profits. As long as there remains a strong demand and a ready market for illicit drugs, there will be individuals willing to run the risks to supply them. To deal rationally with this increasingly serious problem, we must also focus attention on the nature of the demand for these substances and sensible approaches to respond to, and hopefully, minimize the demand. This would require a commitment by all affected segments of society, not just law enforcement officials. We believe that this Committee is an appropriate vehicle for focusing attention on all facets of the problem and suggesting ways in which we can deal

comprehensively with them. We look forward to working with this Committee as it pursues these issues, and we welcome any assistance you can provide us as we strive to stem the flow of illicit drugs and the enormous profits which criminals are reaping from this traffic.

Thank you. I will be happy to respond to any questions you may have.

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