



1300 I STREET, SUITE 125  
P.O. BOX 944255  
SACRAMENTO, CA 94244-2550

Public: (916) 445-9555  
Telephone: (916) 323-8405  
Facsimile: (916) 322-2368  
E-Mail: Peter.Williams@doj.ca.gov

January 14, 2014

RE: *Responses to Written Questions from the Little Hoover Commission Regarding the Underground Economy*

To the Little Hoover Commission:

I have prepared the following answers in response to your questions submitted to me by Beth Miller of the Little Hoover Commission. These are my answers from the level of a prosecutor with exposure to underground economy cases. They are not necessarily meant to constitute official answers from the Attorney General or the Department of Justice.

**1. In what ways have new trends in the underground economy, such as the growing array of counterfeit products or the use of electronic technology, changed the work of the Office of the Attorney General and other investigation and enforcement agencies?**

Having at least two large, international ports of entry, and sharing a border with another country, California is particularly vulnerable to the growing problem of imported counterfeit goods. These goods encompass almost everything: batteries, garbage bags, eye drops, energy drinks, clothing, cigarettes, etc. The easier the item to counterfeit, the more likely perpetrators will do so.

The proliferation of cheap but sophisticated computer systems has exacerbated the problem of counterfeiting and the underground economy in general. For instance, it has enabled the crime of piracy (primarily CD, DVD and software copying) to be committed on a large scale, and in almost any location. As a specific example of how technology is changing the landscape of crime in the state, the California Department of Justice (DOJ) has encountered computer software during a recent investigation that successfully replicated encrypted tax stamps used on cigarettes in California. This, and other methods of avoiding the tobacco excise tax, form a significant part of the underground economy problem.

Expanding counterfeit trends, coupled with cheap, readily available yet sophisticated computer systems, has increased the volume and broadened the scope of cases to be addressed by the Attorney General's Office. In 2011, the Attorney General created the eCrimes Unit to investigate and prosecute, among other crimes, identity theft and technology crimes in which an electronic device or network is used. Now, as discussed in detail in Question Number Two below, the Attorney General's Office has assigned four DOJ agents and one prosecutor to a newly-formed task force, called TRaCE (Tax Recovery and Criminal Enforcement), which was

created in partnership with the Board of Equalization (BOE) and other state revenue agencies to control the underground economy. With respect to crimes enabled by electronic technology, the task force will utilize, whenever possible, Penal Code section 502.01 to confiscate and forfeit any computer systems used to defraud the state as part of any tax evasion, piracy or counterfeiting scheme.

**2. How will the design of the new team created by AB 576 aid in the state's revenue recovery activities? Please include in this discussion the relocation of task force members' offices, as well as the decision to add a state-level prosecutor to enforcement efforts. What does the new team bring to the state's efforts that was missing previously?**

The practicality of a multi-agency underground economy task force had been loosely discussed between members of the Attorney General's Office and the BOE for several years prior to the legislation as a way to promote cooperative efforts among different agencies concerned with the underground economy. TRaCE began to materialize while AB576 worked its way through the legislature, and recently became reality when DOJ was able to commit manpower and resources to the task force.

The TRaCE task force shares common goals with AB 576, and its creation dovetails with the purpose of the legislation. Information sharing among the delineated agencies pursuant to AB 576 will create leads into underground economy criminal activity. Those leads can then be examined by the task force to determine if a full-scale criminal investigation should be undertaken. These leads will augment the task force's other sources of information from local and federal law enforcement entities, along with intelligence from informants. Leads that may not warrant a criminal investigation by TRaCE, but are still significant, can be directed to the appropriate agency for civil prosecution or other remedial measures. In addition to acting as a receptacle for leads created as a result of the cooperation mandated by AB 576, TRaCE would also be available to consult with those cooperating agencies on the most effective manner in which to collect and organize shared data in order to generate the most fruitful leads.

Like AB 576, the purpose of the TRaCE task force is to increase collaboration among the involved agencies. Collaboration is greatly enhanced by having dedicated personnel working at the same site. In this regard, BOE has established a site for TRaCE and equipped it with the needed computers and related items to enable the task force to operate efficiently and effectively. In my experience, the most effective task forces place the agents, auditors and support staff in the same facility.

By dedicating a prosecutor to the task force, as the Attorney General's Office has done here, it has allowed commitments from other agencies to be more forthcoming. Having a prosecutor embedded with the task force allows other agencies to feel comfortable that the time expended by their personnel will result in the timely review by a prosecutor familiar with underground economy issues, and likely result in the filing of criminal cases and eventual convictions. Without a dedicated prosecutor, many agencies can be reluctant to commit personnel or resources to a new and novel effort. In this instance, once the Attorney General's Office directed a dedicated prosecutor to the task force, it gave the BOE and Franchise Tax Board the

confidence to commit resources to the group. Other agencies, including the FBI, have given verbal commitments to assigning agents to the task force.

There has never been a statewide effort to combat the multiple and varying aspects of the underground economy in any sustained, systematic way. There are local efforts from time-to-time, and various state agencies may consistently attack a limited portion of the underground economy. But these inconsistent local efforts or narrow state efforts cannot do what the TRaCE task force is set up to accomplish. TRaCE places different agents and investigators from different agencies, each with a unique and valuable skill set, in one location in order to enhance the ease with which underground economy cases—many with varying criminal components like payroll tax fraud, income tax evasion, excise tax fraud, counterfeiting and money laundering—can be investigated.

**3. What potential challenges may arise for the new team, how are the member agencies planning to respond to those challenges, and what help could they use from other state leaders or organizations?**

One substantial challenge for the TRaCE task force will be the high volume of cases, even if the task force limits itself only to large and/or high profile crimes. Since its inception several weeks ago (and before we have even established our full complement of agents and investigators), the task force has already received multiple leads into several large cases. Compounding this workload problem is the large size of the state and the existence of underground economy schemes in most of the major regions of the state. Initially, the task force will operate out of Sacramento and investigate cases statewide. Eventually however, successful prosecution of cases will require the establishment of task force branches in Los Angeles and the Bay Area; areas that investigations have revealed as hot spots for criminal underground economy activity.

Absent new funds, the TRaCE task force will attempt to coordinate efforts with interested local law enforcement agencies and district attorneys' offices in Los Angeles, San Diego and the Bay Area in order to provide them guidance on the underground economy crimes that their areas are experiencing. The task force will also provide leads and investigative assistance to local law enforcement. Of course, such piecemeal efforts will lack a consistent catalyst to provide a sustained and effective effort to combat the underground economy. Further, without a dedicated entity in the immediate area consistently combating these crimes, it can be difficult for local agencies to build the institutional knowledge needed to investigate often highly sophisticated schemes to avoid taxes and regulations.

The TRaCE task force and AB 576 provide critical means for the agencies involved in combating the vast problem represented by the underground economy to collaborate and cooperate. Regardless of its relative participation, each agency gains the benefit of leveraging efforts with the combined resources of others. Participating agencies also gain the valuable ability to publicize investigative efforts within affected industries in order to deter criminal conduct, and to educate the public on the dangers and substantial costs posed by the underground economy.

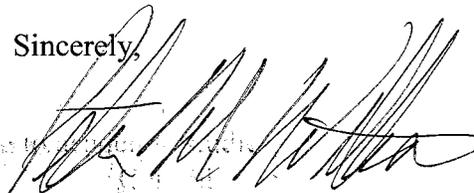
**4. With a problem as complex and ever-changing as the underground economy, what principles should the state's top policymakers use in setting realistic expectations and metrics for measuring success?**

It is anticipated that tax revenue to the state will increase as a result of the enforcement efforts of TRaCE and the mandates of AB 576. If full commitment is given by the legislature (by providing resources) and the various state agencies (by providing personnel), tax revenue should rise after a sustained effort over a period of time. Of course, the use of revenues as a metric and correlating revenue increases to enforcement efforts will require an analysis that also accounts for variables such as changes in the economy and tax rates.

Various types of tax evasion, as they relate to the underground economy, have existed in this state on a large scale for decades. According to academic studies, the underground economy has grown almost unchecked since the last Little Hoover Commission report on the underground economy thirty years ago. By some estimates, the underground economy is as large as the state's budget. Based on past cases and many conversations with informants, there is now an established, ingrained culture in this state whereby perpetrators believe any risk from law enforcement associated with tax evasion, counterfeiting, piracy or other aspects of the underground economy, is just part of the cost of doing business and will not likely result in criminal convictions and imprisonment. This culture will take time to reverse.

A metric more within the control of the task force would be to consider the number of investigations, the number of prosecutions, and the number of convictions that result directly or indirectly from the TRaCE task force and AB 576. Along with this, the value of any forfeiture of ill-gotten gains should be considered, as should orders for restitution to the state.

Sincerely,



PETER M. WILLIAMS  
Deputy Attorney General