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GSA CONTRACTORS WHO CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

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GSA CONTRACTORS WHO CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT

TUESDAY, MARCH 14, 2006

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:30 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Norm Coleman, Chairman of the Subcommittee, presiding.

Present: Senators Coleman, Levin, and Carper.

Staff Present: Raymond V. Shepherd III, Staff Director and Chief Counsel; Jay Jennings, Senior Investigator; Mary D. Robertson, Chief Clerk; Leland B. Erickson, Counsel; Mark L. Greenblatt, Counsel; Steven A. Groves, Counsel; Mark D. Nelson, Counsel; Brian M. White, Professional Staff Member; Cindy Barnes, Detailee (GAO); Joanna Ip Durie, Detailee (ICE); Elise J. Bean, Chief Counsel and Staff Director to the Minority; Eric J. Diamant, Detailee (GAO); Matt Schmitten, Intern; John Kilvington, (Senator Carper); and Tom Spangler, (Senator Akaka).

OPENING STATEMENT OF SENATOR COLEMAN

Senator COLEMAN. This hearing of the Permanent Subcommittee on Investigations is called to order.

Good morning and welcome. This is the third Subcommittee hearing focusing on Federal contractors with unpaid tax debts. These are not your everyday tax delinquents, but rather contractors who receive millions of dollars from American taxpayers, yet refuse to pay their fair share.

Just a note, I am going to walk through both what we are going to talk about today, and give a little history. But I do want to express my appreciation for the work of the Government Accountability Office. They really have done some outstanding work in this area, and as Chairman of this Subcommittee, I am very appreciative.

And there are some things that have been done and others that continue to need to be done, but I also want to acknowledge the response of the IRS in dealing with these matters. I think we have come a long way in a short period of time. There is more work to be done. I am going to express some concerns in that area, but I do want to start off by expressing my appreciation.

Senator Levin, I know that you have an Armed Services Committee hearing. I have a pretty full statement. Do you have time,

or I would actually defer to you if you wanted to make a statement, and then do what you have to do? And then I will proceed from there.

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Mr. Chairman, thank you for your usual courtesy in that regard, and I want to first just thank you for your leadership in this area, for your sticking with a very important subject.

We have a huge tax gap in this country, estimated at about $350 billion a year. That is the gap between the taxes that businesses and organizations and individuals owe the Federal Government and what they have actually paid.

And when so many Americans fail to pay the taxes that they owe, it begins to undermine the fairness of our tax system, forcing honest taxpayers to make up the shortfall needed to pay for basic Federal protections—like Social Security, Medicare, and the weapons needed by our men and women on the front lines of our military.

Today's hearing focuses on one particular group that contributes to that $350 billion annual tax gap, the contractors who are awarded contracts by the General Services Administration and get paid with taxpayers' dollars while, at the same time, failing to pay their taxes.

And in testimony before this Subcommittee today, the Government Accountability Office, the GAO, will describe almost 4,000 such civilian contractors who have dodged their tax obligations and accumulated tax debts to Uncle Sam totaling at least $1.4 billion and are still awarded government contracts.

In related reports released over the last 2 years, the GAO found 27,000 DOD contractors with accumulated tax debts totaling $3 billion and 33,000 civilian contractors with accumulated tax debts totaling at least $3.3 billion. Those are huge numbers. Tens of thousands of companies receiving contracts and payments on those contracts from the Federal Government while owing billions of dollars in unpaid taxes, and it is just simply mind-boggling that this is allowed to continue.

I want to join you, Mr. Chairman, in thanking our witnesses who are here today. Thanking the IRS and the other agencies, including the GSA, who are working hard to address this issue, which you have identified and the Subcommittee has investigated and continues to investigate and press for loophole closing and gap closing in this area.

The kind of leadership that you have shown here is the kind that we are going to need to close this tax gap that exists for lots of reasons in many ways. In other parts of our Subcommittee work, we are going to try to close other parts of this tax gap, including the abuses that are exemplified when tax havens are utilized by taxpayers to avoid taxes to Uncle Sam.

But this morning's hearing is a very important one. It is a continuation of a series of hearings in this area, which you have chaired. I hope to be able to get back for some questions. I would ask unanimous consent that the balance of my statement be inserted in the record.

Senator COLEMAN. Without objection.

Senator LEVIN. Thank you again for yielding to me.
[The prepared statement of Senator Levin follows:]

PREPARED STATEMENT OF SENATOR LEVIN

The current tax gap in this country is about $345 billion per year. That $345 billion gap is the difference between the taxes that businesses, organizations, and individuals owe the federal government and what they've actually paid. When so many Americans fail to pay the taxes that they owe, it begins to undermine the fairness of our tax system, forcing honest taxpayers to make up the shortfall needed to pay for basic federal protections—like social security, Medicare, and the weapons needed by our men and women on the frontlines of our military.

Today's hearing focuses on one particular group that contributes to that $345 billion tax gap—contractors who are awarded contracts by the General Services Administration (GSA) and get paid with taxpayer dollars while, at the same time, failing to pay their taxes. In testimony before this Subcommittee today, the Government Accountability Office (GAO) will describe 3,800 such civilian contractors who have dodged their tax obligations and accumulated tax debts to Uncle Sam totaling at least $1.4 billion—and are still awarded government contracts. In related reports released over the last 2 years, GAO found 27,000 DOD contractors with accumulated tax debts totaling $3 billion and 33,000 civilian contractors with accumulated tax debts totaling at least $3.3 billion. Those are huge numbers—tens of thousands of companies receiving contracts and payments on those contracts from the federal government, while owing billions of dollars in unpaid taxes. It's simply mind boggling that this is allowed to continue.

Tax dodging by any federal contractor is not only unfair to the honest taxpayers left to make up the difference, but also to the honest companies that have to compete against the tax dodgers that aren't paying what they owe, while honest companies do.

One of the main problems here is that contractors are being allowed into the system in the first place and are being awarded contracts even though they owe taxes. There should be a red flag on any contract application by a company that owes back taxes and a requirement for them to explain the circumstances. Tax dodgers should not receive contracts to begin with—their tax debts should be paid before more contracts are awarded, or, at a minimum, until arrangements are made for them to repay the back taxes they owe.

Tax chiseling by federal contractors is not a new story, but it is particularly galling when engaged in by folks who make their living directly from taxpayer dollars. In 1997, Congress enacted the Taxpayer Relief Act which, in part, authorized federal agencies to withhold 15 percent of any federal payment going to a person with an outstanding tax debt. The goal was to stop taxpayer dollars from being paid to a tax deadbeat, unless a portion was withheld off the top to reduce that person's tax debt. In 2004, we increased the percentage that can be withheld from a contract payment to up to 100 percent.

The Taxpayer Relief Act sought to apply a common sense principle to government operations: to offset the taxpayer dollars sent to people who haven't paid their tax bills by directing a percentage of the total be withheld to reduce their tax debt. That common sense principle isn't always easy to apply in a government that has hundreds of thousands of contractors on the books, but it must be applied and the computer capability to apply that principle exists today.

Until recently, the federal tax levy program was not an effective tool to stop contractor tax deadbeats. But under this Subcommittee's scrutiny, it is improving. The clearest proof is the increase in back taxes collected from federal contractors. In 2003, the tax levy program collected $7 million. In 2005, it collected $42 million, a six-fold increase in two years. That's a little progress, anyway, though still far from the $100 million per year projected by GAO as the minimum that should be collected.

One reason for this progress is the Federal Contractor Tax Compliance Task Force, which was formed after the Subcommittee's first hearing on this topic in 2004, and which has worked hard to improve the tax levy program. These improvements include the following:

- A few years ago, DOD, which issues more contract dollars than any other federal agency, had only 1 out of 16 payment systems integrated into the tax levy program. Now, 18 out of 20 systems are routinely screened for tax levies.
- Prior to 2006, many federal contractors failed to submit valid Taxpayer Identification Numbers (TINs) to the federal government. Without a TIN, the federal government can't perform the computer matches needed to identify tax

deadbeats. Last year, in response to the urging of this Subcommittee, the IRS developed a consent-based TIN verification system, requiring taxpayers to allow verification of their TINs as a condition of competing for Federal contracts. The program started October 31, 2005 and by the end of the year, 16 percent of the 380,000 contractors registered in the Central Contractor Registry (CCR) had validated their TINs. By October 31, 2006, 100 percent will have gone through the TIN validation process. Hopefully, the days of missing or false TINs will then be behind us, greatly strengthening the effectiveness of the Federal Payment Levy Program matching process.

- Another milestone is a new effort to identify those federal contractors who have failed to file any tax return. Until recently, the tax levy program had focused only on contractors who have filed tax returns. For the first time last year, a file containing all awarded contracts from DOD and GSA for the past year was matched against IRS data to identify contractors who are non-filers. An analysis is now being conducted on the data to determine appropriate next actions.
- Still another gap in the tax levy program has been federal contractors who are paid by purchase cards, meaning either credit cards or debit cards. To date, these contract payments, which total about $10 billion annually, have been excluded from the tax levy program. That doesn't make sense. In response to the Subcommittee's request, the task force has completed a study of this problem and recommended blocking payments over $2,500 via purchase cards to contractors with an active tax debt. The Task Force is now developing a process to create an indicator that a contractor is not eligible to be paid by purchase card and must be paid by check or electronic transfer, payment mechanisms which are already subject to the tax levy program.

Each of these steps is moving us toward a more effective tax levy program, but a lot more needs to be done, including stopping contractors that have tax debt from receiving a contract in the first place. We should be stopping these contractors before they get in the door.

Most federal contractors provide valuable goods or services, and do so while paying their taxes. Other contractors stuff taxpayer dollars in their pockets with one hand, while stiffing Uncle Sam with the other. This tax dodging hurts honest taxpayers, honest businesses, and our country as a whole. Effective use of the federal tax levy program is necessary to help keep the tax dodgers from succeeding.

I commend Senator Coleman for his leadership and sustained effort on this important issue. I look forward to the testimony today.

Senator COLEMAN. And Senator Levin, I want to thank you again for your leadership in this area. You really pointed the way, and it has been a privilege for me to continue moving with you in this direction in a very bipartisan way.

And you are right. Average folks, taxpaying citizens of this country, they pay their fair share. They live up to their obligations, and they are the ones that are hurt by this. A greater burden falls on them.

In some of these cases, the type of taxes that aren't paid, payroll taxes, you are not only ripping off the government, you are ripping off your employees, who had the money taken out of their pay. Instead of then submitting it and it covers things like Social Security and Medicare, things of that nature, what we see—and we have seen in this investigation—is unscrupulous folks, contractors using it for their own purposes.

So a lot of folks are hurt in this, but you have had the vision for a long time, and I just wanted to applaud you for that.

Senator LEVIN. Thank you so much.

Senator COLEMAN. What I am going to do is first get a sense of the problem through review of a handful of disturbing cases. We have one contractor that provides security services for the Federal Government that was paid more than $1 million from American

taxpayers over the past 2 years, even though he owes more than $12 million in payroll taxes.

The last few years, as his company failed to turn over payroll taxes that were withheld from employees' paychecks, the owner made large cash withdrawals from the company for his personal use. I believe more than $100,000 of that money GAO investigators indicated was spent on gambling.

And again, we are talking about, in this case, payroll taxes. So the employees, part of their wages are being withheld. But instead of being forwarded, as they should be, to Uncle Sam, they are put in someone's pocket.

Another contractor provides public communications services to the Federal Government and was paid $100,000 and owes more than $2 million in payroll taxes. And while he kept his employees' payroll taxes, the owner purchased residential property valued at $1 million and made numerous cash withdrawals totaling $500,000 at casinos.

A third contractor sells emergency supplies, was paid $100,000 by the Federal Government while simultaneously owing more than $700,000 in back taxes. The IRS assessed a penalty against the owner for failing to remit payroll taxes and imposed a Federal tax lien that was in effect when the contractor received a Federal contract. While refusing to pay his employees' payroll taxes, the owner made several real estate purchases, including a home worth over a million dollars.

And sadly, these are just the tip of the iceberg. The Subcommittee's efforts, in concert with the work of the Government Accountability Office, has revealed that 3,800 Federal contractors who contract with the General Services Administration owe back taxes totaling $1.4 billion.

In an age of increasingly tight fiscal discipline, that $1.4 billion could be put toward our homeland security, our children's education, our job training programs. It adds insult to injury that these tax deadbeats are actually paid enormous amounts of money every year from American tax coffers, and I think that is a good phrase, "tax deadbeats" being paid enormous amount of money every year.

Our hearing today will address why these tax cheats were able to do business with the government in the first place and what we need to do to put a stop to it. This hearing continues our longstanding investigation of Federal contractors who cheat on taxes.

In February 2004, the Subcommittee held a hearing that examined Federal contractors doing business with the Department of Defense, and we looked at over $3 billion being owed there. In 2005, the Subcommittee looked at unpaid taxes by civilian contractors for various Federal civilian agencies. And the total there was $3.3 billion, and that is with a "B," that had not been paid.

So this now is the third hearing. This focuses on GSA contractors that provide a vast array of products and services to the Federal Government, ranging from office supplies, furniture, communications equipment, security services, automobiles, office space, and landscaping. We will also explore how to fix the problem so that these contractors cannot continue to fleece American taxpayers.

There is an old adage that states if you want to have the right answer, you have to ask the right question. When it comes to Federal contractors, we have been asking the wrong questions, perhaps not asking enough questions.

The Federal Government has been trying, since the year 2000, to identify tax cheats by asking Federal contractors actually a very narrow question. Whether they have been indicted or convicted of tax evasion in the last 3 years. It is a very specific crime.

The Subcommittee's investigation has shown, however, that this question is simply too narrow to weed out tax delinquent contractors. The simple fact is that not all tax frauds result in a conviction for tax evasion. Indeed, there is a broad spectrum of tax-related violations that are utterly ignored by our contracting review process. As a result, many Federal contractors continue to receive contracts even though they owe massive amounts in back taxes.

Take the case of Jack Easterday, who is the owner of nine nursing homes and a computer software firm in California. Just a few weeks ago, Mr. Easterday was convicted of 47 counts of failing to turn over $3 million in payroll taxes that he had withheld in trust for his employees. He used the money for personal gain. Paid himself and his wife an average salary of more than $338,000 between 1998 and 2004, and purchased a 10,000 square foot home for $750,000 in 1997.

He purchased a dining room table and chairs that seated 22 people, along with a 24-place setting of Limoges china. He purchased a Rolex watch for $16,340. He owned a sailboat and jet skis. He was living like Louis XIV, compliments of the American taxpayer.

Mr. Easterday was convicted of willfully failing to account for and turn over payroll taxes, but he was not convicted of tax evasion, which is a different violation of the code. Consequently, Mr. Easterday can honestly represent that he has not been indicted for or convicted of tax evasion in the last 3 years and, therefore, potentially would remain eligible to contract with the Federal Government in the future.

Mr. Easterday is just 1 of 97 known cases of egregious tax abuse by Federal contractors that were identified by this Subcommittee with the assistance of the GAO. These 97 contractors are the worst of the worst, yet none of the 97 contractors has been indicted or convicted of tax evasion. Therefore, every single one of those worst of the worst would be potentially able to slip their tax violations through our contracting personnel.

On the other hand, if we asked those 97 contractors, including Mr. Easterday, the right questions, we would know that they were tax deadbeats before we gave them contracts. Clearly, we are not asking the right questions, and we are not asking broad enough questions.

That is only half the problem. The other half is that there is no verification of the tax-related representations that contractors make. Even though we ask contractors if they have been indicted for or convicted of tax evasion, we do not identify those who lie.

Neither the Internal Revenue Service nor the Department of Justice currently provides GSA with lists of persons or companies who have been indicted for or convicted of tax evasion. Therefore, GSA

has no method to verify whether contractors' representations are true.

Clearly, we must not only ask the right questions, we also need to verify the truth of the answers that we receive. Until this problem is rectified, the Federal Government is likely to be awash in Federal contractors who are cheating on their taxes.

But there is good news to report as well. The principal objective of this Subcommittee's investigation is to increase the effectiveness of the Federal Payment Levy Program under which a portion of Federal contractors' payments are levied to pay off their outstanding tax debt.

When we started in 2003, levies on Federal contractors amounted to $7 million. Substantial credit is due to the GAO and the Commissioner of the IRS, the Administrator of GSA, the Secretary of Defense, the Commissioner of the Financial Management Service, whose support led to the establishment of the Federal Contractor Tax Compliance Task Force. The task force has addressed and resolved several problems that inhibit levies, and it is continuing to work on a number of additional problems.

And I started off this hearing by saying I appreciate their hard work, and I applaud their success. To date, the notable accomplishments of these efforts include the establishment of a taxpayer identification number verification program in the Central Contractor Registration, IRS's release of $28 billion in additional tax debt for levy purposes, and the creation and testing of a Federal contractor nonfiling program.

All of these improvements are designed to increase the number of levies on Federal contractors' payments, and the results demonstrate that we are succeeding. But the task force's work is not finished. The Financial Management Service must find a way to impose levies on all Federal contractor payments, especially those that are made with purchase cards.

The task force needs to develop procedures to ensure that all Federal contractors are registered in the Central Contractor Registration. Further, the task force needs to develop procedures to ensure that all Federal agencies use the validated name and taxpayer identification number from the Central Contractor Registration for all tax-related purposes.

I expect that today's hearing will add to the task force's to-do list. Specifically, the tax-related questions and the Representations and Certifications Application need to be revised, and processes need to be developed to verify contractors' tax-related statements.

On the first panel this morning, we will hear from the GAO representatives on the results of our request to determine if there are tax delinquent Federal contractors working for the General Services Administration who are on the GSA's general schedule.

To date, their hard work has resulted in the identification of 57,000 Federal contractors who owe $6.3 billion. I want to repeat that. To date, their hard work has resulted in the identification of 57,000 Federal contractors who owe $6.3 billion in unpaid taxes, including 97 contractors who flagrantly abused the tax system and who have been referred to the IRS for further investigation.

On the second panel, we will hear from the Commissioner of the IRS and the Acting Deputy Administrator of GSA concerning the

actions they have taken or plan to take to ensure that Federal contractors who abuse the tax system are identified and that those who owe tax have their contract payments levied.

I would like to make it clear I am pleased with the results that the Federal Contractor Tax Compliance Task Force has achieved to date. I applaud the Commissioner of the IRS, the Administrator of GSA, and other participants for their active support of the task force's work.

However, I am concerned that only 1 of the 97 cases of potential fraud identified by the Subcommittee have been prosecuted. This is well below the infamous baseball Mendoza line.

In closing, it is simply unacceptable that tax cheats who owe the government billions in back taxes get millions of dollars from the government. This Subcommittee will continue to aggressively pursue this matter until the Federal Government tightens its procedures to ensure that these tax deadbeats are prohibited from receiving lucrative government contracts.

[The prepared statement of Senator Coleman follows:]

Good morning and welcome to today's hearing. This is the third Subcommittee hearing focusing on federal contractors with unpaid tax debts. These are not your everyday tax delinquents, but rather contractors who receive millions of dollars from American taxpayers and yet refuse to pay their fair share of taxes.

Some of these tax-delinquent contractors fraudulently used withheld payroll taxes for their business or personal use. Keep in mind that payroll taxes include withholdings from employees' wages for Social Security, Medicare, and individual income taxes. These contractors, like all employers, hold these wages in trust for their employees and are required to remit them to the IRS. Rather than fulfilling their legal obligations, these contractors have diverted the money for their own personal gain. An investigation by the Government Accountability Office in conjunction with this Subcommittee uncovered numerous contractors who bought luxury cars, boats, and multi-million dollar properties, even though they owed hundreds of thousands of dollars in unpaid taxes.

To get a sense of the problem, let's review of handful of disturbing cases:

- One contractor that provides security services for the federal government was paid more than $1 million from the American taxpayers over the past two years, even though he owes more than $12 million in payroll taxes. Over the last few years, as his company failed to turn over payroll taxes it withheld from its employees paychecks, the owner made large cash withdrawals from the company for his personal use. More than $100,000 of that money was spent gambling.
- Another contractor who provides public communications services to the federal government was paid $100,000 and owes more than $2 million in payroll taxes. While he kept his employees' payroll taxes, the owner purchased a residential property valued at $1 million, and made numerous cash withdrawals totaling $500,000 at casinos.
- A third contractor who sells emergency supplies was paid $100,000 by the federal government, while simultaneously owing more than $700,000 in back taxes. The IRS assessed a penalty against the owner for failing to remit payroll taxes and imposed a federal tax lien that was in effect when the contractor received a federal contract. While refusing to pay his employees' payroll taxes, the owner made several real estate purchases, including a million dollar home.

Sadly, these are just the tip of the iceberg. The Subcommittee's efforts—in concert with the hard work of Government Accountability Office—have revealed that 3,800 federal contractors who contract with the General Services Administration owe back taxes amounting to a $1.4 billion. In an age of increasingly tight fiscal discipline, that $1.4 billion could be put towards our homeland security, our children's education, or job training programs. It adds insult to injury that these tax deadbeats are actually paid enormous amounts of money every year from American tax coffers.

Our hearing today will address why these tax cheats were able to do business with the government in the first place, and what we need to do to put a stop to it. This hearing continues our long-standing investigation of federal contractors who cheat on their taxes. In February 2004, the Subcommittee held a hearing that exam-

ined federal contractors doing business with the Department of Defense who owed $3 billion in unpaid taxes. In June 2005, the Subcommittee held a hearing that identified $3.3 billion dollars in unpaid taxes by civilian contractors at various federal civilian agencies. This third hearing will focus on GSA contractors who provide a vast array of products and services to the federal government, ranging from office supplies, furniture, communications equipment, security services, automobiles, office space and landscaping. We will also explore how to fix the problem so that these contractors cannot continue fleecing the American taxpayers.

There is an old adage that states: "If you want the right answer, you have to ask the right question." When it comes to federal contractors, we have been asking the wrong questions. The federal government has been trying since 2000 to identify tax cheats by asking federal contractors one narrow question—whether they have been indicted for or convicted of tax evasion in the last three years. The Subcommittee's investigation has shown, however, that this question is simply too narrow to weed out tax-delinquent contractors. The simple fact is that not all tax frauds result in a conviction for tax evasion. Indeed, there is a broad spectrum of tax-related violations that are utterly ignored by our contracting review process. As a result, many federal contractors continue to receive contracts even though they owe a massive amount in back taxes.

Take the case of Jack Easterday, who is the owner of nine nursing homes and a computer software firm in California. Just a few weeks ago, Mr. Easterday was convicted on 47 counts of failing to turn over as much as $3 million in payroll taxes that he had withheld in trust for his employees. He used the money for personal gain. He paid himself and his wife an average annual salary of more than $338,000 between 1998 and 2004. He purchased a 10,000 square foot home for $750,000 in 1997. He purchased a dining room table and chairs that seated 22 people along with a 24 place setting of Limoges china. He purchased a Rolex watch for $16,340. He owned a sailboat and jet skis. He was living like Louis XIV, compliments of the American taxpayer.

Mr. Easterday was convicted of willfully failing to account for and turn over payroll taxes. More importantly, he was not convicted of tax evasion, which is a different violation of the code. Consequently, Mr. Easterday can honestly represent that he has not been indicted for or convicted of tax evasion in the last three years, and therefore, he would remain eligible to contract with the federal government in the future.

Mr. Easterday is just one of the 97 known cases of egregious tax abuse by federal contractors that were identified by the Subcommittee, with the assistance of GAO. These 97 contractors are the worst of the worst. Yet, none of those 97 contractors has been indicted for or convicted of tax evasion. Therefore, every single one of those "worst of the worst" would be able to slip their tax violations by our contracting personnel. On the other hand, if we had asked those 97 contractors, including Mr. Easterday, the right questions, we would have known that they were tax deadbeats before we gave them contracts. Clearly, we are asking the wrong questions.

But that is only half of the problem. The other half is that there is no verification of the tax-related representations that contractors make. Even when we ask contractors if they have been indicted for or convicted of tax evasion, we do not identify those who lie. Neither the Internal Revenue Service nor the Department of Justice currently provides GSA with lists of persons or companies who have been indicted for or convicted of tax evasion. Therefore, GSA has no method to verify whether contractors' representations are true. Clearly, we must not only ask the right questions, but also verify the truth of the answers we receive. Until this problem is rectified, the federal government is likely to be awash in federal contractors who are cheating on their taxes.

But there is good news to report as well. The principal objective of this Subcommittee's investigation is to increase the effectiveness of the Federal Payment Levy Program under which a portion of federal contractor's payments are levied to pay off their outstanding tax debt. When the Subcommittee started this investigation in 2003, levies on federal contractors amounted to $7 million. In two short years, collections have grown to $42 million. Substantial credit is due GAO and the Commissioner of IRS, the Administrator of GSA, the Secretary of Defense, and the Commissioner of the Financial Management Service whose support led to the establishment of the Federal Contractor Tax Compliance Task Force. The Task Force has addressed and resolved several problems that inhibit levies and it is continuing its work on a number of additional problems. I appreciate their hard work and I applaud their success.

To date, the notable accomplishments of these efforts include the establishment of a Taxpayer Identification Number Verification Program in the Central Contractor Registration, IRS' release of $28 billion in additional tax debt for levy purposes, and

the creation and testing of a federal contractor non-filing program. All of these improvements are designed to increase the number of levies on federal contractors' payments and the results demonstrate that we are succeeding.

But the Task Force's work is not finished. The Financial Management Service must find ways to impose levies on all federal contractor payments, especially those that are made with purchase cards. The Task Force needs to develop procedures to ensure that all federal contractors are registered in the Central Contractor Registration. Further, the Task Force needs to develop procedures to ensure that all federal agencies use the validated name and Taxpayer Identification Number from the Central Contractor Registration for all tax-related purposes. I expect that today's hearing will add to the Task Force's to-do list. Specifically, the tax-related questions in the Representations and Certifications Application need to be revised, and processes need to be developed to verify contractors' tax-related statements.

On the first panel this morning, we will hear from GAO representatives on the results of our request to determine if there are tax-delinquent federal contractors working for the General Services Administration or who are on GSA's General Schedule. To date, their hard work has resulted in the identification of 57,000 federal contractors who owe $6.3 billion in unpaid taxes, including 97 contractors who had flagrantly abused the tax system and have been referred to IRS for further investigation.

On the second panel, we will hear from the Commissioner of IRS and the Acting Administrator of GSA concerning the actions they have taken or plan to take to ensure that federal contractors who abuse the tax system are identified and that those who owe tax have their contract payments levied. I would like to make it clear that I am pleased with the results that the Federal Contractor Tax Compliance Task Force has achieved to date. I applaud the Commissioner of IRS, the Administrator of GSA and other participants for their active support of the Task Force's work. However, I am concerned that only one of the 97 cases of potential fraud identified by this Subcommittee has been prosecuted. This is well below the infamous baseball Mendoza line.

In closing, it is simply unacceptable that tax cheats who owe the government millions in back taxes get millions of dollars from the government. This Subcommittee will continue to aggressively pursue this matter until the federal government tightens its procedures to ensure that these tax deadbeats are prohibited from receiving lucrative government contracts.

Senator COLEMAN. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thank you, Mr. Chairman.

To our witnesses, welcome. We thank you for being here. We thank you for the work that you are doing on behalf of our country and our taxpayers.

I have been over on the Senate floor just before I came over here, Mr. Chairman. And this hearing is actually especially well timed. I don't know if it is just a coincidence or not. But we are debating this week whether to raise the debt ceiling of our country by over three quarters of a trillion dollars.

This is a country where 5 years ago, we actually had a balanced budget. Actually, surpluses as far as the eye can see. And now, we look at these huge deficits that, frankly, don't get a whole lot smaller unless you assume we are not going to be spending any money in Iraq in the future, or spending any money in Afghanistan in the future, or you assume that we are not going to do anything to fix the alternative minimum tax problem.

If you make all of those assumptions, then maybe it looks like the deficit is getting smaller. Those aren't very valid assumptions. And as a result, we know the deficit is not going to get a whole lot smaller at all.

It turns out that the deficit last year was over $300 billion. And as the Chairman here knows and I think our witnesses know, the IRS has reported that last year there was a tax gap—monies owed

to the Federal Government, to the Treasury from any number of sources, including contractors—but about a $290 billion tax gap.

And one of the things that we ought to do and certainly doing through this hearing today is putting a spotlight on some of it, maybe about $6 billion. And while that may seem like it is relatively small, that is a lot of money compared to zero, which is what we have been collecting from these contractors.

The President has actually put in his budget proposal for fiscal year 2007 some ideas that would enable IRS to go out and collect some of these monies that are owed.

Senator Bayh—Evan Bayh—our colleague from Indiana has a proposal that I think he is going to introduce soon that has merit and would probably lead, if implemented, to collecting maybe another $15 billion per year, further reducing the tax gap.

Senator Coburn and I, who lead another Subcommittee of this Committee focusing on financial management, are working on improper payments. And as it turns out, there is about roughly $50 billion worth of improper payments that are made each year. Most of that is overpayments. A little bit of it is underpayments. But it is about $50 billion all told.

That doesn't include all the agencies. It doesn't include, for example, DOD. But it is real money. And if we could even get half of it, it would make a difference in the amount of money that we are borrowing.

The other thing is entitlement programs. I know particularly for folks on my side of the aisle, the entitlement programs are sacred. We don't want to savage them. I sure don't. Having said that, there are some of the entitlement programs, some aspects of some of the entitlement programs probably could be means tested without doing harm to upper middle income folks and, frankly, upper income people in our country.

And also I would mention enhanced rescission powers, Mr. President—well, maybe some day Mr. President. [Laughter.]

Today, though, it is just Mr. Chairman.

I mention enhanced rescission powers. The President has asked for line-item veto powers. I think what he is asking for is maybe a bridge too far, but we actually passed in the House of Representatives legislation that I authored with a couple of our colleagues that provided for a 2-year test drive for line-item veto powers, where the President could propose rescinding spending if it was not authorized.

If it was not authorized, he could propose to rescind it all in a particular line-item. If it was authorized, he could rescind up to 25 percent of it. Either house could override the rescission with a 51 percent majority. Just a bare majority.

And I think if the President, the way we have crafted our proposal, if the President abused what new power we have given him, then after 2 years he would lose that power. And it is just really a 2-year test drive. I think it is probably just a better approach, if we are going to get into that, than simply taking up what the President has proposed.

The other thing I would say, we are debating it right now over on the Senate floor, Pay-go. The idea that if Senator Carper or Senator Coleman want to increase spending for a particular proposal,

we have to come up with an offset. If we want to cut taxes, if it has an adverse effect on the deficit, we have got to come up with an offset either on the spending side or on the revenue side.

And if you put all of these things together, they actually would make a real difference. They would make a real difference in the fiscal management of our country. And a good place to start, frankly, is where we are today.

And I am just delighted that we are holding this hearing. A chance to kind of gauge the success, the progress that is being made, and figure out what more we can do to get us heading in the right direction.

Mr. Chairman, again, I am happy to be here with you, to sit at your side, and we welcome the testimony from our witnesses. Thank you.

Senator COLEMAN. Thank you, Senator Carper.

I do know the chart lays out $7.7 billion that Federal contractors owe the Federal Government. We are paying them money, and they owe us $7.7 billion. And then even for the Federal Government, $7.7 billion is a lot of money.

I would like to welcome our first panel to this important hearing. Gregory Kutz, Managing Director of the Forensic Audits and Special Investigations Unit at the Government Accountability Office, accompanied by Steve Sebastian, a Director with the Financial Management and Assurance Team at the GAO, and also accompanied by Special Agent John Ryan, an Assistant Director with the Forensic Audits and Special Investigations Unit. Gentlemen, I welcome you back to the Subcommittee.

GAO is here to testify on the latest information they have developed pursuant to our request for an investigation of Federal contractors who are not paying their taxes. The purpose of this hearing is to identify further corrective actions that can be taken to improve the effectiveness of the Federal Payment Levy Program.

Again, it is good to see you gentlemen. I appreciate your hard work, which has resulted in the identification of more than 50,000 Federal contractors who owe more than $6 billion in unpaid taxes in just our last two hearings. And then I look forward to hearing about the General Services Administration contractors who are not paying their taxes.

I am particularly interested in knowing what we can do to identify these deadbeats before they are awarded Federal contracts. As you are aware, pursuant to Rule 6, all witnesses who testify before the Subcommittee are required to be sworn. I would ask you to please stand, raise your right hand.

Do you swear the testimony you are about to give before this Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

The WITNESSES. I do.

Senator COLEMAN. You are acquainted with the timing system. One minute before the red light comes on, you will see the lights change from green to yellow. If you can sum up your testimony at that time, we will enter your entire written testimony into the record.

And Mr. Kutz, I understand that you will be presenting the GAO statement this morning. Please proceed.

TESTIMONY OF GREGORY D. KUTZ,[1] MANAGING DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS UNIT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, ACCOMPANIED BY STEVEN J. SEBASTIAN,[1] DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE TEAM, AND JOHN J. RYAN,[1] ASSISTANT DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS UNIT

Mr. KUTZ. Mr. Chairman, as you mentioned, this is the third time that we have been before this Subcommittee to discuss government contractors that have significant tax problems, and you have noted some of the progress that has been made and some of the other issues that remain.

I commend you and the Subcommittee for holding this hearing and for your consistent and aggressive oversight of this important matter. Today, Mr. Sebastian is going to join me in doing the statement, and he will open, and then I will close.

Mr. SEBASTIAN. Thank you, Mr. Kutz.

Mr. Chairman, thank you for the opportunity to discuss issues surrounding Federal contractors with tax problems. We previously testified that thousands of DOD and civilian agency contractors abused the tax system with little or no consequence, and that serious impediments prevented the Federal Government from collecting hundreds of millions of dollars in outstanding taxes annually through the Federal Payment Levy Program.

At those hearings, you expressed concern over how contractors who routinely abuse the tax system could continue to get government contracts, and you asked us to investigate the process GSA uses to screen contractors for government-wide business. Our bottom line today is that thousands of GSA-approved contractors abuse the tax system.

Our testimony has two parts. First, I will discuss increased collections through the levy program, issues that prevent the Federal Government from effectively screening prospective contractors for tax problems, and the extent to which GSA contractors doing business with the Federal Government owe substantial tax debt.

Second, Mr. Kutz will discuss egregious cases of tax abuse related to these contractors and how this has led to an unfair competitive advantage on the part of tax cheats.

First, important progress has been made to increase the collection of taxes owed by contractors since you began focusing attention on the issue, as the posterboard illustrates. In fiscal year 2003, despite tens of thousands of Federal contractors owing billions of dollars in taxes, the levy program collected just $7 million.

Numerous issues contributed to this low collection rate, including many of DOD's payment systems not being matched against tax debt for levy, tens of billions of dollars in tax debt not being referred to the program, and deficiencies in FMS's processes for matching Federal payments for levy.

This Subcommittee's continued focus on these matters has had a positive impact. For example, and as you mentioned, IRS reassessed and referred an additional $28 billion in tax debt to the levy

[1] The combined prepared statement of Mr. Kutz, Mr. Sebastian, and Mr. Ryan appears in the Appendix on page 40.

program. DOD now includes many of its pay systems in the program. And FMS is working to address control deficiencies that excluded tens of billions of dollars in Federal payments from potential levy.

Although we believe more can be collected, for fiscal year 2005, tax collections from contractors via the levy program increased to over $42 million. While some progress is being made on the back end, our testimony today sheds disturbing light on why contractors with outstanding taxes are able to routinely get Federal contracts.

In reviewing how GSA screens prospective contractors, we found that neither Federal law nor GSA's own policies require that tax debt be considered in making contract award decisions. The FAR does not require contracting officers to consider tax debt in determining whether a prospective contractor meets the requirements of a responsible source. Consequently, no consideration is given as to whether companies that do not pay their taxes have the integrity or ethics to perform the contract.

Also statutory restrictions preclude contracting officers from having access to tax debt information unless furnished by the businesses themselves or disclosed in public records. Consequently, contracting officers do not have ready access to the tax status of prospective contractors in making qualification determinations.

Not surprisingly, these limitations have led to a substantial number of businesses being cleared for government contracts who owe significant tax debt. Our work shows that over 3,800 GSA-approved contractors had over $1.4 billion in outstanding tax debt as of June 2005.

Mr. Kutz will now discuss the results of our investigation of 25 egregious cases of tax abuse related to these contractors.

Mr. KUTZ. Thank you.

All 25 of the GSA contractors that we investigated had abusive and potentially criminal activity related to the Federal tax system. As you mentioned, our prior testimony highlighted 97 defense and civilian agency contractors that had similar problems. All 25 of the GSA contractors had, as you mentioned, Mr. Chairman, unpaid payroll taxes, which represent amounts withheld from employees' wages for Federal income taxes, Social Security, and Medicare.

However, rather than fulfill their roles as trustees of this money and forward it to the IRS, these contractors diverted the money for use in their business or for personal gain. Regardless of the cause, willful failure to remit payroll taxes to the IRS is a felony.

Mr. Chairman, as you requested, we have pictures related to the 25-case study GSA contractors for today's hearing. Note that in some cases, we have altered the picture to protect individual identities.

As shown on the posterboards, our investigations related to the lifestyles of the owners and officers of these contractors, and they revealed the following: Many million in multi-million dollar homes, numerous luxury vehicles; ownership of millions of dollars of commercial property, rental property, and land; hundreds of thousands of dollars spent gambling at casinos such as the Trump Taj Mahal in Atlantic City and the Bellagio in Las Vegas; and the purchase of a 20-karat diamond men's bracelet.

Diversion schemes by owners and officers included inflated salaries, millions of dollars of cash withdrawals, and substantial loans. Some owners were simply poor business managers. However, many clearly accumulated substantial personal wealth at the same time their companies failed to pay their taxes.

Other issues related to these companies and their owners included check kiting, money laundering, embezzlement, and hundreds of thousands of dollars of unpaid personal income taxes.

The companies we investigated were small to mid-sized and closely held. Some of the industries included security, building maintenance, and information technology. Ironically, these potential felons are doing business with the Departments of Defense, Justice, and Homeland Security.

Our testimony also highlights two cases where contractors with unpaid taxes won awards based on price, beating out contractors that paid their fair share of taxes. This situation creates a disincentive for the vast majority of government contractors that pay their fair share and could result in further erosion in compliance with our Nation's tax system.

In conclusion, the real question today is why is the Federal Government doing business with these contractors? Further, at the Committee's recent Katrina fraud hearing, a senior Justice Department official spoke of a zero tolerance policy for individuals that are caught stealing disaster money. In contrast, our investigations have shown a 100 percent tolerance policy for government contractors stealing payroll tax money.

Mr. Chairman, this concludes our statement. We look forward to your questions.

Senator COLEMAN. Thank you very much, Mr. Kutz. We could start a new reality TV show, "Lifestyles of Rich and Famous Tax Deadbeats." [Laughter.]

Can we talk first about competitive disadvantage or competitive advantage? And correct me if I am mistaken here, but essentially what you are saying is, in some of these cases is you believe that some of these tax deadbeats apply for a contract with an understanding that they are not going to be paying all of their taxes, and they can factor that into their bid?

Mr. KUTZ. We don't know about that. But when we looked at the two case studies, for example, they were wage-based type services—moving services, etc. And clearly, you have at least a 15 percent advantage where the payroll tax is not in the wage base.

And also many of these companies were not paying their corporate income taxes, and many of the owners weren't paying their personal income taxes. So for small, closely held companies, that would provide a significant cost advantage.

Senator COLEMAN. Is there any information to indicate that folks have done this before or any kind of habitual conduct here?

Mr. KUTZ. We have certainly seen evidence of this from work Mr. Sebastian and I have done of companies and owners. They would open up one company, shut it down. Open up another one.

We have seen instances where individuals were involved with dozens of companies that did not pay their taxes, including payroll taxes.

Senator COLEMAN. You also talked about Federal Acquisition Regulation requires government contracts with responsible contractors. And the situation that we have today is the questions that are taken into consideration, what is responsible, do not include whether there are existing tax liens, do not include whether there have been any kind of indictments, convictions for things such as failing to remit payroll taxes. Is that correct?

Mr. KUTZ. That is correct. And I would agree with your opening statement that we are asking the wrong question.

Senator COLEMAN. What question would you ask?

Mr. KUTZ. Well, I think it needs to be a much broader question about compliance with the Federal tax system in whole, whether it be payroll taxes or other. And certainly, payroll taxes, in our view, would be the most egregious type of behavior that we have seen.

Senator COLEMAN. And I am curious. To me, it seems pretty obvious. We are sitting here on March 14, 2006. We have been looking at this issue for a number of years. I mean, it is not rocket science. If you ask somebody a narrow question, you get a narrow answer.

If you know that folks who are involved in this, and it is interesting because you actually identified a broad range of conduct. Not only did we see in some of these cases the failing to remit payroll taxes, but if you dig a little deeper, you have unpaid personal taxes. You have some instances of money laundering, check kiting, kind of a list of conduct here.

Can you give me a sense as to why we haven't been asking the broader questions?

Mr. KUTZ. Well, Mr. Sebastian and I testified back in the late 1990s on the issue. There was actually a bill, it was H.R. 4181, that would have amended the Debt Collection Improvement Act and would have barred these companies with egregious behavior from doing business with the government. And that was passed out of the House Government Reform Committee, but did not go any further.

And so, again, I don't know the full reason. There was a lot of pushback from the contract community and the procurement community at that time, including the Defense Department. But I would think that given that the vast majority of contractors do pay their fair share, that from a fairness perspective, they would probably like to see something done because they are having to compete with these people.

Senator COLEMAN. And part of the whole purpose of the lien program is not to put people out of business. It is to put them on a schedule of paying off taxes. And in fact, if we, the government, are giving you additional contracts, but you have tax liens—let us say you weren't even barred—we would be making sure that we get that money coming back.

Mr. KUTZ. Whatever is done on the front end, you need to have an effective levy program on the back end. We certainly agree with that, and I think that there has been a lot of progress made in that area, as Mr. Sebastian showed and you mentioned in your opening statement.

Senator COLEMAN. I will pursue this next line of inquiry with both the Commissioner and the Deputy Administrator. But talk to me about how we evaluate, find out whether, in fact, the information, the answers we are getting are correct.

There seems to be a wall between the IRS and other agencies. I understand it is statutory. We will talk about that. Can you talk about the limitations that we have of checking the accuracy of contractors' answers and then move me to a potential fixing of that situation?

Mr. KUTZ. Certainly. Under the 6103 sharing rules, there are certainly limitations as to what can be shared. I mean, we have been asked, even on the companies that we have investigated, by the Defense Department and other agencies, "Can you tell me who they are?" And we can't tell anybody who they are. We can certainly speak to the IRS about it, and IRS faces the same issue. And so, there is a sharing issue here.

One of the possible solutions to that would be a contractor consent. Right now, we understand that contractors have to get into the Central Contract Registry, and have to allow a consent for a check of the taxpayer identification number with the Internal Revenue Service.

And so, it would seem that you could possibly expand that, that if you want to do business with the government, you have to go through the Central Contract Registry, not only allowing a search for the taxpayer identification number, but also a search for any unpaid tax problems. That is one of several possible solutions.

Senator COLEMAN. So today, just so I understand, we have—and we talked about this at our last hearing—to get the contractor consent to check to see that you got the taxpayer ID that you signed into the system. You are saying you have got to expand that to have a consent to identify any tax liens?

Mr. KUTZ. Yes. That would certainly be—not tax liens, actual tax debt.

Senator COLEMAN. Tax debt.

Mr. KUTZ. Tax liens certainly is another piece of information you could get. We get that, in many cases, from public sources. So that is something you could get, potentially, now.

Senator COLEMAN. I am trying to figure out, though, the practical way to do it. Tax liens are public information.

Mr. KUTZ. Yes.

Senator COLEMAN. Tax convictions are public information. Not just a conviction for tax evasion, but a conviction for failing to remit payroll taxes, that is public information.

What is the bar in the system today? What prevents the GSA when they are contracting with an individual who has tax liens, substantial, X number of tax liens, who may, in fact, have tax convictions—what prevents them today from knowing that information when they make a determination that this is or is not a responsible contractor?

Mr. KUTZ. I don't think anything prevents them. Certainly our evidence, when we have looked at the situation, is that they are not doing it. And I think even if they were doing it, there would have to be specific guidelines out there as to what they were going to do with the information.

I mean, what would be the criteria for not giving a contract or letting someone be on the GSA schedule? That would be something we think would have to be developed if this information was considered.

Senator COLEMAN. I presume that the IRS has a central registry of all tax liens? Is that a presumption, fair presumption?

Mr. SEBASTIAN. That is correct.

Senator COLEMAN. Is that registry available to other government agencies to cross reference, see whether potential contractors are on that list?

Mr. SEBASTIAN. No, I do not believe so.

Senator COLEMAN. And is that a statutory problem? Is that a 6103 problem, or is it a procedural problem?

And I will pursue this line of inquiry with the Commissioner. But Mr. Sebastian, from your perspective, that list is out there. It has a full inventory of everybody who has a tax lien. I presume the IRS, if they do a contract, they probably run through that list. But my understanding is GSA doesn't have access to that?

Mr. SEBASTIAN. I am not certain what the prohibition would be because you are correct. This is information that is available in the public domain. If GSA or any contracting officer were to do a search of public records, they would be able to identify tax liens associated with the prospective contractor.

Senator COLEMAN. Mr. Kutz, you talked about, post-Katrina, a zero tolerance for folks who are ripping off the system. But then we looked at instances here where folks aren't remitting payroll taxes, and you talked about 100 percent tolerance.

I want to step back a little. In the past, our last hearing, we identified 97 cases of egregious tax abuse. The sense I got from either you or Mr. Ryan that these were potentially criminal cases. To date, has there been one prosecution out of those 97?

Mr. KUTZ. That is what IRS has represented to us.

Senator COLEMAN. Can you give me your assessment of the aggressiveness in IRS dealing with the criminal aspect of these violations?

Mr. KUTZ. Yes, and let me just give you that I think when you looked at the Katrina Hurricane, John Ryan and I have seen that they are prosecuting $2,000 check fraud cases. And here we see individuals with a million dollars of payroll tax money with no action.

So I think what we are talking about here is on the criminal side. When we first looked at the 120 cases, we saw no criminal pursuit of any of the 120. Now that we have referred them to the IRS, we do believe that there is action going on.

I would say, though, on the civil side, on the collection side, there is a lot of activity. For example, with respect to the 25 cases today, I believe at least 10 of them had trust fund penalty assessments against the owners and/or officers.

And so, I think from a collection standpoint, we have seen some fairly aggressive action. On the criminal side, we haven't seen that, and we are certainly looking to hear possibly what the commissioner would say about a strategy going forward as to how IRS would intend to pursue payroll tax cases here.

Senator COLEMAN. And Mr. Ryan, have you been working with the IRS? Do they typically work, by the way, with the GAO where you have identified these cases, provide the information? Do you have regular contact with the criminal side with the IRS?

Mr. RYAN. That is not the way it works, Senator. What has happened in the past is, is that we have identified the cases. We have referred them to the IRS. And quite honestly, right prior to your hearings, we usually get a call to find out what is going on.

I have been in contact with the IRS criminal investigative group as of last week. They have provided a briefing as to the criminal investigations. To be honest, I had no expectations that the criminal investigative group would get back to us. They obviously have their job that they need to do.

They need to work with the U.S. attorneys office. They need to decide what the strategy is going forward. Are they going to do parallel civil/criminal? That is up to the agency to decide the direction.

But we give them the referral. My expectation is that they won't get back to me, and they usually call right before the hearing.

Senator COLEMAN. Do you have a sense—either you, Mr. Ryan, or Mr. Kutz—about any kind of deterrent effect of criminal prosecutions? Is that something that you think would make a difference?

Mr. KUTZ. And again, I will let Mr. Ryan add to that. I think that is one of the strategies the Katrina fraud task force had, and we talked about that at the full Committee hearing. That is why they are going after the zero tolerance policy now so that, for future disasters, people may think twice about trying to steal disaster money.

Certainly the case you talked about is a several million dollar payroll tax case. I would think that if a handful of those are successfully prosecuted that that would send a message that you are going to have more than collection actions taken in some cases if you have payroll tax problems.

Mr. RYAN. I believe if the IRS works very closely with Department of Justice, and Department of Justice could get a message out to the U.S. attorneys offices about the importance of paying the payroll taxes, and there is emphasis by the U.S. attorneys in those particular districts to pursue those type of cases, I think it awakens everyone's idea that there is a problem and that they need to go after it, and they are going to go after it. As you know, they can pursue it both civilly and criminally.

Senator COLEMAN. Just a process question. The 25 cases that you have looked at here, there are no names attached to those. And that goes back to the appropriate privacy considerations that we have when dealing with tax issues.

What access do you have to the names? How does it work when you are trying to dig into this, how are you able to identify these tax deadbeats? What kind of authority do you have to do that?

Mr. KUTZ. Well, we work with your staff, with the Joint Committee on Taxation. We need to clear getting access to the taxpayer information with the Joint Committee on Taxation.

Once we have that clearance, we have access to IRS what is called the unpaid tax assessment file. That is what we use data

mining to match that against the disbursement activity and other activity to identify our cases.

And hopefully, the 122 that we have pursued so far would be, as you mentioned, some of the worst of the worst because we used certain criteria in getting to those 122, such as the most number of payroll tax periods outstanding, the most dollars outstanding, and other things.

We can only get to the criminal type activity in our investigations once we actually pick the contractors, and we can do criminal background checks. And then we do our lifestyle checks on them. And so, we don't really have a systematic way of looking for the most interesting lifestyles. But as you can tell, we have found some fairly interesting ones so far.

Senator COLEMAN. Hopefully, as a result of this, those lifestyles will be somewhat more restrained as their tax obligations are being met.

Gentlemen, I want to thank you for your attendance today, and I will now call the second panel.

Senator CARPER. Mr. Chairman, I have another hearing going on at this same time. I am trying to do justice to both.

Again, we appreciate what you have shared with us today. Let me just ask you a couple of questions, and I don't think I am going to be going over ground that the Chairman has already covered. But if I have, just bear with me, please.

When I heard you giving your testimony, I thought I heard one of you saying there is no law—Federal law at least—that requires that taxes owed be considered when contracts were awarded. Is that what you said?

Mr. SEBASTIAN. That is correct.

Senator CARPER. Are you aware of states that might be doing things a little smarter?

Mr. SEBASTIAN. I personally have not looked at what the State processes are with respect to contracting. So I am really not sure.

Mr. KUTZ. Senator, I would say that 24 of the 25 case studies today had State and local tax liens also. So these are not only Federal unpaid tax cases. They are also State cases.

Senator CARPER. Let me just follow up on that. Our Chairman was a mayor. I was a governor. And we still think a little bit as I call them recovering governors, recovering mayors. What are the implications, if any, for State revenues or for municipal revenues? Is it reasonable to assume that not only is the Federal Government, the Federal taxpayer being bilked, but the same is true of the State and local levels?

Mr. SEBASTIAN. The presence of State tax liens would indicate that would be the case. Yes.

Senator CARPER. OK. I am going to ask you, basically, what do we need to do?

And when I say "we," it is not just this Subcommittee. It is not just the Senate. It is not just the Congress—the House and the Senate. It is not just the Administration. It is not just the agencies. But when I say "we," I am looking at more of a collective response. But let us start with us here in the Senate. What do we need to do?

Mr. SEBASTIAN. I think one of the ideas that was presented a few minutes ago was a consent-type process, where a prospective contractor would agree or consent to a tax check as part of registering to do business with the Federal Government. That would then allow the IRS to share the tax status of the prospective contractor with the contracting officer because he essentially would get the consent from the prospective contractor.

Now coupled with that, there would need to be some stringent guidelines that would be worked out as to what would constitute a serious noncompliance with the tax laws such that the contracting officer could make a determination that the prospective contractor was not a responsible source.

Senator CARPER. All right. Mr. Chairman, I was just sitting here thinking somebody solved this problem. And it may be in Minnesota. It may be a State. Maybe your State. It might be a city or county in Minnesota. Maybe another State. I bet somebody solved this problem.

And they probably figured out how to solve it in a way that is not hopelessly complex, maybe in a way that harnesses technology.

Mr. KUTZ. Senator, one thing that some States do that we are aware of is they actually publish the names of individuals and companies that don't pay their taxes. And again, that may or may not have had a lot of effect.

And I think that what they would do is send notices to them, saying that if you don't pay your taxes within a certain period of time, we are going to put your name on the Internet and publish it. And I think some of the States have had some experience of revenue coming in as a result of that.

Senator CARPER. OK. Do we need to pass a law to provide for the kind of consent that you just mentioned?

Mr. SEBASTIAN. Ultimately, you might need to consider legislation. It is one thing to publish guidelines and regulations. It is another thing to enforce them. And so, I think down the road, you may need to consider legislation to that effect.

Senator CARPER. Mr. Chairman, I don't know if you have given that any consideration. Have you talked about that in your Subcommittee?

Senator COLEMAN. No. But today, I mean the whole purpose, there are two things that will come out of today. One is asking the right questions. Two is being able to verify, and part of verification is going to be process by which we get consent.

So, certainly, that is what is on the table here, and I would like to hear the next panel to see whether there are some problems with that or why it can or can't be done.

Senator CARPER. Thank you.

Just sort of thinking outside of the box, how might we better use technology in order to come up with a system whereby we collect more of the revenues that are owed, but we don't end up with a system that is just hopelessly complex to administer and to operate?

Mr. KUTZ. Well, one of the things, as we mentioned earlier and you may have been out, what is called the Central Contract Registry, which is where all contractors are supposed to register that do business with the government. Right now, our understanding is

that is somewhat of a stovepipe system. It is not integrated with all of the systems at all of the agencies.

Ultimately, it would seem the integration of that system with agency contract payment systems, possibly with the offset and levy program would facilitate more timely identification and levy of information.

Certainly with respect to tax system modernization, any systems changes that could more timely identify payroll tax problems to get it in the hands of revenue officers before—in some of these cases, we see 10 or 15 years of payroll tax noncompliance. And it would seem that trying to get to those, if someone misses a payroll tax deposit, that is a huge red flag that they are either having cash flow problems or they are stealing the money.

So it would seem something to get on the front end of that process is an important technological thing that would be useful.

Senator CARPER. All right. Mr. Ryan, go ahead. I know you are dying to say something.

Mr. RYAN. Actually, I believe Senator Coleman. Asking the right question, we have policies in the banking industry, "Know your customer." Maybe we should have, "Know your contractor."

Maybe ask the right questions in regards to the TIN that you are using to do business, the TIN that you are using to pay your taxes, the TIN that you have ever done business with. The more information that we have, the more intelligence that we can gather, the better decisions that we can make.

If you allow these contractors to continue on not paying their taxes, then the pressure is put on law enforcement at the end to do something from a criminal standpoint. The more you can do up front to cut this off, I think the better chance we have of recovering the funds, instead of trying to look at it from a criminal angle.

And I just am a big believer in having the controls up front and utilizing law enforcement for a lot of things, but not collecting taxes at this point in regards to working out between collections and the criminal side.

Senator CARPER. Mr. Chairman, I think there is a lot of wisdom in what Mr. Ryan just said.

I have maybe one more question I would like to ask. And as more and more agency purchases, at least some of the smaller ones, are being made with purchase cards—and I think these cards work a whole lot like credit cards that we are all familiar with—I understand that it is difficult sometimes to collect back taxes from payments made using purchase cards.

And I just want to know what are our options in this area, and what has the task force been working on in this regard, if at all?

Mr. RYAN. I don't know what the task force was working on, but working with credit cards pretty much my whole career, you are absolutely correct. One of the areas before you are awarding the contract is getting back to asking those questions. If you are going to disburse funds for someone, I guess you should really know who they are. You should know whether or not they have the tax problems before you get into the contracting area.

The purchase card is not only a contract payment method, it is also an acquisition. So in some of the small purchases, you are going to have a problem with going to your commercial vendors.

But when the purchase card is used to pay on contracts, I think the contracting officer should be involved before the contract is awarded and knowing exactly what the tax problem is with that payer.

Mr. KUTZ. I think the actual mechanics of levying a purchase card payment are very difficult. I think that the better solution is to identify the contractors up front and not let the officers use credit cards to make the payments. Because if they can't levy the credit card payment, you could at least levy a normal payment.

So it would be possibly making sure that the people who are procuring the services don't let the contractors use the purchase cards, require them to go through another payment process that you can levy.

Senator CARPER. Do you agree with that, Mr. Sebastian?

Mr. SEBASTIAN. Yes.

Senator CARPER. OK. I also noted during your testimony, gentlemen, that you said that most of the companies that you have looked at in the work of the task force were small to mid-sized companies, closely held. Do I assume from that that none of them are publicly traded companies?

Mr. KUTZ. I don't believe any of the 120 were publicly traded companies.

Mr. SEBASTIAN. I don't believe so.

Senator CARPER. All right. Good enough. We are grateful to you for your presence and testimony today, for your response to our questions, and for the good work that you are doing.

Senator COLEMAN. I am going to do just a little follow-up. Mr. Sebastian, on a couple of occasions, you talked about needing strict standards for evaluating the impact of these liens. In fact, it was you, Mr. Kutz, who mentioned that on the House side, there had been an effort to actually prohibit folks who have liens from doing contracts.

And my sense of the rationale for not doing that was that we don't want to prohibit everyone who has a tax lien from being a Federal contractor. If they are making their payments, if they had some problem that could be explained, that perhaps they could still do this work.

On the other hand, you get these pattern defenders, you get the serial offenders, you get folks that go way beyond just the tax lien. We want to somehow draw that line. What is a responsible contractor?

Is there a way that we could set up a system—and maybe it goes to the consent, getting it early on—where they are not precluded if they have a lien from having a contract. But if there is a payment, right away, we know that if payroll taxes that first period or second period aren't remitted that we could somehow step in? There could be an early warning system that would allow us to stop these folks from being in a position where, in the end, they owe millions of dollars, which is what we have today.

Can you kind of walk me through that? Would there be a way, and that goes to Senator Carper's question, a simple way using technology whereby folks who have a lien, have had a history here. But if they are still allowed to contract, that if—it is kind of like a parolee—you have got an X violation, you have got a problem.

Can technology allow us to set up that early warning system? Are you aware of any systems where this is done?

Mr. SEBASTIAN. Well, I will approach it from a couple of views. One would be the early warning that payroll tax deposits are missed.

Back when Mr. Kutz and I did an initial study looking at payroll taxes and the enforcement over this area, the IRS did have what was called an FTD alert program, which conceptually would have alerted the IRS to any missed tax deposits and would have been an early warning, as Mr. Kutz had indicated, that there may be indications the company is in trouble or that someone is stealing.

What we found, though, was that there were some significant deficiencies with regard to how that alert process was being run so that information was not getting into the hands of the field officers until quarters, even years after the initial tax deposits had been skipped.

And not having looked at that program in a number of years, I am not sure whether they have made improvements, etc. But that would be one avenue of identifying whether you have got an early warning of missed deposits.

For those contractors or individuals that want to do business that already have outstanding tax debt, I think the task force has already implemented a process with the Department of Defense and was considering doing so with civilian agencies, where the IRS would actually have information available at the time of contract award.

That would essentially enable them to begin levying payments immediately upon the point in time that the contractor would receive the first payment. One of the issues that we raised in the previous studies looking at the Federal Payment Levy Program is the period of time it takes to actually provide appropriate statutory notice to the contractor that you are going to levy the payments.

There is an appeals process, which can take months. In the mean time, payments are being missed. They are being made to the individual and are not being levied.

So I think the actions that the task force has taken with respect to DOD, and I believe, again, they are expanding that to civilian agencies, to actually get information at the time of contract award would allow IRS to send the collection due process notices out to the contractor at that point in time, and they can begin levying the payments immediately. That will at least allow the government to collect some of those revenues.

Also, I think to the extent that a taxpayer has entered into and is complying with the terms of an installment agreement that, in and of itself, would indicate that they are working to get themselves back into compliance and would be a factor that should be considered in determining whether you are dealing with a responsible source.

Senator COLEMAN. But in fact, the new contract would also be subject to the installment process because that is what we are missing now?

Mr. SEBASTIAN. Yes.

Senator COLEMAN. We have a tax lien. We don't know about it. We haven't asked you the question. We haven't identified it and

whether you are or not paying it. If you are not paying it back, that would go to the question of whether it is a responsible party. If you are paying it back, certainly the new contract would also be subject to the levy program.

Mr. SEBASTIAN. And that is why you would really have to consider going to a consent-type process, where the prospective contractor recognizes up front that to do business with the Federal Government, they will need to consent to a tax check. And that may essentially bring them to the table and negotiate for a payment process with the IRS.

Senator COLEMAN. Thank you. Senator Carper, anything further at this point?

Senator CARPER. Actually, I do have one thing. Sitting here listening to this conversation, it reminds me, as I was saying earlier, that some State, some county, some city probably already figured out how to solve this problem.

As it turns out, I met with the management of a large credit card company last week, and they shared with me one of the things that they do to reduce the amount of bad debt, bad credit card debt that is out there. And what they have developed over time is software that enables them to intercede with their credit card holders.

If they have a credit card holder, for example, who has traditionally been making all their payments, paying off everything, and then they stop doing that. And maybe they are paying part of it, and then less and less, and eventually getting to the point where they are not even making the minimum payment. The credit card company intercedes before they get to the point where the payment isn't being made.

Or the other things that trigger the intervention are if maybe this credit card was the only one that the consumer had, but then they got some other credit cards. And maybe they started using the credit cards of a subprime operations, subprime lenders.

The credit card company—the initial one we are talking about here, the one I met with—they intercede early on, just to see. It is really an early warning system, and it has worked very well for them. And I am sure a variation of this could be developed to work for us.

And if it works for them—I said somebody has already invented this wheel, and I think maybe I met with some of the inventors last week.

Senator COLEMAN. What I find fascinating is this Subcommittee last week, we were looking at I think our 22nd Katrina hearing. We had folks from the inspector general's office talking about things being lost in the pipeline. That was one of the problems. And my reaction was talk to FedEx. They will tell you where it is in the pipeline.

Talk to any small business. If you order something, they can tell you exactly where. At AutoZone, here is where the carburetor is at this point in time. And they can tell you the city that it is in, how long it is going to take.

The Federal Government has great resources. We should be able to use that technology, and this is another area. Talk to one of those credit card companies and see what we can do to establish an early warning system that would then not have us in a situa-

tion where we are looking at $2 million worth of unpaid taxes and another million dollars in continuing to contract with these folks.

Gentlemen, thank you. I appreciate your testimony.

We will now call the second and final panel of witnesses for this morning's hearings.

We have with us the Hon. Mark Everson, Commissioner of the Internal Revenue Service, and Kathleen M. Turco, the Acting Deputy Administrator of the General Services Administration.

Mr. Everson, it is good to see you again. This is the third time we have gotten together to discuss Federal contractors not paying their taxes.

As I stated in my opening statement, for preliminary comments in my opening statement, I believe we made a lot of progress, Commissioner, since we first began discussing this issue and having you before this Committee. I think it was in February 2004.

I look forward to hearing what progress has been made since your last appearance in June 2005, and I am encouraged by the tremendous increase in tax collections from Federal contractors over the past 2 years. I believe that in regard to the Defense Department, if I recall the figures, I think we were collecting about $680,000 when we had our first hearing, and it is somewhere close to $20 million right now. I think that is about a 3,000 percent increase in collections.

Mr. EVERSON. On a small base.

Senator COLEMAN. Yes. But it shows progress, and I appreciate that.

Senator CARPER. Mr. Chairman. I want to apologize to this panel. I am going to have to leave during your testimony. I very much appreciate your being here. And got a chance to work with Commissioner Everson a little bit before and mindful of the work that he is trying to do, and we look forward to partnering with both of you. Thank you.

Senator COLEMAN. Thanks, Senator Carper.

Commissioner, I still continue to be concerned about the criminal side, and we will talk about that a little bit.

Ms. Turco, I welcome you to this hearing. I am disappointed that Mr. Bibb, the Acting Administrator, could not be here, but I appreciate your filling in for him. I would like your assurance that you are speaking on behalf of the Acting Administrator and that you will bring these matters that we discuss at this hearing directly to his attention.

I look forward to discussing whether the Federal Government should be doing business with contractors who continue to abuse the tax system. I also want to know what can be done to identify tax delinquent Federal contractors on a regular basis and how you propose to deal with them.

I understand that GSA has become a contributor member of the Federal Contractor Tax Compliance Task Force. And I know you recognize the importance of this work, and I appreciate your continuing support for this effort.

Again, before we begin, pursuant to Rule 6, all witnesses who testify before this Subcommittee are required to be sworn. At this time, I would ask you to rise. Please raise your right hand.

Do you swear the testimony you are about to give before the Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

The WITNESSES. I do.

Senator COLEMAN. Thank you.

Commissioner Everson, we will have you go first, followed by Ms. Turco. You know the timing system. Your entire written statement will be entered into the record. You may proceed.

TESTIMONY OF THE HON. MARK EVERSON,[1] COMMISSIONER, INTERNAL REVENUE SERVICE, U.S. DEPARTMENT OF THE TREASURY

Mr. EVERSON. Thank you, Mr. Chairman and Senator Carper.

I want to start out introducing my mother. I have testified some 30 times before Congress since I have had this job. She has not been here before. And I want to assure you that, to the best of my knowledge, she is not a delinquent Federal contractor. [Laughter.]

If she has been doing it, it has been really quite cleverly disguised.

Senator COLEMAN. Does this mean, Commissioner, that I have to really be nice to her son today because your mom is here?

Mr. EVERSON. You do. You use everything you can when you are on this side of the table. Absolutely. [Laughter.]

Senator CARPER. Mr. Commissioner, my parents used to say the apple, in this case me, didn't fall too far from the tree. And I am really watching your mom's lips very carefully to see if they move when you speak. [Laughter.]

Welcome, Mr. Everson.

Mr. EVERSON. OK. Well, thank you.

Before turning to today's subject, let me first say that I appreciate your strong support for strengthening the integrity of the tax system through enhanced enforcement. This Subcommittee has shown impressive leadership in combating abusive tax shelters and those who play fast and loose with the tax code, as has the counterpart Subcommittee where I was here just last week, as Senator Carper knows, on looking at EITC and erroneous payments.

This includes the Subcommittee's efforts on the KPMG investigation. I just want to once again—as I did at the press conference last August 29 with the attorney general—commend you, Mr. Chairman, Senator Levin, and the staff of the Subcommittee for just the outstanding work that was done contributing to that investigation, which really was a landmark event in terms of making sure that practitioners and others adhere to professional standards and follow the law.

I also want to thank the Committee for the support it has provided to the Administration's budget request for IRS enforcement activities. That is very important. It is a continuing subject and one that the more you weigh in, the better off we are.

Turning to compliance by Federal contractors, Americans certainly have every right to expect that anybody doing business with the Federal Government pays their taxes. Contractors receiving

[1] The prepared statement of Mr. Everson appears in the Appendix on page 70.

Federal tax dollars shouldn't cheat the very same taxpayers by passing on their tax bills to them.

We take seriously the issue of Federal contractors being delinquent on their Federal tax obligations. As you know, for the past 2 years, we have worked closely with other Federal agencies through the Federal Contractor Tax Compliance Task Force, and we were making progress.

We have taken steps, as you indicated, to enhance the automated Federal Payment Levy Program. We removed some of the operational exclusions, as you mentioned, that have prevented tax debts from being available for levy to match payments to levies.

A valid TIN and name are now required, and we have implemented the 100 percent continuous levy authority on defense contractors. We did that last April. And beginning last November, we began matching individual income tax debts and payroll trust fund penalties against contractor payments.

As you have indicated, 122 delinquent contractor cases were referred to us by the GAO. We put these cases ahead of others in the queue to provide appropriate focus. Looking at the 122 cases as a whole, 74 are now closed.

Of this number, 12 paid their obligation in full for slightly over $6 million; 48 are in bankruptcy, out of business, or not collectible because of hardship or liquidation; another 14 cases have installment agreements in place; 9 cases have been referred for criminal investigation. As you indicated, one recently resulted in actual conviction, a 47-count conviction. And two other cases are being referred to DOJ.

That leaves almost 40 additional open cases. These cases that represent over $25 million owed by taxpayers are in the collection process. We are moving forward on a number of initiatives to combat delinquent Federal contractors beyond these cases, of course.

We will continue to review potential changes in the exclusion policy criteria. Can we get that pool of potential taxes larger, as we have already done? This will make additional debts available for levy. And in July, we are going to take some steps that I gather will speed up the notice process, which will help us.

I know that some Members of the Subcommittee, as you indicated, Mr. Chairman, would like for us to look at the front end of the process for ways to prevent delinquent contractors from ever receiving Federal contracts. Currently, a prospective contractor, as you have indicated, only has to answer one question. Some have suggested the list of questions be broadened. They urge that IRS get involved in verifying the answers, possibly on an annual basis.

While I can certainly understand the motivation to do this, I am concerned that it could drive the IRS into the realm of procurement policy.

Senator, it is similar to the conversation we had last week. A lot of tax administration is done on the back end. That is the way our system works. The degree to which you bring us forward, you run the risk in this day of great concerns on privacy of having the image of an ever-intrusive IRS.

So there are some of the same considerations we got to with EITC or that we get to right now in the very important debate about proper immigration policy, where some are suggesting that

our tax records be shared in order to have workplace enforcement of the immigration laws.

We believe Congress can do several things to help us collect delinquent taxes from Federal contractors. We have proposed a change in the tax code to allow the IRS to implement the 100 percent levy on all vendor payments, not just for goods and services.

Second proposal—we have actually made five proposals in the budget that strengthen information reporting and other areas, that go parallel to the request for additional monies. The second proposal would actually allow us to improse a levy for employment tax liabilities prior to a collection due process hearing.

This is important. It gets at the issue you were just talking about. Right now, any time a payment is missed, it goes down a corridor where there are all sorts of procedural steps that need to be taken before we can do the levy. This proposal would treat the levy as comparable to our right.

Right now, talking about States, if a State is going to issue a refund or we are going to issue a refund, there is a reciprocity as the ability to levy that refund by either one of the governmental levels. Then you can go back and challenge it with all appropriate due process, but we can get the money first and then go through the process.

We would like to do the same thing on employment taxes because these pyramid. If somebody gets in trouble, they can use the government as a bank. They have no intention to necessarily break the law. They want to pay it back, but this 15 percent can be an important point. We would like to get after this with that change.

The other proposal we would make would increase information reporting for certain government payments for property and services. We think this would be helpful in this contractor issue as well.

Let me just close by repeating the point you have heard me make in the past. We want to vigorously attack noncompliance by contractors, but I would emphasize that consideration for taxpayer rights must be balanced with our desire that Federal contractors pay their taxes. Thank you.

Senator COLEMAN. Thank you, Commissioner. Ms. Turco.

TESTIMONY OF KATHLEEN M. TURCO,[1] ACTING DEPUTY ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION

Ms. TURCO. Thank you.

Mr. Chairman, let me begin by saying that the General Services Administration takes very seriously the issue of contractors not paying their Federal taxes. We want to be in the vanguard of those agencies working to make certain that the American people are paid in full by all those who enjoy the privilege of doing business with the Federal Government.

I will address the highlights of what I reported in my testimony. Let me begin with the pre-award phase of the contract award process. Prior to the award of a contract, GSA determines whether prospective contractors are responsible in accordance with the Federal Acquisition Regulation.

[1] The prepared statement of Ms. Turco appears in the Appendix on page 88.

The process GSA follows is specifically governed by the FAR, which requires that in order to be deemed responsible, a prospective contractor must have adequate financial resources, be able to comply with the delivery or performance schedule, have a satisfactory performance record, possess a satisfactory record on integrity and business ethics, possess the necessary organization, experience, and technical skills, have accounting and operations oversight, and have the production, construction, and technical equipment and facilities to perform the work required.

A pre-award survey can be conducted if the contracting officer has reason to believe that one or more of the aforementioned factors are in doubt. An overall responsibility determination is also dependent on the contractor representations and certification statements. Contractors must provide and enter these into the FAR by using the Online Representations and Certification Application System.

Furthermore, all agencies have access to the ORCA application system and can ascertain information on the contractor's status. In turn, contracting officers must use the ORCA to obtain information on competing vendors prior to awarding a contract.

This information includes a certification addressing whether or not the offeror or any principals within a 3-year period preceding this offer have been convicted of or had a civil judgment rendered against them for a number of offenses, including tax evasion. As has been discussed earlier, this may be too narrow a definition, Mr. Chairman, and we need to look at that.

We have also integrated the ORCA system and the Central Contractor Registration, known as the CCR. The CCR data collected includes addresses, types of business line, socio-economic data, taxpayer identification numbers, points of contact, and electronic funds transfer information for payments. With the inclusion of the CCR data, we have expanded the government-wide use of the CCR and the TINs as part of our due diligence.

In the fall of 2005, the CCR program began validating the TIN data. In order to complete CCR registration and qualify to bid for Federal Government contracts, the TIN and the taxpayer name combination must match exactly to the TIN and taxpayer name used in Federal tax reporting. Nonmatching vendors are notified to contact the IRS. The vendor is deemed nonactive, i.e., they don't match. They cannot bid on any contracts.

Another area that we have been addressing today is the use of the purchase card payments as part of GSA's SmartPay Program and whether the card payments are subjected to levies pursuant to the Federal Payment Levy Program. We continue to examine a number of approaches to provide charge card information that may be of assistance in the levy issue.

One approach involves development of more robust data sharing practices, possibly including a data warehouse within the GSA's SmartPay Program. If developed, this approach could provide more granular commercial merchant identification data for use in the Federal levy process. We clearly have more work to do in this area, and we look forward to working with the task force in addressing how we can go about a data warehouse or other means in terms of improving or using the purchase card payments for offset.

I hope my testimony has provided an adequate snapshot of what we are working on at GSA, and I am happy to answer any questions you might have.

Senator COLEMAN. Thank you, Ms. Turco.

Just the last point first, the Federal purchase card payments. At this point, it is my understanding that they are not subject to the Federal Payment Levy Program?

Ms. TURCO. That is correct.

Senator COLEMAN. And so, what we are talking about is similar to Senator Carper's question, to make sure that those payments are subject to the levy program, just coming up with the right system?

Ms. TURCO. Yes, sir.

Senator COLEMAN. We appreciate and do look forward to your work in this area.

In your testimony, I think you used the phrase, you were talking about things that can be looked at in determining whether somebody is a responsible contractor. And you talked about—I think you used the phrase—"convicted of a number of offenses, including tax evasion."

When you say "number of offenses," beyond tax evasion, are there other tax-related convictions or indictments that are questioned or that are referred to when dealing with potential contractors?

Ms. TURCO. No. I think we only ask for tax evasion.

Senator COLEMAN. Do you have any reaction? To me, it is kind of obvious that there are a whole range of other failures to submit payroll taxes just being one of a number of offenses. Has there been discussion before this hearing as to broadening the scope of those questions?

Ms. TURCO. Well, Mr. Chairman, I think that was what the GAO folks were talking about in terms of expanding beyond tax evasion. I would say that this is part of the Federal Acquisition Regulation, and it could be that in terms of how we go about the process of submitting changes to the FAR that we may not have had full knowledge that, in fact, tax evasion is a very narrow question.

And so, I think what we would like to do is to go back and work with the Chief Acquisition Officer at GSA as well as with the IRS as to whether or not we could expand the questions.

Senator COLEMAN. Commissioner Everson.

Mr. EVERSON. I just want to make a commercial for one thing that we are interested in. You may not be aware of this, Senator, but failure to file your income tax return is not a felony.

So the basic issue of nonfiling, which represents about 10 percent of the tax gap, you wouldn't even get at it. I suspect you wouldn't be asking people to necessarily report on misdemeanors. I mean, how deep are you going to go with all of this? But we have said we think that ought to be a felony, and it is not.

Senator COLEMAN. Some of these to me, Commissioner, seem like low-hanging fruit. I mean, it is pretty obvious that if you are asking people to make a determination as to business integrity and ethics, if you have a history, or in this case, you could have convictions—convictions, regardless of what the level of not submitting payroll tax—the Easterday case is a good example.

You have got convicted, the charge was $3 million. I thought that the investigation showed about $18 million, somewhere between $15 million and $18 million, if not more, of Federal taxes not being remitted. That is pretty substantial. And not to be asking that question, to me, seems so narrow and blind that I would hope we would go back and then take a look at kind of the broad range of what things to ask about.

And again, that is without making the judgment that these are automatically debars. I am not sure I want to look at that. It may be the size of the offense. It may be the repetitiveness of the offense. There are some folks who have a problem, and they then make all efforts to correct it. They sign up. They do payments, installment payments as part of the levy program. They meet their obligations. That is not the problem for me.

If you are being directed to make a judgment about business integrity and ethics, you have got to be able to ask the questions that can help you make that evaluation. I would hope we would go back then, and clearly, this is something that absolutely needs to be done.

A question about taxpayer identification—TINS, taxpayer identification numbers. When a contractor comes forward, they have a taxpayer identification number. Do the contractors have one taxpayer identification number, or do they change, do they have different numbers for different transactions?

Mr. EVERSON. Well, it depends on how many different business entities they have established and what legal forms they have. But your taxpayer identification number doesn't change for that entity.

Senator COLEMAN. But if you have somebody who wants to game the system, and is it possible then to simply change the name of the business and have a different number? Is that possible?

Mr. EVERSON. Well, you go through a proceeding. I think that if it was done for fraudulent purposes, which I would think would be pretty unusual, I suppose you could run into problems there. But again, if you look at particularly you go to larger businesses, it depends on what is in the tax return or what is not or what are the related party deals. It can be very different forms.

Senator COLEMAN. How do we know if people have different taxpayer identification numbers? And here is what I am looking at. I am looking at cases that if we go back through these investigations, we clearly had some contractors who were gaming the system.

Mr. EVERSON. Sure.

Senator COLEMAN. And part of the gaming of the system is that they would create new companies. They would have obligations, and they would just create a new company and get a new contract. So I am dealing front end now, not back end.

Mr. EVERSON. Yes.

Senator COLEMAN. How do we know——

Mr. EVERSON. I don't think that that would be——

Senator COLEMAN. How do we know whether folks have different taxpayer identification numbers?

Mr. EVERSON. With a new business, I think you would have to ask questions. Again, this is a procurement question. It is not a tax question.

The tax law here would follow the legal entity, who is the taxpayer, if you will? But if you are asking previous things that someone or officers or owners have done in their career, that is a different question. It is not a tax question, from my point of view.

Senator COLEMAN. The challenge is to figure out how to get those who are gaming the system, how to hold them accountable up front. It is less of a problem if you stop them on the front end than you have got to deal with the back end, at the same time without making the system so burdensome that people can't work their way through it, and then we talk about government bureaucracy.

But somewhere I still think we have to look at the front end, ask the broader questions. At least have the information so that then you can render a judgment.

And Commissioner, in regard to the way you operate, IRS, and what I am thinking here is that you may have a situation where some of the statutory prohibitions that others have, I am not sure whether they impact you. But if you do a contract, do you go back and check whether there are liens? Do you have the ability to just kind of go back and check, see whether there are tax liens?

Mr. EVERSON. We do. I have the same ability that anybody else has. But 6103 information, as you say, is protected. So what you have to do is be extremely careful, Senator, on the use of that information.

You have talked about liens. If something is public, an organization can go back and check the public record. They wouldn't do it via us, if you will. That is the trick here or where you run into trouble because the legal interpretations on this have always been very conservative. So we do not, even if something has become public, open up that public record of the lien, if you will.

And the difficult thing here for a procurement organization, which is even for us separate from the rest of our operation, is you would have to go and you would have to check at something like 4,200 different counties and see whether the lien was placed somewhere.

Senator COLEMAN. Well, I am trying to get a practical way to get access to public information.

The IRS, do you probe contractors, or do you have the ability to look in greater depth at potential contractors than any other government agency?

Mr. EVERSON. No, I wouldn't say that we would interpret our authorities that way, and I don't think we do.

Senator COLEMAN. Do you have access in terms of information? My concern with tax liens are public information?

Mr. EVERSON. Yes.

Senator COLEMAN. But the question is, where do you have to look for that public information?

Mr. EVERSON. Right.

Senator COLEMAN. Is there a single source? Is there a single file? Do you have a single file of all taxpayers who have tax liens?

Mr. EVERSON. Well, we have our systems where we have in all of our collection systems. And liens and levies, just to give you an idea of the volumes here, levies fell after the reforms of 1998. They went all the way down to something like 217,000.

Last year, they were back over 2,700,000, I believe. Yes, that is the case. Same thing with liens. Liens declined to 170,000 in 1999. They are back up over 500,000.

We have those, but again, that is protected information because those are centralized databases protected, as you say, under statute. Nobody else has any one-stop shopping to go find that. They have got to go and look elsewhere.

Senator COLEMAN. Do you have an automated lien system database?

Mr. EVERSON. We have a database that covers all the collections and which would enable you to go by taxpayer and see whether there is a lien on them.

Senator COLEMAN. So when you have a potential contractor, you check the potential contractor and their taxpayer identification number?

Mr. EVERSON. No, I am not saying we do that. That is not for tax enforcement purposes. That is a distinction. I would not do something at the IRS, use information that we have for personnel purposes, for hiring purposes, anything that would violate the principles of 6103 until you give me permission as the Congress to do that.

Senator COLEMAN. Again, I am just dealing with public information, lien information.

Mr. EVERSON. I will check and verify this. But I don't believe we go to the step of checking with each of those 4,200 municipalities or the States or where there is a lien.

Senator COLEMAN. This is more from a policy perspective now, not a process perspective. If liens are public information, would it be in the best interest of government to have a single database with liens that the GSA could then check to verify whether, in fact, there are liens?

There are other steps you would have to go to in terms of the impact of those liens and what impact they would have on a potential contract. But just in terms of not having to go to X number of counties, courthouses——

Mr. EVERSON. Sure. That is a——

Senator COLEMAN. Is there anything from a policy perspective? Put your policy hat on. Understanding great reverence for privacy, for protecting identities. But we have public information.

Mr. EVERSON. Yes.

Senator COLEMAN. Taxpayer liens. Why shouldn't there be a single database that the GSA or others can go to to determine whether a contractor does, in fact, have liens against them?

Mr. EVERSON. I don't have a problem with that from a tax point of view. That is a procurement question. And if GSA or the White House procurement officer would ask that a database like that would be developed, fair enough. And it is no different than the same question on convictions or other areas.

Senator COLEMAN. Ms. Turco, any response to that? Would that be helpful if you had a single place that you could go to to determine whether, in fact, there were outstanding liens against a prospective contractor?

Ms. TURCO. Yes, I think it would be. I think it would enhance in terms of the review process that we undertake with the contractors.

Senator COLEMAN. Commissioner Everson, when you went through your list of those 97 cases, you indicated that some of the businesses are out of business?

Mr. EVERSON. Yes.

Senator COLEMAN. How do you verify that?

Mr. EVERSON. I believe all of these cases, as you know from my commitment to you 2 years ago, were investigated by our criminal investigators. I am sure that they have checked that pretty closely.

Senator COLEMAN. Would you go back and verify that? There seems to be some question about—again, this is the trust you have got to verify.

Mr. EVERSON. Absolutely. It sounds like you have information that I don't. So I am happy to take a look at that. And any case you have got, we will take a look at it.

Senator COLEMAN. I would just ask if you have your folks go back and verify.

Mr. EVERSON. I think you know, Senator, from the KPMG and other matters, when you give us something, we take a good look at it.

Senator COLEMAN. And we appreciate that, Commissioner.

And while touching on the verification issue, if I can go to you, Ms. Turco? One of the concerns we have in our investigation, we don't see the verification of the tax-related answers that potential Federal contractors provide on the representation and certification application. Is there a verification process?

Ms. TURCO. Chairman, no. There is not a verification process. It is a review process. The verification would be with the IRS.

Senator COLEMAN. What I would like is for you to commit to work with the IRS and other member of the contractor tax compliance group to look at this verification issue.

I just think so much of what we do is on the back end. Commissioner, so much of what you do is on the back end, and that is resource intensive. And if on the front end, we can kind of check some of this stuff out, get some of the miscreants and the deadbeats out of the system up front, it is less work for you, and it is less abuse to the system.

Mr. EVERSON. Again, though, Senator, there is a big distinction between what is public information and what is not. And we have had this discussion in the past. Where do you draw the line between what is a legitimate tax challenge that a taxpayer is making versus something that is, as you have said, abusive or repetitive? And these are hard lines to draw and subject to a lot of interpretation.

And the difficulty here and I am sure why GSA and others, it hasn't evolved more on the procurement side, they are not tax experts. So you draw, getting into this, getting into the weeds here, it is a tough thing fraught with a lot of sensitivity for Americans of all stripes.

Senator COLEMAN. But the pretty basic stuff, the most basic kind of elements of this whole thing is you have folks out there today who have liens, and they have liens because they have obligations

that have not been met. So a determination has been made that this is your responsibility to meet that obligation.

Mr. EVERSON. Yes.

Senator COLEMAN. And unfortunately, then we have contracts going out to folks who really have no consideration and no knowledge of whether these folks have had a prior history, have had obligations. And as a result, we are paying contracts that are not subject to the liens, even though these people have some responsibility. Or in the worst case, to go beyond the liens, folks who may have been convicted of serious, serious tax violations. And again, we have no knowledge.

And so, in the end, I don't know how you can make a judgment about business integrity and business ethics when we don't have the questions. We don't have the information. Even when we get the answers, we don't verify them.

Mr. EVERSON. Sure. I agree with you entirely on the information that is public.

Senator COLEMAN. Let me ask you a question. We talked about the government purchase cards.

Mr. EVERSON. Yes.

Senator COLEMAN. That was a concern of the Senator from Delaware. He has a lot of these operations in his State. So I appreciate that. [Laughter.]

Mr. EVERSON. I haven't heard from him yet on our proposal that credit card issuers report gross receipts for businesses to us. I may hear from him. He is big on the tax gap, but we will see what happens when I get there. I hope I will have his support.

Senator COLEMAN. The question I have is I understand that the Financial Management Service identified about 8,000 contractors who owed about I think it was close to $750 million in taxes. And we only levy a small percentage of that, as I understand.

Are you familiar with that? Can you help me understand the issue there of the difficulty in levying in those cases?

Mr. EVERSON. With the purchase cards, I guess you have an intermediary there, and that is the problem. But my understanding, and perhaps my colleague can help me on this, is that the task force has looked at this, and they say that we can address this problem.

I have it, and I covered it in the written testimony. I will just read that to you. The task force is currently pursuing an interim procedure to match debts in TOP with a CCR database maintained by the DOD. If a match is found, the CCR—that is the database itself—would be updated with a field that the contractor is not eligible to be paid by a purchase card program.

So they would have to go down the other corridor for payment, and I guess they would be basically locked out of the purchase card program. But the teams that have looked at this seem to feel that that is a better approach as opposed to working on the purchase card, trying to intrude into the card workings itself.

Senator COLEMAN. I appreciate the continued work in that area. It is certainly an area of concern.

And let me kind of pull all this together, if I can. Clearly, this Chairman certainly believes—I can't speak for all Members of the Subcommittee. But I would suspect that most Members of this Sub-

committee would want us to take a more complete look at the contractor, this issue of contractor responsibility under the Federal Acquisitions Regulations, the FAR, to look in determining whether compliance with tax laws has taken place.

That we go beyond limiting the questions to indictments or convictions for tax evasion. That we are able to look at noncompliance. That we look at the broader spectrum of tax violations, including some that we have talked about today.

But in addition, and I think you mentioned, Commissioner Everson, there are folks here who have State, unsatisfied State tax liens that are involved in this that, clearly, we don't look at. Unpaid outstanding tax debt, that is, that we don't look at.

And so, I would hope that we would put in place a system, and I would expect—more than hope, I would expect that we have in place a system that asks the broader questions and that provides ways to verify consistent with the deep concerns about privacy. But that we do those things particularly with the opportunities technology affords us to have in a central place information about tax liens and other things that are a matter of public record.

And that would make it easy for those who are issuing contracts to be able to look at that and then to make some judgments and determinations on a policy perspective of the impact that those liens and those other obligations would have. So there is work to be done. I am an optimist, so I am going to end on the positive note.

I really do appreciate what has been done so far. I think we have made great strides. And Commissioner, we have come a long way on this and other issues. You mentioned the KPMG and the sham tax transactions. I believe I remember not only do you have that statement there, but I think it was about $3 billion? With a "B," $3 billion in additional revenues?

Mr. EVERSON. The "Son of Boss?" Yes, the Son of Boss settlement is over $4 billion that we have at this stage. And we have others. We have just finished the application period for a global settlement initiative covering 21 transactions. A lot of good news there, too.

So we are making some progress. I just thank you for your support on the budget and on some of these legislative proposals we have. I think those are very important, too, sir.

Senator COLEMAN. Even for the Federal Government, millions and billions are real dollars.

Mr. EVERSON. We go after it all, yes, sir.

Senator COLEMAN. As I said earlier, this is the third in a series of hearings on tax delinquent Federal contractors. This Subcommittee will remain focused and vigilant on this issue.

We are going to, in the next couple of days, have to make some tough votes about budgetary matters, and there are programs that, as a former mayor, I look at—for community development block grants and community service block grants. And the ag side, Food Stamps and a whole range of things, which we are talking in the billions that have a—low billions, a billion dollars or $2 billion—that have a substantial impact on the quality of life of a lot of our citizens.

And it greatly troubles me when I see billions being unpaid, and I think we have got to keep doing what we are doing.

So I do appreciate the work that you have been doing and the work that you will continue to do, and we look forward to making further progress with the IRS and GSA, FMS, and the other relevant Federal agencies.

Thank you very much. This hearing is now adjourned.

[Whereupon, at 11:09 a.m., the Subcommittee was adjourned.]

APPENDIX

PREPARED STATEMENT OF SENATOR AKAKA

I wish to thank Chairman Coleman and Ranking Member Levin for bringing the extent of the problem of unpaid taxes by federal contractors into clear focus. I am proud to partner with you in finding viable solutions to contractor tax abuse which costs American taxpayers billions per year. The two preceding hearings held by this Subcommittee have yielded positive results—an increase in levies against tax cheaters; the creation of the Federal Contractor Tax Compliance Task Force; and stepped up investigations of non-compliant contractors.

Despite such positive steps, there remains the nagging question of why should any federal contractor receive government funds if he or she fails to do what nearly 84 percent of Americans do every year—pay taxes? Why isn't there a zero tolerance policy when it comes to federal contractors who are either abusing or ignoring the tax system?

Just last month, our full Committee heard from the head of the Department of Justice Hurricane Katrina Fraud Task Force who said a zero tolerance policy greatly aided in the prosecution of Katrina-related fraud cases. Given that many of the initial Katrina cases involved low-level dollar figures, a zero tolerance policy might work when we're dealing with billions in unpaid taxes by federal contractors.

Because of the PSI hearings—and what I believe is a real commitment from IRS Commissioner Everson—there has been a coordinated and cooperative effort to close the tax gap for federal contractors. I look forward to hearing from the Commissioner what he sees as the next steps in dealing with this pervasive problem.

I do want to raise a couple of additional concerns that tie into today's hearing. Knowing that the job of detecting—deterring—and prosecuting tax fraud rests with the IRS, I continue to oppose outsourcing the collection of unpaid taxes which I feel is as an inherently governmental job. Because contracting officers cannot access tax information, I want to know how the IRS is reviewing contractors who are competing for and being selected to receive these contracts. I am also curious whether individuals employed by contractors—those who will actually perform the work—will be held to the identical performance and ethical standards as IRS employees. We know that IRS employees may be fired for breaking any of what's called the twelve deadly sins. It's unfair for contract employees to be held any less of a standard if they are doing such important work.

I know from our hearings here and the Joint Committee on Taxation hearing I attended last May that Commissioner Everson is fully engaged in closing the gap between what is owed to the federal government and what gets paid to the federal government. But in doing so, we must make sure that IRS contractors fulfill their tax obligations.

In closing, I also want to acknowledge the outstanding work being done by Mr. Kutz and his team at GAO. Sixteen years ago, GAO began its high risk list, and for 16 years the area of uncollected taxes has been on the list. In fact, GAO expanded the list to include the backlog of uncollected debts and the IRS's ability to detect noncompliance of tax laws. I mention this, because tomorrow, my Subcommittee—Oversight of Government Management—will hold its sixth hearing in 12 months on the GAO high risk list. Senator Voinovich and I, just as Senator Coleman and Senator Levin here, are working with GAO and selected agencies to resolve long- term, systemic problems. That is why I am so pleased to be a part of this continuing effort to ensure that federal contractors are not cheating the American people of their hard-earned money.

Mr. Chairman and Senator Levin, I want to thank you for holding today's hearing and for including in GAO's ongoing review of tax delinquent contractors my special concern of whether a 1996 law that allows the federal government to withhold federal contractor payments for state debts is working. You understand that Minnesota and Michigan, like Hawaii, could use these uncollected state taxes to pay for state health and education programs. Thank you.

United States Government Accountability Office

GAO

Testimony

Before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

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FINANCIAL MANAGEMENT

Thousands of GSA Contractors Abuse the Federal Tax System

Statement of

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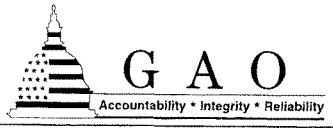

GAO-06-492T

March 14, 2006

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Highlights

Highlights of GAO-06-492T, a testimony before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

FINANCIAL MANAGEMENT

Thousands of GSA Contractors Abuse the Federal Tax System

Why GAO Did This Study

In February 2004 and again in June 2005, GAO testified that some Department of Defense (DOD) and civilian agency federal contractors abused the federal tax system with little consequence. Previous problems we identified with contractors with unpaid taxes have led to concerns over whether any interagency contractors, such as those on the General Services Administration's (GSA) federal supply schedule, failed to pay their taxes. GSA, through its federal supply schedule and other interagency contracts, arranges for federal agencies to purchase billions of dollars of goods and services directly from private vendors. GAO was asked to determine if GSA contractors, including both contractors that were paid by GSA and GSA interagency contractors, have unpaid federal taxes, and if so, to (1) determine the magnitude of tax debts owed by GSA contractors; (2) identify examples of GSA contractors that have tax debts and are also engaged in potentially abusive, fraudulent, or criminal activities; and (3) determine whether GSA screens contractors for tax debts and criminal activities prior to awarding contracts and at the exercise of any government contract options.

www.gao.gov/cgi-bin/getrpt?GAO-06-492T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory Kutz at (202) 512-7455 or Steve Sebastian at (202) 512-3406.

What GAO Found

Over 3,800 GSA contractors had tax debts totaling about $1.4 billion as of June 30, 2005. This represented approximately 10 percent of the number of GSA contractors during fiscal year 2004 and the first 9 months of fiscal year 2005.

GAO investigated 25 GSA contractors with abusive and potentially criminal activity. These businesses had not forwarded payroll taxes withheld from their employees and other taxes to IRS. Willful failure to remit payroll taxes is a felony under U.S. law. Furthermore, some company owners diverted payroll taxes for personal gain or to fund their businesses. These contractors worked for a number of federal agencies including the departments of Defense, Justice, and Homeland Security.

A number of owners or officers of the 25 GSA contractors have significant personal assets, including commercial properties, houses worth over $1 million, and luxury vehicles. In addition, several of the owners of these GSA contractors gambled hundreds of thousands of dollars at the same time they were not paying the taxes that their businesses owed.

Examples of Abusive and Potentially Criminal Activity

Type of Business	Unpaid tax debt	Payments to contractor	Contractor activity
Emergency supplies	Over $700 ,000	Up to $100,000	Company loaned hundreds of thousands of dollars to company officer at same time company was not paying its taxes.
Security services	Over $9 million	At least $1 million	Company owner made cash withdrawals to fund an unrelated business and purchase a men's gold bracelet worth over $25,000.
Security services	Nearly $2 million	At least $1 million	Company repeatedly underpaid taxes to fund business while company owner reported personal income of nearly $1 million

Source: GAO's analysis of IRS, FMS, GSA, public, and other records.

Neither federal law, as implemented by the Federal Acquisition Regulation (FAR), nor GSA policies require contracting officers to specifically consider tax debts in making contracting decisions either at initial award or when considering options to extend. In addition, federal law generally prohibits the disclosure of taxpayer data, and consequently contracting officers have no access to tax data directly from the IRS. GSA contractors that do not pay tax debts could have an unfair competitive advantage in costs because they may have lower costs than tax compliant contractors on government contracts. This is especially true in wage-based businesses that provide homogenous types of goods and services. GAO's investigation identified instances in which contractors with tax debts won awards based on price differential over tax compliant competing contractors.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss General Services Administration (GSA) contractors that have abused the federal tax system while doing business with the federal government. In hearings held by this subcommittee in February 2004 and again in June 2005,[1] we testified that some Department of Defense (DOD) and civilian agency federal contractors abused the federal tax system with little consequence. In 2005, we designated interagency contracting, in which GSA plays a prominent role, as a new high-risk area.[2] This designation is partly based on the fact that interagency contracting[3] tends to create an incentive for the agency awarding the contracts to focus more on increasing contracting volume that generate fees than on compliance with sound contracting policy and required procedures (see app. II for further details on GSA's contracting role).

This testimony continues a body of work which has identified federal contractors with unpaid taxes. Our prior work gave rise to concerns over whether GSA interagency contractors, such as those on GSA's federal supply schedule, have also failed to pay their fair share of taxes.[4] As a result, you asked us to determine if GSA contractors have unpaid federal taxes,[5] and if so, to (1) determine the magnitude of tax debts owed by GSA

[1] GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-414T (Washington, D.C.: Feb. 12, 2004), and *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-683T (Washington, D.C.: June 16, 2005).

[2] See GAO, *High-Risk Series, An Update*, GAO-05-207 (Washington, D.C.: January 2005).

[3] Interagency contracts are those in which one federal agency (typically GSA) awards the contract, such as a federal supply schedule contract, and other federal agencies use the contracts, frequently paying a fee to do so.

[4] See GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-95 (Washington, D.C.: Feb. 12, 2004), and *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-637 (Washington, D.C.: June 16, 2005).

[5] For purposes of this report, GSA contractors include both contractors that were paid by GSA and GSA interagency contractors. GSA-paid contractors are contractors paid by GSA finance centers for goods and services. These goods and services may be used by GSA internally or may be purchased by GSA for the benefit of other agencies (such as GSA global supply purchases of commercial items for sale to federal agencies). GSA interagency contractors are contractors awarded contracts by GSA (such as federal supply schedule and governmentwide acquisition contracts) from which agencies routinely acquire services and products for their procurement needs.

contractors; (2) identify examples of GSA contractors that have tax debts and are also engaged in potentially abusive, fraudulent, or criminal activities; and (3) determine whether GSA screens contractors for tax debts and criminal activities prior to awarding contracts and at the exercise of any government contract options.

To identify GSA contractors with unpaid federal taxes, we obtained and analyzed the Internal Revenue Service (IRS) tax debt data as of June 30, 2005. We matched the identities of contractors with IRS tax debts to federal contractors that were either paid or awarded contracts by GSA to contract with federal agencies during fiscal year 2004 and the first 9 months of fiscal year 2005. To illustrate indications of abuse or potentially criminal activity, based on our data mining, we selected 25 GSA contractors for a detailed audit and investigation. For these 25 contractors, we reviewed copies of automated tax transcripts and other tax records (for example, revenue officer's notes) and performed additional searches of criminal, financial, and public records. To determine whether GSA contracting officers are required to consider tax debts or other criminal activities, we examined the Federal Acquisition Regulation (FAR) and GSA regulations, policies and procedures for conducting responsibility determinations on prospective contractors. We also discussed acquisition policies and procedures used to award contracts with GSA officials and, as part of these discussions, we determined whether contracting officers specifically consider tax debts or perform background investigations in determining whether a prospective contractor is a responsible source before the contract is awarded and before the option to extend the contract is exercised. For details on our scope and methodology, see appendix I.

We conducted our audit work from June 2005 through January 2006 in accordance with U.S. generally accepted government auditing standards. We performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Summary

During fiscal year 2004 and the first 9 months of fiscal year 2005, thousands of GSA contractors abused the federal tax system with little consequence.[6] Specifically, our analysis of data provided by the

[6] We considered activity to be abusive when a contractor's actions or inactions, though not illegal, took advantage of the existing tax enforcement and administration system to avoid fulfilling federal tax obligations and were deficient or improper when compared with behavior that a prudent person would consider reasonable.

Department of Treasury's Financial Management Service (FMS), GSA, and the IRS indicates that over 3,800 GSA contractors, or about 10 percent of all GSA contractors, had tax debts totaling about $1.4 billion as of June 30, 2005.[7] The unpaid taxes included corporate income, payroll,[8] excise, and unemployment taxes.

We found instances of abusive or potentially criminal activity related to the federal tax system through our audit and investigation of 25 GSA contractor case studies. These 25 contractors provided a variety of goods and services, including building maintenance, security services, and computer services. During fiscal year 2004 and the first 9 months of fiscal year 2005, the contractors were tasked by multiple agencies, including the departments of Defense, Justice, Homeland Security, and Veterans Affairs to perform work under a GSA contract.

The 25 contractors owed primarily payroll taxes, with some dating back to the mid-1990s. These payroll taxes included amounts withheld from employee wages for Social Security, Medicare, and individual income taxes. However, rather than fulfilling their role as "trustees" and forwarding these amounts to IRS, many of these GSA contractors diverted the money for personal gain or to fund the business. Willful failure to remit payroll taxes is a criminal felony offense[9] while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense.[10] In one case study, the contractor did not pay its tax liability at the time the company was making a loan to a company officer for hundreds of thousands of dollars in the 1990s. The company subsequently filed for bankruptcy. After the company's bankruptcy was discharged in the late 1990s, the company failed again to remit all of its payroll taxes. At the same time of owing payroll taxes, the company officer who received the loan acquired a luxury vehicle and purchased a residential property currently valued in the millions of dollars. Similarly, a number of owners

[7] Because many GSA contractors are interagency contractors, some of the approximately 3,800 contractors described in this report may also have been included in our reports concerning DOD and civilian federal contractors that abuse the federal tax system.

[8] Payroll taxes are amounts that employers withheld from employees' wages for federal income taxes, Social Security, and Medicare but failed to remit to IRS, as well as the related employer matching contributions for Social Security and Medicare taxes. Employers are responsible for remitting payroll taxes to IRS and are liable for any outstanding balance.

[9] 26 U.S.C. § 7202.

[10] 26 U.S.C. § 7215 and 26 U.S.C. §7512 (b).

or officers in the other 24 case studies had significant personal assets, including commercial properties, houses worth over $1 million, and luxury vehicles. Despite owning significant assets, the owners or officers did not pay the delinquent taxes of their businesses, and sometimes did not pay hundreds of thousands of dollars of their own individual income taxes. Several owners also gambled hundreds of thousands of dollars at the same time they were not paying the taxes that their businesses owed.

The Federal Acquisition Regulation (FAR) limits awards of contracts to responsible prospective contractors. A responsible prospective contractor is a contractor that meets seven specific criteria,[11] including adequate financial resources and a satisfactory record of integrity and business ethics. However, neither federal law, as implemented by the FAR, nor GSA implementing policy specifically require contracting officers to take into account a contractor's tax debt when assessing whether a prospective contractor is responsible. In policies issued to implement the FAR, GSA's guidance does not discuss whether or how tax debts should be considered when making a determination of responsibility. We also found that the FAR does not require, and GSA has not issued a policy on, assessing a current contractor's tax debts at the time the government exercises an option to extend a contract. As a result, no review is systematically performed by GSA to determine if such contractors have unpaid taxes at the time a contract is awarded or when an option to extend a contract is exercised by the government.

Due to the lack of specific responsibility criteria related to tax debts, limited GSA access to tax information, and lack of other procedures to assess contractor tax debts, GSA ultimately awarded contracts, including supply schedule contracts that other federal agencies may use to acquire services and products for their procurement needs, to businesses with significant tax debts. Federal law generally prohibits the disclosure of taxpayer data, and consequently contracting officers have no access to tax data directly from the IRS. Contracting officers can obtain some tax debt information by checking publicly available data sources to determine if IRS or state agencies have filed tax liens against a tax debtor's assets. However, liens that IRS places on the company and/or its officers are not available at a single publicly available database, and IRS does not always file liens against tax debtors.

[11] FAR 2.101; 9.104-1.

Finally, in wage-based businesses that provide homogeneous goods and services, GSA contractors that owe tax debts have an unfair advantage in price competition because they do not bear the same costs, such as payroll taxes, that tax compliant contractors do on government contracts.

Magnitude of Unpaid Taxes of GSA Contractors

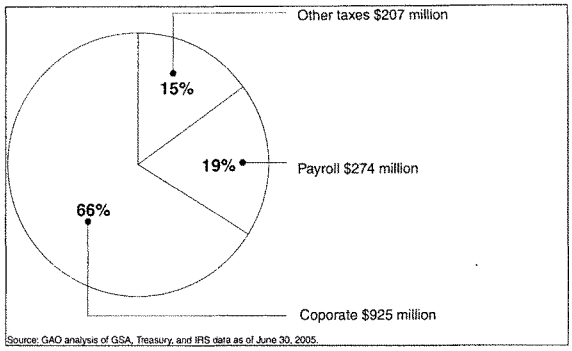
Over 3,800 GSA contractors had about $1.4 billion in unpaid federal taxes as of June 30, 2005.[12] This represents approximately 10 percent of GSA contractors during fiscal year 2004 and the first 9 months of fiscal year 2005. We took a conservative approach to identifying the amount of tax debt owed by GSA contractors, and therefore the amount is likely understated.

Characteristics of Contractors' Unpaid Federal Taxes

As shown in figure 1, 85 percent of the approximately $1.4 billion in unpaid taxes owed by GSA contractors was comprised of corporate income and payroll taxes. The other 15 percent of taxes included excise, unemployment, individual income, and other types of taxes. Unlike our previous reports on contractors with tax debts, a larger percentage of taxes owed by GSA contractors was comprised of corporate income taxes, which are unpaid amounts that corporations owe on the income of their business. This was due to a handful of GSA contractors that owed a significant amount of corporate income tax debts as of June 2005. Excluding this handful of cases, payroll taxes make up about 40 percent of the outstanding taxes owed by GSA contractors.

[12] Our estimate of GSA contractors with tax debt as of June 30, 2005, (1) excluded tax debts that have not been agreed to by the tax debtor or affirmed by the court, (2) tax debts from calendar year 2005, and (3) tax debts of $100 or less.

Figure 1: Type of Federal Tax Debt Owed by GSA Contractors



Source: GAO analysis of GSA, Treasury, and IRS data as of June 30, 2005.

Unpaid payroll taxes include amounts that an employer withholds from an employee's wages for federal income taxes, Social Security, and Medicare—but does not remit to IRS—and the related matching contributions of the employer for Social Security and Medicare. Employers who do not remit payroll taxes to the federal government are subject to civil and criminal penalties.

The amount of unpaid federal taxes we identified among GSA contractors—$1.4 billion—is likely understated. First, to avoid overestimating the amount owed by government contractors, we intentionally limited our scope to tax debts that were affirmed by either the contractor or a tax court for tax periods prior to 2005.[13] We did not include the most current tax year because recently assessed tax debts that appear as unpaid taxes may involve matters that are routinely resolved between the taxpayer and IRS, with the taxes paid, abated,[14] or both within

[13] We eliminated from our analysis all tax debt coded by IRS as not having been agreed to by the taxpayer (for example, by filing a balance due return) or a tax court. For financial reporting, those cases are referred to as compliance assessments.

[14] Abatements are reductions in the amount of taxes owed and can occur for a variety of reasons, such as to correct errors made by IRS or taxpayers or to provide relief from interest and penalties. 26 U.S.C. § 6404.

a short period. We eliminated these types of debt by focusing on unpaid federal taxes for tax periods prior to calendar year 2005 and eliminating tax debt of $100 or less.[15]

Also limiting the completeness of our estimate of the unpaid federal taxes of GSA contractors is the fact that the IRS tax database reflects only the amount of unpaid taxes either reported by the contractor on a tax return or assessed by IRS through its various enforcement programs. The IRS database does not reflect amounts owed by businesses and individuals that have not filed tax returns and for which IRS has not assessed tax amounts due. During our review, we identified instances from our case studies in which GSA contractors failed to file tax returns for a particular tax period and, therefore, were listed in IRS records as having no unpaid taxes for that period. Further, our analysis did not attempt to account for businesses or individuals that purposely underreported income and were not specifically identified by IRS. According to IRS, underreporting of income is the largest component of the estimated $345 billion annual gross tax gap. IRS estimates that underreporting accounts for more than 80 percent of the total gross tax gap. Consequently, the true extent of unpaid taxes for these businesses and individuals is not known.

GSA Contractors Involved in Abusive and Potentially Criminal Activity Related to the Federal Tax System

As discussed previously, businesses with employees are required by law to collect, account for, and transfer income and employment taxes withheld from employees' wages to IRS. Businesses that fail to remit payroll taxes to the federal government are liable for the amounts withheld from employees, and IRS can assess a trust fund recovery penalty (TFRP) equal to the total amount of taxes not collected or not accounted for and paid against individuals who are determined by IRS to be "willful and responsible" for the nonpayment of withheld payroll taxes.[16] In addition to civil penalties, criminal penalties exist for an employer's failure to turn over withheld employee payroll taxes to IRS. Willful failure to remit payroll taxes is a criminal felony offense punishable by imprisonment of not more than 5 years,[17] while the failure to properly segregate payroll

[15] A "tax period" varies by tax type. For example, the tax period for payroll and excise taxes is generally one quarter of a year. The taxpayer is required to file quarterly returns with IRS for these types of taxes, although payment of the taxes occurs throughout the quarter. In contrast, for income, corporate, and unemployment taxes, a tax period is 1 year.

[16] 26 U.S.C. § 6672.

[17] 26 U.S.C. § 7202.

taxes can be a criminal misdemeanor offense punishable by imprisonment of up to a year.[18]

Our audit and investigation of the 25 case-study business contractors showed substantial abuse or potential criminal activity as all had unpaid payroll taxes and have diverted those funds for personal or business use. The 25 case-study contractors typically operate in wage-based industries, providing security, building maintenance, computer services, and personnel services for GSA and the departments of Defense, Homeland Security, Justice, and Veterans Affairs. The types of contracts that were awarded to these contractors included products and/or services related to law enforcement, disaster relief, and national security. The amount of unpaid taxes associated with these case studies ranged from approximately $100,000 to over $9 million. Furthermore, we determined that several of the case studies had unpaid state and local taxes where state and local taxing authorities had filed multiple tax liens against them. Subsequent to the award of the most recent contract by GSA, one case study company and its owner were debarred from future federal contracts for illegal activity unrelated to their failure to pay their payroll taxes.

Table 1 highlights 10 case studies with unpaid taxes. Our investigations revealed that, despite their companies owing substantial amounts of taxes to the IRS, some owners had substantial personal assets—including commercial real estate, interest in a chain store, or multiple luxury vehicles. Further, several owners owned homes worth over $1 million.

See appendix III for the details on the other 15 GSA contractor case studies. We are referring the 25 cases detailed in our report to IRS so that it can determine whether additional collection action or criminal investigation is warranted.

[18] 26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

Table 1: GSA Contractors with Unpaid Federal Taxes

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
1	Emergency supplies	Up to $100,000	Over $700,000	• Company made large loans to a company officer at same time the company was not paying its taxes. • IRS assessed a Trust Fund Recovery Penalty against owner. • Company filed for bankruptcy protection owing substantial state and federal taxes. • The owner owned multiple real properties, including a million dollar home, and a luxury vehicle while company owed taxes. • Company had a federal tax lien at time GSA awarded a federal supply schedule contract.
2	Security services	At least $1 million	Over $9 million	• Company filed for bankruptcy in 2000s. • At the time company was not remitting all of its payroll taxes to IRS, the owner withdrew large amounts of funds from the company for personal use. • Owner used over $100,000 on gambling. • Company submitted false reports on a government contract. • Owner is being investigated for fraud.
3	Building maintenance	Up to $100,000	Over $700,000	• Company affiliated with two other related entities with tax debt. • Company filed for bankruptcy in 2000s. • Company did not file some recent payroll tax returns. • Owner made large cash withdraws totaling tens of thousands of dollars during the time little or no payroll taxes were remitted to IRS. • At the same time that the company was remitting little of its payroll taxes to IRS, the owner bought a luxury automobile, owned a number of rental properties, and had partial ownership in a chain store. • Owner owes over $100,000 in personal income taxes.
4	Security services	At least $1 million	Nearly $2 million	• Tax debt is primarily unpaid payroll taxes. • Company repeatedly underpaid payroll taxes to fund company operations. • At the time company was underpaying payroll taxes, owner's reported personal income was nearly $1 million. • Company and IRS are negotiating installment agreement to pay unpaid taxes. • Owner owns residential property, commercial real estate, and land worth over $1 million. • Owner owes over $200,000 in personal income taxes.
5	Building maintenance	Up to $100,000	Over $2 million	• Company owes over $2 million in unpaid payroll taxes for more than 10 tax periods. • Owner used unremitted payroll taxes to fund the business. • Owner owns multiple commercial and residential properties.

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
6	Moving services	At least $100,000	Over $2 million	• Company claimed payroll taxes were not paid due to employee embezzlement. • Company filed offer in compromise with IRS for about 5 percent of its outstanding tax balance, which IRS rejected. • The owners own homes cumulatively valued over $1 million and own several luxury vehicles. • Spouse of one of the owners recently received about $1.5 million in cash for sale of house.
7	Building maintenance services	At least $100,000	Over $1 million	• Company owes payroll taxes for about 20 tax periods. • IRS placed federal tax liens on company from late 1990s to early 2000s. • Owner owes over $250,000 in personal income taxes.
8	Building maintenance services	At least $1 million	Over $100,000	• Almost all taxes owed are unpaid payroll taxes. • The owner maintains two residential properties valued at over $1million in total. • Federal and state tax liens were filed against the company.
9	Human resource services	At least $100,000	Over $400,000	• IRS reported company's tax debts to Treasury for continuous levy on federal contractor payments. • Owner owns multiple real properties and several luxury vehicles. • At the time owner did not remit all taxes owed to IRS, the owner made multiple large cash withdraws at gambling casinos. • Company obtained contract for hurricane relief efforts.
10	Public communications	Up to $100,000	Over $2 million	• Almost all taxes owed are unpaid payroll taxes. • The owner owns residential properties valued at about $1 million. • At the time the company did not pay all of its payroll taxes, the owner made about $500,000 of cash withdrawals at gambling casinos.

Source: GAO's analysis of IRS, FMS, GSA, public, and other records.

The following provides illustrative detailed information on several of these cases.

- Case 1: This contractor provides emergency supplies for civilian agencies. At the same time the company was not paying its taxes, the company made a loan to a company officer for hundreds of thousands of dollars. The company subsequently filed for bankruptcy owing a substantial amount of federal and state taxes. After the company came out of bankruptcy, the company again failed to remit all of its taxes, including payroll taxes. IRS assessed a trust fund recovery penalty against the company and the owner for willful failure to remit payroll taxes.
- Case 2: The company provided security services for a civilian agency. Our investigative work indicates that an owner of the company made multiple

cash withdrawals, totaling close to $1 million, while the contractor owed payroll taxes. The company's owner used the cash withdrawals to fund an unrelated business and purchase a men's gold bracelet worth over $25,000. The company's owner has been investigated for fraud.

- Case 4: The company provides security services for a civilian agency. Our investigative work indicates that the owner of the company did not make tax deposits because the company did not have the funds to pay employee costs or other business expenses. However, we found that the company owner owns multiple properties worth over $1 million. The owner also owes IRS approximately $200,000 for personal income taxes.

Tax Debts Are Generally Not Considered When Awarding Contracts

Federal law implemented in the FAR, and GSA internal policies do not require GSA contracting officers to examine tax debt when awarding contracts, nor do they provide guidance as to what role, if any, tax debt should play in determining whether prospective contractors meet the general criteria of responsible contractors. Also, due to a statutory restriction on disclosure of taxpayer information, even if tax debts specifically were to be considered in the awarding of contracts, no coordinated or independent mechanism exists for contracting officers to obtain complete information on contractors that have unpaid tax debt. Therefore, GSA does not screen contractors for tax debts prior to awarding contracts to GSA-paid contractors and GSA interagency contractors, and ultimately, contractors with unpaid federal taxes receive contracts from the federal government.

Contractors with Federal Tax Debts Are Not Explicitly Prohibited from Doing Business with the Federal Government

Federal law implemented in the FAR and GSA internal policies do not expressly prohibit a contractor with unpaid federal taxes from being awarded contracts from the federal government. Although the FAR requires that federal agencies only do business with responsible contractors, it does not specifically require federal agencies to deny the award of contracts to businesses and individuals that have unpaid taxes, unless the contractor was specifically debarred or suspended by a debarring official for specific actions, such as conviction for tax evasion.

As part of the contractor responsibility determination for prospective contractors, the FAR requires contracting officers to determine whether a prospective contractor meets several specified standards, including adequate financial resources and a satisfactory record of integrity and business ethics. However, the FAR does not require contracting officers to

consider tax debt in making this determination.[19] Similarly, GSA policies in implementing the FAR do not provide any additional guidance to GSA contracting officers on whether or how tax debts should be considered when making a determination of financial responsibility.[20] According to GSA officials, contracting officers may consider delinquent tax debts as part of their overall determination of a prospective contractor's financial capability; however, the focus of such evaluation is on determining whether the contractor has the financial capability to deliver the products and services. Thus, there is no expectation that the contracting officer will consider tax compliance when evaluating whether companies have the integrity or ethics to perform the contract. In addition, according to GSA officials, the determination for financial capability of the contract is only applicable when awarding new contracts.[21] Thus, if the contractor does not pay its tax debts after the contract award, no consideration of this will be made by GSA contracting officers for the duration of the contract or at the subsequent exercise of any options to extend, which for certain GSA Supply Schedule contracts can last up to 20 years.

The FAR specifies that unless compelling reasons exist, agencies are prohibited from soliciting offers from, or awarding contracts to, contractors that are debarred, suspended, or proposed for debarment for various reasons, including tax evasion.[22] Conviction for tax evasion is cited as one of the causes for debarment, while commission, i.e., indictment, for

[19] The government may suspend a contractor suspected of tax evasion, upon adequate evidence, and debar a contractor for a conviction or civil judgment for commission of tax evasion. Further, prospective contractors are required to certify in their bids or proposals whether they or their principals, within the preceding 3 years, were convicted or had civil judgments rendered against them for commission of tax evasion, and whether they or their principals are presently indicted or otherwise criminally or civilly charged with commission of tax evasion.

[20] GSA provides guidance to GSA contracting officers in the General Services Administration Acquisition Manual (GSAM), Acquisition Letters, and Procurement Information Bulletins.

[21] The FAR does not require a responsibility determination when an agency exercises options to extend a contract. For one contract file we reviewed, the contractor filed for bankruptcy prior to GSA's action to extend. GSA exercised the option without consideration of the bankruptcy. GSA subsequently could not recover over $100,000 in audit disallowances pursuant to the bankruptcy ruling.

[22] Prior to awarding a contract, contracting officers are required to consult a governmentwide list, called the Excluded Parties List System (EPLS), of contractors that have been debarred, suspended, or declared ineligible for government contracts, and review the prospective contractor's self-certification of debarment and suspension.

tax evasion is cited as a cause for suspension. However, the deliberate failure to remit taxes, in particular payroll taxes, while a felony offense, will likely not result in a company being debarred or suspended unless the contractor was indicted or convicted of the crime. During our work, we found that none of the contractors described in this testimony, nor the 97 contractors we reported in our previous work, have been charged with tax evasion,[23] despite having abusive and potentially criminal activities related to the tax system.

Restrictions on Tax Data Hamper Making Contractor Responsibility Determinations

Current law restricts contracting officers' access to tax debt information unless reported by prospective contractors themselves or disclosed in public records. Consequently, contracting officers do not have ready access to information on unpaid tax debts to assist in making contractor responsibility determinations with respect to financial capability, ethics, and integrity.

Contracting officers do not have a coordinated and independent mechanism to obtain accurate tax debt information on contractors that abuse the tax system. Federal law does not permit IRS to disclose taxpayer information, including tax debts.[24] Thus, unless the taxpayer provides consent,[25] certain tax debt information can only be discovered from public records when IRS files a federal tax lien against the property of a tax debtor.[26] However, contracting officers are not required to obtain credit reports, which provides public record information, and when credit reports are obtained, GSA contracting officers generally focus on the contractor's credit score and not necessarily any liens or other public information. In addition, public record information is limited because IRS does not file tax liens on all tax debtors, and, while IRS has a central repository of tax liens, contracting officers do not have access to that information. Further, the listing of a federal tax lien in the credit reports of businesses or individuals may not be a reliable indicator of a contractor's

[23] GAO-04-95, GAO-05-637.

[24] 26 U.S.C. § 6103.

[25] For example, contractors must provide IRS consent to validate taxpayer identification numbers (TINS) provided by the contractors in the Central Contractor Registration system. GSA officials stated that the contractor is not registered into the system until the TIN is validated with IRS records.

[26] Under section 6321 of the Internal Revenue Code, IRS has the authority to file a lien upon all property and rights to property, whether real or personal, of a delinquent taxpayer.

tax indebtedness because of deficiencies in IRS's internal controls that have resulted in IRS not always releasing tax liens from property when the tax debt has been satisfied.[27]

Unless reported by prospective contractors themselves, contracting officers face significant difficulties obtaining or verifying tax compliance information on prospective contractors. For example, in one contractor file we reviewed, a GSA official did inquire about a federal tax lien with a prospective contractor. The prospective contractor provided documentation to GSA demonstrating the satisfaction of the tax liability covered by that lien. However, because the GSA official could not obtain information from the IRS on tax debts, this official was not aware that the contractor had other unresolved tax debts unrelated to this particular tax lien.

GSA Contractors Not Required to Undergo Further Determination of Responsibility or Background Investigation

GSA interagency contractors are not only approved to do business with GSA, but with all federal agencies. The FAR does not require agencies that use contracts awarded by other agencies to perform additional background or other investigation to validate the awarding agencies' determination that the contractors are responsible. Agency officials at the four agencies at which we inquired—the departments of Justice, State, and Veterans Affairs, and the National Aeronautics and Space Administration— generally stated that they did not perform additional background or other investigations when using contractors selected for interagency contracts. These officials informed us that they had assumed GSA performed all the screening necessary to ensure that the contractors were responsible contracting sources. Consequently, when GSA awards interagency contracts to contractors with tax debt, contractors with tax debts will be given an opportunity to do business with other federal agencies for the duration of the GSA contract.

[27] GAO, *IRS Lien Management Report: Opportunities to Improve Timeliness of IRS Lien Releases*, GAO-05-26R (Washington, D.C.: Jan. 10, 2005).

Contractors with Tax Debts Have Unfair Cost Advantage in Contract Competition

GSA contractors with tax debts have an unfair advantage in costs when competing with contractors that pay their taxes. This is particularly true for wage-based industries that provide relatively basic types of goods and services, such as security and moving services. The most egregious abuse, not remitting employee payroll taxes, saved these companies over 15 percent of the employee's wages. Clearly, contractors that do not pay their taxes do not bear the same costs that tax compliant contractors have when competing on contracts. As a result, when in direct competition for homogenous types of goods and services in wage-based businesses, these contractors could offer prices for their goods and services that are lower than their tax compliant competitors. Our investigations showed that some GSA contractors that did not fully pay their payroll taxes were issued task orders based solely on price over competing contractors that did not have any tax debts. The following provides information on these cases.

Case 1: A GSA Schedule contractor was competitively awarded a task order from the GSA schedule in the late 1990s to provide temporary personnel services over another GSA contractor that was compliant with its taxes. The task order award was based solely on the hourly cost of the temporary employee. At the time, the contractor had owed taxes for at least 10 years. This contractor had a history of incurring payroll taxes on one company, then upon being assessed a trust fund recovery penalty on that company but making little or no payments, closing that company and starting another. The owner later renewed the contract under a new company name and Taxpayer Identification Number.

Case 2: A GSA Schedule contractor was issued two competitive task orders for services related to moving office furniture and equipment. On both task orders, the contractor's offer for services was significantly less than three competing offers on the first order and two competing offers on the second order. The contractor owed about $700,000 in unpaid taxes (mostly payroll taxes) while its competitors did not owe any unpaid taxes. Because the contractor did not pay its payroll taxes, a significant cost in a wage-based business, the contractor's cost structure provided the contractor more flexibility in setting its price in the competition for federal contracts.

Concluding Comments

There is widespread concern today about contractor fraud and related ethics problems in federal government contracting. However, except for contractors charged with or convicted of tax evasion, no laws or policies exist today that prevent GSA contractors with abusive and potentially criminal activity related to the federal tax system from being awarded

contracts and doing business with federal agencies. Aside from any general concerns about the federal government doing business with contractors that do not pay their taxes, allowing these contractors to do business with the federal government while not paying their taxes could create an unfair competitive advantage for these contractors. In essence, the current contract award process fails to encourage contractors to pay these taxes. This causes a disincentive to contractors to pay their fair share of taxes, and could lead to further erosion in compliance with the nation's tax system.

Appendix I: Objectives, Scope, and Methodology

Our objectives were to (1) determine the magnitude of tax debts owed by GSA contractors; (2) identify examples of GSA contractors that have tax debts and are also engaged in potentially abusive, fraudulent, or criminal activities; and (3) determine whether GSA screens contractors for tax debts and criminal activities prior to awarding contracts and at the exercise of any government contract options.

To identify the magnitude of unpaid taxes owed by GSA contractors, we first identified the federal contractors that were either GSA interagency contractors or that were paid by GSA. To identify GSA-paid contractors, we obtained from the Department of the Treasury's Financial Management Service (FMS) the Payments, Claims, and Enhanced Reconciliation (PACER) database containing all Automated Clearing House (ACH) and check payments made by FMS on behalf of GSA to federal contractors during fiscal year 2004 and the first 9 months of fiscal year 2005.[1] To identify contractors screened by GSA's Federal Supply Service (FSS), we obtained and analyzed GSA data on Multiple Award Schedule (MAS) contracts and other FSS award contracts as recorded in the Federal Supply Service Automated Supply System (FSS-19). To identify contractors screened by GSA's Public Buildings Service (PBS), we obtained and analyzed GSA data from its Pegasys and FPDS-NG systems. To identify contractors screened by GSA's Federal Technology Service, we obtained and analyzed GSA data from its Pegasys system.

To identify GSA contractors with unpaid federal taxes, we obtained and analyzed the Internal Revenue Service (IRS) unpaid assessment data as of June 30, 2005. We matched the GSA screened and/or paid contractor records to the IRS unpaid assessment data using the taxpayer identification number (TIN) field. We also matched data obtained from competing bidders (those who were not awarded the task order) to the IRS assessment database using the TIN field to determine whether they owed tax debt. To avoid overestimating the amount owed by contractors with unpaid tax debts and to capture only significant tax debts, we excluded from our analysis tax debts and payments meeting specific criteria to establish a minimum threshold in the amount of tax debt and in the amount of payments to be considered when determining whether a tax debt is significant. The criteria we used to exclude tax debts are as follows:

[1] Although the GSA Kansas City finance center does make contractor payments on behalf of other agencies, they were able to identify those payments made for GSA contracts.

- tax debts that IRS classified as compliance assessments or memo accounts for financial reporting,[2]
- tax debts from calendar year 2005 tax periods, and
- contractors with total unpaid taxes of $100 or less.

The criteria above were used to exclude tax debts that might be under dispute or generally duplicative or invalid, and tax debts that are recently incurred. Specifically, compliance assessments or memo accounts were excluded because these taxes have neither been agreed to by the taxpayers nor affirmed by the court, or these taxes could be invalid or duplicative of other taxes already reported. We excluded tax debts from calendar year 2005 tax periods to eliminate tax debt that may involve matters that are routinely resolved between the taxpayer and IRS, with the taxes paid or abated within a short period. We further excluded tax debts of $100 or less because they are insignificant for the purpose of determining the extent of taxes owed by GSA contractors.

To identify indications of abuse or potentially criminal activity, we selected 25 GSA contractors for a detailed audit and investigation. The 25 contractors were chosen using a non-representative selection approach based on our judgment, data mining, and a number of other criteria. Specifically, we narrowed the 25 contractors with unpaid taxes based on the amount of unpaid taxes, number of unpaid tax periods, amount of payments reported by GSA and FMS,[3] indications that owner(s) might be involved in multiple companies with tax debts, and selection of contractors doing business with a variety of federal agencies.

We obtained copies of automated tax transcripts and other tax records (for example, revenue officer's notes) from IRS as of June 30, 2005, and reviewed these records to exclude contractors that had recently paid off their unpaid tax balances and considered other factors before reducing the number of businesses to 25 case studies. We performed additional searches of criminal, financial, and public records. In cases where record

[2] Under federal accounting standards, unpaid assessments require taxpayer or court agreement to be considered federal taxes receivables. Compliance assessments and memo accounts are not considered federal taxes receivable because they are not agreed to by taxpayers or the courts.

[3] Amount of payments reported by FMS and amounts reported by GSA could differ because contractors that have been pre-approved by GSA to do business with the government also receive payments from disbursing entities other than FMS, for example, Department of Defense or the U.S. Army Corps of Engineers.

searches and IRS tax transcripts indicate that the owners or officers of a business are involved in other related entities[4] that have unpaid federal taxes, we also reviewed the related entities and the owner(s) or officer(s), in addition to the original business we identified. For the selected 25 cases, our investigators also contacted some contractors, performed interviews, and reviewed contract files to determine the extent of price competition and to identify bidders on competitively awarded contracts.

To determine the extent to which contracting officers are to consider tax debts or other criminal activities, we examined the Federal Acquisition Regulation (FAR) and GSA policies and procedures for conducting responsibility determinations on prospective contractors, including specific guidance on responsibility determinations and periodic reviews focusing on the quality of contract awards. We discussed acquisition policies and procedures used to award contracts with officials from the Office of Chief Acquisition, FSS, FTS, and PBS. As part of these discussions, we asked whether contracting officers specifically consider tax debts or perform background investigations to determine whether a prospective contractor is a responsible source before the contract is awarded. We also discussed with GSA officials whether any review is performed by the contracting officer at the option to extend the contract. Additionally, we interviewed an official from GSA's Kansas City Credit and Finance Center to determine how the center makes financial determination recommendations and the role, if any, that tax debts have on that recommendation.

To obtain an understanding of what steps other federal agencies take to screen GSA supply schedule contractors for tax debts or other criminal activities, we interviewed procurement agency officials at selected civilian agencies (including the National Aeronautics and Space Administration and the departments of Justice, State, and Veterans Affairs). We selected these agencies based on a number of criteria, including national security concerns and amount of payments to contractors, especially those with tax debts. As part of these discussions, we determined the level of reliance agencies placed on GSA's contractor qualification determinations in awarding contracts, even for sensitive contracts such as security, to contractors that have been approved by GSA as responsible sources.

[4] We define related entities as entities that share common owner(s) or officer(s), a common TIN, or a common address.

We conducted our audit work from June 2005 through January 2006 in accordance with U.S. generally accepted government auditing standards, and we performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Data Reliability Assessment

For the IRS unpaid assessments data, we relied on the work we performed during our annual audits of IRS's financial statements. While our financial statement audits have identified some data reliability problems associated with the coding of some of the fields in IRS's tax records, including errors and delays in recording taxpayer information and payments, we determined that the data was sufficiently reliable to address this report's objectives. Our financial audit procedures, including the reconciliation of the value of unpaid taxes recorded in IRS's masterfile to IRS's general ledger, identified no material differences.

For Payments, Claims, and Enhanced Reconciliation (PACER) database, we interviewed FMS officials responsible for the database and reviewed documentation provided by FMS supporting quality reviews on its databases. In addition, we performed electronic testing of specific data elements in the database that we used to perform our work.

To help ensure reliability of GSA-provided data, we interviewed GSA officials concerning the reliability of the data provided to us. In addition, we performed electronic testing of specific data elements in the databases that we used to perform our work and performed other procedures to ensure the completeness of the contract data provided by GSA. We also reviewed the results of the GSA Inspector General's audit of the system's internal controls completed in support of GSA's fiscal year 2004 consolidated and combined financial statements.

Based on our discussions with agency officials, review of agency documents, and our own testing, we concluded that the data elements used for this testimony were sufficiently reliable for our purposes.

Appendix II: Background

As the federal government's principal business agent, General Services Administration's (GSA) activities and programs are diverse and have governmentwide implications. Through its supply schedules and governmentwide acquisition contracts, GSA arranges for federal agencies to purchase billions of dollars of goods and services directly from private vendors. In addition, its telecommunication and computer services and real estate activities involve huge sums of money and extensive interaction with the private sector.

GSA provides goods and services and develops policy through a network of 11 regional offices and a central office in Washington, D.C. GSA's programs are generally run by its three service components—Federal Supply Service (FSS), Federal Technology Service (FTS), and Public Buildings Service (PBS).[1]

FSS assists federal agencies in acquiring a full range of products—including over 4 million commonly used commercial items, ranging from furniture, computers, tools, equipment, and motor vehicles. FSS also supports agencies in acquiring services, such as professional consulting, travel, transportation, and property management. FSS has followed a self-service business model, using contracts, called supply schedule contracts, that are designed to be flexible, simple to use, and consistent with commercial buying practices. FSS negotiates master contracts with vendors, seeking discounts off commercial list prices that are at least as favorable as the discounts offered to those vendors' most favored customers. Federal agencies can then use these supply schedule contracts to issue task orders from which goods and services are acquired.

FTS provides customers with telecommunications products and services—voice, data, and video—and a full range of IT products and services. Unlike FSS, FTS has followed a full-service business model, providing assisted procurement services to help agencies define and fill their IT and telecommunications requirements. FTS is a major user of the FSS supply schedule contracts as well as a range of contract vehicles FTS and other federal agencies have awarded—commonly known as governmentwide acquisition contracts.

[1] GSA is in the process of merging FSS and FTS into a new service component called Federal Acquisition Service.

PBS is the primary property manager for the federal government, utilizing government buildings and privately owned leased facilities.[2] In order to meet the office space needs for federal agencies, GSA hires and manages private sector professionals, such as architects, engineers, and contractors to design, renovate, and construct federal buildings. In addition, GSA leases space in cities and small towns when leasing is the practical answer to meeting federal space needs.

From a financing standpoint, GSA is unusual among federal agencies in that most of its funding does not come from direct appropriations from Congress. Instead, GSA's funding comes from fees GSA charges agencies for the goods and services provided and the rents from its buildings. As such, GSA must encourage other agencies to acquire goods and services from the contracts GSA has awarded to help cover its operating costs. In fiscal year 2004, GSA reported revenues of approximately $20 billion to cover the costs of its operations.

[2] Over 30 other executive branch agencies, including DOD and the departments of State, Veterans Affairs, and Transportation, have some level of authority to purchase, own, or lease office space or buildings.

Appendix III: Contractors with Unpaid Taxes

Table 1 in the main portion of this testimony provides data on 10 detailed case studies. Table 2 shows the remaining case studies that we audited and investigated. As with the 10 cases discussed in the body of this testimony, we also found substantial abuse or potentially criminal activity related to the federal tax system during our review of these 15 case studies. The case studies involving businesses with employees primarily involved unpaid payroll taxes. Several of the companies negotiated an installment or repayment agreement with the Internal Revenue Service (IRS) but subsequently defaulted on that agreement.

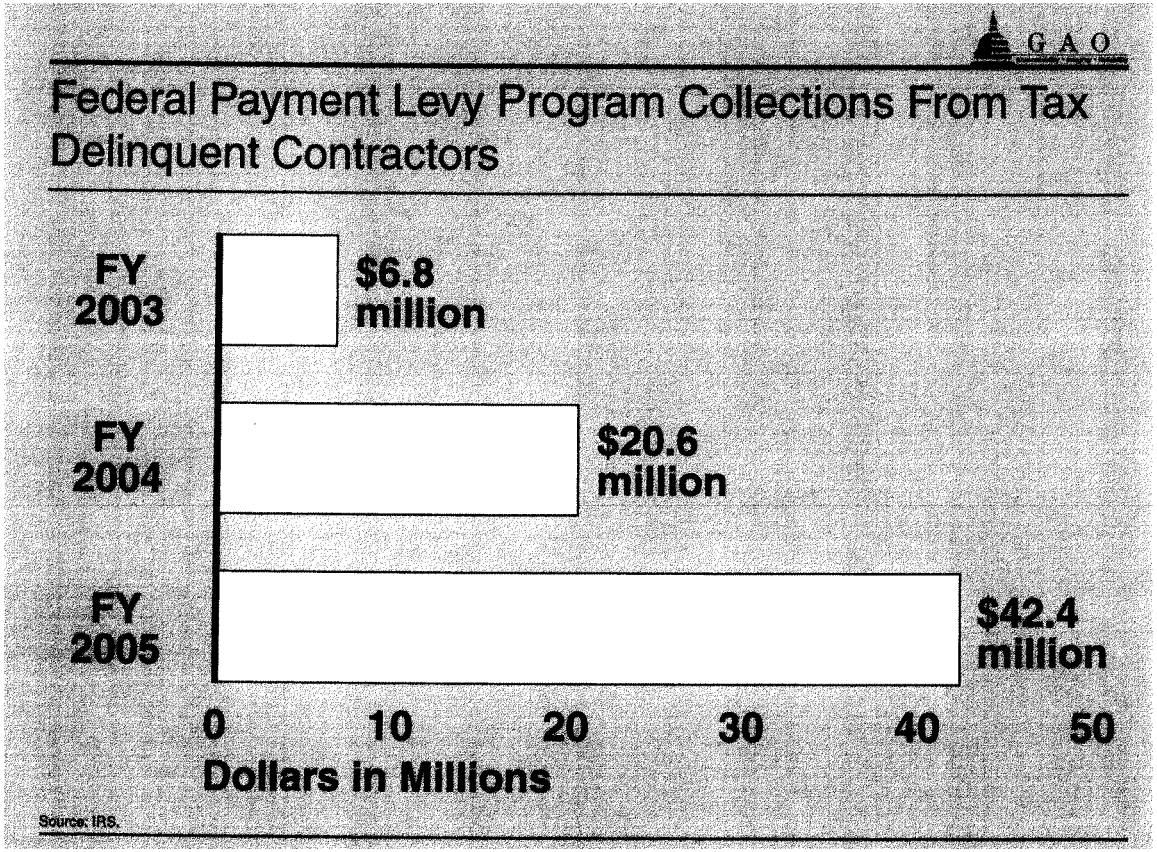
Table 2: GSA Contractors with Unpaid Federal Taxes

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
11	Commercial research	At least $100,000	Nearly $400,000	• Company repeatedly underpaid its payroll taxes since the 1990s and owes payroll tax debt for more than 15 tax periods. • Company diverted payroll taxes to fund business. • Company negotiating offer in compromise with IRS. • Owner owns a million dollar home. • Multiple state tax liens totaling more than $50,000 filed against the company.
12	Management consulting services	At least $1 million	Nearly $200,000	• Company in active repayment agreement with IRS. • Company awarded grants by Department of Housing and Urban Development.
13	Financial Related Services	Up to $100,000	Over $1 million	• Company tax debts cover more than 10 tax periods beginning in the 1990s. • Tax debt is primarily unpaid payroll taxes.
14	Web site development services	At least $100,000	Over $200,000	• Company sporadically made payroll tax payments in the early 2000s. • Company negotiated installment agreement in 2000s but subsequently defaulted on the agreement within the next year.
15	Information technology services	At least $100,000	Over $2 million	• Tax debt is unpaid payroll taxes covering nearly 15 tax periods. • The company is a chronic nonfiler of payroll taxes and repeatedly fails to remit payroll tax deposits. • IRS initiated litigation against company.
16	Data processing services	At least $1 million	Over $100,000	• Tax debt is unpaid payroll taxes covering about 10 tax periods. • Company attempted to establish installment agreement after offer in compromise for about $50,000 was rejected by IRS. • IRS assessed a Trust Fund Recovery Penalty against owner.

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
17	Elevator services	Up to $100,000	Over $800,000	• Company repeatedly underpaid its payroll taxes since the early 2000s. • Company entered into installment agreement with the IRS but subsequently defaulted. • IRS assessed owner Trust Fund Recovery Penalties of more than $300,000 for willful failure to pay payroll taxes. • Multiple state and local tax liens totaling more than $200,000 filed against the company.
18	Security services	At least $1 million	Over $2 million	• Company negotiated installment agreement with IRS but frequently late in payments. • Bank closed company's checking account because of suspected check kiting. • Owner owns million-dollar lakeside residence. • Multiple federal and state tax liens totaling over $2 million filed against the company since early 2000s.
19	Facilities management services	At least $1 million	Over $500,000	• Business affiliated with one other related entity with over $500,000 in unpaid taxes. • Tax debt largely consists of payroll taxes. • Company negotiated installment agreement with IRS in 2000s but defaulted on agreement the following year. • Owner leasing a luxury vehicle.
20	Manufacturing fixtures	At least $1 million	Over $100,000	• Owner owns commercial property worth nearly $2 million. • IRS assessed a Trust Fund Recovery Penalty against owner for willful failure to pay payroll taxes. • Multiple state and county tax liens filed against the company.
21	Computer consulting services	Up to $100,000	Over $100,000	• The company has not remitted payroll taxes or filed payroll tax returns to the IRS since early 2000s. • IRS reported company's tax debts to Treasury for continuous levy on federal contractor payments.
22	Security services	Up to $100,000	Over $3 million	• Tax debt is primarily unpaid payroll taxes covering nearly 15 tax periods. • Company attempted offer in compromise but was rejected by IRS. • Owner owned commercial properties and a yacht.
23	Communication equipment	Up to $100,000	Nearly $900,000	• Tax debt is primarily unpaid payroll taxes from the 1990s. • Company offered IRS to settle debt for about a third of what it owed, but IRS rejected the compromise offer. • Owner convicted of money laundering. • Multiple state tax liens filed against company totaling over $100,000.

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
24	Computer processing services	At least $100,000	Over $1.7 million	• Company and IRS agreed to compromise debt in 2000s for about half of what it owed but the company defaulted on the agreement (no payments were made). • Company has not filed payroll tax returns subsequent to compromise agreement. • IRS assessed trust fund recovery penalty on owner for willful failure to remit payroll taxes. • Company officer was arrested for assault.
25	Human resources services	At least $100,000	Over $100,000	• Company affiliated with one other related entity that owed about $100 thousand in payroll taxes. • Company negotiated installment agreement in early 2000s but subsequently defaulted. • Company went out of business in 2000s. • Owner owns commercial property worth over $1 million, multiple residential properties, and a boat.

Source: GAO's analysis of IRS, FMS, GSA, public, and other records.


GAO
Federal Payment Levy Program Collections From Tax Delinquent Contractors
FY 2003
$6.8 million
FY 2004
$20.6 million
FY 2005
$42.4 million
0
10
20
30
40
50
Dollars in Millions
Source: IRS.

GAO

Examples of Million-Dollar Homes and Luxury Vehicle Owned by Tax Delinquent Contractors

Source: GAO (Digitally altered).

GAO

Bellagio Hotel and Casino and Example of 20-Karat Diamond Bracelet Owned by a Tax Delinquent Contractor

Source: Bellagio , Jacob and Co.

WRITTEN TESTIMONY OF THE COMMISSIONER OF INTERNAL REVENUE SERVICE MARK EVERSON BEFORE SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS PERMANENT SUBCOMMITTEE ON INVESTIGATIONS HEARING ON FEDERAL CONTRACTORS WHO CHEAT ON THEIR TAXES MARCH 14, 2006

Good morning Chairman Coleman, Ranking Member Levin and members of the Permanent Subcommittee on Investigations. I am pleased to appear before you again to discuss a topic that I can assure you is as important to me as it is to you.

Before I turn to today's topic, I would like to update you on a subject I referenced in last year's testimony --- the tax gap. When I appeared before you last June, the IRS had developed preliminary estimates for the tax gap. The tax gap is the difference between the amount of tax imposed on taxpayers for a given year and the amount that is paid voluntarily and timely. The tax gap represents, in dollar terms, the annual amount of noncompliance with our tax laws.

In February, we released final numbers based on a recently completed National Research Program review of tax year (TY) 2001 data for individual taxpayers. This data shows that our overall annual tax gap is $345 billion. Through enforcement initiatives and the collection of late payments we are able to reduce that by some $55 billion, leaving a net tax gap of $290 billion.

This is obviously a huge number in real terms, but perhaps its greatest significance is what it does to undermine the tax system as a whole. Nearly 84 percent of all taxpayers are paying what they owe on a timely basis. They expect their friends and competitors to do likewise. And, they certainly expect anyone that does business with the Federal Government to be paying their fair share.

Federal Contractors

All federal contractors should be held to high standards. Compared to contractors in the private sector, for instance, federal contractors face stiffer penalties and more regulations involving equal opportunity and other laws. Contractors receiving taxpayer dollars should not cheat these very same taxpayers by passing their tax bills on to them. While we recognize that taxpayers may have legitimate differences with the IRS regarding their tax obligations, there are specific mechanisms for addressing those differences. Simply ignoring, or actively evading, one's established tax obligations is not acceptable.

This is my third time before this subcommittee on this very issue. I first appeared in 2004 to respond to the Governmental Accountability Office (GAO) report on 47 DOD contractors who were delinquent in their taxes. I appeared again last year to discuss 50 civilian contractors that GAO had identified as also being delinquent. At that time, I pointed out the progress that the IRS had made working with the Financial Management Service (FMS), the General Services Administration (GSA), the Department of Defense (DoD), the Office of Management and Budget (OMB) and the Department of Justice. Together these agencies formed the Federal Contractor Tax Compliance (FCTC) Task Force.

My testimony this morning is designed to accomplish four objectives:

- Update you on the progress we have made working with the FCTC as well as advise you of other actions the IRS has taken since I last testified on this subject;
- Update the 122 cases (47 DoD, 50 civilian, and 25 GSA) identified by GAO;
- Advise you on some steps we hope to take to further limit future occurrences of Federal contractors not paying their total tax obligations; and
- Suggest some legislative proposals that will assist in preventing future tax evasion and assist us in reducing the tax gap.

Progress Report

The Federal Payment Levy Program (FPLP) provides an automated process for serving tax levies and collecting unpaid taxes through FMS. The FMS uses its Treasury Offset Program (TOP) to match certain types of federal payments against federal tax debt records. As a result, the program applies a portion of these federal payments to the outstanding tax liabilities. I would now like to outline the steps we have taken administratively to enhance the FPLP.

We have removed many of the operational exclusions that had prevented tax debts from being available for levy through the FPLP. Consequently, from October thru January of Fiscal Year (FY) 2006, FPLP collections have risen to over $81 million dollars as opposed to $58 million at the same time last year. Collections from all Federal contractors were also higher, but not as dramatically. In FY 2006 total FPLP contractor collections were $13 million while a year ago at this point they were $12 million.

We have also maintained our cooperative efforts with other Federal agencies. DoD, GSA and the IRS jointly implemented a TIN validation program last October to validate all TINs in the Central Contractor Registration (CCR). This program will aid in accurate information reporting and federal tax collection with respect to contractors. All TINs will be validated within 12 months of implementation. In the first two months of the program, we were able to validate over 62,000 of the 380,000 registered vendors as of December 30, 2005. We expect to validate the remaining vendors by the end of 2006.

We have also implemented a process to research FMS name/TIN mismatches. FMS provides a weekly listing of entities where the payor name and the TIN do not match. Research is conducted to match the payor name/TIN within the IRS database. When matches are determined, an "alias" name control is input to the FMS data base "Client". As of mid-February, we completed research on 82 percent of the FMS accounts. We found matches for 24 percent of the mismatches FMS had provided. This process has made an additional $84 million of tax debts available for a potential match.

The FCTC task force has also been working on the problem concerning the use of purchase cards to pay contractors. It is currently pursuing an interim procedure to match debts in TOP with the CCR database maintained by the DoD. If a match is found, the CCR would be updated with a field that the contractor is not eligible to be paid by the purchase card program and will have to be paid by a payment system currently in TOP.

We have also made progress on reducing the number of federal payment systems that do not match against Federal debts. To date, 18 of the 20 Defense Finance Accounting Service (DFAS) payment systems have been implemented in the automated process. These last two payment systems account for less then 0.03 percent of Federal payments.

In addition, a study was conducted to match individual tax debts against vendor payment files. During the early implementation of the FPLP, a decision was made not to match individual tax debts against vendor payment files to avoid the possibility of mistakenly levying a business' Federal payment to collect an unrelated individual's tax debt. This was because the FMS' payment file does not distinguish between Social Security Numbers (SSNs) and Employment Identification Numbers (EINs). Each of these numbers are 9 digits and the concern was that a vendor payment would be mistakenly levied to collect the tax debt of an unrelated individual taxpayer based on the vendor's EIN being identical to an individual's SSN. For this reason, only business tax debts were matched against vendor payment files.

The task force has revisited this issue and attempted to quantify the impact of a potential matching program utilizing the Name Control. What we found was that initially there were 4800 EINs in the data base that matched unrelated SSNs. However, if the Name Control was used in conjunction with the EIN for matching purposes, only 4 potential matches were identified. As a result, beginning last November, we began matching individual income tax debts and payroll trust fund penalties assessed on individual owners against contractor payments. This resulted in an initial match of approximately 1000 individual tax debts totaling debt balances of $240,000.

In January, we began analyzing all awarded DoD contracts from January 2005 thru November 2005 and for civilian contracts from July 2004 thru July 2005 to determine the extent to which there are non-filers being awarded federal contracts. We are now attempting to establish a system that would identify these non-filers and direct them to existing compliance systems to address the non-filing.

Enforcement has also been a high priority for us since I testified last June. I will talk about the 122 cases identified by the GAO later in my testimony. Many of these cases involve failure to pay employment taxes. Those cases can present even greater challenges for a criminal prosecutor.

It is important to understand, however, that our focus is not just on these 122 cases. We take instances of any Federal contractor not paying taxes very seriously.

We have issued notices of levy against funds in the bank accounts of Federal contractors and on accounts receivable, including accounts receivable due from federal agencies. In some cases, in order to collect 100 percent of a tax debt rather than the 15 percent collected via the FPLP, the revenue officer may block the taxpayer's inclusion in the FPLP and instead issue a paper levy directly to the federal agency.

In April 2005, we implemented the 100 percent continuous levy authority granted by the American Jobs Creation Act. Currently, we are only able to apply this 100 percent levy to Defense contractor payments. As a result, $15.4 million was collected through last January, instead of the $2 million that would have been collected under the 15 percent authority. With other Federal agencies, it is impossible to distinguish between payments for goods and services and other types of payments. We are now seeking a statutory change that will allow the 100 percent continuous levy authority for *all* Federal vendor payments, not just for "goods and services". This will allow us to impose the 100 percent levy on all Federal payments. Significant additional FPLP collections could have been made between April 2005 and January 2006 had we had that authority.

We have regularly filed notices of Federal Tax Lien to protect the government's interest in any asset owned by the taxpayer. In some cases, the Federal contractors appear to have related entities which are also being investigated and could result in the filing of nominee or alter ego liens so collection can be pursued on an asset not titled to the taxpayer.

We also issue summonses, when necessary, in order to secure information necessary to make a collectibility determination or to provide information to complete an income tax return.

The Trust Fund Recovery Penalty is also being used against Federal contractors who are delinquent on their wage withholding taxes. When this penalty is assessed against the responsible persons, those persons are personally liable and their personal assets can be attached, even though they may not be the taxpayer.

Steps are also being taken to improve the quality of our overall efforts on Federal contractor cases. Specifically, we have:

- Issued procedural guidance and made systemic changes. We have issued interim guidance to the Collection Field function containing procedures for working cases involving taxpayers who do business with the Federal government;

- Revised the group manager manual to include a requirement for the manager to maintain a list of all taxpayers in the group's inventory who are Federal contractors and to review those cases;

- Made systemic changes to the field inventory management system;

- Developed and issued "Tool Kits" for field revenue officers to increase their effectiveness in dealing with these types of cases.

GAO Cases

As you know, in 2004 the GAO cited 47 cases of DoD contractors being delinquent on their taxes. A year later, they identified another 50 civilian contractors doing business with the Federal government as having outstanding tax obligations. Recently, an additional 25 GSA cases have been identified.

I intend to update you on the status of these cases, but first I want to put the situation in context. When the 97 DoD and the civilian cases first came to the IRS, we examined them outside our normal process. Because of the Congressional hearings, these cases rightfully received significant public attention and many assumed that all or most of these Federal contractors were criminals and should be prosecuted.

As a result, all of these cases were first reviewed in IRS by our Criminal Investigation (CI) division. Under normal protocol, cases are referred to CI at the very end of the examination process, after we have examined all the facts and concluded that a potential criminal violation may exist. So, in a sense, the process was reversed for these specific cases. They were taken out of queue, if you will.

I know that there is a desire, and perhaps an expectation, by some that many of these contactors should have been subject to criminal prosecution. However, it is extremely difficult to meet the standard that would elevate these cases to a criminal prosecution. Stated another way, these cases are not a target rich environment for a criminal investigation.

The most difficult issue facing a criminal investigation on these cases is documenting sufficient evidence of affirmative acts of evasion to establish willfulness.

Willfulness is difficult to prove in employment tax cases because the government must show that the conduct was intentional and not simply a result of bad business decisions or mistakes.

Both the Department of Justice Tax Division and the United States Attorneys Offices consider overall "jury appeal" when deciding if a tax prosecution will be authorized.

Jury appeal is best demonstrated when the unpaid employment taxes inure directly to the taxpayers benefit.

Case selection is one of the key factors in determining whether a case will be successfully prosecuted. The CI division has vast experience in determining the prosecution potential of cases selected for investigation, evidenced by a 96.3% acceptance rate at the Department of Justice and 92.2% acceptance rate at the United States Attorneys Offices. The Employment Tax Program has been highly successful primarily because of the diversity and egregiousness of the high-dollar, high-impact cases selected for investigation.

With that in mind, we had experienced agents review the GAO referral information on the 47 DoD, the 50 civilian contractor and the 25 GSA cases.

Looking at the 122 total cases as a whole, 74 are now closed and no further criminal or civil action is anticipated. Nine cases have been referred for criminal investigation. These nine cases have a total of nearly $41 million in potentially collectible dollars. Two cases have been completed and are being referred to the Department of Justice for prosecution. In 5 of these cases, CI was already looking at the taxpayer prior to the GAO referral.

In 1 of those 5 cases, we have secured a conviction. A nursing home operator in California was found guilty on 47 counts of willful failure to truthfully account for and pay over payroll taxes owed to the government.

Of the remaining 74 closed cases, 12 paid their obligation in full for a total of slightly over $6 million. Eleven of the cases are in Chapter 11 bankruptcy and another 25 are out of business. Eleven more are classified as currently not collectible because of hardship, liquidation, or for other reasons. There are another 14 cases with installment agreements in place.

That leaves a total of 39 open cases. Of this total, Offers in Compromise have been made in three cases; four are in either the collection due process (CDP) appeals process or in the Automated Collection System. We have 32 cases totaling over $18 million that are with our Collection Field function (CFf) on which we are pursuing case resolution.

Of these 122 total cases, 48 are currently in the FPLP. While we make every effort to insure that all appropriate cases are referred to the FPLP, there are several reasons why a case would not be. For example, the taxpayer might have requested or entered into an installment agreement and the levy is prohibited by statute. Also prohibited by statute is the imposition of the levy on cases where an Offer in Compromise is being investigated or has been accepted. Other statutory prohibitions include where the taxpayer has filed for bankruptcy protection, and where the taxpayer has submitted a request of a CDP hearing.

Sometimes cases are not referred for operational reasons. For example, the IRS generally will not refer cases to the FPLP where there is an active criminal investigation going on, where there is a determination that the debt is uncollectible, or where the revenue officer assigned to an investigation determines that a levy might not be the best manner in which to collect the debt.

We are often asked why any of these cases would be classified as "currently not collectible". There are several reasons. First, the entity may be staying in compliance with current filing and payment requirements, but is unable to pay the back taxes, so collection is deferred until the taxpayer's ability to pay the back taxes improves. Second, the entity may have gone out of business and there never will be any collection potential. Third, the entity may that have undergone a liquidating bankruptcy. Finally, an individual taxpayer may have the debt classified as uncollectible if an analysis of income and expenses indicates no ability to pay delinquent taxes and necessary living expenses.

Future Actions

Working with the FCTC, we plan to continue to move forward on a number of initiatives in FY 2007 and beyond. We plan to make changes in the FPLP Exclusion Policy Criteria which will make more accounts available for the FPLP. Changes to this program include:

- Changing account exclusions to include modules with adjustment claims that will contain a balance due.
- Changing account exclusions criterion from 3 months to 1 month of the accounts collection statute except for SSA and Office of Personnel Management (OPM) payments.
- Including pending Installment Agreements (IA) where a levy already exits. If an existing FPLP levy preceded the pending IA request, we do not remove the account from the FPLP until the IA is approved and established.

In July, we expect to make changes to accelerate the progress of collections. These changes include:

- Federal Contractors identified from the Federal Procurement Data System—Next Generation (FPDS-NG) file in order to accelerate notice status accounts to final notice.
- Business Master File (BMF): CDP rights incorporated into the 2nd notice stage to accelerate to earlier collection stage - July 2006.

We are also still pursuing legislative changes to section 6331(h) of the Internal Revenue Code (IRC) to implement the 100 percent levy on vendor payments in addition to payments for "goods and services".

We are continuing to work with the FCTC on the problems associated with collecting debts from vendors utilizing purchase cards. The Task Force is pursuing the

implementation of a process to match debts in TOP with the CCR. If a match occurs the CCR would be updated with a field indicator that the contractor is not eligible to be paid by the purchase card program and will be re-directed to a payment mechanism currently in TOP. This only corrects new contracts and FCTC is exploring how to re-direct payments that already have contracts.

We also plan to escalate our search for non-filers. A file containing all awarded contracts from DoD and GSA for the past year was matched against IRS data to determine the non-filer universe. An analysis is being conducted on the data to determine appropriate next actions.

I know there is some desire on the part of members of this Subcommittee for us to look at ways on the front end that we can prevent contractors who are delinquent in their federal taxes from ever receiving federal contracts. Currently the only question that prospective contractors have to answer is whether they have been convicted of income tax evasion. This refers to a conviction under section 7201 (Income Tax Evasion) of the IRC and an affirmative answer could result in debarment of the contractor from receiving a Federal contract.

Some have suggested that the list of questions be broadened and that IRS become involved in verifying the answers, possibly on an annual basis. While I can certainly understand the motivation to do this, I am concerned that it could improperly involve the IRS in broader procurement policy questions and possibly raise taxpayer privacy issues.

The IRS has a defined mission. We have a set of duties, and before those duties are changed or expanded, there ought to be careful consideration of the policy implications of the specific change or expansion.

We live in an era where there is an acute sensitivity to individual privacy and we take our responsibility to protect that taxpayer privacy very seriously. We have an excellent reputation in that area. The sharing of tax information with other government agencies is a government-wide policy issue that needs to be worked in conjunction with the Administration, the Office of Management and Budget, and ultimately the Congress.

This committee has always been a strong supporter of our budget requests. The FY 2006 budget provided a $446 million increase that is allowing us to undertake several new enforcement initiatives that we believe will provide a significant return on investment. The FY 2007 budget, if fully funded, will allow us to continue the progress on those enforcement priorities while maintaining our strong focus on service. The increase in FY 2006 was done through a program integrity cap adjustment. The 2007 Budget again proposes a cap adjustment to maintain this increase.

Legislative Proposals

We believe that there are several things that can be done legislatively which will assist in collecting delinquent taxes from federal contractors. I have already mentioned one earlier in my testimony. We would like to see a change to section 6331(h) of the IRC to

allow the IRS to implement the 100 percent levy on all vendor payments not just those for goods and services. In addition, the Administration has proposed improving the FPLP program by allowing FMS to retain directly a portion of the levied funds as payment for FMS's fees, while still crediting the taxpayer's account for the full amount collected.

The President's proposed FY 2007 Budget also included five legislative initiatives designed to reduce the tax gap. Two of these can be helpful in going after contractors who fail to remit their taxes properly.

The first proposal would allow the levy to be imposed for employment tax liabilities prior to a CDP hearing in a fashion similar to levies issued to collect a federal tax liability from a state income tax refund. Taxpayers would have the right to a CDP hearing on these liabilities within a reasonable time after the levy.

The delinquency of many of the Federal contractors involves payroll taxes. Currently, we are authorized to take various collection actions including issuing Federal tax levies. However, before a tax levy can be issued, the IRS must provide the taxpayer with a notice and an opportunity for an administrative CDP hearing, and for judicial review. While the CDP rules provide important safeguards, they raise unique problems in the context of employment taxes.

Frequently, an employer who fails to satisfy its Federal tax liabilities for one period will also fail to satisfy them for later periods resulting in a "pyramiding" of unpaid taxes. Some employers who request a CDP hearing or judicial review for one tax period will continue to accrue, or pyramid, their employment tax liabilities during the CDP proceedings. Liabilities for the subsequent periods cannot be collected by levy until the employer has been given notice and opportunity for hearing and judicial review for each period, thus the need for a post levy CDP hearing.

Our second proposal would require increased information reporting for certain government payments for property and services. This proposal would authorize the Treasury Secretary to promulgate regulations requiring additional information reporting and backup withholding on non-wage payments by Federal, state and local governments to procure property and services. Certain payments would be exempt. These could include payments of wages and interest, already subject to withholding, payments for real property, payments to tax exempt entities or foreign governments, intergovernmental payments, and payments made pursuant to a classified or confidential contract.

The President's other three proposals to reduce the tax gap are not directly related to the federal contractor issue but are important none the less. The first would increase reporting on payment card transactions. Payment cards (including credit cards and debit cards) are a growing form of payment in retail business transactions. The failure of some businesses to accurately report their gross income, including income derived from payment card transactions, represents a significant portion of the tax gap.

Specifically, the Administration proposes that the Treasury Secretary be given the authority to promulgate regulations requiring annual reporting of the aggregate reimbursement payments made to merchants in a calendar year, and to require backup withholding for card issuers in the event that a merchant payee fails to provide a valid taxpayer identification number to the merchant bank.

It is clear that increased information reporting and backup withholding are highly effective means of improving compliance with tax laws. Because reimbursement information is provided to merchants, requiring this information to be reported to the IRS on an aggregate annual basis will impose minimal burden on card issuers. In addition, implementing a backup withholding system for payment card reimbursements to businesses would lead to material improvements in the compliance rates of these taxpayers without imposing a significant burden.

The second would clarify when employee leasing companies can be held liable for their clients' Federal employment tax. Employee leasing is the practice of contracting with an outside business to handle certain administrative, personnel, and payroll matters for a taxpayer's employees. Typically, these firms prepare and file employment tax returns for their clients using the leasing company's name and employer identification number, often taking the position that the leasing company is the statutory or common law employer of the clients' workers.

Non-compliance with the Federal employment tax reporting and withholding requirements is a significant part of the tax gap. Under present law, there is uncertainty as to whether the employee leasing company or its client is liable for unpaid Federal employment taxes arising with respect to wages paid to the client's workers. Thus, when an employee leasing company files employment tax returns using its own name and employer identification number, but fails to pay some or all of the taxes due, or when no returns are filed with respect to the wages paid by a company that uses an employee leasing company, there can be uncertainty as to how the Federal employment taxes should be assessed and collected.

The Administration's proposal would set forth standards for holding employee leasing companies jointly and severally liable with their clients for Federal employment taxes. The proposal would also provide standards for holding employee leasing companies solely liable if they met certain specified standards.

The third legislative proposal would expand the signature requirement and penalty provisions applicable to paid tax preparers. Under current law, paid tax return preparers are required to sign and include their taxpayer identification number (TIN) on income tax return and related documents that they prepare for compensation. Paid return preparers, however, are not required to sign and include their TINs on non-income tax returns or related documents such as employment tax returns, excise tax returns, and estate and gift tax returns.

The Administration's proposal would expand preparer identification and penalty provisions to non-income tax returns. Further, it would impose penalties for preparing non-income tax return related documents that contain false, incomplete, or misleading information or certain frivolous positions that delay collection.

Conclusions

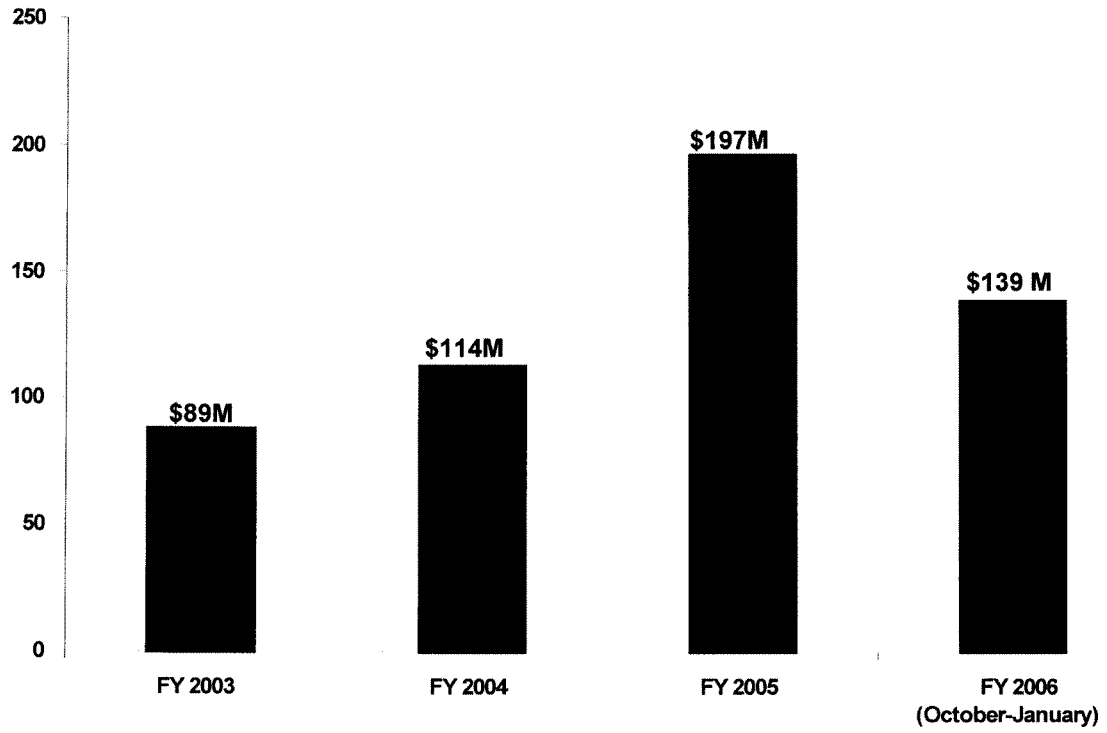
The IRS takes seriously the issue of federal contractors being delinquent on their Federal tax obligations. We have been working hard for the last two years and are continuing to work with other Federal agencies as part of the Federal Contractor Task Force to address this problem. Each agency on that task force has its own role in the process. The GSA is responsible for procurement. We are responsible for tax collection and administration. The Department of Justice is there to prosecute criminal offenses. By working together, we are making progress.

Of the 122 cases referred to us by GAO and GSA, we are still pursuing case resolution on 39 either through our civil or criminal enforcement investigative process. We have a conviction in one case and eight others remain under criminal investigation.

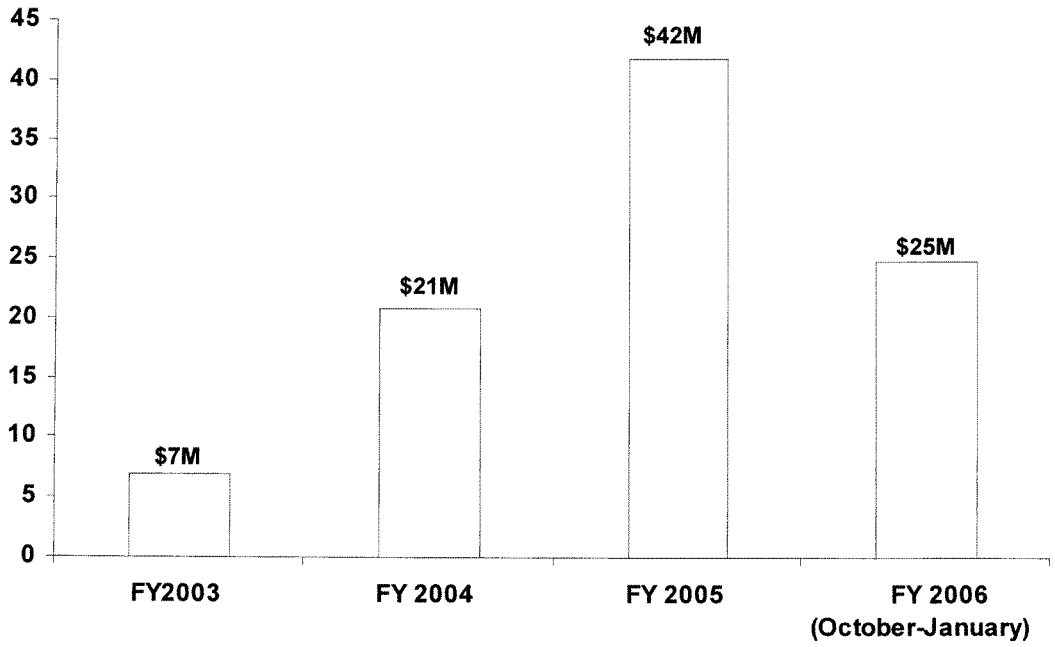
Our efforts in this area would be helped by enactment of the Administration's legislative proposals including the post levy CDP, extending the 100 percent levy to vendor payments other than "goods or services", and the reporting and back-up withholding of aggregate payments made by local, state and federal governments to contractors.

Thank you again for the opportunity to be here this morning and I will be happy to respond to any questions.

Federal Payment Levy Program
Total Collections

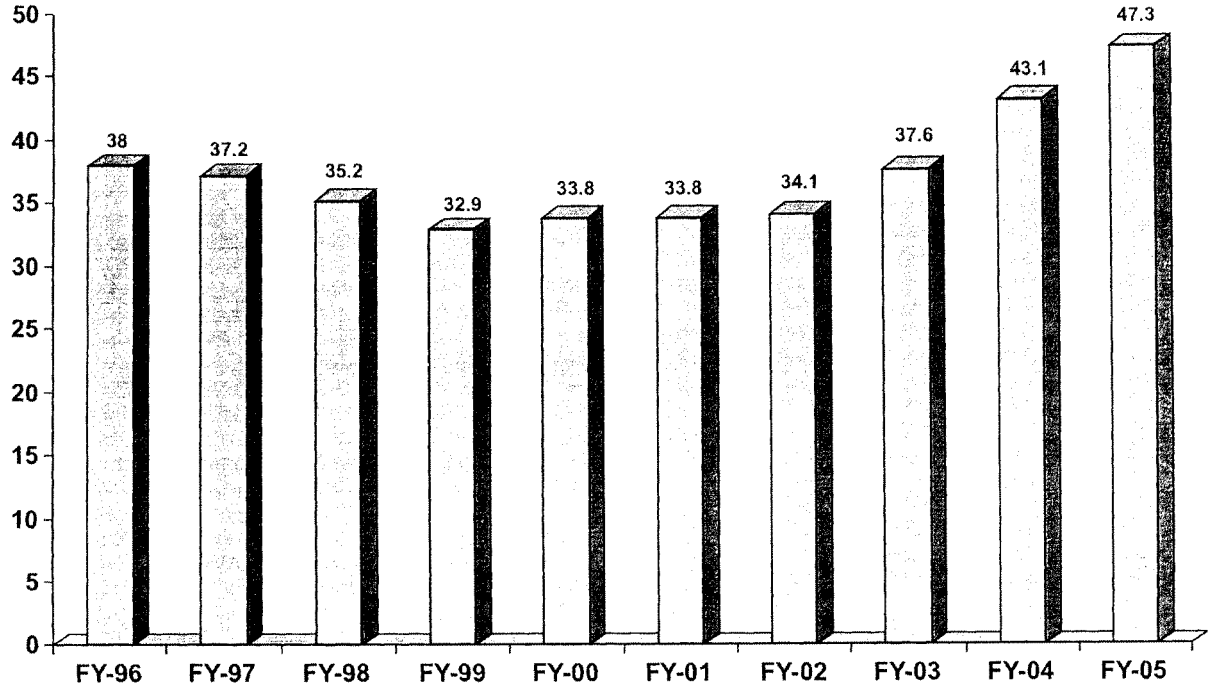


FEDERAL PAYMENT LEVY PROGRAM
TOTAL CONTRACTOR COLLECTIONS
(CIVILIAN and DFAS/DoD VENDORS)



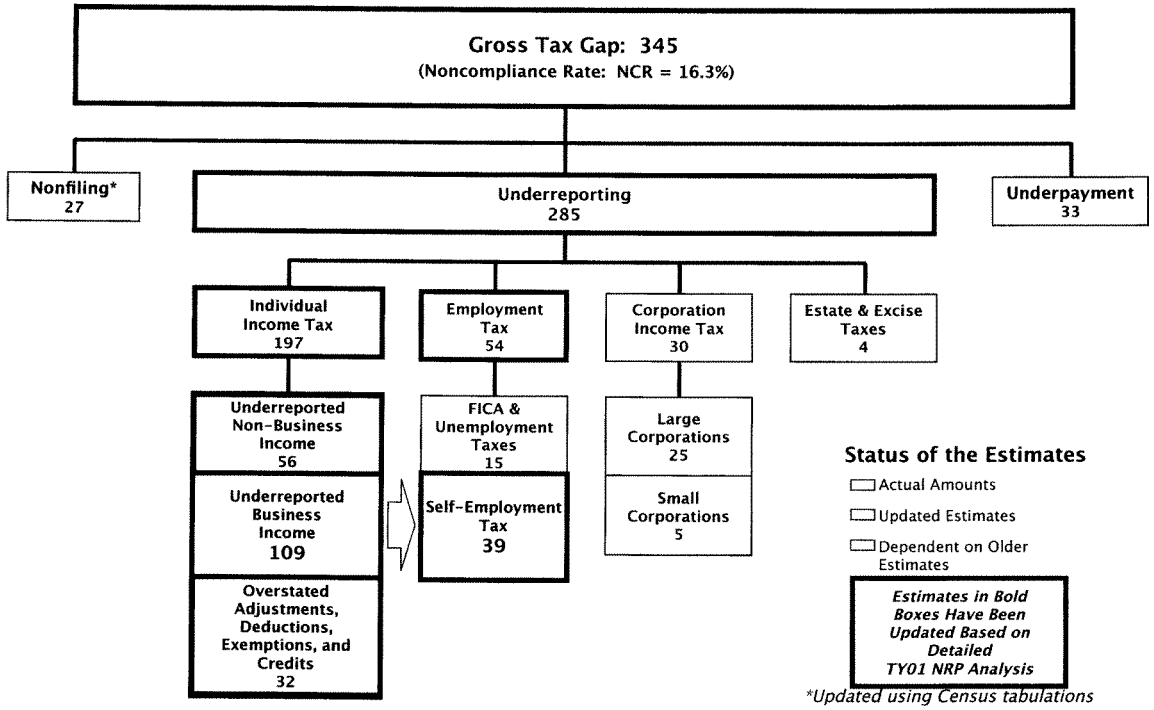
IRS Enforcement Revenue

Dollars in Billions



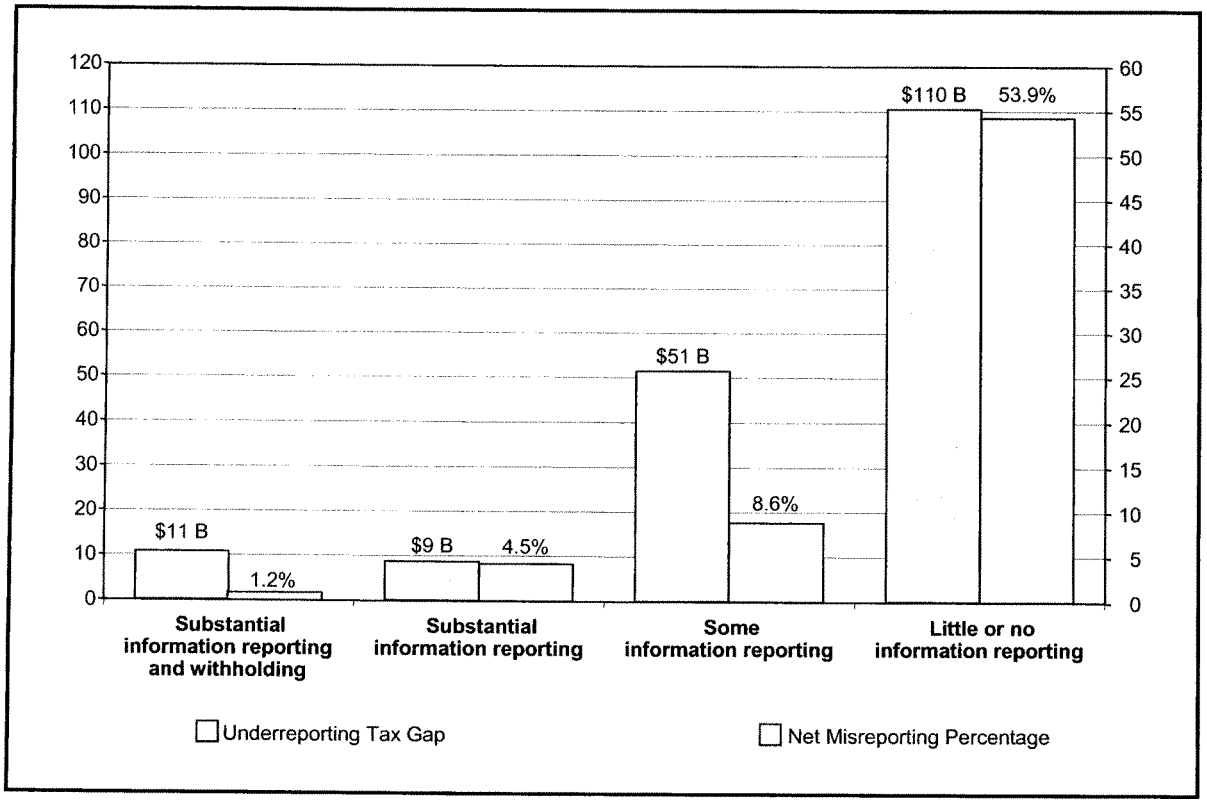
Tax Year 2001 FEDERAL TAX GAP

(in Billions of Dollars)

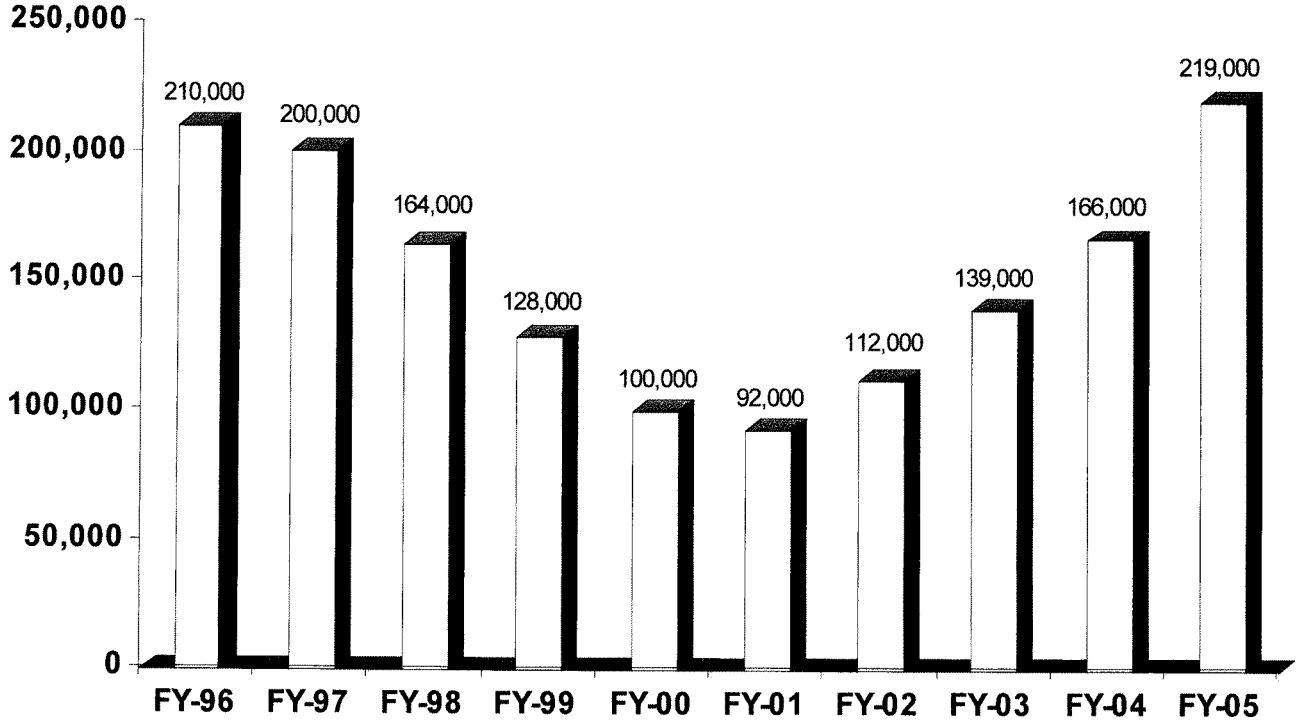


Internal Revenue Service • February 2006

Individual Income Tax Underreporting Gap



High Income Audits



Individual Income Tax Underreporting Gap Estimates, Tax Year 2001

Type of Income or Offset	*Tax Gap ($B)*	*NMP †*
Total Underreporting Gap	**197**	**18%**
Underreported Income	**166**	**11%**
Non-Business Income	**56**	**4%**
Wages, salaries, tips	10	1%
Interest income	2	4%
Dividend income	1	4%
State income tax refunds	1	12%
Alimony income	*	7%
Pensions & annuities	4	4%
Unemployment Compensation	*	11%
Social Security benefits	1	6%
Capital gains	11	12%
Form 4797 income	3	64%
Other income	23	64%
Business Income	**109**	**43%**
Nonfarm proprietor income	68	57%
Farm income	6	72%
Rents & royalties	13	51%
Partnership, S-Corp, Estate & Trust, etc.	22	18%
Overreported Offsets to Income	**15**	**4%**
Adjustments	-3	-21%
SE Tax deduction	-4	-51%
All other adjustments	1	6%
Deductions	14	5%
Exemptions	4	5%
Credits	**17**	**26%**
Net Math Errors (non-EITC)	*	

† NMP = Net Misreporting Percentage

* Less than $0.5 billion.

Internal Revenue Service • February 2006

STATEMENT OF

KATHLEEN M. TURCO
ACTING DEPUTY ADMINISTRATOR

U.S. GENERAL SERVICES ADMINISTRATION

BEFORE THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

U.S. SENATE

MARCH 14, 2006

Mr. Chairman, Members of the Subcommittee, my name is Kathleen M. Turco. I am the Acting Deputy Administrator of General Services. I am pleased to have this opportunity to appear before you today to discuss the General Accountability Office's (GAO) recent report titled "Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence." My testimony will address, in order, the issues that you raised in your letter of March 3, 2006.

Mr. Chairman, I know you are interested in what can be done to be sure that tax-delinquent General Services Administration (GSA) contractors are identified and subjected to the Federal Payment Levy Program. The answer is that many things can and have been done. As I will specifically address in my testimony, GSA has participated with the U.S. Department of the Treasury in the Federal Contractor Tax Compliance Task Force to identity several key automated systems changes that have enhanced the accuracy of the information that we presently have regarding Federal contractors. We also are working with our GSA SmartPay® vendors to explore the options for purchases from tax debtors where the GSA SmartPay® purchase card is used as a payment mechanism.

We believe that the issues you raise in your March 3 letter are very important and very complex. Progress on understanding and resolving the issue of Federal contractors who are tax debtors must be measured and precise to ensure accurate reporting of tax information and a appropriate response that furthers the interests of the Department of the Treasury and the Federal acquisition community. We believe that we are making such progress and are happy to present this information to you.

First, I would like to address your question related to the products and services that are available on the Multiple Awards Schedule, also known as MAS, as well as the scope, size, and use of the MAS program.

The MAS program provides Federal agencies with a simplified process of acquiring commonly used supplies and services in varying quantities while obtaining volume discounts. MAS indefinite-delivery contracts are awarded to commercial firms using competitive procedures. The MAS contractors provide supplies and services at stated prices for a given period of time, for delivery within a stated geographic area, such as the 48 contiguous states, the District of Columbia, Alaska, Hawaii, and overseas. GSA seeks to obtain pricing equal to or better than that given to the contractors' most favored customers, recognizing that the terms and conditions of commercial sales vary and there may be legitimate reasons why the best price is not achieved. In addition, GSA encourages agencies to seek price reductions and award work to the contractors that provide the best value.

Currently, there are 17,495 MAS contracts in place covering the following services and products:

Services

- Information Technology
- Facilities Maintenance and Management

- Communications (languages, public relations)
- Professional Engineering Services
- Financial and Business Solutions
- Furniture (interior design, relocation, installation, etc.)
- Javits Wagner O'Day eligible products (Purchase from People Who Are Blind or Severely Disabled)
- Human Resources
- Law Enforcement, Security, Emergency Preparedness
- Logistics
- Management Consulting
- Environmental Services
- Travel and Transportation
- Vehicle (leasing, rental, maintenance, repair)

Products

- IT hardware and software
- Tools
- Paper Products
- Office Supplies
- Vehicles
- Recreational Equipment (including trophies/awards)
- Law Enforcement Equipment
- Copiers

For fiscal year 2005, approximately $33.8 billion worth of sales were recorded through the MAS program.

The second issue I'd like to touch on is the process GSA follows to make responsibility determinations based on the representations and certifications application submitted by contractors. Prior to the award of a contract, GSA determines whether prospective contractors are "responsible" in accordance with the Federal Acquisition Regulation (FAR). The process GSA follows is specifically governed by FAR 9.104-1(a), which requires that in order to be deemed responsible, a prospective contractor must:

> Have adequate financial resources;
> Be able to comply with the delivery or performance schedule;
> Have a satisfactory performance record;
> Possess a satisfactory record on integrity and business ethics;
> Possess the necessary organization, experience, technical skills, accounting and operations oversight; and
> Have the production, construction and/or technical equipment and facilities to perform the work required.

A pre-award survey is conducted if the Contracting Officer has reason to believe one or more of the aforementioned factors are in doubt. Per FAR 9.106-1, a pre-award survey is

not required for the acquisition of commercial items. However, the Contracting Officer must still determine financial responsibility even for the acquisition of commercial items.

One method of determining financial responsibility by GSA Contracting Officers is to review and evaluate the latest company financial statements. Other facts that could be considered is how long the company has been in business, any bankruptcies during the company's lifetime, bond rating by Moody's or Standard and Poor's, etc..

If a pre-award survey is needed, the Contracting Officer submits a Standard Form (SF) 1403, *Pre-award Survey of Prospective Contractor* to GSA's Finance Office. GSA Credit and Finance personnel examine technical capability, production capability, quality assurance capability and financial capability, including a check of the accounting system. For contracts involving the production of commercial items, GSA sometimes uses GSA Form 353, *Performance Evaluation and Facilities Report*. This evaluation examines monthly production capacity; production equipment; production methods; management; inspection; quality assurance procedures; packaging, packing and marking; and performance history.

An overall responsibility determination also is dependent on contractor representations and certifications. Contractors provide these FAR required statements by using the Online Representations and Certifications (ORCA) system. The Contracting Officer is responsible for reviewing the representations and certifications to be sure that they do not present information that would impede an affirmative finding of contractor responsibility.

Another issue raised in your letter is the integration of ORCA and the Central Contractor Registration (CCR) as part of the Business Partner Network, including GSA's management of CCR and efforts related to taxpayer identification number validation. The Integrated Acquisition Environment was established as one of twenty four e-government initiatives. Its mission is to provide a shared services environment for those functions which are common to all Federal acquisition activities. One of these is the CCR, which is the single point of registration for those wanting to do business with the Federal Government as prescribed in the Federal Acquisition Regulation.

This system allows us to collect basic vendor information one time and share it among all agencies. It collects addresses, business lines, socio-economic data, points of contact and electronic funds transfer (EFT) information for payment in one place, eliminating the need for registrants to find, enter and maintain multiple Federal agency databases. Registrants are responsible for registering and maintaining their own data. We require an annual revalidation to maintain the active status necessary to receive awards and payments. As of March 3, 2006, there are currently 413,000 active registrants.

Wherever possible, data is validated by the authoritative source. Since April 2005, registration information is passed to the Small Business Administration (SBA) in real time to validate certifications for 8(a), HUBZone and Small Disadvantaged Business. The employee and revenue values provided by the registrant are also used by the SBA to calculate business size for each North American Industry Classification System (NAICS)

code to assist contracting officers. Contracting Officers are still responsible to make a size determination on each contract based on its characteristics.

On October 30, 2005, the CCR program began validating the Taxpayer Identification Number (TIN) and Taxpayer Name of each new registrant and updating existing CCR registrants with Internal Revenue Service (IRS) records. The TIN matching process is a joint effort between the General Services Administration (GSA), the Department of Defense, and the IRS to improve the quality of data in Government acquisition systems. All CCR registrants were informed that new or modified records would trigger the IRS validation in CCR registration. In order to complete CCR registration and qualify to bid for Federal Government contracts or apply for Federal grants, the TIN and Taxpayer Name combination provided in the IRS Consent Form screen must match exactly to the TIN and Taxpayer Name used in Federal tax matters. It is now averaging 1-2 business days to validate new and updated records prior to becoming active in the CCR database. If the data does not match, the registrant is provided an IRS helpdesk number to call.

Another part of the Business Partner Network of systems is ORCA, which I previously mentioned. This system extracts CCR information from the database and enters it into appropriate contract clauses to eliminate re-keying by the vendor. The appropriate individual then validates its accuracy. Subsequent solicitations will use this data unless an offeror provides an exception for that solicitation. Tax evasion is covered in one multi-purpose clause covering fraud, embezzlement, tax evasion and other areas; only 69 records reflected an affirmative response to this question. This clause also provides information on penalty for misrepresentation.

I'd now like to briefly address GSA's ability to determine whether federal contractors have been indicted for or convicted of tax evasion as part of the Responsibility Determination.

Every MAS solicitation contains clause, 52.212-3 *Offeror Representations and Certifications—Commercial Items*. In this clause, the offeror certifies, to the best of its knowledge and belief, whether the offeror and/or any of its principals—within a three-year period preceding this offer, have been convicted of or had a civil judgment rendered against them for the following:

> commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a Federal, state or local Government contract or subcontract; violation of Federal or state antitrust statutes relating to the submission of offers; or commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, or receiving stolen property.

This information may be obtained directly from the contractor or from the ORCA system.

Another issue you raise in your letter is the status of ongoing work related to GSA by the Federal Contractor Tax Compliance Task Force and especially the effort to be sure that

purchase card payments are subjected to levies pursuant to the Federal Payment Levy Program.

The purchase card is a charge card issued as part of GSA's SmartPay® Program which provides commercial purchase card services to approximately 350 Government agencies and organizations. The program enables agencies to avoid an estimated $1.4 billion in administrative processing costs annually on relatively low-cost purchases through the use of a streamlined, commercial buying process. These services are provided through five contractor banks. GSA obtains summary level data on purchase card transactions under this program, for purposes such as monitoring payments. We do not receive detailed, transaction-by-transaction information.

Since May 2005, at your request, GSA actively participates in the Federal Contractor's Tax Compliance (FCTC) Task Force Purchase Card Subgroup. As a task force participant, GSA explored potential approaches to address the collection of outstanding tax debts through the GSA SmartPay® Program purchase card business line, in coordination with officials from the Department of the Treasury's Internal Revenue and Financial Management Services, and the Defense Finance and Accounting Service, and the Office of Management and Budget.

GSA participated in subsequent FCTC subgroup meetings in June, October and November 2005, as well as numerous phone conversations on this matter. For the November meeting, GSA arranged for the GSA SmartPay® contractor banks, as well as representatives from the major charge card associations, to meet with FCTC officials to discuss the feasibility of various approaches to the levy issue.

Since neither GSA, nor the Federal Agencies using the GSA SmartPay® purchase card, pay the individual merchants directly (a range of banks both within and without the GSA SmartPay® Program make these payments in coordination with the charge card associations and other entities), the idea of government agencies withholding payments from individual merchants does not appear workable.

Alternative approaches such as requiring the banks to withhold funds from individual merchants were also rejected as the GSA SmartPay® banks informed us that their automated systems do not possess this functionality. The banks also raised issues of liability for erroneous levies; legal concerns regarding levy authority; challenges associated with determining a specific vendor's identity within multiple, related charge card systems; anticipated costs associated in changing commercial systems; the need to change card association agreements in place with a merchant community numbering in the millions, etc. This matter is further complicated by the fact that the bank that issued the card, and the bank that issues the payment to the merchant for the transaction, are often different banks.

The industry advises that a third alternative, involving "blocking" transactions such that government purchase cards cannot be used with specific merchants until their tax delinquencies are resolved, is not possible given the current infrastructure. While

industry can "block" transactions, it can do so only very broadly. For example, all hardware stores could be blocked, as opposed to one specific hardware store.

While Government charge card business is substantial, it is relatively small in comparison to world-wide commercial and individual card use. For example, MasterCard volume for the first six months of calendar year 2005 equaled $556 billion. VISA's annual transaction volume is reportedly $3 trillion dollars annually, as compared to a total of $24 billion total for all GSA SmartPay® product lines, encompassing purchase, travel and fleet charge cards, for all of fiscal year 2005. Industry expressed concerns regarding the potential costs for commercial system infrastructure changes solely to satisfy government-unique needs.

Under the GSA SmartPay® Program, GSA contracts for commercial charge card services. We are concerned that the levy issue is outside the scope of the current negotiated contracts and may actually be a broader banking industry issue. We are also concerned that future actions on the levy issue take into account any potentially negative impact on the small business community, and that if a requirement for the banking industry to levy charge card payments is mandated, that a funding strategy be identified to implement such a change.

Given the significant administrative processing cost savings accruing to agencies from purchase card use, we also believe any levy process needs to be largely transparent to the user in order to avoid discouraging use of the card. In fiscal year 2005 alone, the top 10 agencies in the program transacted approximately 26 million purchases with an average value of just under $700. Most purchase cardholders are non-procurement personnel who use the card in the course of delivering mission services to the public and other customers. Loss of the streamlined processes the card affords, especially for so-called "micro-purchases" under $2,500, could inadvertently discourage card use and loss of the attendant card use benefits the Government currently enjoys. Movement of these purchases away from cards in order to support a levy process could exacerbate current workload problems caused by procurement personnel staffing shortages as the primary vehicle for small purchases moves back to purchase orders and other traditional, paper intensive processes.

Another possible solution under discussion in the FCTC is to flag the CCR records as "Debtors" and issue new policy that the card cannot be used to place orders above the micro-purchase threshold with firms who have this flag. These orders would have to go through the order/invoice process in order to utilize the levy procedure. While this may be a compromise, the implementation needs to be worked out, as many ordering activities do not check or have access to the CCR under current procedures. This process would also require a new systems interface between Treasury and CCR in order to keep the flag current.

We also understand that in 2004, section 6331 of the Internal Revenue Code (26 U.S.C. 6331) was amended to allow the Treasury to continuously levy up to 100 percent of a federal vendor payment to collect outstanding tax obligations. Under previous law, Treasury was authorized to continuously levy only up to 15 percent of specified federal

payments. Many Federal payments, such as salary, retirement, and benefit payments, are regularly recurring payments that can be continuously levied until the outstanding tax obligation is satisfied. Vendor payments, however, are not regularly recurring payments and present fewer opportunities for collection. A technical correction to this new authority allowing Treasury to continuously levy up to 100 percent of all vendor payments would be another step toward reducing the tax indebtedness of Federal vendors.

At GSA, we take the issue of unpaid contractor taxes very seriously. We continue to participate in the subgroup looking for practical solutions. For example, we are examining the feasibility of asking competitors for the successor GSA SmartPay® contracts to identify potential alternative courses of action to address the levy issue. However, at this point we cannot predict what alternatives industry will propose, if asked, and how workable or cost-effective these approaches may be. We expect to award these new contracts during fiscal year 2007, with implementation in late November 2008.

Finally, I'd like to address the issue of whether Federal contractors who abuse the federal tax system should be barred from doing business with the Government or, if they are currently doing business with the Government, should be suspended or debarred.

Under current law and regulation the focus of debarment is to exclude companies that are presently not responsible. Tax evasion is a recognized cause for debarment. Similarly, bribery, falsification of records, embezzlement, committing a fraud or criminal offense in performing a Government contract are causes for debarment. The existence of a cause for debarment does not necessarily require that the contractor be debarred; the seriousness of the contractor's acts or omissions and any remedial measures or mitigating factors must be considered. The current regulation establishes a presumption that certain crimes will result in debarment, but it is a rebuttable presumption. It should be kept in mind that debarment is not a punishment for a crime but rather a measure designed to protect the Government from dealing with non-responsible vendors. It is the debarring official's responsibility to determine in each case whether debarment is in the Government's interest. Current law and regulation set an appropriate balance by granting discretion to the debarring official to measure the nature and seriousness of the offense.

GSA will continue to work with our fellow agencies to explore additional options to address the serious matter of contractors who do not pay their taxes. Thank you for providing this opportunity for GSA to appear before you. I will be happy to answer any questions you may have.

# # #

Characteristics of Egregious Tax Abuse*

Tax-Related Characteristics	Department of Defense (DOD) Contractors	Civilian Agency Contractors	Total Contractor Cases	Percent of Total Contractor Cases
Outstanding, unresolved tax debt	47	50	97	100
Federal tax liens	34	37	71	73
State tax liens	26	37	63	65
Trust fund recovery penalty assessments	18	27	45	46
Failed to file tax returns by entity and/or owner	12	6	18	19
Conviction for tax evasion	0	0	0	0
Indictment for tax evasion	0	0	0	0

*Prepared by the Majority Staff of the Senate Permanent Subcommittee on Investigations
(Based on analysis of 97 GAO Case Studies)

Permanent Subcommittee on Investigations
EXHIBIT #1

U.S. DEPARTMENT OF JUSTICE

United States Attorney's Office
Northern District of California

11th Floor, Federal Building
450 Golden Gate Avenue, Box 36055
San Francisco, California 94102
(415) 436-7200
FAX: (415) 436-7234

FOR IMMEDIATE RELEASE
February 9, 2006

NURSING HOME OWNER CONVICTED OF FAILING TO PAY OVER $3 MILLION IN EMPLOYEES' TAXES TO IRS

OAKLAND -- United States Attorney Kevin V. Ryan announced that Jack E. Easterday of Alameda, California, was convicted today by an Oakland jury of 47 counts of willful failure to truthfully account for and pay over payroll taxes owed to the government. The jury, after deliberating for two days, found that the defendant withheld income taxes and Social Security taxes from his employees but never paid them to the government. Easterday is the owner of numerous nursing home facilities in the East Bay. He was convicted today for his failure to pay over the payroll taxes owed by the following facilities:

- Employee Equity Administration Inc,
- Eden West Convalescent Hospital,
- Homewood Care Center,
- Oakland Care Center,
- Sunrise Healthcare Center, and
- Skilled Logic Systems, Inc.

The guilty verdict followed a three day jury trial before U.S. District Court Judge Claudia Wilken.

Mr. Easterday, 51, was charged on March 11, 2005, with 47 counts of willfully failing to truthfully account for and pay over to the IRS the income taxes and Social Security taxes that he withheld from his employees. The criminal information charged Mr. Easterday with failing to pay over taxes of $3,008,311 from the years 1998 to 2002. Evidence at trial showed that the defendant failed to pay over $18 million in payroll taxes from 1998 to 2005, which will be considered for sentencing purposes.

The evidence at trial showed that the IRS had attempted to collect the taxes from the defendant for years before the charges were filed. However, the defendant thwarted the efforts of the IRS to collect the taxes by, among other things, paying himself and his wife exorbitant salaries and directors fees, while he was pleading poverty to the IRS collection agents.

The sentencing of Mr. Easterday is scheduled for May 15, 2006 before Judge Claudia Wilken in Oakland. The maximum statutory penalty for each count in violation of 26 U.S.C. Section 7202 is 5 years and a fine of $10,000. However, any sentence following conviction would be imposed by the court after consideration of the U.S. Sentencing Guidelines and the federal statute governing the imposition of a sentence, 18 U.S.C. § 3553.

Permanent Subcommittee on Investigations
EXHIBIT #2

Thomas Moore and Cynthia Stier are the Assistant U.S. Attorneys who prosecuted the case with the assistance of Kathy Tat. The prosecution is the result of a four-year investigation by the Internal Revenue Service.

Further Information:

Case #: CR 05-00150

A copy of this press release may be found on the U.S. Attorney's Office's website at www.usdoj.gov/usao/can.

Electronic court filings and further procedural and docket information are available at https://ecf.cand.uscourts.gov/cgi-bin/login.pl.

Judges' calendars with schedules for upcoming court hearings can be viewed on the court's website at www.cand.uscourts.gov.

All press inquiries to the U.S. Attorney's Office should be directed to Luke Macaulay at (415) 436-6757 or by email at Luke.Macaulay@usdoj.gov.

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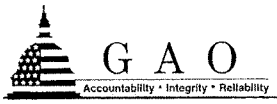

United States Government Accountability Office
Washington, DC 20548

April 21, 2006

The Honorable Norm Coleman
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security
and Governmental Affairs
United States Senate

Subject: Responses to Post Hearing Questions

Dear Chairman Coleman:

This letter responds the request by you and Senator Akaka for additional information related to the Subcommittee's March 14, 2006 hearing entitled *GSA Contractors Who Cheat on Their Taxes and What Should Be Done about It*. Enclosed are our responses to the supplemental questions you submitted for the record. Our responses are based largely on information contained in our published reports and testimonies related to Department of Defense, civilian agency, and GSA contractors with unpaid taxes and reflect our views based on that information.

If you have any further questions or would like to discuss these responses, please call Gregory Kutz at (202) 512-7455, or Steve Sebastian at 202-512-9521.

Sincerely yours,

Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Steven J. Sebastian
Director
Financial Management and Assurance

Enclosure-1

Permanent Subcommittee on Investigations
EXHIBIT #3

RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD
SUBMITTED BY

SENATOR NORM COLEMAN

to

GOVERNMENT ACCOUNTABILITY OFFICE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
GSA CONTRACTORS WHO CHEAT ON THEIR TAXES
AND WHAT SHOULD BE DONE ABOUT IT
March 14, 2006

1. **For each of the 25 GSA contractor cases identified at the hearing, please indicate whether the contractor had:**

- **an outstanding federal tax lien,**
- **an outstanding state tax lien,**
- **a trust fund recovery penalty assessed,**
- **been indicted for tax evasion,**
- **been convicted of tax evasion,**
- **been indicted for any criminal tax offense, or**
- **been convicted for any tax offense.**

The tax related offenses should include an indictment or conviction charged under 26 U.S.C. 7202, 26 U.S.C. 7203, 26 U.S.C. 7206(1) or 18 U.S.C. 371.

Answer:

As requested, table 1 below provides detailed data on the 25 GSA contractors with unpaid tax debt as they relate to (1) federal tax liens, (2) state tax liens, (3) trust fund recovery penalties assessed, (4) indictments for tax evasion, (5) convictions for tax evasion, (6) indictments for any criminal tax offense and (7) conviction for any criminal tax offense.

Table 1. GSA Contractors with Unpaid Federal Taxes

Case study	Federal tax lien?	State tax lien?	Trust fund recovery penalty assessed?	Indicted for tax evasion?	Convicted of tax evasion?	Indicted for any criminal tax offense?	Convicted for any criminal tax offense?
1	Yes	Yes	Yes	No	No	No	No
2	Yes	Yes	No	No	No	No	No
3	Yes	Yes	Yes	No	No	No	No
4	Yes	Yes	No	No	No	No	No
5	Yes	Yes	No	No	No	No	No
6	No	Yes	No	No	No	No	No
7	Yes	No	No	No	No	No	No
8	Yes	Yes	No	No	No	No	No
9	Yes	Yes	No	No	No	No	No
10	Yes	Yes	No	No	No	No	No
11	Yes	Yes	Yes	No	No	No	No
12	Yes	Yes	No	No	No	No	No
13	No	Yes	No	No	No	No	No
14	Yes	Yes	Yes	No	No	No	No
15	Yes	Yes	No	No	No	No	No
16	Yes	No	Yes	No	No	No	No
17	Yes	Yes	Yes	No	No	No	No
18	Yes	Yes	No	No	No	No	No
19	Yes	Yes	No	No	No	No	No
20	No	Yes	Yes	No	No	No	No
21	Yes	Yes	No	No	No	No	No
22	Yes	Yes	Yes	No	No	No	No
23	Yes	Yes	No	No	No	No	No
24	Yes	Yes	Yes	No	No	No	No
25	Yes	Yes	Yes	No	No	No	No

Source: Internal Revenue Service and public records

2. Of the 40,000 GSA contractors GAO reviewed, how many failed to file tax returns?

Answer:

The Internal Revenue Service (IRS) does not maintain a database of companies that failed to file tax returns. Without such a database, we were not able to determine the extent to which the 40,000 GSA contractors failed to file tax returns. However, through our extensive review of tax transcripts, revenue officer's notes, and other tax records, we were able to determine that at least four of the 25 case study companies we investigated did not file tax returns.

RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD SUBMITTED BY

SENATOR DANIEL AKAKA

to

GOVERNMENT ACCOUNTABILITY OFFICE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
GSA CONTRACTORS WHO CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT
March 14, 2006

1. Mr. Kutz, your testimony from last November described the missed opportunities to levy billions of dollars because of FMS's management and oversight deficiencies. Please describe the steps that the Financial Management Service (FMS) has taken to correct data quality problems such as payments where the agency payment station was not loaded into the system; payments contained inaccurate Taxpayer Identification Numbers; or payments that contained blank or invalid names. Also, please explain if the situation that you described last November has improved based on changes implemented by FMS.

Answer:

The Department of Treasury's Financial Management Service (FMS) has made significant progress in implementing our recommendations for correcting data quality problems in their payment process. The following is a synopsis of our recommendations from our report[1] and FMS's actions to address those recommendations.

- In June 2005, we reported that FMS did not update its Treasury Offset Program (TOP) database to capture payments from about 150 agency paying stations, resulting in $40 billion of fiscal year 2004 civilian agency contractor payments being excluded from potential levy. We recommended that FMS update the TOP database to include payments from all agency locations and develop and implement a monitoring process to ensure that TOP's list of agency paying locations is consistently updated. FMS has updated the TOP database to include all agency paying locations in TOP for potential levy. FMS also developed and implemented procedures to monitor agency paying locations to ensure that the TOP list is consistently updated.

- In June 2005, we also reported that FMS disbursed payments without proper TINS, vendor names, and payment types. We recommended that FMS monitor payment files to ensure that the payment files contain all the proper information necessary for offset and notify agencies of any deficiencies noted from this monitoring. In response to our recommendation, FMS issued a bulletin to the heads of government

[1] *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-637 (Washington, D.C.: June 16, 2005).

departments and agencies reminding agencies of the requirement for payment files to be accurate and complete. FMS also began issuing monthly "report card" letters to the agencies' Chief Financial Officers that provided information on the agency's compliance with TIN and payee name. According to FMS officials, the implementation of these steps has resulted in agencies making substantial progress in providing complete and accurate payment files to FMS. According to Treasury, the reported compliance rates for TINS and payee names are about 99 percent which is significantly higher than the compliance rate of about 80 percent prior to the implementation of our recommendations.

2. Based on data collected during your investigation last year, I understand that the unpaid federal tax for civilian contractors was $1.5 billion between the period of 1990 and 1999. Between the period of 2000 to 2002, the amount was $1.1 billion, and for 2003, the amount was $500,000,000. At first glance, this data shows a terrible trend of an ever increasing rate of tax delinquency among civilian contractors. Should we interpret this trend to mean that the tax delinquency problem among federal contractors is getting worse over time? Or, does this trend just mean that the capability to identify tax delinquency is getting better? Furthermore, if the trend is in fact true, are there any additional steps to include new legislation, besides your previous recommendations that we should take to stop this wave of irresponsibility?

Answer:

Based on the limited data we have, it is not possible to conclude whether the tax delinquency problem among civilian contractors is getting worse over time. The tax debt amount is affected by both the accumulation of interest and penalties (making the tax debt bigger) and the collection of taxes (making the tax debt smaller) over time. Additionally, the amounts you note represent only those taxes specifically identified by IRS as being owed by contractors. These numbers do not consider the magnitude of additional tax debt that may be owed by contractors which IRS has not specifically identified, such as amounts owed by contractors who have not filed tax returns. Because of these offsetting factors, it is difficult to draw a conclusion about whether the situation is getting better or worse based simply on the date of the tax module alone. However, we believe that the sheer magnitude of tax debts owed by civilian contractors that we were able to identify does indicate a problem. As for additional steps that could be taken, besides our previous recommendations, as you suggest in question number 4, the Federal Acquisitions Regulations could be modified to require contracting officers to require a review of tax delinquency before the issuance of a contract.

3. Mr. Kutz, in our subcommittee hearing last year I spoke about the lack of effort on the part of FMS to collect state tax debts from federal payments. Do you believe any progress has been made on this issue since your last report? And, please describe any barriers to progress on the part of the states or FMS.

Answer:

In July 2005, we reported that the federal government and states have not taken any action to collect unpaid debt through reciprocal agreements. As a result, we recommended that FMS notify states of the opportunity to enter into reciprocal agreements with the federal government to collect delinquent debts through offsets of federal and state payments, and assess the cost and potential benefits of developing reciprocal agreements with the states to collect delinquent debts through offsets of federal and state payments. FMS has made limited progress in implementing our recommendations. According to FMS officials, FMS conducted a conference call last year with state officials to describe how reciprocal agreements can be established with the federal government to collect delinquent debts through the offset of federal payments. FMS officials also stated that they obtained debt and payment information from two states, New Jersey and Maryland, to perform analysis on whether it would be beneficial to enter into reciprocal agreements. Based on this analysis, they found potential benefit in the offset of federal and state payments. FMS officials stated that they are continuing to look at this issue to determine the operational and legal issues that need to be resolved in order to implement our recommendations. However, until FMS implements reciprocal agreements with states, FMS and the states will continue to miss opportunities to collect outstanding debts through the reciprocal offsetting of payments.

4. You testified that the Federal Acquisitions Regulations (FAR) do not specifically require a review of tax delinquency before the issuance of a contract. Should FAR be changed to require such a review? If so, how would the tax delinquency information be made available to contracting officers since they are generally prohibited from viewing taxpayer information?

Answer:

In our 2004 report on Department of Defense contractors that abuse the federal tax system,[2] we recommended that the Director of Office of Management and Budget (OMB) develop and pursue policy options for prohibiting federal contract awards to contractors in cases in which abuse to the federal tax system has occurred and the tax owed is not contested. In this recommendation, we stated that options could include designating such tax abuse as a cause for governmentwide debarment and suspension or, if allowed by statute, authorizing IRS to declare such businesses and individuals ineligible for government contracts. However, OMB has not implemented this recommendation. Currently, FAR does not specifically require contracting officers to take into account a contractor's tax debt when assessing whether a prospective contractor is a responsible party and therefore should be awarded a contract. As a result, neither GSA nor other federal agencies perform reviews to determine whether prospective contractors have unpaid taxes at the time a contract is awarded.

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[2] GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence,* GAO-04-95 (Washington, D.C.: Feb. 12, 2004).

Another policy option is to change federal law, as implemented by the Federal Acquisition Regulation, and require the contracting officer's responsibility review to include an assessment of contractor tax delinquency before issuance of a contract. In addition to the general concerns about the federal government doing business with delinquent taxpayers, allowing these contractors to do business with the federal government creates an unfair competitive advantage over the vast majority of contractors who pay their taxes. This causes a disincentive to contractors to pay their fair share of taxes, and could lead to further erosion in compliance with the nation's tax system. However, certain issues would need to be considered in implementing such a provision, including ensuring the accuracy of taxpayer information, timely communication of the tax status of a prospective contractor to the contracting officer, and the legal barriers that currently prevent IRS from disclosing taxpayer information. This latter issue could be addressed through a requirement that prospective contractors certify that they do not owe any tax debts and provide consent to IRS to provide information on their tax status to the contracting officer. In addition, other issues would need to be addressed, such as developing a standard on what constitutes abuse of the federal tax system and the ability to expedite the negotiation of contracts as quickly as possible.[3]

(192208)

[3] We considered activity to be abusive when a contractor's actions or inactions, though not illegal, took advantage of the existing tax enforcement and administration system to avoid fulfilling federal tax obligations and were deficient or improper when compared with behavior that a prudent person would consider reasonable.

RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD
SUBMITTED BY
SENATOR NORM COLEMAN
for
THE HONORABLE MARK EVERSON
Commissioner
Internal Revenue Service

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
GSA CONTRACTORS WHO CHEAT ON THEIR TAXES
AND WHAT SHOULD BE DONE ABOUT IT
March 14, 2006

1. **Before the IRS enters into a contract for goods and services with a federal contractor, does it go farther than other agencies by asking potential contractors about more than just indictments and convictions for tax evasion?**

   - **Isn't it the case that the IRS checks to ensure that its potential contractors are complying with the tax laws, including unpaid tax debts?**

     Answer: Yes. IRS Policy and Procedures Memorandum (P&P) No. 9.1 (see attached) ensures that prospective contractor tax indebtedness is considered as part of the responsibility (financial and technical capability) determination required by Federal Acquisition Regulation (FAR) 9.103 for all IRS solicitations over $250,000. Tax checks are requested by the contracting officer, and conducted by IRS' SBSE Office of Revenue Reporting which reports the results to the contracting officer, although specifics regarding the check are not disclosed. The responsibility review of tax check results focuses on tax indebtedness (and other factors) of a magnitude that could jeopardize contract performance, and therefore may warrant a finding of non-responsibility. For each confirmed tax delinquent contractor that is awarded a contract, the contracting officer facilitates debt collection by notifying the IRS Collection Policy director. It is important to note that this is only one aspect of the responsibility determination required by the FAR. It is not a "go/no go" situation.

   - **Isn't it a fact that tax-related convictions and federal tax liens that have been filed are public information?**

     Answer: Yes, tax-related convictions that are a part of the public record of a judicial tax administration proceeding are public information. Similarly, filed notices of federal tax lien available to the public in state and county recording offices are public information.

Permanent Subcommittee on Investigations
EXHIBIT #4

- **Is there any reason why the IRS can't share this public information on a regular basis with GSA?**

  Answer: The IRS is vulnerable to claims of unauthorized disclosure if it shares with GSA information from its records and files, even if that information is available from an outside source such as courthouse records. Section 6103 of the Code provides that return information is confidential unless the Code contains an exception to the confidentiality rule. There is no specific exception in the Code for this "public record" information. Federal Courts have split on whether such "public record" information continues to be confidential. A number of courts have held that once tax information enters the public domain in the course of a tax administration proceeding, or as a result of tax administration activities (such as collection), the information is no longer protected by section 6103's confidentiality rule. Other Federal Courts have taken a stricter view and determined that any disclosure of return information is unauthorized unless specifically authorized by statute. These courts reject any notion of a public record exception to the confidentiality rule holding that section 6103 prohibits the disclosure of tax information regardless of whether that information has previously been publicly disclosed. Thus, while GSA could obtain information about convictions and tax liens from public sources, the IRS risks violating the strict construction of section 6103 by disclosing the same information taken from its own files and records.

2. **Recently, the Financial Management Service identified a total of 8,150 contractors who collectively owed $753 million in unpaid taxes and were paid with government purchase cards in 2005. The IRS has authorized the Financial Management Service to levy only a fraction of these contractors to satisfy their tax debt. Correspondingly, the IRS has not made the tax debt of over 6,000 of these contractors available for collection through levy. Would you agree to review these cases and determine if their tax debts can be made available for levy?**

   Answer: Financial Management Service (FMS) and Internal Revenue Service (IRS) held a meeting March 2006 and agreed that FMS will request VISA/Master Card accounts paid through purchase card and match this data against the Treasury Offset Program (TOP). FMS will forward all matches to the IRS to accelerate Collection Due Process Notices to ensure these cases are available for levy. We will explore the feasibility of receiving this information from Visa/Master Card every 3 to 6 months to ensure these accounts are ready for levy when matches occur.

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RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD
SUBMITTED BY
SENATOR DANIEL AKAKA
to
THE HONORABLE MARK EVERSON
Commissioner
Internal Revenue Service

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
GSA CONTRACTORS WHO CHEAT ON THEIR TAXES
AND WHAT SHOULD BE DONE ABOUT IT
March 14, 2006

1. **Commissioner Everson, in your testimony last year, you discussed the Federal Contractor Tax Compliance Task Force. You indicated that the task force included the General Services Administration and that initial meetings were held regarding offsets to contractors paid with purchase cards. Could you describe the progress that this task force has made in developing and implementing a system to levy offsets against tax delinquent contractors who are paid using government purchase cards?**

   Answer: The Federal Contractor Tax Compliance (FCTC) met with Visa/Master Card and the banks to discuss their roles in this process. To take steps in addressing and moving forward on this task, General Services Administration (GSA) reviewed their processes and scheduled a meeting with the Internal Revenue Service and Financial Management Service (FMS) April 27, 2006 to discuss how to leverage GSA SmartPay data, now and in the future, to support FMS tax levy matching process. The agencies will address the following topics: data from GSA SmartPay required by FMS; procedures needed to transmit data to FMS using the GSA SmartPay data currently provided by banks; and brainstorm for ideas to transmit data to FMS in the future if a data warehouse is implemented for GSA SmartPay. This includes the possibility of incorporating Central Contractor Registration (CCR) information with GSA SmartPay data to flag in the CCR those contractors who are delinquent in paying federal debts.

2. **While I believe that Collection Due Process (CDP) is beneficial to protect against unfair or premature collection practices, we are dealing with the issue of irresponsible federal contractors who in some cases are not even paying payroll taxes - money collected from employees and required to be held in trust. Do you have any suggestions on how to change the due process to ensure a fair collection effort, but not hinder the Internal Revenue Service's (IRS) ability to collect money owed from business who are being paid with federal dollars? For example, should we exclude corporations with long overdue or payroll tax debts from the current CDP?**

   Answer: In my testimony, I mentioned the Administration's legislative proposal to permit post-levy CDP procedures for levies made to collect Federal employment tax liabilities, treating them in a manner similar to the current procedures applicable to levies issued to collect a State tax refund via the State Income Tax Levy Program. This proposal would cover Federal employment tax liabilities owed by Federal contractors. It would not, however, apply to other Federal taxes owed by Federal contractors. As we continue to work with the FCTC, we will consider legislative proposals to amend the CDP rules, including the task force's previous proposal to grant post-levy CDP for levies on federal payments made to contractors, regardless of the type of tax at issue.

3. **The IRS is outsourcing the collection of unpaid taxes. As you testified, contracting officers generally cannot access tax information. I am interested to know how the IRS is reviewing contractors who are competing for and being selected to receive these contracts to ensure that these contractors do not have unpaid taxes. I also wish to know whether individuals employed by contractors – those who will actually perform the work – will be held to the identical performance and ethical standards as IRS employees. We know that IRS employees may be fired for breaking any of what's called the twelve deadly sins. I believe it is unfair for contract employees to be held any less of a standard if they are doing such important work.**

   Answer: In response to the first part of the question above, yes, IRS Policy and Procedures Memorandum (P&P) No. 9.1 ensures that prospective contractor tax indebtedness is considered as part of the responsibility (financial and technical capability) determination required by Federal Acquisition Regulation (FAR) 9.103 for all IRS solicitations over $250,000. Tax checks are requested by the contracting officer, and conducted by IRS' SBSE Office of Revenue Reporting which reports the results to the contracting officer, although specifics regarding the check are not disclosed. The responsibility review of tax check results focuses on tax indebtedness (and other factors) of a magnitude that could jeopardize contract performance, and therefore may warrant a finding of non-responsibility. For each confirmed tax delinquent contractor that is awarded a contract, the contracting officer facilitates debt collection by notifying the IRS Collection Policy director. It is important to note that this is only one aspect of the responsibility determination required by the FAR. It is not a "go/no go" situation.

These procedures are altered where, instead of soliciting a prospective contractor to provide debt collection services directly, the IRS elects to issue a task order for collection services against an existing GSA Federal Supply Schedule contract. In such case, a responsibility determination as required by FAR 9.103 would have been made by the GSA prior to awarding the schedule contract. For the task orders issued for the limited implementation of the IRS' Private Debt Collection Initiative, the IRS requires that all contractor personnel who either are assigned to a task order or who have access to taxpayer data, undergo an IRS-conducted background investigation that includes being in full compliance with all Federal tax laws and regulations. Under the limited implementation task orders, tax checks are required annually for all contractor employees and managers working on or managing the contract.

In response to the second part of your question which we coordinated with the Contracting Officer, IRS is holding the Contractor to the same standards that apply to IRS employees. Specifically, IRS employees & the Contractor are held to the Fair Debt Collection Practices Act; to Internal Revenue Code Sections 6103(a), 6103(n) and 7431(a)(2), Protections Against Unauthorized Disclosure, and Protections with respect to Third Parties, among others. Below is the specific section in the IRS debt collection task orders.

J.3 LAWS, REGULATIONS, AND STANDARDS GOVERNING COLLECTION ACTIVITY

J.3.1 The Contractor shall comply with all applicable Federal and State laws. The principal Federal statutes and regulations currently governing collection activity on Federal tax debt are listed below. IRS will monitor the Contractor's collection activity and failure to comply with applicable laws and regulations will be considered a breach of contract. The laws and regulations listed below are available for review upon request by the Contractor to the Contracting Officer.

- Internal Revenue Code of 1986, as amended.
- Internal Revenue Code Sections 6103, 7213, 7213A, 7431, and Treasury Regulations Section 301.6103(n)-1 (disclosure, disclosure related penalty provisions, and disclosure implementing regulations).
- 18 USC Sections 641 and 3571.
- Taxpayer Bill of Rights, Subtitle J of Title VI of Technical and Miscellaneous Revenue Act of 1988 (TAMRA), PL 100-647 (sections 6226 through 6247).
- Taxpayer Bill of Rights 2, PL 104-168, 110 Stat. 1452 (1996).

- Federal Claims Collection Act of 1966, PL 89-508.
- Debt Collection Act of 1982, PL 97-365.
- Debt Collection Improvement Act of 1996, PL 104-134, 31 USC § 3701 et seq.
- Fair Debt Collection Practices Act, PL 95-109, 15 USC § 1692 et seq.
- Privacy Act of 1974, as amended, PL 93-579, 5 USC § 552a.
- Federal Claims Collection Standards, 31 CFR Parts 900-904 (65 Fed. Reg. 70390, Nov. 22, 2000).
- Treasury Financial Manual, Volume I, Part 5, Chapter 4000 (Making Deposits) and Volume I, Part 6, Chapter 8000 (Cash Management), as amended.
- Internal Revenue Service Restructuring and Reform Act of 1998, PL 105-206 (RRA 98).
- Any laws enacted or regulation published after award of this contract, which governs the collection of federal taxes, including but not limited to modifications or additions to the statues described herein.

J.3.2 Internal Revenue Code Provisions

The following is a list of applicable Internal Revenue Code Provisions. This is a representative list and is not all encompassing or exhaustive.

J.3.2.1 Protections provided by the Fair Debt Collection Practices Act (15 USC section 1692 et. seq.) – The Fair Debt Collection Practices Act (FDCPA) applies to private collection agencies. Certain provisions of the FDCPA have been incorporated into section 6304 of the Internal Revenue Code (I.R.C. or Code) and apply to IRS employees. PCAs will be fully subject to all requirements under the FDCPA, including those specifically applicable to IRS employees under section 6304 of the Code. PCAs, for instance, will be prohibited from communicating with taxpayers at an unusual or inconvenient time or place, or engaging in conduct that is harassing, oppressive, or abusive.

J.3.2.2 Protections Against Unauthorized Disclosure (I.R.C. section 6103) – Sections 6103(n) and 7431(a)(2) of the Code currently permit a taxpayer to pursue legal action against any person who is permitted to receive taxpayer returns or return information for purposes of assisting in tax administration, but who unlawfully discloses that information. Contractors are persons within the meaning of section 6103(n). Criminal penalties also may be imposed under I.R.C. sections 7213 and 7213A. These provisions will apply to PCAs. Treasury regulations section

301.6103(n)-1 places certain and clear requirements on the disclosures of tax returns and return information to Contractors; no re-disclosures by the Contractor are allowed without prior written approval from the IRS. The regulation places specific notification requirements upon the Contractor as well as allows IRS to set safeguards for compliance by the Contractor (and any subcontractor). This provision will apply to PCAs and the IRS will be required to submit annual reports outlining the safeguards in place at the PCAs' locations to prevent unauthorized disclosures.

J.3.2.3 Protections with Respect to Third-Parties – PCAs will not be authorized to communicate with third parties other than the taxpayer's representative in accordance with Sec. J.4.4.2.3, unless specific approval is secured from the IRS prior to the making of such contact. Additionally, PCAs are required to secure specific approval from IRS for any third party contacts initiated in the performance of this contract. Under no circumstances can the PCA divulge any information about the taxpayer, his or her account, or the nature of the call to anyone other than the taxpayer or their authorized representative. Skip tracing that does not result in the divulging of information and that is consistent with the limitations found in 15 USC section 1692(b) is permissible, provided the specifics are documented in the PCAs Operational Plan and approved by the IRS.

J.3.2.4 Protections with Respect to Communications – PCAs will be required to comply with the Code provisions governing notices reflecting balances due, penalties, and interest (I.R.C. sections 6631, 6751(a) and 7522). In addition, PCAs will be required to comply with Code and Internal Revenue Manual provisions governing taxpayer interviews by employees, I.R.C. section 7521.

J.3.2.5 Protections against Conduct that Violates Minimum Standards – Section 1203 of RRA98 prohibits certain specified conduct by IRS employees, including conduct in connection with the collection of unpaid tax. IRS employees, for example, are prohibited from violating any constitutional or civil right of, or retaliating against a taxpayer or taxpayer representative. PCAs will be required to comply fully with the provisions of section 1203, including, to the extent permissible under applicable law, the removal of PCA employees who violate the requirements of this provision from working on this contract. IRS will submit annual reports to Congress outlining compliance by PCAs with the restrictions contained in section 1203 of RRA 98.

J.3.2.6 Assistance from the National Taxpayer Advocate and the Taxpayer Advocate Service (TAS) (I.R.C. sections 7803(c) and 7811) – The office of the National Taxpayer Advocate (NTA) provides assistance to taxpayers seeking help in resolving their problems with the IRS. Any taxpayer may request and obtain the assistance of TAS. PCAs will be required to:

1. Inform taxpayers of their right to obtain assistance from the TAS
2. Immediately refer any case where such assistance is requested or where the taxpayer describes a significant hardship (as defined in section 7811(a)(2) of the Code and the Internal Revenue Manual) to the IRS designated point of contact.

J.3.3 The Contractor shall meet all applicable State and Local licensing requirements and bonding/insurance requirements. Additionally, the Contractor shall be licensed to perform debt collection activities in all States, Territories, and Federal jurisdictions of the United States.

J.3.4 The Contractor shall ensure that all attempts to collect on accounts do not involve harassment, intimidation, or the use of false or misleading representations. There shall be no communications concerning such debt to persons other than the taxpayer or the taxpayer's designated representative unless requested by the taxpayer and approved by the IRS. No taxpayer information shall be conveyed to a third party without receipt of a signed Power of Attorney authorization from the taxpayer in accordance with Section J.4.4.2.3.

J.3.5 The Contractor shall indemnify and hold the Federal Government harmless from any and all third party liability, loss, damages, claims and/or other expenses, including but not limited to attorney's fees (whether incurred before or after litigation has commenced) and court costs, for Contractor activities arising under or related to the task order. The Contractor is not authorized to represent the interests of the United States in court, or to otherwise provide legal services for or on behalf of the United States. In no case will the government be liable for a wrongful act of a PCA or their employees.

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RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD
SUBMITTED BY

SENATOR NORM COLEMAN

to

MS. KATHLEEN M. TURCO

Acting Deputy Administrator
General Services Administration

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
GSA CONTRACTORS WHO CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT
March 14, 2006

1. The Federal Acquisition Regulations require that the government only do business with responsible contractors. This entails a contractor responsibility determination before a contract is awarded. The Representations and Certification Application that all contractors must complete to be a federal contractor specifically asks if they have been indicted for or convicted of tax evasion in the last three years. This question stems from one case – the government's contract with Clarendon, Ltd., an entity controlled by fugitive financier Marc Rich. We clearly need broader questions to identify federal contractors who are not complying with the tax laws. Will GSA commit to working with IRS and other members of the Federal Contractor Tax Compliance Task Force to identify the best tax-related questions, and revising the Representations and Certifications Application accordingly?

   Answer: Yes, we will work with the IRS, other members of the Federal Contractor Tax Compliance Task Force, and the Civilian Agency Acquisition Council (responsible for the Federal Acquisition Regulation (FAR)) to identify the best tax-related questions and to revise the Online Representations and Certifications Application accordingly. As discussed in detail at the March 14, 2006 hearing, statutory restrictions concerns greatly impact the information that the IRS can share regarding tax delinquencies. Therefore, the issue of being able to verify contractor answers to any tax related questions becomes a key question. We look forward to working with the IRS and other members of the Federal contracting community to address, as best we can while still meeting the statutory requirements, the serious problem of tax delinquent contractors.

Permanent Subcommittee on Investigations
EXHIBIT #5

2. Our investigation has also shown that there is no verification whatsoever of the tax-related answers that potential federal contractors provide on the Representations and Certifications Application. Will GSA commit to working with IRS and other members of the Federal Contractor Tax Compliance Task Force to establish effective verification procedures for contractors' tax-related representations?

   Answer: Yes, although, as noted above, there are statutory restrictions limiting the information that the IRS can provide regarding tax delinquencies. We will work with the IRS and other interested agencies to determine what flexibilities exist in this regard with the intent of improving the Federal procurement system.

3. On February 9th a federal contractor, Mr. Jack Easterday, was convicted on 47 counts of failing to remit payroll taxes to the IRS. The trial established that Mr. Easterday failed to pay over $18 million in payroll taxes that he had withheld from his employees. When information of this nature comes to GSA's attention, what actions are taken to follow up? When you receive adverse information about a contractor like Mr. Easterday, do you identify all agencies with which the contractor has an active contract and notify them of his conviction? Is it likely that Mr. Easterday will be considered for suspension or debarment? Who will decide if Mr. Easterday and his companies are going to be suspended or debarred? We request that you keep the Subcommittee informed of any suspension or debarment action taken against Mr. Easterday or his companies.

   Answer: GSA has two roles in the suspension and debarment arena. First, GSA is responsible for maintaining the Excluded Parties List System (EPLS), a database containing current and historical information on all companies and individuals suspended, debarred or otherwise excluded from Federal programs by Federal executive agencies. Second, in support of its own acquisition activities, GSA through its Office of Inspector General, identifies, reviews, and determines whether conduct by our contractors, including officers, directors and principals, warrants suspension or debarment. It is important to note that all major Federal executive agencies possess this authority. Therefore, as a cooperative matter, under the auspices of the Interagency Suspension and Debarment Committee (ISDC), agencies follow a "lead agency" practice under which the agency with the greatest interest in a particular contract, contractor or individual engaged in alleged wrongdoing assumes the responsibility for initiating a suspension or debarment action. No single agency has ever been designated to be the centralized monitor of contractor compliance. Instead, investigations of alleged wrongdoing, follow-on referrals, and specific recommendations pertaining to suspension and debarment are generally executed by the particular agency with the greatest ties to the subject matter and the most extensive access to facts. For example, since GSA administers many Governmentwide contracts, including the Multiple Award Schedules Contract Program, GSA addresses alleged wrongdoing related to those contracts and also

receives referrals from customer agencies that pertain to alleged misconduct in connection with customer agency orders under GSA contracts.

GSA understands the Easterday matter to involve an individual criminally convicted of tax evasion, a subject addressed by the Internal Revenue Service (IRS) and prosecuted by the Department of Justice (DOJ). If the IRS and/or DOJ were to refer the matter to GSA's Office of Inspector General, the follow-up actions would include determining what contractual relationships exist between GSA and Mr. Easterday and any companies or businesses that are under his control. If multiple Government agencies are involved, a "lead agency" would be mutually-selected to pursue possible suspension and/or debarment proceedings. For example, if a contractor's primary connection to the Federal government is through the operation of nursing homes and hospitals, either the Department of Health and Human Services or the Department of Veterans Affairs would arguably be the most appropriate lead agency. In cases where GSA accepts lead agency status, its Office of Inspector General conducts an investigation, obtains documents, and prepares a recommendation to GSA's Suspension and Debarment Official.

Although we do not have specific information on the Easterday case, it is important to note that a criminal conviction for tax evasion could support a debarment referral for any contractor. The Federal Acquisition Regulation (FAR) at 48 CFR 9.406-2(a)(3) lists "tax evasion" as a potential cause for debarment, During the decision-making process, the FAR instructs the Debarment Official to determine whether debarment is in the Government's interest. The FAR also requires that the seriousness of the contractor's acts or omissions, and any remedial measures or mitigating factors, should be considered when making a debarment decision.

In response to the other questions posed, GSA will follow up with the ISDC to ascertain whether suspension or debarment proceedings have commenced, and if not, work with the Committee members to ascertain which agency should take the lead for purposes of initiating such action. If a suspension or debarment is ultimately imposed against Mr. Easterday, his name will appear in the EPLS, and at that time the entire Government will be on notice of Mr. Easterday's non-responsibility pursuant to the FAR. GSA will keep the Subcommittee informed on this matter.

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