

**Before the Committee on Transportation and Infrastructure  
United States House of Representatives**

---

For Release on Delivery  
expected at  
11:00 a.m. EST  
Tuesday  
July 22, 2003  
CC-2003-148

**Controlling Costs and Improving the  
Effectiveness of Federal Highway  
Administration and Federal Transit  
Administration Programs**

**Statement of  
The Honorable Kenneth M. Mead  
Inspector General  
U.S. Department of Transportation**



Chairman Young, Ranking Member Oberstar, and other members of the Committee:

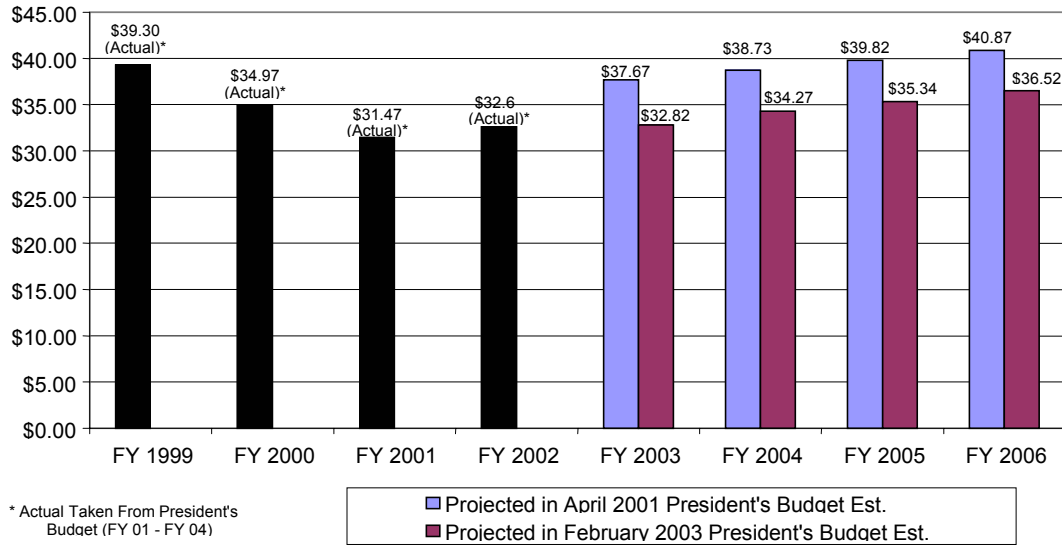
We appreciate this opportunity to testify today on controlling costs and improving the effectiveness of Federal Highway Administration (FHWA) and Federal Transit Administration (FTA) Programs. Whether funds are lost to cost overruns, schedule delays, or fraud, the result is the same—fewer resources are available for important transportation projects. To illustrate, if the efficiency with which the \$500 billion invested by the Federal Government and states over the last 6 years on highway projects had been improved by only 1 percent, an additional \$5 billion would be made available—enough to fund 4 of the 15 active major highway projects.

The Concurrent Resolution on the Budget for Fiscal Year (FY) 2004 requires House and Senate authorizing Committees to identify opportunities to eliminate waste, fraud, and abuse in mandatory programs under their jurisdiction. The Senate and House Budget Committees' savings target for the House Transportation and Infrastructure Committee totaled \$491 million, or about 1 percent of the Department's overall FY 2004 budget request.

On the one hand, it is important to reduce spending, and eliminating waste, fraud, and abuse should be the first step in efforts to control costs. On the other hand, to address unmet needs and important national priorities, the Congress recently authorized spending increases in some critical programs, including national defense and homeland security.

A number of proposals have also been made to increase funding for highway and transit infrastructure programs at a time when Highway Trust Fund tax receipts have declined 20 percent from \$39.3 billion in FY 1999 to \$31.5 billion in FY 2001. Current estimates show that from FY 2003 through FY 2006, Highway Tax Fund revenues will be about \$18 billion less than projected in April 2001, and are not expected to return to the FY 1999 level until FY 2008.

**Actual and Projected Highway Trust Fund Tax Revenue  
Includes Highway and Transit Accounts  
(FY 1999 to FY 2006)**



Whether or not this Congress ultimately decides to increase funding for surface transportation investments, we believe significant opportunities exist to (1) use funds more efficiently and effectively, (2) avoid unnecessary cost increases, (3) cut costs and reduce losses to fraud and abuse, and (4) increase revenues to the Highway Trust Fund by strengthening efforts to prevent fuel tax evasion.

From FY 1997 through the first half of FY 2003, we identified over \$2.6 billion in recommended funds that FHWA and FTA could put to better use and questioned more than \$33.6 million in costs. While the extent of fraud we are seeing today is not on the scale seen during the 1960s and 1970s, during the last 4½ years, indictments for highway and transit-related fraud have tripled and convictions have doubled. Currently we have over 100 ongoing investigations of infrastructure projects or contracts in 35 states.

Secretary Mineta, Deputy Secretary Jackson, Administrator Peters, and Administrator Dorn have also emphasized the need to improve oversight to get more value from the Federal investment. Their commitment to improve stewardship and oversight is clearly demonstrated in the recently submitted reauthorization proposal—the Safe, Accountable, Flexible, and Efficient Transportation Equity Act of 2003, or SAFETEA. Enacting the proposal’s various provisions, many of which respond directly to recommendations we have made, will go a long way to stretch Federal dollars by helping ensure that funds are spent cost-effectively, and increasing Highway Trust Fund revenues through strengthened enforcement and investigative efforts to detect and prevent fuel tax fraud.

We recognize that the Congress may not complete its consideration of the reauthorization bill this year. Some members have discussed the possibility of a “bridge” reauthorization for 1 or 2 years. Should this option be chosen, we believe you should consider incorporating SAFETEA’s proposed stewardship, oversight, and revenue protection provisions into the bridge reauthorization, which would immediately begin to improve the effectiveness of our investments and provide key tools to increase revenues by attacking fuel tax evasion schemes.

Today I will discuss the following four key areas where our audits and investigations have highlighted opportunities to improve the efficiency and effectiveness of transportation investments, achieve cost savings, and increase revenues to the Highway Trust Fund.

- ***Putting Idle Funds to Use on Important Projects***
- ***Getting More for the Transportation Dollar by Strengthening Project Management and Financial Oversight***
  - *Preparing Reliable Project Cost Estimates*
  - *Preparing Finance Plans to Identify Cost, Schedule, Funding and Risks to Projects*
  - *Ensuring That Statewide Plans Properly Represent to the Taxpayer How Funds Will Be Spent*
  - *Recovering Overpayments From Contractors and Resolving Construction Claims*
  - *Implementing More Cost-Effective Engineering Alternatives*
  - *Refocusing FHWA Efforts on Project Management and Financial Oversight*
- ***Detecting and Preventing Fraud***
  - *Strengthening Debarment Authority*
  - *Enhancing State Oversight*
  - *Sharing of Federal Recoveries with the States*
- ***Combating Fuel Tax Evasion—Securing Tax Revenue to Which the Highway Trust Fund Is Entitled***

## **Putting Idle Funds to Use on Important Projects**

To its credit, FHWA performs annual reviews of funds that States have obligated, but not used. However, in FY 2001 we found \$238 million that States no longer needed on projects to which they had been obligated. Of this amount, \$54 million

had been idle for 16 years on a freeway project in Connecticut that had never been started. Funds that are no longer needed by States should be made available for use on other projects or returned to the U.S. Treasury. We will continue to work with Administrator Peters and her staff to ensure that idle funds are identified so that they can be used on important projects.

## **Getting More for the Transportation Dollar by Strengthening Project Management and Financial Oversight**

We have reviewed a number of major projects that stand as examples of good project management—projects such as Utah’s I-15 and the Alameda Corridor in California. In contrast, we have reviewed projects, such as the Central Artery in Massachusetts and the Springfield Interchange in Virginia, in which management and oversight were ineffective, leading to significant cost increases, financing problems, schedule delays, or technical or construction difficulties. Our audits have identified the following measures for ensuring that we get more for each project dollar spent:

- Preparing reliable project cost estimates;
- Preparing finance plans to identify project cost, schedule and funding risks;
- Ensuring that statewide plans properly represent to the taxpayer how funds will be spent;
- Recovering overpayments from contractors and resolving construction claims;
- Implementing more cost-effective engineering alternatives; and
- Refocusing FHWA efforts on project management and financial oversight.

### **Preparing Reliable Project Cost Estimates**

One problem we have repeatedly seen is that cost estimates on major highway and transit projects have been unreliable and resulted in substantial cost increases. For example, we found the Virginia Department of Transportation understated project cost estimates by \$236.5 million, or 35 percent, on the Springfield Interchange Project by not including estimates for some known and planned costs. In addition, the baseline estimate was prepared far too early and was based on plans that were only 15 to 20 percent complete. Cost estimating problems also occurred on the San Francisco Bay Area Rapid Transit Airport Extension. Our April 2000 report noted that the project’s cost had increased by \$316 million over the initial cost estimate.

When initial costs are unreliable, decision-makers do not have the information needed to choose the most cost-effective transportation solutions. In addition, subsequent cost increases erode the public's trust in Federal, State, and project officials' ability to act as good stewards of public funds. We note that as part of the financial integrity provisions of SAFETEA and consistent with our prior recommendation, FHWA will develop minimum standards for estimating project costs.

### **Preparing Finance Plans to Identify Cost, Schedule, Funding and Risks to Projects**

Another problem is that finance plans are not usually required for highway projects under \$1 billion, although such projects can also burden a State's management resources. A finance plan is a management tool that is vital in providing project managers and the public with information on how much a project is expected to cost, when it will be completed, whether adequate funding is committed to the project, and whether there are risks to completing the project on time and within budget.

In our opinion, finance plans should be prepared for projects costing \$100 million or more, and responsibility for approving those plans should be delegated to the States, with the Secretary reserving the right to review any plan. If the States are going to spend \$100 million of taxpayer money, it is reasonable to require them to develop an approved finance plan that identifies project costs, milestones, and funding sources. The Department has incorporated this new requirement in its reauthorization proposal.

### **Ensuring That Statewide Plans Properly Represent to the Taxpayer How Funds Will Be Spent**

Under Code of Federal Regulations, Title 23, States are required to prepare financially constrained 3-year transportation plans and submit these plans concurrently to FHWA and FTA for joint approval. These plans are representations to the taxpayers of how the States intend to use the taxpayers' money to meet their transportation needs and identify which projects will be funded, their costs, and funding sources. This is particularly important in States that have large projects ongoing, because cost increases on one large project can put pressure on the State's ability to fund its other transportation needs.

We reviewed one State's plans covering the years 1994 to 2000 and found that, in large part, the plans were unrealistic. For example, of 152 interstate, primary and urban construction projects included in the plans, only 30 percent were started on

time, 57 percent were delayed, and 13 percent were eliminated. One of the reasons this occurred was the cost estimates included in the plan understated the actual cost of the projects, making the funding identified for the overall highway construction program insufficient. We also found that FHWA had approved the plans. FHWA must ensure that Statewide plans are realistic and achievable and include reliable cost estimates and funding commitments to complete the projects identified. Without reliable cost estimates and funding commitments, the Statewide plans have little value.

### **Recovering Overpayments From Contractors and Resolving Construction Claims**

Change orders to contracts are initiated by the project or contractors in response to changes in the project's scope or differing site conditions. However, some change orders are a result of design errors or omissions caused by consultant engineers. Recovery of funds paid on these change orders offers an opportunity to reduce project costs, which benefits the Federal and State governments. Maintaining tight control over change orders and promptly resolving outstanding construction claims are key in controlling project costs. For example, the \$14.62 billion Central Artery/Tunnel Project in Boston might be able to reduce costs by aggressively pursuing opportunities to recover costs of design errors or omissions caused by engineering consultants.

To date, the Project's cost recovery efforts have been anemic. First, 8 years of cost recovery efforts have led to only \$30,000 in recoveries from a single consultant, even though 76 cost recovery items, involving \$53.7 million in change orders, have been reviewed and resolved to date. The \$30,000 represents less than one-tenth of 1 percent (.056 percent) of the amount in question.

Second, the Project's cost recovery efforts have not resulted in the timely resolution of many change orders. For example, the Project currently has approximately 295 unresolved change orders, valued at \$188 million, of which 76 have been outstanding for 2 to 7 years. Timely resolution of change orders in the Cost Recovery Program is important, because the longer the issues remain unresolved, the more difficult it becomes for project officials to determine whether the change orders were caused by design errors.

### **Implementing More Cost-Effective Engineering Alternatives**

Obtaining the best value for an investment requires an analysis of various alternatives. Since 1970, many industries and Government agencies have successfully employed Value Engineering (VE) programs to control costs on major projects. The purpose of these programs is to objectively review all

reasonable alternatives during the design phase to find more cost-effective alternatives. FHWA's VE program, established in 1997, requires that a study be performed on all Federal-aid National Highway System projects with an estimated cost of \$25 million or more, and on other projects where using VE has a high potential for cost savings.

According to FHWA's FY 2001 Annual Federal-aid Value Engineering Summary Report, the latest report available, the States conducted 378 VE studies that included 2,013 recommendations estimated to save \$2.4 billion. FHWA Division personnel approved about 50 percent of the recommendations made in FY 2001, saving approximately \$865 million, or 36 percent of the total value of VE recommendations. While FHWA and the States have realized some savings, we identified other VE opportunities which were not implemented.

For example, in 2002 Maryland officials, who manage the Wilson Bridge Project, rejected a VE proposal to change from one type of girder to another, which would have saved up to \$59 million. Maryland officials claimed that the VE proposal would cause significant delays that could result in additional costs. However, our review found that the rejected proposal was technically feasible and would not result in a cost increase. After FHWA advised the State to more objectively reexamine the rejected VE proposal, project officials accepted it as a design change and saved \$59 million.

### **Refocusing FHWA Efforts on Project Management and Financial Oversight**

Our work has shown that FHWA's oversight of Federal-aid Highway projects has been ineffective at times because, until recently, FHWA managers rarely focused on program and major project management and financial oversight. Historically, FHWA has taken a partnership approach in exercising its oversight role of Federal-aid Highway projects, with FHWA channeling money for highways to the States and working with State personnel to administer highway contracts. This partnership is important, but it is equally important that FHWA be willing to step back and make the hard calls when necessary. As a result of the partnership, FHWA has sometimes missed larger management issues. For example, at the time the Central Artery announced a \$1.4 billion cost increase in 2000, FHWA officials had approved thousands of engineering design changes. Nonetheless, they were caught unaware when a cost increase was announced, even though they had just approved the project's finance plan.

Further, FHWA's expertise is limited in emerging technologies, such as financing, cost-estimating, program analysis, environmental processes, and schedule management. This is because FHWA's workforce is primarily structured



around engineering skills that were in greater demand during construction of the interstate system. Of FHWA's workforce of 2,860 employees, 1,130, or approximately 40 percent are engineers. Yet in the remaining 60 percent, or 1,750 employees, specialist skills, needed to oversee State management processes, are in short supply. For example, FHWA employs 88 financial specialists, who primarily perform financial management tasks internal to FHWA, rather than analyzing project finance plans and evaluating state financial management processes.

Many of the needed oversight improvements our work has identified are addressed in the Administration's SAFETEA proposal. For example, the stewardship and oversight provisions of SAFETEA require the Secretary to establish an oversight program focused on financial integrity and project delivery. Under these provisions, the Department is required to perform annual reviews of States' financial management and project delivery systems to effectively oversee federally assisted projects. Further, Administrator Peters is working to restructure FHWA's workforce to bring the right set of skills to bear on oversight activities.

## **Detecting and Preventing Fraud**

During the last 4½ years, highway and transit-related fraud indictments have tripled, convictions have doubled, and monetary recoveries totaled more than \$80 million. However, the extent of fraud we are seeing today is not on the scale seen during the 1960s and 1970s. We currently have over 100 ongoing investigations of infrastructure projects or contracts in 35 States.

Fraud schemes we commonly see today include bid-rigging and collusion among contractors, false claims for work or materials not provided on the project, product substitution by contractors or vendors who provide substandard or inferior materials, and bribery of inspectors to look the other way on their duty to ensure quality of work or materials. Examples of investigations we have been working on during the past year include:

- A case in Massachusetts involving the alleged "shorting" of construction related materials (asphalt, stone and sand) by a construction contractor, who falsified weight tickets on numerous Federal-aid Highway projects, including the Central Artery/Tunnel Project. This contractor currently has \$40 million worth of contracts with the State of Massachusetts.
- A Connecticut-based engineering firm with approximately \$38 million in highway and bridge construction contracts awarded by various State transportation departments within the last 5 years whose president was

indicted in January 2003 for inflating over \$1.9 million in time and labor charges.

- In California, three specialty construction contractors conspired to rig bids and share the market of federally-funded bridge design and construction projects. Our investigation led to criminal prosecution of the contractors, two of whom have agreed to civil fines totaling almost \$1 million.

Fraud involving the Disadvantaged Business Enterprise (DBE) Program for minority and women contractors who are used as “false front” companies is an area with serious enforcement and compliance problems that appears to be nationwide in scope and requires more attention. Our current caseload includes over 30 ongoing DBE investigations in 16 States. This type of fraud often involves prime contractors who conspire with sham (false front) DBE firms to fraudulently meet required DBE participation criteria in order to obtain contracts. In such cases, DBEs either do not perform the work or yield total control of personnel and operations to the prime contractors. This crime defrauds the integrity of the DBE Program and harms legitimate DBEs who abide by the law. Examples of recent DBE investigations include:

- A subcontractor working on a \$30 million FHWA-funded Central Artery/Tunnel demolition project alleged to be a “front” for two other non-DBE qualified demolition firms.
- A New York-based prime contractor alleged to have utilized four “front” companies to fraudulently qualify as a DBE on \$257 million worth of federally-funded roadway improvement projects in the New York City metropolitan area. The four “fronts” supposedly received approximately \$23.5 million, but did not perform any work on these projects.

To her credit, Administrator Peters has initiated several efforts to combat DBE fraud, such as providing State Department of Transportation (DOT) staff with DBE fraud training material, establishing a website for the exchange of DBE Program information and successful practices in deterring this kind of fraud, and coordinating DBE reviews with my office.

Beyond our criminal investigative efforts however, additional measures can be taken to protect the Government’s interest against fraud on transportation projects, such as strengthening debarment authority, enhancing State oversight, and sharing monetary recoveries from Federal judgments with States whose programs are damaged by the fraud.

## **Strengthening Debarment Authority**

In our opinion, when contractors are convicted of fraud, they should be debarred from participating on future federally-funded projects for an appropriate period of time depending on the severity of the case and culpability of the company and/or its corporate principals. Debarred contractors are excluded from receiving prime contracts or serving as subcontractors. However, under current regulations, FHWA has wide discretion in determining whether or not to debar convicted contractors, and contractors are allowed to appeal debarments to FHWA at any time and continue to work on their contracts, even though they have been convicted of fraud against the Federal-aid Highway Program.

For example, in 2001 three major construction companies in the New York City area, co-owned by the Scalamandre brothers, pled guilty to felony fraud charges involving payoffs to organized crime to influence labor unions on FHWA-funded road projects. Because debarment is not mandatory under the current Federal-aid rules, it took over 6 months after the company was convicted to obtain a 3-year debarment. Now, 1 year after debarment, the firms are appealing to FHWA to lift their debarment. Should FHWA turn down this appeal, the firms can file subsequent appeals with FHWA, further burdening the agency by requiring its expenditure of time and legal resources to defend its action.

Making debarment mandatory when the principals of a firm are convicted of fraud will increase the protection of taxpayer's money and the deterrent effect of debarment actions. At our recommendation, FHWA is examining a potential regulation change mandating debarment.

## **Enhancements to State Oversight Needed**

Congress, the Federal Government, and State governments are all concerned with preventing fraud and abuse in transportation projects. For example, we co-sponsored two National Fraud Conferences on Highway Construction and Related Programs with the American Association of State Highway Transportation Organizations, American Public Transportation Association, FHWA, FTA, and the Missouri and Georgia Departments of Transportation to enhance contract oversight at the State level. Outreach initiatives like these conferences provide opportunities to increase State awareness of critical issues and to share investigative techniques with State auditors and investigators. In recent years we have joined forces with State investigative agencies to conduct highway construction fraud cases, achieving significant results.

However, because the States are the first line of defense in preventing and detecting fraud in transportation projects, more needs to be done to help strengthen

State oversight. Specifically, the States should be encouraged to expand their internal audit and investigative capabilities in order to increase the number and frequency of project audits, and ensure the timely referral of suspected fraud to FHWA and our office.

### **Sharing Federal Recoveries With the States**

States are the first line of defense in preventing and detecting fraud in transportation programs, and more needs to be done to strengthen State oversight. Since the States' programs are damaged by the fraud, sharing in the recoveries would help them restore their programs and provide support for further fraud deterrence and detection efforts. However, States normally do not receive a portion of any monies recovered in successful fraud prosecutions because generally fines and recoveries from such Federal case judgments must be returned to the Federal Treasury.

The sharing of monetary recoveries occurred in a civil settlement with Contech Construction Products, Incorporated, and Ispat-Inland, Incorporated, involving a product substitution case in Louisiana. The companies substituted substandard polymer-coated steel culvert pipe used in highway and road construction projects from 1992 through 1997. Under the settlement agreement, the United States and Louisiana shared in a \$30 million recovery, with Louisiana directly receiving \$5.2 million to compensate for the cost of the investigation and losses due to the product substitution. In addition, Louisiana received another \$5.4 million as a credit to its unobligated FHWA balance for use on future projects.

The Administration's SAFETEA proposal would require that portions of monetary judgments won in Federal criminal and civil cases against contractors perpetrating highway or transit program fraud be shared with the State or locality injured by the fraud. We believe that adopting this provision would help States restore their programs damaged by fraud.

### **Combating Fuel Tax Evasion—Securing Tax Revenue to Which the Highway Trust Fund Is Entitled**

Fuel tax fraud creates a drain on Highway Trust Fund revenues, which FHWA estimates costs at least \$1 billion annually. Although fuel excise taxes represent less than 2 percent of total Federal tax revenues, they are a critical funding source for Department of Transportation programs. Taxes on gasoline, diesel and other fuels provide about \$33 billion each year, or 89 percent of the Highway Trust Fund revenues used to finance highway and transit projects nationwide. Increased

tax collections mean increased revenues for funding additional highway and transit projects.

Highway Trust Fund revenue losses to fuel tax evasion were much worse at the Federal level in the late 1980s and early 1990s before Congress took steps to prevent evasion schemes, many of which were perpetrated by the Russian mafia and New York organized crime families. During the 1990s, we conducted numerous cases with the Internal Revenue Service (IRS) involving “daisy chain” schemes. Typically in those cases, perpetrators created multiple paper transfers of fuel among fictitious companies to conceal the party liable for remitting the tax to the Government. The entity in the chain with liability for the tax often existed only on paper or disappeared. The statutory shift in the point of taxation from the wholesale level to the terminal rack,<sup>1</sup> expanded enforcement, and other improvements to detect tax evasion schemes (for example, dyeing untaxed fuel for ready identification by law enforcement authorities) have reduced the opportunity for daisy chain schemes and increased revenues.

While legislative changes made inroads in the motor fuel tax evasion problem, there are still a variety of ways fuel taxes may be evaded or underpaid, and tax evaders have quickly adapted fraud schemes to take advantage of the remaining loopholes. More can be done, especially at the State level, to strengthen enforcement and investigative efforts directed at profitable tax evasion schemes, such as cross-border bootlegging of fuel. This type of scam typically occurs when bordering States have a significant difference in their motor fuel tax rates. Essentially, the bootleggers steal the difference between taxes charged in low-tax and high-tax jurisdictions by purchasing fuel—and paying the associated tax—in a low-tax jurisdiction, and then smuggling the fuel into a high-tax jurisdiction where they sell it and pocket the difference in taxes. This type of fraud affects both the State and Highway Trust Fund revenues. This fraud also occurs when untaxed motor fuels are smuggled into the country, or when “tax exempt” fuel (such as fuel intended for use on Native American reservations) is instead sold as “tax paid” fuel.

For example, as a result of a joint investigation we conducted with Texas State officials and the Federal Bureau of Investigation, two owners of several trucking companies and convenience stores located in the Lubbock, Texas area, were convicted and recently sentenced for their involvement in a scheme to avoid paying State motor fuel excise taxes on several million gallons of fuel that they purchased and resold. The scheme involved the purchase of motor fuel falsely

---

<sup>1</sup> The Tax Reform Act of 1986, effective January 1, 1988, changed the point of taxation for gasoline tax collection from the wholesaler/distributor to the fuel terminal (or “rack”), which is the last “bulk storage” point in the distribution chain. The Omnibus Budget Reconciliation Act of 1993, effective January 1, 1994, similarly changed the point of taxation for diesel fuels from the wholesaler to the fuel terminal (or “rack”).

represented as being for resale to the Navajo Reservation, which is exempt from State motor fuel taxes. The trucking company owners then created false drivers' logs and transport manifests to make it appear as though the fuel was being transported for resale to the Navajo Reservation. Instead, the fuel was being used by their trucking companies and sold in their convenience stores without payment of the required State motor fuel taxes. In August 2002, the defendants were sentenced to 42 and 18 months in prison, respectively, followed by 36 months of supervised release, after they pleaded guilty to felony mail and wire fraud charges. In addition, the defendants' associated companies also pleaded guilty to wire and mail fraud and were ordered to pay \$5.5 million in restitution.

Possible actions to prevent tax evasion at the State level include the States changing the point of collection for State fuel taxes similar to the change made by the Federal Government in the early 1990s; better documentation of fuel sold for tax exempt purposes (for example, fuel for non-highway use such as agriculture); and strengthening State enforcement efforts to catch and deter bootleggers and other tax evaders.

At the Federal level, aviation "jet" fuel tax evasion is an area several independent petroleum industry analysts allege is possibly costing billions of dollars of lost tax revenues and which requires further examination. It is the only major category of transportation fuel not currently subject to Federal excise tax at the rack. Instead, this fuel is sold tax-free to wholesalers and is not taxed until sold to an end user such as an airline. Jet fuel used for commercial purposes, taxed at a considerably lower rate than diesel fuel (4.4 cents versus 24.4 cents per gallon), is in effect chemically the same as kerosene, and can readily be used in on-road diesel trucks. Tax evasion opportunities exist when jet fuel is diverted to diesel truck use similar to the evasion schemes seen in the late 1980's and early 1990's, prior to the statutory shift in the point of gasoline and diesel taxation from the wholesale level to the terminal rack. Taxing jet fuel at the rack would bring it into conformity with Federal gasoline and diesel fuel taxes and help reduce tax evasion opportunities.

For example, according to a recent KPMG consulting analysis, 1 year after the State of Florida began taxing jet and diesel fuels at the rack in 1996, the State experienced a 21.4 percent increase in jet fuel tax collections and a 13.2 percent increase in diesel fuel tax collections. While Florida's experience is not conclusive, it does illustrate the potential to increase tax collections by moving the point of taxation to the rack and reducing tax evasion opportunities.

The overall impact of fuel tax evasion losses to the Highway Trust Fund is amplified, because Highway Trust Fund revenues are down while demands on highway capacity have reached unprecedented levels, and replacement and

rehabilitation costs for existing infrastructure have greatly increased. This is an especially important issue today as Congress considers Transportation Equity Act for the 21<sup>st</sup> Century (TEA-21) reauthorization and is searching for ways to increase Highway Trust Fund revenues and transportation spending without raising taxes. When fuel taxes are not paid, those dollars are not available for the construction and upkeep of our Nation's roads and bridges.

An ongoing commitment to fuel tax fraud enforcement is needed to continue progress made in combating fuel tax evasion—increased tax compliance means increased revenues. FHWA needs to continue its commitment to the Joint Fuel Tax Compliance Project by promoting enforcement activities and developing new strategies to encourage compliance to help ensure all taxes are collected and remitted to the Highway Trust Fund.

In addition, although the DOT has perhaps the greatest interest in reducing the evasion of fuel taxes at the Federal level, only the IRS is authorized to enforce fuel tax compliance and investigate related evasion schemes. While IRS has worked with the DOT Office of Inspector General (OIG) on joint task forces in the past, the DOT OIG lacks the authority and access to records necessary to initiate investigations of its own, and the IRS does not devote extensive resources to fuel tax enforcement. For example, according to the IRS, today it has approximately 20 active criminal investigations nationwide involving all forms of excise taxes, only 2 of which involve gasoline or diesel fuel, and none which involve jet fuel. Also, since many States do not tax jet fuel, they do not consider investigating jet fuel-related tax evasion schemes to be a priority.

To more effectively combat fuel tax evasion, we believe further legislative changes are needed including:

- Establishing a nationwide intergovernmental program financed by the Highway Trust Fund to direct the coordination of intergovernmental efforts to prevent and detect fuel excise tax evasion schemes.
- Amending the tax code to allow intergovernmental law enforcement agencies, such as State and local fuel tax enforcement officers and DOT OIG special agents, access to motor and jet fuel-related excise tax records.
- Taxing jet fuel at the terminal rack to bring it into conformity with Federal gasoline and diesel fuel taxes to help reduce tax evasion opportunities.

- Increasing FHWA oversight of the Joint Fuel Tax Compliance Project to promote enforcement activities, develop new strategies to encourage compliance, and better monitor IRS and State fuel tax activities funded by the Highway Trust Fund.

This concludes my statement, Mr. Chairman. I would be pleased to address any questions you or members of the Committee might have.