

HENRY A. WAXMAN, CALIFORNIA,
CHAIRMAN

TOM LANTOS, CALIFORNIA
EDOLPHUS TOWNS, NEW YORK
PAUL E. KANJORSKI, PENNSYLVANIA
CAROLYN B. MALONEY, NEW YORK
ELIJAH E. CUMMINGS, MARYLAND
DENNIS J. KUCINICH, OHIO
DANNY K. DAVIS, ILLINOIS
JOHN F. TIERNEY, MASSACHUSETTS
WM. LACY CLAY, MISSOURI
DIANE E. WATSON, CALIFORNIA
STEPHEN F. LYNCH, MASSACHUSETTS
BRIAN HIGGINS, NEW YORK
JOHN A. YARMUTH, KENTUCKY
BRUCE L. BRALEY, IOWA
ELEANOR HOLMES NORTON,
DISTRICT OF COLUMBIA
BETTY McCOLLUM, MINNESOTA
JIM COOPER, TENNESSEE
CHRIS VAN HOLLEN, MARYLAND
PAUL W. HODES, NEW HAMPSHIRE
CHRISTOPHER S. MURPHY, CONNECTICUT
JOHN P. SARBANES, MARYLAND
PETER WELCH, VERMONT

ONE HUNDRED TENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6143

MAJORITY (202) 225-5051
FACSIMILE (202) 225-4784
MINORITY (202) 225-5074

www.oversight.house.gov

TOM DAVIS, VIRGINIA,
RANKING MINORITY MEMBER

DAN BURTON, INDIANA
CHRISTOPHER SHAYS, CONNECTICUT
JOHN M. McHUGH, NEW YORK
JOHN L. MICA, FLORIDA
MARK E. SOUDER, INDIANA
TODD RUSSELL PLATTS, PENNSYLVANIA
CHRIS CANNON, UTAH
JOHN J. DUNCAN, JR., TENNESSEE
MICHAEL R. TURNER, OHIO
DARRELL E. ISSA, CALIFORNIA
KENNY MARCHANT, TEXAS
LYNN A. WESTMORELAND, GEORGIA
PATRICK T. McHENRY, NORTH CAROLINA
VIRGINIA FOXX, NORTH CAROLINA
BRIAN P. BILBRAY, CALIFORNIA
BILL SALI, IDAHO
JIM JORDAN, OHIO

October 22, 2007

Mr. Erik Prince
Chairman
The Prince Group
1650 Tysons Boulevard, Suite 800
McLean, VA 22102

Dear Mr. Prince:

I have received documents which suggest that Blackwater may have engaged in significant tax evasion. According to an IRS ruling in March 2007, Blackwater violated federal tax laws by treating an armed guard as an "independent contractor." The implication of this ruling is that Blackwater may have avoided paying millions of dollars in Social Security, Medicare, unemployment, and related taxes for which it is legally responsible.

Unlike DynCorp and Triple Canopy, the two other major private military contractors providing security services to the State Department in Iraq, Blackwater classifies its armed guards as independent contractors rather than as employees. Under federal tax laws, this classification has important ramifications. Businesses must pay Social Security, Medicare, and unemployment taxes for their employees. They must also withhold federal income taxes on their salaries. By classifying its armed guards and other personnel as independent contractors instead of employees, Blackwater has apparently evaded withholding and paying these taxes.

When you testified before our Committee on October 2, 2007, Congresswoman Norton asked you why Blackwater treats its security personnel as independent contractors, while your competitors treat their guards as employees. You responded that Blackwater treats its guards as contractors because you found "it is a model that works" and because your guards prefer the "flexibility" of an independent contractor relationship.

Since the hearing, I have learned that the IRS determined in March — six months prior to your testimony — that your classification of a security guard working in Afghanistan as an independent contractor was "without merit." The IRS advised that "[y]ou are responsible for satisfying the employment tax reporting, filing, and payment obligations that result from this determination." By its terms, the IRS ruling applied only to the individual security guard who protested his classification, but the IRS warned that its ruling "may be applicable to any other

Mr. Erik Prince
October 22, 2007
Page 2

individuals engaged by the firm.” The logic of the ruling would appear to apply to your entire workforce in Iraq and Afghanistan.

There is also evidence that Blackwater has tried to conceal the IRS ruling and the evasion of taxes from Congress and law enforcement officials. The IRS determination was issued in response to an inquiry by an individual security guard who questioned his classification as an independent contractor. In June, Blackwater required this employee to sign a nondisclosure agreement before it agreed to pay the back pay and other compensation that he was owed. The terms of this agreement explicitly prohibited the guard from disclosing any information about Blackwater to “any politician” or “public official.” The agreement further provided: “THE UTMOST PROTECTION AND NONDISCLOSURE OF CONFIDENTIAL INFORMATION IS OF CRITICAL IMPORTANCE AND IS THE ESSENCE OF THIS AGREEMENT.”

It is difficult to read the IRS ruling and the nondisclosure agreement and not question Blackwater’s intent and actions. When the IRS issued an alert in 2004 warning employers not to “incorrectly treat employees as independent contractors,” the IRS Commissioner described the “[f]ailure to pay employment taxes” as “stealing from the employees of the business” and said that “those who embrace these schemes face civil or criminal sanctions.” Yet it now appears that Blackwater used this illegal scheme to avoid millions of dollars in taxes and then prevented the security guard who discovered the tax evasion from contacting members of Congress or law enforcement officials.

I hope you will cooperate with the Committee in its investigation into this serious matter.

Background

The tax code draws a distinction between “employees” and “independent contractors.” As the IRS has explained:

An employer must generally withhold federal income taxes, withhold and pay social security and Medicare taxes, and pay unemployment tax on wages paid to an employee. An employer does not generally have to withhold or pay any taxes on payments to independent contractors.¹

In order to determine whether a worker is an employee or an independent contractor, federal regulations require the IRS to examine whether an employer exercises sufficient control over the worker. Companies generally exert more control over the activities of employees, but have less control over independent contractors. The regulations define the employer-employee relationship as follows:

¹ Internal Revenue Service, *Publication 15-A: Employer’s Supplemental Tax Guide* (Jan. 2007).

Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done.²

The regulations identify characteristics of the employer-employee relationship. These include “the furnishing of tools” and “the furnishing of a place to work” to the individual performing the services.³ IRS guidelines state that other factors considered by the IRS include “[i]nstructions that the business gives to the worker,” “[t]raining that the business gives to the worker,” “[t]he extent of the worker’s investment,” and “[t]he extent to which the worker can realize a profit or loss.”⁴

The regulations make clear that a superficial label for a worker’s relationship to the company has no bearing on this determination. They direct the IRS to examine the true nature of the work. As the regulations state:

[T]he designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such a relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like.⁵

Blackwater’s “Independent Contractor” Designations

The largest U.S. government contract for private military companies is the State Department’s “Worldwide Personal Protective Services II” contract. Under this contract, three

² 26 C.F.R. §31.3121(d)-1(c)(2); §31.3306(i)-1(b); and §31.3401(c)-1(b) (relating to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding on wages, respectively).

³ *Id.*

⁴ Internal Revenue Service, *Publication 15-A: Employer’s Supplemental Tax Guide* (Jan. 2007) (describing as additional factors for the IRS to consider: instructions that the business gives to the worker, including when and where to do the work, what tools or equipment to use, what workers to hire or assist the work, where to purchase supplies and services, what work must be performed by a specified individual, what order sequence to follow; training that the business gives to the worker; the extent to which the worker has unreimbursed business expenses; the extent of the worker’s investment; the extent to which the worker makes his or her services available to the relevant market; how the business pays the worker; and the extent to which the worker can realize a profit or loss).

⁵ 26 C.F.R. §31.3121(d)-1(a)(3); §31.3306(i)-1(d); and §31.3401(c)-1(e).

different companies provide protective security services to the Department of State in Iraq: Blackwater, DynCorp, and Triple Canopy. Blackwater has been assigned task orders to operate in Baghdad and Al-Hillah; DynCorp has been assigned task orders to operate in Kirkuk and Erbil; and Triple Canopy has been assigned task orders to operate in Basrah and Tallil. Each contractor is authorized to receive task orders worth up to \$1.2 billion.⁶

The State Department has informed the Committee that under this contract, it has authorized Iraq staffing levels of 920 for Blackwater, 260 for Triple Canopy, and 151 for DynCorp. Within these authorized staffing levels, the number of staff specifically authorized to conduct security operations are 604 for Blackwater, 73 for Triple Canopy, and 77 for DynCorp.⁷

Both DynCorp and Triple Canopy designate their security guards as employees. Blackwater, however, classified its 604 security guards as independent contractors.⁸ Blackwater also classified other Blackwater personnel working in Iraq under the State Department contract as independent contractors. For example, the Blackwater personnel who shot the Iraqi Vice President's bodyguard on December 24, 2006, was working as an "armorer" repairing and maintaining weapons for Blackwater's security guards. This individual was also classified by Blackwater as an independent contractor.⁹

The State Department contract specifies that Blackwater must maintain a high degree of control over the training, equipping, and conduct of its security guards. The State Department contract provides that Blackwater must establish training facilities, submit detailed training plans, and ensure that all security personnel have "successfully completed" at least 155 hours of specialized training before they are sent abroad to protect diplomats.¹⁰ Blackwater is also responsible for "maintaining that level of training throughout the performance of work."¹¹ The State Department contract does not allow any security guards to waive this requirement by using their own individual training methods.¹²

⁶ U.S. Department of State, *Fact Sheet: WPPSII Contracts Awarded to Blackwater, Triple Canopy, and DynCorp* (undated).

⁷ *Id.*

⁸ *Id.*

⁹ *Letter of Termination of Independent Contractor*, Blackwater USA (Dec. 25, 2006) (HOC008383).

¹⁰ *Worldwide Personal Protective Services II Contract*, at sec. C.4.3.2 (Aug. 25, 2004); *Id.* at attachment 5 to app. G, sec. C.

¹¹ *Id.* at sec. C.4.3.2.

¹² *Id.*

Once the security guards are in Iraq, the State Department contract requires Blackwater to provide its personnel with “all logistical support,” including equipment and supplies.¹³ In fact, contractor personnel are expressly prohibited from carrying or using their own weapons while serving in Iraq.¹⁴ Blackwater is also required by the contract to provide food, shelter, and even “laundry services” and “housekeeping” for its guards.¹⁵

The contract requires Blackwater to ensure that its security guards follow precise directions. According to the terms of the contract, Blackwater “shall ensure that all work performed under this contract is accomplished in accordance with the applicable standards/standard operating procedures, general orders and specific orders” issued by the Bureau of Diplomatic Security within the State Department.¹⁶

During your testimony before the Committee on October 2, 2007, you made many statements that emphasized the demanding training and extensive screening of Blackwater security personnel. For example, you highlighted the training Blackwater requires of its entire workforce. You testified that this training includes “embedding at Blackwater, tactics, techniques, procedures, driving, firearms, defensive tactics” as well as “a full psychological evaluation, medical/dental exam, physical tests, shooting tests.”¹⁷ You described this regimen as “very, very rigorous” and a significant expense for Blackwater.¹⁸

You also testified to the tight discipline Blackwater exercises over its workforce. You said that Blackwater provides its workers with “uniforms, equipment, body armor, boots, everything you wear from head to toe.”¹⁹ You testified that Blackwater provides its personnel with a handbook with “all the dos and don’ts of what they are expected to do and not do.”²⁰ According to your testimony, if your personnel do not follow these instructions, “we fire them,”

¹³ *Id.* at sec. C.4.3.8.1.1.

¹⁴ U.S. Embassy, Baghdad, Iraq, *Mission Firearms Policy* (Aug. 2006).

¹⁵ Worldwide Personal Protective Services II Contract, at sec. C.4.3.8.1.1 (Aug. 25, 2004).

¹⁶ *Id.* at sec. C.4.1.1.

¹⁷ House Committee on Oversight and Government Reform, Testimony of Erik Prince, *Hearing on Blackwater USA: Private Military Contractor Activity in Iraq and Afghanistan*, 110th Cong. (Oct. 2, 2007).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

even when the infraction is as minor as a “bad attitude” or “riding someone’s bike that is not his.”²¹

Repeatedly, you referred to Blackwater personnel as “our guys.”²²

The terms of the State Department contract and your own statements would appear to make your security personnel employees, not independent contractors. When Congresswoman Norton asked you about their status, however, you insisted that Blackwater guards are independent contractors.

At one point, Congresswoman Norton asked why your company treats its workforce differently than do the other two companies working for the State Department under the same contract:

REP. NORTON: DynCorp and Triple Canopy and other security firms that support the State Department treat their personnel as employees entitled to these benefits. Why do you treat your personnel differently from these two companies?

MR. PRINCE: I don’t know the differences in how they compensate their people. I will tell you we have the highest retention in the industry. We have guys that sign up for us at a very, very high rate. So we don’t get losses. Men and women seem to feel very well treated by us.

REP. NORTON: Well, of course, one of the differences is in the employee benefit package I have just named. Does Blackwater hire personnel as independent contractors in order to avoid legal responsibility for the company?

MR. PRINCE: No, it is actually really what the men that deploy for us prefer. We find it is a model that works.²³

Later, you emphasized that the reason Blackwater uses independent contractor arrangements is because your workforce prefers it:

MR. PRINCE: They like the flexibility of signing on for a certain period of time and being able to schedule their off time around an anniversary, a child’s birthday, being home for Christmas, et cetera. So it gives them flexibility as to when they are going to

²¹ *Id.*

²² *Id.*

²³ House Committee on Oversight and Government Reform, *Hearing on Blackwater USA: Private Military Contractor Activity in Iraq and Afghanistan*, 110th Cong. (Oct. 2, 2007).

deploy, when they are going to go to work. Just like--

REP. NORTON: Does it really give them more flexibility than the other two companies who have them as employees? Those people don't have the same kind of flexibility? Or what kind of flexibility can you have if you need your employees at a time of engagement, for example?

MR. PRINCE: I don't know, ma'am.

REP. NORTON: Well, I think the fact is, when you need them, you need them. You don't say, you can go home for Christmas, sir.²⁴

When Congresswoman Norton asked you explicitly about whether Blackwater "can avoid making Social Security contributions or withholding taxes" as a result of its independent contractor designation, you responded: "I am not sure on that."²⁵

The March 2007 IRS Determination

On March 30, 2007, the IRS issued a letter to Blackwater ruling that the company had improperly classified a Blackwater security guard as an independent contractor rather than an employee. This letter was written in response to a complaint filed by a former "Personal Security Specialist" for Blackwater in Afghanistan who provided to the IRS his "independent contractor" agreement with the company, as well as additional information about the terms of his work for the company.

In its ruling, the IRS informed Blackwater that its designation of the security guard as an independent contractor was "without merit," concluding:

We hold the worker to have been an employee of the firm. ... [Y]our statement that the worker was an independent contractor pursuant to a written agreement is without merit.²⁶

In its ruling, the IRS methodically applied the provisions of the tax code and the Treasury regulations to make its determination. The IRS made the following findings regarding Blackwater's relationship with the guard:

²⁴ *Id.*

²⁵ *Id.*

²⁶ Letter from Internal Revenue Service to Blackwater Security Consulting LLC (Mar. 30, 2007).

- “The firm submitted a written agreement between the firm and worker to provide the services. The agreement explained the type of work, work rotation, and that the worker’s services were an essential part of the services that the firm offers its clients”;
- “[Y]ou retained the right to change the worker’s methods and to direct the worker to the extent necessary to protect your financial investment”;
- “The firm required the worker to personally perform his services for its client”;
- “The worker followed instructions regarding his assignment from the firm’s client”;
- “The firm paid the worker’s travel expenses such as taxi, hotel, and air fare”;
- “The firm performed an evaluation and had the right to suspend the worker for violating its procedures”;
- “[T]he worker did not invest capital or assume business risks, and therefore, did not have the opportunity to realize a profit or incur a loss as a result of his services”; and
- “The worker was not engaged in an independent enterprise, but rather the services performed by the worker were essential to your client, as your client was dependent on you providing the necessary people with specific security skills, and a necessary and integral part of your business.”²⁷

These factors and others led the IRS to conclude that Blackwater had mischaracterized its worker as an independent contractor instead of an employee. As the IRS determined:

In evaluating the facts in this case, it is clear that the worker performed services in a manner consistent with an employer-employee relationship. Applying the law, regulations, and principles set forth in various revenue rulings and court cases, as well as the categories of evidence outlined above, we conclude that the worker was an employee of the firm for Federal employment tax purposes, and not an independent contractor engaged in his own trade or business.²⁸

The IRS made clear that Blackwater’s efforts to describe the worker as an independent contractor were irrelevant to its determination. As the IRS stated:

Section 31.3121(d)-1(a)(3) of the regulations provides that if the relationship of an employer and employee exists, the designation or description of the parties as anything

²⁷ *Id.*

²⁸ *Id.*

other than that of employer and employee is immaterial. Thus, if an employer-employee relationship exists, any contractual designation of the employee as a partner, coadventurer, agent, or independent contractor must be disregarded. Therefore, your statement that the worker was an independent contractor pursuant to a written agreement is without merit. For Federal employment tax purposes, it is the actual working relationship that is controlling....²⁹

Although the IRS evaluated only a single Blackwater employee, it noted that its ruling “may be applicable to any other individuals engaged by the firm under similar circumstances.” The IRS informed Blackwater that “[y]ou are responsible for satisfying the employment tax reporting, filing, and payment obligations that result from this determination” and suggested that Blackwater “contact a tax professional.”³⁰

Finally, the IRS warned Blackwater that section 3509 of the tax code penalizes employers who fail to deduct and withhold employee taxes, noting that the “employer’s liability is doubled in cases where the employer failed to meet the reporting requirements.” Although this code section provides for reduced rates in certain circumstances, the IRS warned Blackwater that these provisions “do not apply in cases of an employer’s intentional disregard of the requirement to deduct and withhold such tax.”³¹

Using information provided by Blackwater and the State Department, my staff has developed an estimate of the amount of taxes that Blackwater apparently failed to withhold and pay under its current contract with the State Department. The estimate is a conservative one because it is based on a single Blackwater contract that began last year and does not take into account taxes that may have been avoided under other government or private contracts held by Blackwater. It illustrates, however, that the sums involved in the apparent tax evasion are large, involving tens of millions of dollars, if not more.

Blackwater was awarded its current State Department contract in May 2006. Under the contract, Blackwater has maintained a force of between 459 and 582 security guards in Iraq who were paid between \$660 and \$738 per day and typically worked 180 days a year.³² My staff

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² Worldwide Personal Protective Services II Contract, Task Order 6 (Baghdad), Amendment 3 (June 26, 2006); *id.*, Task Order 8 (Al Hillah), Amendment 1 (Dec. 28, 2006); Blackwater USA, *WPPS II Baghdad Task Order Cost Proposal* (undated); House Committee on Oversight and Government Reform, Testimony of Erik Prince, *Hearing on Blackwater USA: Private Military Contractor Activity in Iraq and Afghanistan*, 110th Cong. (Oct. 2, 2007) (suggesting that the average Blackwater guard works six months out of the year).

estimates that between May 2006, when the contract began, and March 2007, when Blackwater received the IRS ruling, Blackwater would have avoided withholding and paying approximately the following amounts if it treated these security guards as independent contractors instead of as employees: \$15.5 million in Social Security and Medicare taxes,³³ \$15.8 million in federal income tax withholding,³⁴ and \$500,000 in unemployment taxes.³⁵

One unanswered question is whether Blackwater has continued to avoid withholding and paying Social Security, Medicare, and unemployment taxes and federal income tax withholding for its employees since Blackwater received the IRS ruling in March 2007. One former Blackwater security guard has informed my staff that Blackwater did not withhold and pay these taxes at least through May 2007. If Blackwater has continued this illegal practice, my staff estimates that Blackwater would have evaded an additional \$18 million in taxes from April 2007 through September 2007 under the State Department contract alone.

The Nondisclosure Agreement

The individual security guard who requested the IRS ruling had a dispute with Blackwater over the amount of back pay and other compensation he was owed by Blackwater. On June 6, 2007, Blackwater entered into a "Settlement & Mutual Release Agreement" with the employee. Under this agreement, Blackwater agreed to pay the amount of back pay and other compensation that the employee had been seeking.

Section 8 of the agreement is titled "Covenants Regarding Confidential Information." It provides that the employee is prohibited from contacting "any politician" or "public official" about Blackwater. According to this provision:

³³ Social Security taxes are 12.4% of an employee's earnings up to \$94,200 in 2006 and \$97,500 in 2007. Half of this amount must be paid by the employer and the other half must be withheld by the employer from the employee's wages. Medicare taxes are 2.9% of an employee's earnings, with half of this amount being paid by the employer and the other half being withheld by the employer from the employee's wages.

³⁴ The amount of federal income taxes that Blackwater should have withheld from the security guards' wages depends on the specific circumstances of each guard. For purposes of this estimate, the staff assumed that the financial, marital, and tax circumstances of the Blackwater guards were the same as the averages for all U.S. workers in their income range (\$100,000 to \$200,000).

³⁵ Federal unemployment taxes are \$434 per worker. This federal unemployment tax estimate does not take into account potential state unemployment tax credits.

During the Term of this Agreement, and for a period of five (5) years thereafter, no Party shall ... contact any politician [or] public official ... regarding Confidential Information, the other Party, or any agreement between the Parties.³⁶

The agreement uses bold, underlined, and capitalized text to emphasize the importance of the nondisclosure provisions. It states:

THE UTMOST PROTECTION AND NONDISCLOSURE OF CONFIDENTIAL INFORMATION IS OF CRITICAL IMPORTANCE AND IS THE ESSENCE OF THIS AGREEMENT.³⁷

The agreement was signed by Andrew Howell, Blackwater's General Counsel. He is the same individual who testified for Blackwater at the Oversight Committee's first hearing on Blackwater's activities in Iraq, which was held on February 7, 2007.³⁸

This nondisclosure agreement is abhorrent on its face. Nondisclosure agreements that prohibit individuals from reporting illegal conduct to public officials have been widely held to be unenforceable as against public policy.³⁹ It is deplorable that a company that depends on federal tax dollars for over 90% of its business would even contemplate forbidding an employee to report corporate wrongdoing to Congress and federal law enforcement officials.

In this case, the timing and wording of the nondisclosure agreement and the involvement of Mr. Howell are particularly suspect. After the February 7 hearing, the Committee continued its investigation of Blackwater's activities, sending additional information requests on May 7, 2007, and May 10, 2007.⁴⁰ These requests met with resistance, and on August 3, 2007, the Committee issued a subpoena to compel Blackwater to provide documents it refused to provide

³⁶ Settlement & Mutual Release Agreement between Andrew Howell, General Counsel, Blackwater USA, and former Personal Security Specialist, Blackwater USA (June 6, 2007).

³⁷ *Id.*

³⁸ After the February 7, 2007, hearing, serious questions were raised about the veracity of Mr. Howell's testimony, which included incorrect assertions that Blackwater reports relating to the 2004 Fallujah incident were classified when in fact they were not. Letter from Henry A. Waxman, Chairman, House Committee on Oversight and Government Reform, to Erik Prince, Chairman, Blackwater USA (Aug. 27, 2007).

³⁹ *See, e.g.*, Restatement (Second) of Contracts § 178.

⁴⁰ Letter from Henry A. Waxman, Chairman, House Committee on Oversight and Government Reform, to Erik Prince, Chairman, Blackwater USA (May 7, 2007); Letter from Henry A. Waxman, Chairman, House Committee on Oversight and Government Reform, to Erik Prince, Chairman, Blackwater USA (May 10, 2007).

voluntarily.⁴¹ It was precisely during this time period that Blackwater became aware of the IRS ruling and required the security guard to sign the nondisclosure agreement prohibiting any contact with members of the Committee.

Conclusion

In 2004, the same year Blackwater began working in Iraq, the IRS issued a consumer alert highlighting the top schemes employers used to avoid withholding or paying federal taxes. The alert cautioned that employers who “incorrectly treat employees as independent contractors to avoid paying employment taxes” are “misclassifying worker status.” The alert was issued following “a string of recent convictions and court rulings involving employment tax schemes.” In conjunction with this alert, IRS Commissioner Mark Everson warned:

Failure to pay employment taxes is stealing from the employees of the business. ... The IRS pursues business owners who don't follow the law, and those who embrace these schemes face civil or criminal sanctions.⁴²

The IRS ruling that I have obtained indicates that Blackwater appears to have engaged in precisely this type of illegal tax scheme. Compounding this egregious conduct, it also appears that Blackwater required the security guard who uncovered the tax evasion scheme to sign a nondisclosure agreement to keep members of Congress and other public officials in the dark. If this is accurate, Blackwater's conduct is inexcusable.

In order to investigate Blackwater's actions with respect to this matter, the Committee requests that you provide the following information:

1. All communications between Blackwater or any representative of Blackwater and any official in the federal government, including the Internal Revenue Service, relating to Blackwater's classification of personnel as independent contractors or employees;
2. All documents relating to the classification of Blackwater personnel as independent contractors or employees, including any documents providing legal advice or guidance to Blackwater officials on what factors should be considered in determining whether an individual should be classified as an independent contractor or an employee;

⁴¹ Subpoena from House Committee on Oversight and Government Reform to Erik Prince, Chairman, Blackwater USA (Aug. 3, 2007).

⁴² Internal Revenue Service, *IRS Warns Businesses, Individuals to Watch for Questionable Employment Tax Practices* (Apr. 5, 2004) (online at <http://www.irs.gov/newsroom/article/0,,id=122521,00.html>).

Mr. Erik Prince
October 22, 2007
Page 13

3. For each federal contract held by Blackwater, a listing of the number of persons hired as independent contractors to provide services under the contract, a description of the positions held and services provided by each such person, the dates worked by each such person, the amounts paid by Blackwater to each such person, and the amounts withheld and paid to the Internal Revenue Service, if any, as Social Security, Medicare, or unemployment taxes or withheld as federal income taxes for each such person;
4. All documents relating to the IRS ruling issued on March 30, 2007, or any IRS or other federal audit or investigation of Blackwater for underpayment of federal taxes;
5. All documents relating to any agreement with any employee or independent contractor of Blackwater that includes a provision prohibiting contact or communications with public officials; and
6. All documents relating to the individual security guard who requested the March 30, 2007, IRS ruling, including any communications with other companies relating to the security guard.

Please provide the requested documents no later than November 19, 2007.

The Committee on Oversight and Government Reform is the principal oversight committee in the House of Representatives and has broad oversight jurisdiction as set forth in House Rule X. Enclosed with this letter are instructions on how to respond to the Committee's document request.

If you have any questions about this request, please contact John Williams or Russell Anello of the Committee staff at (202) 225-5420.

Sincerely,



Henry A. Waxman
Chairman

Enclosure

cc: Tom Davis
Ranking Minority Member