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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 to 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

**Responses to Supplemental Questions for the Record**  
**Submitted by**  
**Senator Norm Coleman**  
**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 Questions for the Record**  
**Submitted by**  
**Senator Daniel Akaka**  
**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<sup>1</sup> 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

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

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 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,<sup>2</sup> 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.

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

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

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.<sup>3</sup>

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<sup>3</sup> 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.



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