



FINANCIAL MANAGEMENT

Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence

Highlights of [GAO-05-683T](#), a testimony before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

Tax abuses by contractors working for the Department of Defense, which GAO previously reported on, have led to concerns about similar abuses by those hired by civilian agencies. GAO was asked to determine if similar problems exist at civilian agencies and, if so, to (1) quantify the amount of unpaid federal taxes owed by civilian agency contractors paid through the Financial Management Service (FMS), (2) determine whether there are indications of abusive or potential criminal activity by contractors with unpaid tax debts, and (3) identify any statutory or policy impediments and control weaknesses that impede tax collections under the Federal Payment Levy Program (FPLP).

What GAO Recommends

In its report ([GAO-05-637](#)), on which this testimony is based, GAO makes recommendations to FMS to improve the FPLP and increase by tens of millions of dollars annually the amounts levied from payments to contractors with unpaid federal taxes. GAO also recommended that IRS review the 50 case study contractors identified in the report, and if warranted, pursue collection or criminal investigation. IRS agreed and FMS partially agreed. FMS did not agree that it should withhold payments to contractors without names or work with IRS to address challenges related to levying purchase card payments. GAO disagreed with FMS's assessment and reiterated support for its recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-05-683T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Greg Kutz at (202) 512-9095 or Steven Sebastian at (202) 512-3406.

What GAO Found

FMS and IRS records showed that about 33,000 civilian agency contractors owed over \$3 billion in unpaid federal taxes as of September 30, 2004. GAO investigated 50 civilian agency contractors with abusive and potentially criminal activity. For example, businesses did not forward payroll taxes withheld from their employees to IRS. Willful failure to remit payroll taxes is a felony under U.S. law. Furthermore, several individuals owed multiple businesses with unpaid federal taxes—one owned about 20 businesses that did not fully pay taxes on over 300 returns. Some diverted payroll taxes for personal gain or to fund their businesses, such as building a house, purchasing other real property, and increasing the salary of the company's officer/owner. These contractors worked for a number of federal agencies including the Departments of Justice and Homeland Security, and the National Aeronautics and Space Administration.

Examples of Abusive and Potentially Criminal Activity

Business	Unpaid tax amount	Fiscal year 2004 FMS payments	Contractor activity
Health care	\$18 million	\$300,000	Purchased multimillion-dollar properties while not paying millions in payroll taxes
Consulting	\$1 million	\$200,000	Doubled salary of one officer/owner to over \$750,000 while not remitting payroll taxes
Temporary help	\$900,000	\$1 million	A pattern of over 20 years of closing businesses with tax debts, opening new ones, and incurring more tax debts
Security	\$400,000	\$200,000	Diverted payroll taxes to a foreign bank account to build a house overseas

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

If all tax debts owed by, and all payments made to, the 33,000 contractors were included in the FPLP, FMS could have collected hundreds of millions of dollars in fiscal year 2004. However, because only a fraction of all unpaid taxes and a portion of FMS payments were included in the levy program, FMS collected only \$16 million. For example, about \$171 billion of unpaid federal taxes was not sent to the levy program to be offset against payments because of statutory requirements or IRS policy exclusions such as claims of financial hardship or bankruptcy.

Tens of billions of dollars in federal payments were not matched against tax debts for potential levy because FMS did not proactively manage and oversee the levy program. Until GAO brought it to FMS's attention, FMS was unaware that \$40 billion of contractor payments had not been submitted for potential levy. FMS also did not identify payment files that lacked contractor taxpayer identification numbers, names, or both, resulting in another \$21 billion that could not be levied. FMS also excluded billions of dollars from levy because of what it considered limitations in its automated systems without taking steps to overcome those limitations. Furthermore, civilian agency purchase card payments to contractors totaling nearly \$10 billion could not be levied.