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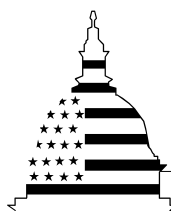
Report to the Permanent Subcommittee
on Investigations, Committee on
Homeland Security and Governmental
Affairs, U.S. Senate

November 2007

MEDICAID

Thousands of Medicaid Providers Abuse the Federal Tax System

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G A O

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Highlights of [GAO-08-17](#), a report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

In fiscal year 2006, outlays for Medicaid were about \$324 billion; about \$185 billion was paid by the federal government. Because GAO previously identified abusive and criminal activity associated with government contractors owing billions of dollars in federal taxes, the subcommittee requested GAO expand our work to Medicaid providers.

GAO was asked to (1) determine if Medicaid providers have unpaid federal taxes, and if so, the magnitude of such debts; (2) identify examples of Medicaid providers that have engaged in abusive or criminal activities; and (3) determine whether the Centers for Medicare & Medicaid Services (CMS) and the states prevent health care providers with tax problems from enrolling in Medicaid or participating in the continuous levy program to pay federal tax debts.

To perform this work, GAO analyzed tax data from the Internal Revenue Service (IRS) and Medicaid data from seven selected states based on magnitude of Medicaid payments and geography. GAO also performed additional investigative activities.

What GAO Recommends

GAO is recommending that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program and evaluate 25 cases for additional collection action and criminal investigation. IRS agreed with our recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-17](#). For more information, contact Greg Kutz at (202) 512-6722 or kutzg@gao.gov.

MEDICAID

Thousands of Medicaid Providers Abuse the Federal Tax System

What GAO Found

Over 30,000 Medicaid providers, about 5 percent of those paid in fiscal year 2006, had over \$1 billion of unpaid federal taxes. These 30,000 providers were identified from a nonrepresentative selection of providers from seven states: California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas. This \$1 billion estimate is likely understated because some Medicaid providers have understated their income or not filed their tax returns.

We selected 25 Medicaid providers with high federal tax debt as case studies for more in-depth investigation of the extent and nature of abuse and criminal activity. For all 25 cases we found abusive and related criminal activity, including failure to remit individual income taxes or payroll taxes to IRS. Rather than fulfill their role as “trustees” of federal payroll tax funds and forward them to IRS, these providers diverted the money for other purposes. Willful failure to remit payroll taxes is a felony under U.S. law. Individuals associated with some of these providers diverted the payroll tax money for their own benefit or to help fund their businesses. Many of these individuals accumulated substantial assets, including million-dollar houses and luxury vehicles, while failing to pay their federal taxes. In addition, some case studies involved businesses that were sanctioned for substandard care of their patients. Despite their abusive and criminal activity, these 25 providers received Medicaid payments ranging from about \$100,000 to about \$39 million in fiscal year 2006.

Examples of Medicaid Providers with Abusive and Criminal Activity

Type of business	Fiscal year 2006		Description of activity
	Unpaid tax debt	Medicaid payments	
Nursing home	\$2 million	\$6 million	Owner fined for jeopardizing health and safety of patients.
Counselor	\$200,000	\$200,000	Owner indicted for fraud for several hundred thousands of dollars relating to a federal program.
Ambulance service	\$300,000	\$300,000	All business's assets were seized by a law enforcements agency for money laundering.

Source: GAO analysis of IRS, CMS, public, and other records.

CMS and our selected states do not prevent health care providers who have federal tax debts from enrolling in Medicaid. CMS officials stated that such a requirement for screening potential providers for unpaid taxes could adversely impact states' ability to provide health care to low income people. Further, federal law generally prohibits the disclosure of taxpayer data to CMS and states.

No tax debt owed by Medicaid providers has ever been collected through the continuous levy program. During our audit, IRS had not made a determination on whether Medicaid payments are considered “federal payments” and thus eligible for its continuous levy program. For fiscal year 2006, if an effective levy was in place for the seven selected states, GAO estimates that the federal government could have collected between \$70 million and \$160 million.

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Abbreviations

CMS	Centers for Medicare & Medicaid Services
EIN	employer identification number
FCTC	Federal Contractors Tax Compliance
FMS	Financial Management Service
HHS	Department of Health and Human Services
IRS	Internal Revenue Service
SSN	Social Security number
TFRP	trust fund recovery penalty
TIN	taxpayer identification number
TOP	Treasury Offset Program

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United States Government Accountability Office
Washington, DC 20548

November 14, 2007

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

The success of our tax system hinges on the public's perception of its fairness, including the extent to which taxpayers believe their friends, neighbors, and businesses are complying with the tax laws and are actually paying their taxes. The Internal Revenue Service's (IRS) own data in this regard are not encouraging. IRS reported that the federal government does not receive hundreds of billions of dollars in taxes owed annually. IRS's most recent estimate is that the gross tax gap (the difference between the taxes that should have been paid voluntarily and on time and what was actually paid) was \$345 billion for tax year 2001. IRS estimated that it would eventually collect \$55 billion of this amount, leaving a net tax gap of \$290 billion in unpaid taxes. IRS enforcement of the tax laws is vital to promote compliance by giving taxpayers confidence that others are paying their fair share. Because of the challenges that IRS faces in its enforcement of tax laws, we continue to include it as a high-risk area for IRS.¹

A portion of the tax gap is owed by individuals and businesses receiving payments from the federal government. For example, over the past several years, we testified that federal contractors (Department of Defense, federal civilian, and General Services Administration contractors) abused the federal tax system with little consequence.² Due to the significance of the issues raised during those hearings, you asked us to provide additional

¹GAO, *High-Risk Series: An Update*, [GAO-07-310](#) (Washington, D.C.: Jan. 2007).

²GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-04-414T](#) (Washington, D.C.: Feb. 12, 2004); *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-05-683T](#) (Washington, D.C.: June 16, 2005); and *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, [GAO-06-492T](#) (Washington, D.C.: Mar. 14, 2006).

information about whether Medicare and Medicaid providers were engaged in similar tax abuses.³

This is the second in a series of reports and testimonies to respond to your request. In March 2007, we testified that Medicare physicians, health professionals, and suppliers paid under the Supplemental Medical Insurance program, also known as Medicare Part B, had abused the federal tax system while doing business with the federal government.⁴ This report will cover Medicaid health care providers from seven selected states who also abused the federal tax system.

The specific objectives of this forensic audit and related investigation were, to the extent possible, (1) determine if providers who receive Medicaid payments have unpaid federal taxes, and if so, the magnitude of federal tax debts owed by these Medicaid providers; (2) identify examples of providers engaged in abusive and criminal activity related to the federal tax system; and (3) determine whether Centers for Medicare & Medicaid Services (CMS) and selected states prevent health care providers with tax problems from enrolling in Medicaid or participate in the continuous levy program to pay federal tax debts.

To identify the extent to which Medicaid providers had unpaid federal taxes, we obtained and analyzed fiscal year 2006 Medicaid payments made to providers in a nonrepresentative selection of seven states:⁵ California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas.⁶ Payments to these states constituted about 43 percent of all Medicaid payments made during fiscal year 2006. These states were selected based on the magnitude of Medicaid payments and geographical location. We also obtained and analyzed the IRS tax debt data as of September 30, 2006.

³In addition to our audits of federal contractors with tax debts, we also conducted audits of combined federal campaign charities and exempt organizations with federal tax debts. GAO, *Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes*, [GAO-06-887](#) (Washington, D.C.: July 28, 2006) and *Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly \$1 Billion in Payroll and Other Taxes*, [GAO-07-563](#) (Washington, D.C.: June 29, 2007).

⁴GAO, *Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System*, [GAO-07-587T](#) (Washington D.C.: Mar. 20, 2007).

⁵There are 56 Medicaid programs, including one for each of the 50 states, the District of Columbia, Puerto Rico, American Samoa, Guam, Northern Mariana Islands, and the Virgin Islands. Hereafter, all 56 entities are referred to as states.

⁶Throughout this report, these seven states are referred to as the selected states.

We matched the lists of Medicaid providers with IRS tax debts using the taxpayer identification number (TIN) to identify Medicaid providers with tax debts. To illustrate the extent and nature of tax system abuse or potentially criminal activity, we selected 25 Medicaid providers for a detailed audit and investigation. The 25 providers were chosen based on the amount of unpaid taxes, number of unpaid tax periods, amount of payments reported by Medicaid, and indications that owner(s) might be involved in multiple companies with tax debts. For these 25 Medicaid providers, we reviewed copies of automated tax transcripts and other tax records (for example, revenue officer's notes) and performed additional searches of criminal, financial, health care, and public records.

To determine whether CMS and states prevent health care providers with unpaid federal taxes from enrolling in Medicaid, we interviewed officials from CMS and selected states and examined the CMS and selected states' regulations, policies, and procedures for making determinations in the enrollment approval process. We also interviewed officials from CMS, IRS, and the Department of the Treasury's Financial Management Service (FMS) concerning any barriers for levying Medicaid payments. A more detailed description of the scope and methodology related to our audit and investigative work supporting this report is provided in appendix I.

We conducted our audit work from July 2006 through August 2007 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.

Results in Brief

In seven selected states, thousands of Medicaid providers abused⁷ the federal tax system with little or no consequence. Specifically, our analysis of data provided by the selected states and IRS indicates that over 30,000 Medicaid providers from the selected states, over 5 percent, had tax debts totaling over \$1 billion as of September 30, 2006.⁸ The unpaid taxes largely

⁷We considered activity to be abusive when a Medicaid provider'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.

⁸Because some Medicaid providers may do business with Medicare and other federal agencies, such as Veterans Affairs, some of the approximately 30,000 Medicaid providers described in this report may also have been included in our reports concerning the Department of Defense, General Services Administration, civilian federal contractors, Medicare Part B providers, and tax-exempt organizations that abuse the federal tax system.

consisted of individual income and payroll taxes.⁹ The \$1 billion estimate of tax debts owed by Medicaid providers is likely understated because IRS data do not reflect all amounts owed by businesses and individuals. Specifically, these do not include amounts owed by businesses and individuals that have not filed tax returns or that have failed to report the full amount of taxes due (referred to as nonfilers and underreporters) and for which IRS has not determined which specific tax debts are owed.

Our audit and investigative work details the nature of abusive and criminal activity related to the federal tax system by 25 Medicaid providers. These 25 providers were paid by Medicaid for a variety of services, including hospital, nursing facility, physician, and ambulance services. Payments ranged from about \$100,000 to approximately \$39 million during fiscal year 2006. Many were established businesses that owed federal payroll taxes withheld for their employees. Rather than fulfill their role as “trustees” of these funds and forward them to IRS as required by law, these health care providers diverted the money for other purposes. These payroll taxes included amounts withheld from employee wages for Social Security, Medicare, and individual income taxes.¹⁰

At the same time that they were not paying their federal taxes, many individuals associated with our 25 cases bought or owned significant personal assets, including commercial properties, expensive homes, and luxury vehicles. One business officer withdrew over \$100,000 in cash at casinos at the same time the business owed millions of dollars in federal taxes. Further, another case study business was sanctioned by its state regulator for substandard care of its patients.

CMS and the selected states do not prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid. CMS has not developed regulations to require states to (1) screen health care providers for unpaid taxes and (2) obtain consent for IRS disclosure of federal tax debts. CMS officials stated that the primary focus of the Medicaid program, in partnership with the states, is to provide health care

⁹Payroll taxes include amounts that employers withhold from employees’ wages for federal income taxes, Social Security, and Medicare 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.

¹⁰Willful failure to remit payroll taxes is a criminal felony offense while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense. 26 U.S.C. §§ 7202, 7215 and 7512 (b).

services for low income people and not the administration of taxes. CMS officials stated that such a requirement could be a burden to the states in their enrollment of providers and could adversely impact states' ability to provide health care to the poor. Even if CMS did want to screen health care providers with tax debts, federal law generally prohibits the disclosure of taxpayer data to CMS and states.¹¹ Thus, CMS and states do not have access to tax data directly from IRS unless the taxpayer provides consent. Consequently, CMS and the selected states have no mechanism or requirement to prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid.

A provision of the Taxpayer Relief Act of 1997 authorizes IRS to continuously levy certain federal payments made to delinquent taxpayers. However, in the 10 years since its passage, IRS had not determined whether Medicaid payments are considered federal payments, and thus subject to the continuous levy program, or determined the feasibility of incorporating these payments into the program. Thus, no tax debt owed by Medicaid providers has ever been collected from Medicaid payments through the continuous levy program. If there had been an effective levy program in place, we estimate that for fiscal year 2006, the selected seven states could have levied payments for the federal government and collected between \$70 million to about \$160 million of unpaid federal taxes. Officials from all seven of the selected states stated that they have a continuous levy program to offset Medicaid payments against their state debts.

Our report makes two recommendations to the IRS Commissioner. First, we recommend that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program. In responding to a draft of our report, IRS agreed with our recommendation but stated that it has already completed studies on whether the Medicaid payments can be incorporated into the continuous levy program. From those studies, IRS concluded that Medicaid disbursements do not qualify as federal payments and therefore cannot be incorporated in the continuous levy program. We modified our report accordingly. IRS agreed with our second recommendation—to evaluate the 25 referred cases detailed in this report for appropriate additional aggressive collection

¹¹States screen health care providers prior to enrollment into the Medicaid program. States also process and pay Medicaid claims and are reimbursed for the federal share of these payments by CMS.

action and criminal investigation as warranted. While we did not make recommendations to either CMS or FMS, they provided technical and other comments to the report. See the “Agency Comments and Our Evaluation” section of this report for a more detailed discussion of agency comments from IRS, CMS, and FMS. We have reprinted the IRS and CMS written comments in appendixes III and IV.

Background

Title XIX of the Social Security Act is a federal and state entitlement program that pays for medical assistance for certain categories of low-income adults and children. This program, known as Medicaid, became law in 1965 and is jointly funded by the federal and state governments (including the District of Columbia and the Territories). Medicaid is the largest source of funding for medical and health-related services for America’s poorest people. More than 50 million persons enrolled in the Medicaid program in fiscal year 2006. In fiscal year 2006, according to CMS, total outlays for Medicaid (federal and state) were approximately \$324 billion, of which about \$185 billion was paid by the federal government.

Medicaid is jointly funded by the federal and state governments. The federal government shares in a state’s Medicaid service costs through a matching formula. The federal matching rate for the cost of services provided to Medicaid beneficiaries is related to a state’s per capita income and in federal fiscal year 2006 ranged from 50 percent to 76 percent.

Centers for Medicare & Medicaid Services

Although the federal government establishes general guidelines for the Medicaid program, requirements are established by each state. CMS, within the Department of Health and Human Services (HHS), is responsible for administering federal matching funds to the states and for legislation and regulations affecting the Medicaid program. CMS also provides guidelines, technical assistance, and periodic assessments of state Medicaid programs.

State Medicaid Agencies

Title XIX of the Social Security Act allows considerable flexibility within the states’ Medicaid plans. Within broad national guidelines established by federal statutes, regulations, and policies, each state (1) establishes its own eligibility standards; (2) determines the type, amount, duration, and scope of services; (3) sets the rate of payment for services; and (4) administers its own program—including enrollment of providers. Medicaid policies for eligibility, services, and payment are complex and

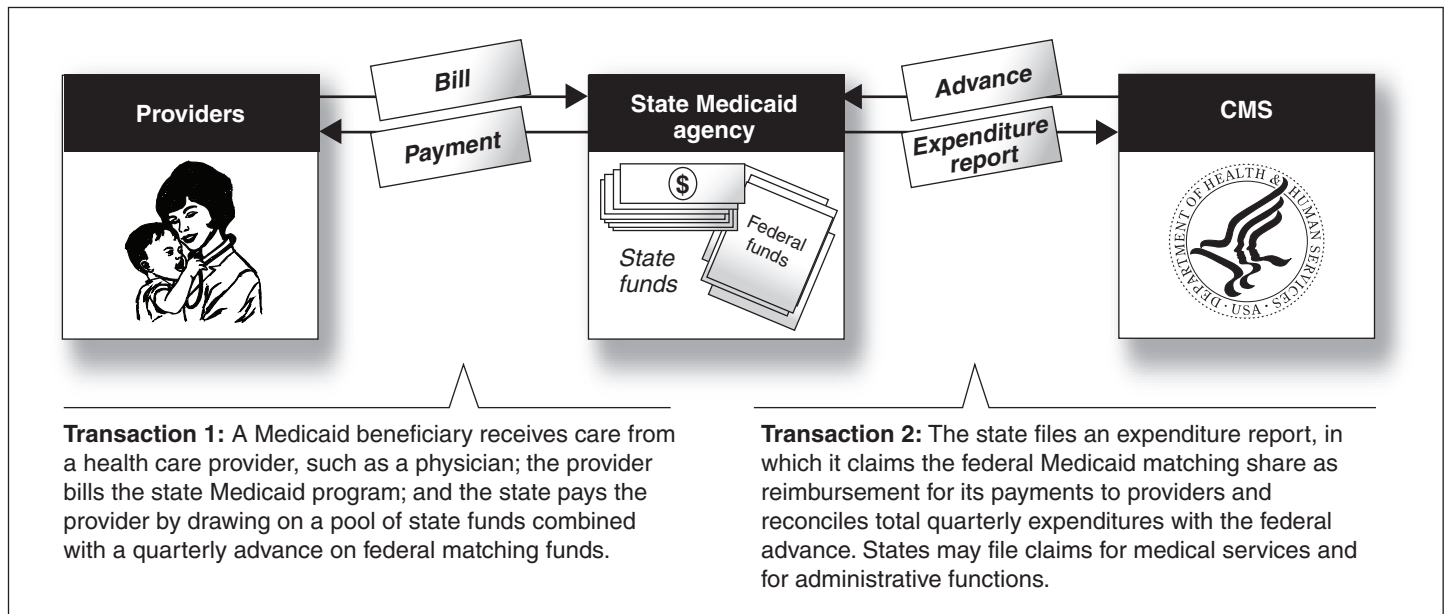
vary considerably, even among states of similar size or geographic proximity. Thus, a person who is eligible for Medicaid in one state may not be eligible in another state, and the services provided by one state may differ considerably in amount, duration, or scope from services provided in a similar or neighboring state. In addition, state legislatures may change Medicaid eligibility, services, or reimbursement during the year.

To receive payment for services or goods provided to beneficiaries from Medicaid, providers must first enroll in the Medicaid program. To enroll, providers must submit a Medicaid enrollment application to the state or their fiscal agents who are responsible for determining whether the providers meet federal and state requirements for enrollment. The state or its fiscal agents are responsible for screening the applications based on CMS and state policies. Once an applicant is deemed eligible by the state or its fiscal agents, Medicaid providers can submit their claims to the state for payment. The state is responsible for claims processing and verifying the claim is accurate, complete, medically necessary, and covered under the state's Medicaid plan. After the claim is approved, the state pays the claim.

The typical Medicaid payment process is illustrated in figure 1. When a Medicaid beneficiary receives care from a health care provider such as a hospital, physician, or nursing home, the provider bills the state Medicaid program for its services. The state in turn pays the provider from a combination of state funds and federal funds, which have been advanced by CMS each quarter. The state then files an expenditure report, in which it claims the federal share of the Medicaid expenditure as reimbursement for its payment to providers and reconciles its total expenditures with the federal advance.¹² In addition to reimbursement for medical services, the state may claim federal reimbursement for functions it performs to administer its Medicaid program, such as enrolling new beneficiaries; reviewing the appropriateness of providers' claims; and collecting payments from third parties, which are payers other than Medicaid, such as Medicare, that may be liable for some or all of a particular health claim.

¹²Each quarter, states submit to CMS an estimate of their Medicaid expenditures for the upcoming quarter. CMS then authorizes the states to draw on federal funds to pay the federal Medicaid share.

Figure 1: Typical Medicaid Payment Process



Source: GAO, Art Explosion (clip art).

Magnitude of Unpaid Federal Taxes of Medicaid Providers

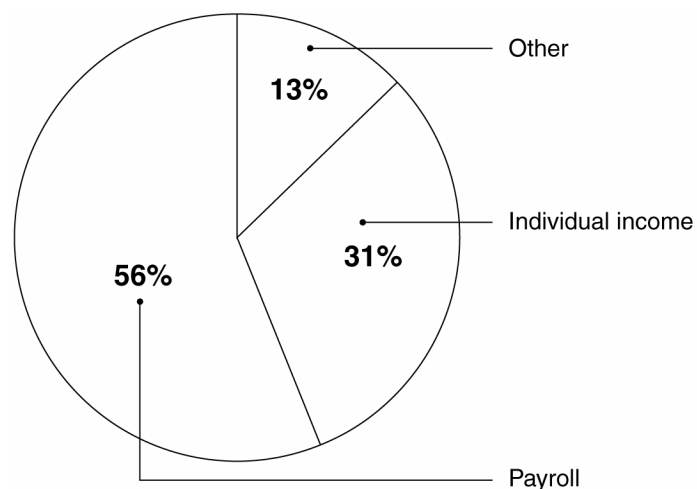
Our analysis found that over 30,000 Medicaid providers at the selected states had over \$1 billion in unpaid federal taxes as of September 30, 2006.¹³ This represents over 5 percent of the approximately 560,000 Medicaid providers paid by the selected states during federal fiscal year 2006. The amount of unpaid federal taxes we identified among Medicaid providers is likely understated because (1) we intentionally limited our scope to providers with agreed-to federal tax debt for tax periods prior to 2006, and (2) the IRS taxpayer data reflect only the amount of unpaid taxes either reported by the taxpayer on a tax return or assessed by IRS through its various enforcement programs and thus the unpaid tax debt amount does not include entities for which IRS had not identified that they did not file tax returns or underreported their income.

¹³Our estimate of Medicaid providers with tax debt as of September 30, 2006, excluded (1) tax debts that have not been agreed to by the tax debtor or affirmed by the court, (2) tax debts from calendar year 2006, (3) approved Medicaid claims less than \$100, and (4) tax debts less than \$100.

Characteristics of Medicaid Providers' Unpaid Federal Taxes

As shown in figure 2, 87 percent of the approximately \$1 billion in unpaid taxes was comprised of individual income and payroll taxes. The other 13 percent of taxes included corporate income, excise, unemployment, and other types of taxes.

Figure 2: Medicaid Providers' Unpaid Taxes by Tax Type



Source: GAO analysis of Medicaid and IRS data as of September 30, 2006.

As shown in figure 2, over half of the unpaid taxes owed by Medicaid providers were payroll taxes. Employers are subject to civil and criminal penalties if they do not remit payroll taxes to the federal government. When an employer withholds taxes from an employee's wages, the employer is deemed to have a responsibility to hold these amounts "in trust" for the federal government until the employer makes a federal tax deposit in that amount. To the extent these withheld amounts are not forwarded to the federal government, the employer is liable for these amounts, as well as the employer's matching Federal Insurance Contribution Act contributions for Social Security and Medicare. Individuals within the business (e.g., corporate officers) may be held personally liable for the withheld amounts not forwarded and they may be assessed a civil monetary penalty known as a trust fund recovery penalty (TFRP).¹⁴ Willful failure to remit payroll taxes can also be a criminal felony offense punishable by imprisonment up to 5 years,¹⁵ while the failure to

¹⁴26 U.S.C. § 6672.

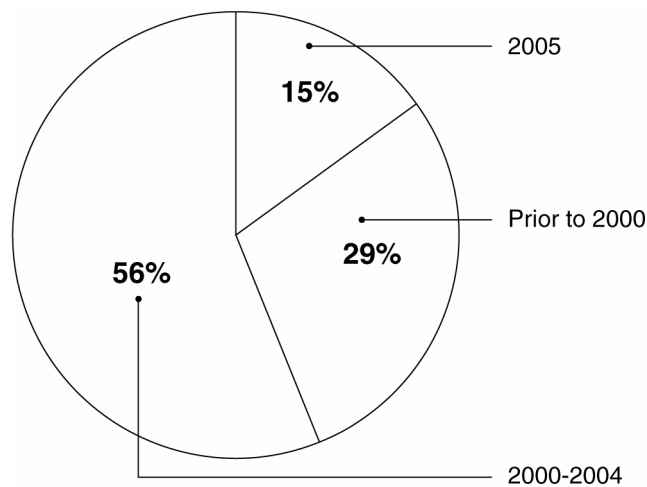
¹⁵26 U.S.C. § 7202.

properly segregate payroll taxes can be a criminal misdemeanor offense punishable by imprisonment of up to 1 year.¹⁶

The law imposes no penalties upon an employee for the employer's failure to remit payroll taxes since the employer is responsible for submitting the amounts withheld. The Social Security and Medicare trust funds are subsidized or made whole for unpaid payroll taxes by the general fund. Thus, personal income taxes, corporate income taxes, and other government revenues are used to pay for these shortfalls to the Social Security and Medicare trust funds.

A substantial amount of the unpaid federal taxes shown in IRS records as owed by Medicaid providers had been outstanding for several years. As reflected in figure 3, about 56 percent of the \$1 billion in unpaid taxes was for tax periods from calendar year 2000 through calendar year 2004, and approximately 29 percent of the unpaid taxes was for tax periods prior to calendar year 2000.¹⁷

Figure 3: Unpaid Taxes of Medicaid Providers by Calendar Year



Source: GAO analysis of Medicaid and IRS data as of September 30, 2006.

¹⁶26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

¹⁷A "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.

Our previous work has shown that as unpaid taxes age, the likelihood of collecting all or a portion of the amount owed decreases.¹⁸ This is due, in part, to the continued accrual of interest and penalties on the outstanding tax debt, which, over time, can dwarf the original tax obligation. The amount of unpaid federal taxes reported above does not include all tax debts owed by Medicaid providers due to statutory provisions that give IRS a finite period under which it can seek to collect on unpaid taxes. There is a 10-year statute of limitations beyond which IRS is prohibited from attempting to collect tax debt.¹⁹ Consequently, if the Medicaid providers owe federal taxes beyond the 10-year statutory collection period, the older tax debt may have been removed from IRS's records. We were unable to determine the amount of tax debt that had been removed.

Unpaid Federal Taxes of Medicaid Providers Is Understated

Although over \$1 billion in unpaid federal taxes owed by Medicaid providers as of September 30, 2006, is a significant amount, it likely understates the full extent of unpaid taxes owed by these or other businesses and individuals. The IRS tax database reflects only the amount of unpaid federal taxes either reported by the individual or business 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. For example, during our audit, we identified instances from our case studies in which Medicaid providers failed to file tax returns for a particular tax period and IRS had not assessed taxes for these tax periods.²⁰ Consequently, while these providers had unpaid federal taxes, they were listed in IRS records as having no unpaid taxes for that period.

¹⁸GAO, *Internal Revenue Service: Recommendations to Improve Financial and Operational Management*, GAO-01-42 (Washington D.C.: Nov. 17, 2000).

¹⁹The 10-year time limit may be suspended and include periods during which the taxpayer is involved in a collection due process appeal, litigation, a pending offer-in-compromise, or an installment agreement. As a result, fig. 3 includes taxes that are for tax periods from more than 10 years ago.

²⁰For example, one of the Medicaid provider case studies had not filed personal income tax returns for the last couple of years. According to IRS records, the Medicaid provider in question earned at least \$300,000 in revenue in the last tax year of our review. In another case example, a Medicaid provider had not filed its tax returns for the last several years. In fact, the IRS revenue officers indicated that the provider was defunct. However, according to IRS records, the Medicaid provider in question earned at least \$1 million in revenue in the last tax year of our review and after the provider was classified as defunct.

Further, our analysis did not attempt to account for businesses or individuals that purposely underreported income and were not specifically identified by IRS as owing the additional federal taxes. According to IRS, underreporting of income accounted for more than 80 percent of the estimated \$345 billion annual gross tax gap.²¹

Finally, our analysis did not attempt to identify Medicaid providers who owed taxes under a separate TIN from the TIN that received the Medicaid payments. For example, sole proprietors and certain limited liability companies may file Medicaid claims under their Social Security numbers (SSN). If these Medicaid providers had employees, they would typically report the payroll taxes under an employer identification number (EIN) and not their SSNs. Consequently, the full extent of unpaid federal taxes for Medicaid providers is not known.

In addition to the IRS tax database not reflecting all assessed tax amounts due, our past audits²² have also found that the IRS tax database contains coding errors that adversely affect IRS's collection activities. IRS's collection process is heavily dependent upon its automated computer system and the information that resides within this system. In particular, the codes in each taxpayer's account in IRS's tax database are critical to IRS in tracking the collection actions it has taken against a tax debtor and in determining what, if any, additional collection actions should be pursued. For example, IRS uses these codes to identify cases it should exclude from the continuous levy program,²³ which is an automated method of collecting tax debt by offsetting certain federal payments made to individuals and businesses, as well as cases it should exclude from other collection actions.

²¹According to IRS, nonfilers and underpayment of taxes made up the rest of the gross tax gap.

²²GAO, *Internal Revenue Service: Procedural Changes Could Enhance Tax Collections*, [GAO-07-26](#) (Washington D.C.: Nov. 15, 2006).

²³Each week IRS sends FMS an extract of its tax debt files containing updated account balances of tax debts that are already in Treasury Offset Program (TOP), the new tax debts that need to be added to TOP, and all taxes in TOP that need to be removed. FMS sends payment data to TOP to be matched against these unpaid federal taxes. If there is a match and IRS has updated TOP to reflect that it has completed all legal notifications, the federal payment is reduced (levied) to help satisfy the unpaid federal taxes. In addition to federal tax debts, the TOP database also includes federal nontax debts, state tax debts, and child support debts.

Examples of Extent and Nature of Medicaid Providers' Abusive and Potentially Criminal Activity Related to the Federal Tax System

For all 25 cases that we audited and investigated, we confirmed that their activities were abusive and in many instances found criminal activity related to the federal tax system. Of these cases, 17 involved businesses with employees who had unpaid payroll taxes, most dating as far back as the late 1990s. However, rather than fulfill their role as “trustees” of this money and forward it to IRS, these Medicaid providers diverted the money for other purposes, including their own salaries. As stated earlier, willful failure to remit payroll taxes can be a criminal felony offense punishable by imprisonment up to 5 years,²⁴ while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense punishable by imprisonment of up to 1 year.²⁵

Table 1 highlights 10 cases of businesses and individuals with unpaid taxes. Our investigations revealed that, despite their businesses owing substantial amounts of taxes to IRS, some owners had substantial personal assets—including expensive homes and luxury cars. We are referring the 25 cases detailed in our report to IRS for appropriate collection action and criminal investigation.

Table 1: Medicaid Providers with Unpaid Federal Taxes

Case	Nature of work	Medicaid payments ^a	Unpaid federal tax ^b	Comments
1	Hospital	\$9 million	\$5 million	<ul style="list-style-type: none"> • Business's tax debts are primarily composed of unpaid payroll taxes beginning in the late 1990s. • IRS reported tax debts to the continuous levy program for collection action. • IRS proposed an injunction to close the business in a recent year because the business continued to accumulate tax debt. • IRS assessed a TFRP against business owners. • IRS attempted to levy a bank account but the owner closed the account prior to the levy. • Business owners had several large cash transactions in recent years. • Owners own two residences worth over \$2 million. • IRS and the state filed tax liens against the business. • Business received over \$2 million dollars in Medicare payments in a recent year.

²⁴26 U.S.C. § 7202.

²⁵26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

Case	Nature of work	Medicaid payments ^a	Unpaid federal tax ^b	Comments
2	Nursing home	\$6 million	\$2 million	<ul style="list-style-type: none"> • Business's federal tax debts are primarily composed of unpaid payroll taxes. • Business received nearly \$2 million in Medicare payments in a recent year. • IRS reported tax debts to the continuous levy program for collection action. • Business charged with patient abuse, and business and business owner also fined and suspended for jeopardizing the health and safety of patients. • IRS filed tax liens against the business and business owner. • Related business owes over \$1 million of unpaid taxes that have been referred to the continuous levy program.
3	Nursing facility	\$3 million	\$3 million	<ul style="list-style-type: none"> • Business's federal tax debts are primarily unpaid payroll taxes. • Business officer owns multiple properties; one worth over \$1 million. • IRS assessed over a \$1 million TFRP against the business officer. • Business defaulted on an installment agreement with IRS. • Business received nearly \$3 million in Medicare payments in a recent year. • IRS reported business's tax debts to the continuous levy program. • Business is involved in a lawsuit for malpractice in a recent year. • Business officers filed for bankruptcy in early 2000s. • IRS filed tax liens against the business. • Business officer owns a related business that owes over \$200,000 in unpaid federal taxes. IRS reported the related business' tax debts to the continuous levy program.
4	Pharmacy	\$100,000	\$800,000	<ul style="list-style-type: none"> • Business's tax debts are primarily unpaid payroll taxes covering over 7 years. For most of these tax periods, the business filed late and made no tax payments. • Business filed for bankruptcy in the mid-2000s. • Business officer sold assets of the business even though the officer knew the business owed unpaid taxes and also knew that liens were filed. • IRS assessed a nearly \$3 million TFRP against the business officer. • IRS and state filed tax liens against the business. • Business officer owns a related business that owes unpaid federal taxes.
5	Home health services	\$2 million	\$1 million	<ul style="list-style-type: none"> • Business's tax debts are primarily unpaid payroll taxes. • Business filed for bankruptcy while a business officer continued to earn over \$250,000 a year. • Business officer owns a luxury vehicle and property worth about \$1 million located near a golf course. • Business received over \$1 million in Medicare payments in a recent year. • IRS assessed a TFRP against a business officer. • IRS and state filed tax liens against the business.

Case	Nature of work	Medicaid payments ^a	Unpaid federal tax ^b	Comments
6	Dental	\$200,000	\$300,000	<ul style="list-style-type: none"> Dentist's tax debts are primarily unpaid income taxes. Dentist generally had not made any federal tax payments since early 1990s. In a recent year, dentist earned over \$300,000 and did not file an income tax return. Dentist owes debts to other federal agencies, including delinquent student loan debt. IRS and state filed tax liens against the dentist.
7	Home care	\$2 million	\$3 million	<ul style="list-style-type: none"> Business's tax debts are primarily unpaid payroll taxes beginning in the late 1990s. Business did not file tax returns in late 1990s and early 2000s. Business owners own multiple real properties, including a million dollar residence, luxury vehicles, and a recreational boat. IRS assessed over \$1 million TFRP against one business owner. Business filed bankruptcy in a recent year. IRS and state filed tax liens against the business. Business owners own several related health care businesses which are in bankruptcy status.
8	Clinic	\$3 million	\$1 million	<ul style="list-style-type: none"> Business's tax debts are primarily unpaid payroll taxes. Business owner borrowed over \$2 million from the business while business owed payroll taxes. Business owner owns residential property worth nearly \$4 million dollars, several luxury vehicles, and a recreational boat. Business did not file required tax return in a recent year. IRS assessed a TFRP against owner. IRS and state filed tax liens against the business.
9	Nursing home facilities	\$39 million	\$16 million	<ul style="list-style-type: none"> Business's tax debt is primarily unpaid payroll taxes. Business fined for quality of care violations in early 2000s. Business officer withdrew over \$100,000 in cash at casinos at the same time he was not paying the nursing home's taxes. Multimillion-dollar IRS and state tax liens filed against the business.
10	Professional counselor	\$200,000	\$200,000	<ul style="list-style-type: none"> Owner's tax debt is primarily individual income taxes. Owner and spouse currently under investigation for mail fraud. Owner has a felony conviction. Owner indicted for fraud for several hundred thousand dollars relating to a federal program. IRS filed tax liens against the owners.

Source: GAO analysis of IRS, FMS, Medicaid claims, public, and other records.

Notes: Dollar amounts are rounded. The nature of unpaid taxes for businesses was primarily due to unpaid payroll taxes. A Medicaid provider can submit claims using either an EIN or SSN. In our report, any provider submitting a claim with an EIN is referred to as a business, and any provider submitting a claim with an SSN is referred to as an individual.

^aMedicaid payments are Medicaid claims paid by states for fiscal year 2006 (October 1, 2005, to September 30, 2006).

^bUnpaid tax amount was as of September 30, 2006.

The following provides illustrative detailed information on four cases we audited and investigated.

- Case 1: During the time the owners of the hospital owed over \$5 million in payroll taxes, the owners purchased a vacation home worth about \$1 million. IRS assessed a trust fund recovery penalty (TFRP) of nearly \$2 million against the owners, filed federal tax liens totaling nearly \$8 million against the owners and hospital, attempted to levy the owners' bank accounts, and proposed an injunction to close the hospital because the business continued to accumulate tax debt. The hospital received over \$9 million in Medicaid payments during fiscal year 2006.
- Case 2: While owing over \$2 million in unpaid payroll taxes, the nursing home owner and business were fined for jeopardizing the health and safety of their patients. The nursing home owner attempted to sell the business and other real estate property and promised to pay tax debts in full. However, the owner did not sell the business or real estate and took other actions to avoid federal tax liens. IRS fined the owner over \$400,000 in a recent year for intentionally disregarding IRS's tax reporting and filing requirements. The owner also has a related business that owes over \$1 million in unpaid taxes. The nursing home received over \$6 million in Medicaid payments during fiscal year 2006.
- Case 4: The managing officer of a pharmacy sold off business assets without notifying IRS while knowing that the business owed over \$800,000 in unpaid payroll taxes over 7 years. In an attempt to collect unpaid debts from the officer, IRS assessed a TFRP of nearly \$3 million and filed federal tax liens against the officer and the business. The officer owns a related entity that also owes a large amount of taxes, and recently started up a new corporation using the same address as the pharmacy. The pharmacy received nearly \$100,000 in Medicaid payments during fiscal year 2006.
- Case 8: A medical clinic owner owns a house worth nearly \$4 million, several luxury vehicles, and a pleasure boat while owing taxes. The owner also borrowed over \$2 million from the business and sold properties for about \$1 million at the same time the business owed over \$1 million in unpaid payroll taxes. In addition, IRS generated a tax return for the business in a recent year because the business owner did not file it. The medical clinic received over \$2 million in Medicaid payments during fiscal year 2006.

In addition to the 25 cases that we identified through IRS tax records, we separately also found a Medicaid provider that was recently convicted for

failure to pay employment taxes owed by several nursing homes.²⁶ The nursing home businesses received over \$25 million in Medicaid payments during fiscal year 2006. According to court documents, the nursing homes owed over \$14 million in unpaid taxes. At the same time the businesses owed taxes, the owner bought a 10,000 square foot house with a current estimated value of over \$2 million. The court records indicate that the owner spent tens of thousands of dollars furnishing the house including crystal chandeliers, a 132-piece set of Haviland Bavarian porcelain china, and oriental rugs. The owner used company funds to pay personal expenses such as a housekeeper, children's nanny, monthly pension for a parent who never worked at the company, a sailboat, and jet-skis. While owing taxes, the owner also went on vacations to Hawaii and gambling trips to Las Vegas and Reno, Nevada. Court records also indicate that while in Hawaii, the owner bought a \$16,000 Rolex watch, the day before one of the required federal tax deposits was due.

Providers with Unpaid Federal Taxes Are Not Prohibited from Enrolling or Receiving Payments from Medicaid

CMS and the selected states do not prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid. CMS has not developed regulations to require states to (1) screen health care providers for unpaid taxes and (2) obtain consent for IRS disclosure of federal tax debts. CMS officials stated that the primary focus of the Medicaid program is to provide health care services for low income people and not the administration of taxes. Further, federal law generally prohibits the disclosure of taxpayer data to CMS and states and thus, CMS and states do not have access to tax data directly from IRS unless the taxpayer provides consent.²⁷ Further, none of the seven states we contacted have ever implemented a continuous federal tax levy for Medicaid payments. Thus, Medicaid payments to providers that owe federal taxes are not being continuously levied.

Screening for Unpaid Taxes

Federal law does not prohibit providers with unpaid federal taxes from enrolling in and billing Medicaid. Federal regulations and policies require the states, as part of their responsibilities for determining whether the

²⁶Taxpayer records (e.g., IRS Unpaid Assessment File, transcripts) were not accessed for this case example. All information concerning this case was found through court records and Medicaid claim information provided by the state.

²⁷States screen health care providers prior to enrollment into the Medicaid program. States also process and pay the Medicaid claims and are reimbursed for the federal share of such payments by CMS.

providers meet Medicaid requirements for enrollment, to verify basic information on potential providers, including whether the providers meet state licensure requirements and whether the providers are prohibited from participating in federal health care programs. However, federal regulations and policies do not require the states to screen these providers for federal tax delinquency nor do they explicitly authorize the states to reject the providers that have delinquent tax debt from participation in Medicaid. CMS officials stated that the primary focus of the Medicaid program is to provide health care services for low income people and not the administration of taxes. CMS officials stated that such a requirement could be a burden to the states in their enrollment of providers and could adversely impact states' ability to provide health care to the poor. Consequently, the selected states' processes generally do not consider federal tax debts of prospective providers in the Medicaid enrollment process.²⁸

Further, due to a statutory restriction on disclosure of taxpayer information, even if tax debts specifically were to be considered in enrollment in Medicaid, no coordinated or independent mechanism exists for the states to obtain complete information on providers that have unpaid tax debt. Federal law does not permit IRS to disclose taxpayer information, including tax debts, to CMS or Medicaid state officials unless the taxpayer consents, which neither CMS nor the states currently seek.²⁹ Thus, certain tax debt information can only be discovered from public records if IRS files a federal tax lien against the property of a tax debtor or if a record of conviction for tax offense is publicly available.³⁰ Consequently, CMS and state officials do not have ready access to information on unpaid tax debts to consider in making decisions on Medicaid providers.

²⁸ Officials from California stated that they do consider federal debts, including tax debts, if it is self-disclosed on the Medicaid application. California officials said that no verification is made.

²⁹ 26 U.S.C. § 6103.

³⁰ 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.

Medicaid Payments to Providers Are Not Subject to IRS Continuous Levy

Although a provision of the Taxpayer Relief Act of 1997 authorizes IRS to continuously levy certain federal payments made to delinquent taxpayers, no tax debt owed by Medicaid providers has ever been collected using this provision of the law.³¹ In the 10 years since its passage, IRS had not determined whether Medicaid payments are federal payments and thus subject to the continuous levy program or determined the feasibility of incorporating these payments into the program.³²

If there had been an effective levy program in place, we estimate that the selected states could have levied payments for the federal government and collected between \$70 million to about \$160 million of unpaid federal taxes during fiscal year 2006.³³ This estimate was based on those debts that IRS reported to the Treasury Offset Program (TOP) as of September 30, 2006. Officials from all these selected states stated that they have a continuous levy program to offset Medicaid payments against their state debts.

Conclusions

Available data indicate that the vast majority of Medicaid providers appear to pay their federal taxes. However, our work has shown that over 30,000 Medicaid providers have taken advantage of the opportunity to avoid paying their federal taxes. While Medicaid providers are relied on to deliver significant medical services to those most in need, they must also pay their fair share of federal taxes. Many of the individuals involved in our cases have consistently not paid their taxes yet have received millions of dollars in Medicaid payments and have faced no criminal consequences.

³¹To improve the collection of unpaid taxes, IRS is authorized to continuously levy up to 100 percent for federal payments related to goods and services. To implement this levy authority, IRS, in coordination with the Department of the Treasury's FMS, implemented the Federal Levy Payment Program in July 2000. This program uses FMS's Treasury Offset Program (TOP) for the levy of federal payments.

³²In addition to the continuous levy program, IRS also has the authority to legally seize property either held by the taxpayer or owned by the taxpayer and held by a third party. This authority includes the seizure of Medicaid receivables held by states and owed to health care providers. Unlike levies from the continuous levy program, each levy is typically a one-time seizure of property (i.e., Medicaid receivables) held by states at a specific point of time and is done on a case-by-case basis based on the particular circumstances of the case. IRS officials stated that they do not know how much in tax levies were collected from Medicaid payments.

³³Medicaid providers from the seven selected states had \$475 million in tax debts in TOP as of September 30, 2006. In addition, these providers had \$241 million in federal nontax debts, \$202 million in delinquent child support, and \$6 million in state tax debts.

At the same time, some of these individuals are living lives of luxury, financed in part by Medicare and Medicaid payments. Also, IRS has taken little action to explore the continuous levy of Medicaid payments, which over time potentially could have resulted in millions of dollars of collections or to aggressively pursue collection and criminal investigation of the individuals involved in our 25 case studies.

Recommendations for Executive Action

We recommend that the Commissioner of the Internal Revenue Service take the following two actions:

- Conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program.
- Evaluate the 25 referred cases detailed in this report for appropriate additional aggressive collection action and criminal investigation as warranted.

Agency Comments and Our Evaluation

We received written comments on a draft of this report from the Acting Commissioner of Internal Revenue (see app. III) and Acting Administrator of CMS (see app. IV). We also received an e-mail response from FMS.

IRS concurred with our recommendations. In response to our recommendation that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program, IRS stated that both a subgroup of the Federal Contractors Tax Compliance (FCTC) task force and IRS General Counsel have completed an independent study on whether the Medicaid payments can be incorporated into the continuous levy program. Both the FCTC task force and IRS General Counsel concluded that Medicaid disbursements do not qualify as federal payments and therefore cannot be incorporated in the continuous levy program.

In response to a draft of our report, CMS expressed concern about the tone and language we used to discuss our findings. Specifically, CMS interpreted our finding that over 30,000 Medicaid providers had over \$1 billion of unpaid federal taxes as implying that "there is some direct correlation between owing taxes and being a Medicaid provider." Our report clearly states that the vast majority of Medicaid providers are paying their taxes. For the 5 percent of Medicaid providers with tax debt, we simply reported on the facts of what we found, which do not require additional evaluation to satisfactorily address our objective. Furthermore,

regarding our third objective, CMS interpreted our report as implying that there is an underlying connection between the activity (preventing providers with tax problems from participating in the Medicaid program) and the authority and responsibility to perform such activity. Again, it appears that CMS misinterpreted our findings. We specifically stated that federal law does not prohibit providers with unpaid taxes from enrolling in and billing Medicaid. Although CMS is not required to screen potential providers for tax debts, we are concerned that CMS stated it would be inappropriate to prevent medical providers that owe federal taxes participating in the Medicaid program—which would presumably include those egregious cases we identified in this report. We believe that any CMS action to prevent medical providers who refuse to pay their taxes from participating in the Medicaid program would help ensure the integrity of the Medicaid program and does not necessarily conflict with CMS's role in providing health care to low-income individuals.

Both CMS and FMS expressed concern with their agencies involvement in the continuous levy program. CMS stated that we implied that CMS and the Medicaid agencies should be conducting the continuous levy on these payments. FMS stated that our report indicated that, because Medicaid payments include funds the states receive from the federal government, the Medicaid payment is a federal payment. Our report did not state that CMS and the Medicaid agencies should be conducting the continuous levy on Medicaid payments nor did we state that Medicaid payments are federal payments. However, we did report that IRS had not determined whether Medicaid payments are federal payments and recommended that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program.

CMS and FMS also provided us technical corrections to the report which we incorporated, as appropriate.

As agreed with your office, unless you publicly release its contents earlier we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the Secretary of the Treasury, the Commissioner of the Financial Management Service (FMS), the Acting Commissioner of Internal Revenue, the Acting Administrator of Centers for Medicare & Medicaid Services (CMS) and interested congressional committees.

The report is also available at no charge on the GAO Web site at <http://www.gao.gov>. If you have any questions concerning this report, please contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is written in a cursive style with a large, stylized initial "G".

Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Appendix I: Scope and Methodology

To identify the magnitude of unpaid federal taxes owed by Medicaid providers, we used a nonrepresentative selection of states. We selected the states of California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas based on the magnitude of payments made to Medicaid providers and the geographical location of those states. We obtained and analyzed Internal Revenue Service (IRS) tax debt data as of September 30, 2006. We also obtained and analyzed the selected states' federal fiscal year 2006 approved Medicaid payments to providers. We matched the Medicaid payment data to the IRS unpaid assessment data using the taxpayer identification number (TIN) field. To avoid overestimating the amount owed by Medicaid providers with unpaid tax debts and to capture only significant tax debts, we excluded from our analysis tax debts and paid claims meeting specific criteria to establish a minimum threshold for the amount of tax debt and for the amount of paid claims to be considered when determining whether a tax debt was significant. The criteria we used to exclude tax debts are as follows:

- tax debts that IRS classified as compliance assessments or memo accounts for financial reporting,¹
- tax debts from calendar year 2006 tax periods, and
- Medicaid providers with total unpaid taxes and Medicaid paid claims of less than \$100.

These criteria were used to exclude tax debts that might be under dispute or generally duplicative or invalid, and tax debts that were 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 2006 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 and Medicaid-paid claims of less than \$100 because they are insignificant for the purpose of determining the extent of taxes owed by Medicaid providers. Our analysis also did not attempt to identify Medicaid providers

¹Under 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.

who owed taxes under a separate TIN from the TIN under which the Medicaid payments were received. As a result, the full extent of unpaid federal taxes for Medicaid providers is understated.

To identify indications of abuse or potentially criminal activity, we selected 25 Medicaid providers for a detailed audit and investigation. The 25 providers were chosen using a nonrepresentative selection approach based on our judgment, data mining, and a number of other criteria. Specifically, we narrowed down providers to 25 with unpaid taxes based on the amount of unpaid taxes, number of unpaid tax periods, amount of payments reported by Medicaid, and indications that owner(s) might be involved in multiple companies with tax debts. For these 25 cases, we obtained copies of automated tax transcripts and other tax records (for example, revenue officer's notes) from IRS and performed additional searches of criminal, financial, and public records. In cases where record searches and IRS tax transcripts indicated that the owners or officers of a business were involved in other related entities² 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. In instances where we identified related parties that had both Medicaid payments and tax debts, our case studies included those related entities, combining unpaid taxes and combined Medicaid payments for the original individual/business as well as all related entities. Because our investigations were generally limited to publicly available information, our audit of the 25 cases may not have identified all related parties or all significant assets (i.e., personal bank data, companies established to hide assets) that the Medicaid providers own.

To determine the extent to which Centers for Medicare & Medicaid Services (CMS) officials and the states are required to consider tax debts or other criminal activities in the enrollment of providers into Medicaid, we examined CMS policies and procedures, Medicaid regulations, and the selected policies for enrollment. We also discussed policies and procedures used to enroll providers into Medicaid with officials from the selected states. As part of these discussions, we inquired whether the selected states specifically consider tax debts or perform background investigations to determine whether a prospective provider is qualified

²We define "related entities" as entities that share common owner(s) or officer(s), a common TIN, or a common address.

before the enrollment to Medicaid is granted. To determine the extent to which Medicaid payments to providers are continuously levied to pay tax debts, we examined the statutory and regulatory authorities that govern the continuous levy program and interviewed officials from CMS, IRS, and Department of the Treasury's Financial Management Service (FMS) to determine whether any legal barriers existed.

To determine the potential levy collections on Medicaid payments during fiscal year 2006, we used 15 percent and 100 percent of the total paid claim or total tax debt amount reported to the Treasury Offset Program (TOP), whichever was less. A gap will exist between what could be collected and the maximum levy amount calculated because (1) tax debts in TOP may not be eligible for immediate levy because IRS has not completed due process notifications and (2) tax debts may become ineligible for levy because of a change in collection status (e.g., tax debtor filed for bankruptcy).

We conducted our audit work from July 2006 through August 2007 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

To determine the reliability of 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 were 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 the selected states' Medicaid payment databases and FMS's TOP databases, we interviewed the selected states' and FMS officials responsible for their respective databases. In addition, we performed electronic testing of specific data elements in the databases that we used to perform our work. On the basis of 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: Medicaid Providers with Unpaid Federal Taxes

This appendix presents summary information on the abusive or potentially criminal activity associated with 15 of our 25 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 report, we also found substantial abuse and potentially criminal activity related to the federal tax system during our review of these 15 Medicaid providers that also received Medicaid payments in federal fiscal year 2006. The case studies involving businesses primarily involved unpaid payroll taxes.

Table 2: Additional Medicaid Providers with Unpaid Federal Taxes

Case	Nature of work	Medicaid payments ^a	Unpaid federal tax ^b	Comments
11	Physician	\$100,000	\$300,000	<ul style="list-style-type: none"> Physician's tax debt is primarily individual income taxes. Physician owns several luxury cars. Physician defaulted on an installment agreement with IRS. Physician did not file income tax returns in recent years. Physician received tens of thousands of dollars from Medicare in a recent year. IRS filed tax liens against the physician.
12	Hospital	\$13 million	\$7 million	<ul style="list-style-type: none"> Hospital's tax debts are primarily composed of unpaid payroll taxes dating back to the late 1990s. IRS reported tax debts to continuous levy program. Hospital received tens of millions of dollars in Medicare payments in a recent year. IRS assessed trust fund recovery penalty (TFRP) against the business officer. Business officer admitted hiding money from creditors in a recent year. IRS and state filed tax liens against the hospital.
13	Medical center	\$1 million	\$1 million	<ul style="list-style-type: none"> Business's tax debts are primarily composed of unpaid payroll taxes. Business officer owns over \$1 million property and a luxury vehicle. IRS reported related business tax debts to the continuous levy program. IRS and state filed tax liens against the business. Business received over \$300,000 in Medicare payments in a recent year.
14	Physician	\$100,000	\$300,000	<ul style="list-style-type: none"> Physician's tax debts are primarily unpaid individual income taxes. Physician has made little, and in some instances no, federal tax payments to IRS since the late 1990s. Physician claimed limited ability to pay taxes. However, physician owns a residential property worth over \$1 million and also received tens of thousands of dollars from Medicare in a recent year. Physician owes debts to another federal agency. IRS and state filed tax liens against the physician.

Appendix II: Medicaid Providers with Unpaid Federal Taxes

Case	Nature of work	Medicaid payments^a	Unpaid federal tax^b	Comments
15	Physician	\$200,000	\$200,000	<ul style="list-style-type: none"> Physician's tax debts are primarily unpaid individual income taxes dating back to early 2000s. Physician is being sued for malpractice. IRS filed tax liens against the physician. IRS reported tax debts to continuous levy program.
16	Business services	\$600,000	\$500,000	<ul style="list-style-type: none"> Business tax debts are primarily unpaid payroll taxes. IRS rejected the business owner's offer to pay about 10 percent to settle the tax debt due to the owner's ability to pay more. Business owner has an egregious history of not paying taxes. Business owner filed late returns and did not make any payroll tax payment for over 5 years. IRS assessed a TFRP against the business owner. Business owner was recently assessed a TFRP for another related business.
17	Ambulance services	\$700,000	\$400,000	<ul style="list-style-type: none"> Owner's tax debts are primarily unpaid individual income taxes for every year for a decade. Business owner has made no effort to pay taxes owed. Owner made several large cash transactions in recent years. Business owner has multiple real estate properties, including several investment properties.
18	Dental	\$200,000	\$400,000	<ul style="list-style-type: none"> Dentist's tax debts are primarily unpaid individual income taxes dating back to the late 1990s. Dentist did not file tax returns in the early 2000s. Dentist owes delinquent student loans. IRS and state filed tax liens against the business.
19	Medical equipment and supplies	\$300,000	\$500,000	<ul style="list-style-type: none"> Business tax debts are primarily unpaid payroll taxes dating back to the late 1990s. Business officer owns a luxury vehicle. IRS reported tax debts to continuous levy program. IRS and state filed tax liens against the business.
20	Transportation services	\$900,000	\$2 million	<ul style="list-style-type: none"> Business officers own multiple real estate properties, including a residential property worth about \$1 million and two multimillion-dollar commercial properties. Received over \$3 million in Medicare payments in a recent year. IRS assessed a TFRP against the owner. IRS and state filed tax liens against the business.
21	Dental	\$200,000	\$200,000	<ul style="list-style-type: none"> Dentist's tax debts are primarily unpaid individual income taxes dating back to the mid-1990s. Dentist convicted of tax evasion.

Appendix II: Medicaid Providers with Unpaid Federal Taxes

Case	Nature of work	Medicaid payments^a	Unpaid federal tax^b	Comments
22	Family services	\$500,000	\$3 million	<ul style="list-style-type: none"> • Business tax debts are primarily unpaid payroll taxes. • IRS assessed TFRP against business officers. • Business earned over \$3 million in a recent year. • IRS and state filed tax liens against the business.
23	Nursing services	\$1 million	\$2 million	<ul style="list-style-type: none"> • Business tax debts are primarily unpaid payroll taxes. • Business earned over \$1 million in a recent year. • IRS reported business as being in defunct status. • IRS reported tax debts to continuous levy program. • IRS filed tax liens against the business.
24	Ambulance services	\$300,000	\$300,000	<ul style="list-style-type: none"> • Business tax debts are primarily payroll taxes. • All business's assets were seized by law enforcement agency for money laundering. • Business in defunct status in a recent year. • Business received over \$2 million in Medicare payments in the year prior to being defunct. • Owner arrested for cocaine possession. • IRS and state filed tax liens against the business. • IRS assessed a TFRP against the owner.
25	Home health services	\$4 million	\$900,000	<ul style="list-style-type: none"> • Business debts are primarily unpaid payroll taxes. • Business officer owns a luxury vehicle. • IRS assessed a TFRP against the business officers. • IRS and state filed tax liens against the business.

Source: GAO analysis of IRS, FMS, Medicaid claims, public, and other records.

Notes: Dollar amounts are rounded. The nature of unpaid taxes for businesses was primarily due to unpaid payroll taxes. A Medicaid provider can submit claims using either an Employer Identification Number (EIN) or Social Security Number (SSN). In our report, any provider submitting a claim with an EIN is referred to as a business, and any provider submitting a claim with an SSN is referred to as an individual.

^aMedicaid payments are Medicaid claims paid by states for fiscal year 2006 (October 1, 2005, to September 30, 2006).

^bUnpaid tax amount was as of September 30, 2006.

Appendix III: Comments from the Internal Revenue Service



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

September 21, 2007

Mr. Gregory Kutz
Managing Director, Forensic Audits and
Special Investigations
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Kutz:

I have reviewed the draft Government Accountability Office (GAO) report titled: "Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System" (GAO-08-17) and agree with the recommendations. Your report acknowledges the complexity of Medicaid's policies for eligibility, services and payments.

The IRS recognizes the importance and benefits of using the Federal Payment Levy Program (FPLP) as a mechanism to collect delinquent taxes by levying numerous other categories of federal payments disbursed or administered through Financial Management Services (FMS). During Fiscal Year (FY) 2006 alone, we collected \$299 million through FPLP as compared to \$197 million in FY 2005. Through July 2007, we collected \$286 million.

We are currently working with FMS and the Centers for Medicare and Medicaid Services (CMS) as part of a subgroup of the Federal Contractors Tax Compliance (FCTC) task force. We are exploring two options to systemically levy all CMS Medicare payments. The first option is to utilize the process for levying Department of Defense payments, known as the Non Treasury Disbursed Office process. The second option proposes to have FMS take on the disbursement process of the CMS contractors in the Healthcare Integrated General Ledger Accounting System, known as the Treasury Disbursed Office process.

The FCTC subgroup has also considered the feasibility of incorporating into the FPLP disbursements made to medical providers under the Medicaid program. The FCTC subgroup analysis concluded that Medicaid disbursements flowing from the federal government to state Medicaid agencies do not qualify as federal payments for the purpose of continuous levy under section 6331(h) of the Internal Revenue Code. The FCTC subgroup's analysis is based on the nature of the Medicaid disbursement as a state entitlement, and the considerable operational discretion vested in state agencies in the administration of the Medicaid program, including discretion to create unique eligibility standards for enrollment of providers and to establish criteria for disbursement

2

of funds. These important factors distinguish Medicaid disbursements from federal payments under Medicare, which are transmitted more directly from the federal government to medical providers. IRS' Office of Chief Counsel also completed a study of these issues and concurred with the FCTC subgroup's conclusion that Medicaid disbursements do not qualify as federal payments subject to continuous levy.

If you have any questions, or if you would like to discuss this response in more detail, please contact Frederick W. Schindler, Director, Collection Policy at (202) 283-7650.

Sincerely,



Linda E. Stiff
Acting Commissioner

Enclosure

Enclosure

Recommendation 1:

Conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program.

Response:

The FCTC subgroup and the IRS Office of Chief Counsel have completed independent studies and determined that Medicaid disbursements do not qualify as federal payments and therefore cannot be incorporated in the continuous levy program.

Recommendation 2:

Evaluate the 25 referred cases detailed in this report for appropriate additional aggressive collection action and criminal investigation as warranted.

Response:

The IRS will work with your office to secure additional information on the 25 cases identified in your audit with indications of abuse or potential criminal activity. We plan to review each of these case files and refer them for additional action as appropriate.

Appendix IV: Comments from the Centers for Medicare & Medicaid Services



DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator
Washington, DC 20201

DATE: SEP 27 2007

TO: Gregory Kutz
Government Accountability Office

FROM: Kerry Weems *Kerry Weems*
Acting Administrator

SUBJECT: Government Accountability Office (GAO) Draft Report: "Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System" (GAO-08-17)

Thank you for the opportunity to review and comment on the subject GAO draft report. The objectives of the report were--(1) to determine if Medicaid providers have unpaid Federal taxes and, if so, the magnitude of such debts; (2) to identify examples of Medicaid providers that have engaged in abusive or criminal activities; and (3) to determine whether the Centers for Medicare & Medicaid Services (CMS) and the States prevent health care providers with tax problems from enrolling in Medicaid or participate in the continuous levy program to pay Federal tax debts.

Section 6034 of the Deficit Reduction Act of 2005 (DRA), codified at 42 U.S.C. 1396y-6, established the Medicaid Integrity Program and provided a dedicated appropriation to support the Medicaid Integrity Program's implementation. Although the States are generally responsible for Medicaid program integrity, including provider enrollment, CMS is responsible for implementing the Medicaid Integrity Program. In doing so, CMS strives to improve information sharing among State Medicaid programs and other stakeholders.

Although the draft report includes no recommendations for action by CMS, we are concerned about the tone and language in the draft report that reference, and would imply, certain responsibilities of CMS and the State Medicaid agencies which, under current law, would be inappropriate. We would suggest two approaches to address such concerns: (1) Revise the language, if appropriate, to remove the suggestion of such responsibilities; and (2) Include language in the recommendations section which states that neither CMS nor the States have such responsibilities.

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Specific Comments

1. Goals of the Report--The goals of the report, as they are phrased, make implications that are never addressed in the report. For instance, Goal 1 is to “determine if providers who receive Medicaid payments have unpaid Federal taxes, and if so, the magnitude of Federal tax debts owed by these Medicaid providers.” As indicated, the goal is to collect information about Medicaid providers that would be relatively objective; however, the implication is that there is some direct correlation between owing taxes and being a Medicaid provider. This implied connection is never evaluated or addressed in this inquiry.

Goal 3 is to “determine whether CMS and selected States prevent health care providers with tax problems from enrolling in Medicaid or participate in the continuous levy program to pay Federal tax debts.” Again, although this would appear to be a relatively factual determination, the implication is that there is an underlying connection between the activity (preventing providers with tax problems from participating in the Medicaid program) and the authority and responsibility to perform such activity. In fact, as discussed in the report, the authority is limited, if not precluded by existing law.

2. Continuous Levy Program -- Page 6 of the report states that--

“A provision of the Taxpayer Relief Act of 1997 authorizes the Internal Revenue Service (IRS) to continuously levy certain Federal payments made to delinquent taxpayers. However, in the 10 years since its passage, IRS has not determined whether Medicaid payments are considered Federal payments and thus subject to the continuous levy program or determine the feasibility of incorporating such payments into the program.”

It is clear that the Continuous Levy program is the direct responsibility of the IRS, and as indicated, the IRS has not determined that Medicaid payments fall under the purview of the program. Furthermore, as stated in the draft report, Federal law prohibits disclosure of taxpayer data to CMS and States. Nevertheless, the report implies that the administrators of Medicaid (i.e., CMS and the State Medicaid agencies) should be conducting the indicated activities, despite the fact that the report does not establish any relationship between being a tax delinquent, meeting the requirements of being a Medicaid provider, and receiving Medicaid payments. Further, there is no connection made in the report between the amount of the tax delinquency of the entities (which happens to be Medicaid providers) and the level of Medicaid payments made to such providers.

GAO Recommendation

There were no recommendations made to CMS.

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Additional Technical Comments

Apart from comments on the draft report's substantive arguments, CMS notes several typographical/stylistic errors in the report. For instance, page 8 describes CMS as the "Centers for *Medicaid* and Medicaid Services." (Emphasis added.) Additionally, Table 1, designed to highlight Medicaid providers/tax cheats, repeatedly refers to the providers as having received "Medicare" funds.

In conclusion, the report does not make the case for actions by CMS and State Medicaid agencies, and yet leaves the impression that CMS and States should be conducting certain activities even if precluded under current Federal law. We believe that the stated goals for this investigation were based on misconceptions about the authority and responsibilities of the Medicaid program. The language of the report consequently reflected these misconceptions. In this regard, we suggest, at a minimum, that the recommendations of the final version of the report state clearly that neither CMS nor the States have an obligation to screen potential Medicaid providers for unpaid Federal tax debts. Furthermore, the report should be edited to remove any implication that CMS and State Medicaid agencies are in any way responsible for the report's findings.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Greg D. Kutz, (202) 512-6722, or kutzg@gao.gov

Acknowledgments

In addition to the contact named above, the following individuals made major contributions to this report: Matthew Valenta, Assistant Director; Erika Axelson; Ray Bush; Jeremiah Cockrum; Bill Cordrey; Kenneth Hill; John Kelly; Tram Le; Barbara Lewis; Andrew McIntosh; John Ryan; Steve Sebastian; Robert Sharpe; Barry Shillito; Pat Tobo; and Jenniffer Wilson made key contributions to this report.

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