

**OPENING STATEMENT
OF
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RANKING MINORITY MEMBER
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
*CIVILIAN CONTRACTORS WHO CHEAT ON THEIR TAXES
AND WHAT SHOULD BE DONE ABOUT IT***

June 16, 2005

The current annual tax gap in this country is about \$300 billion. That \$300 billion gap is the difference between the taxes that businesses, organizations, and individuals owe the federal government and what they've actually paid. When so many Americans fail to pay the taxes that they owe, it begins to undermine the fairness of our tax system, forcing honest taxpayers to makeup the shortfall needed to pay for basic federal protections – like social security, Medicare, and the weapons needed by our men and women on the frontlines of our military.

Today's hearing focuses on one particular group that contributes to that \$300 billion tax gap – government contractors who get paid with taxpayer dollars while, at the same time, failing to pay their taxes. In a report released today, GAO describes 33,000 civilian contractors who have dodged their tax obligations and accumulated tax debts to Uncle Sam totaling at least \$3.3 billion. In a related report released last year, GAO found 27,000 DOD contractors with accumulated tax debts totaling \$3 billion. Those are huge numbers – tens of thousands of companies receiving contracts and payments on those contracts from the federal government, while owing billions of dollars in unpaid taxes. It's simply mind boggling that this is allowed to continue.

Tax dodging by any federal contractor is unfair – not only to the honest taxpayers left to make up the difference, but it's also unfair to the honest companies that have to compete against the tax dodgers that aren't paying their fair share.

The main responsibility here has got to be with FMS, as our Chairman has said. There should be a red flag on any contract where a company owes back taxes and there should be monies withheld from any payments on these contracts until those back taxes are paid. Some tax dodgers should not receive contracts to begin with – their tax debts should be paid before more contracts are awarded, or, at a minimum, until arrangements are made for them to pay the back taxes.

GAO tells us that about \$1.2 billion, or 37% of the unpaid taxes owed by civilian contractors, involve payroll taxes. What that means is that contractors failed to send to the IRS sums withheld from employees' wages for federal, Social Security, and Medicare taxes. The failure to send those payroll taxes to the IRS is more than a debt owed to the federal government – it is a crime, since payroll funds withheld from employees' wages are held in trust, and it is

illegal for companies not to send those funds to the government. Another \$1.5 billion, or 40% of the total, involve unpaid corporate income taxes. All of the \$3.3 billion are unpaid taxes which a court has determined or the taxpayer has admitted are owed to the government. The taxes at issue here are not disputed amounts, in other words.

GAO also took a closer look at 50 of the contractors with unpaid taxes and found egregious examples of companies dodging taxes, sometimes for years, and, in some cases, spending money meant for payroll taxes on luxuries for themselves such as expensive homes or cars. Despite those abuses, those contractors kept getting contracts and payments on those contracts using taxpayer dollars. For example, one contractor owing \$1 million in unpaid taxes was paid \$1.5 million in FY2004 by the Department of Homeland Security and other federal agencies. Another contractor owing \$900,000 had a 20-year history of opening a business, failing to remit payroll taxes to the IRS, closing the business, and then repeating the cycle. On and on, while continuing to get more government contracts.

Tax chiseling by federal contractors is not a new story. In 1997, Congress enacted the Taxpayer Relief Act which, in part, authorized federal agencies to withhold 15 percent of any federal payment going to a person with an outstanding tax debt. The goal was to stop taxpayer dollars from being paid to a tax deadbeat, unless a portion was withheld off the top to reduce that person's tax debt. Last year, we increased the percentage that can be withheld from a contract payment to up to 100%.

The Taxpayer Relief Act sought to apply a common sense principle to government operations: to offset the taxpayer dollars sent to people who haven't paid their tax bills by directing a percentage of the total be withheld to reduce their tax debt. That common sense principle isn't always easy to apply in a government that has hundreds of thousands of contractors on the books, but it must be applied and the computer capability to apply that principle exists.

The Financial Management Service or FMS in the Treasury Department took until July 2000 to establish an automated tax levy program under a larger Treasury Offset Program that handles offsets from government payments for a variety of reasons. It took another two years – until the end of 2002 – for DOD to follow suit.

GAO estimates that, last year, the tax levy program for civilian contractors ought to have collected a minimum of \$50 million, but FMS actually collected only about \$16 million, or just over 30% of the projected total. The GAO report spells out a number of reasons why this collection rate is so low.

First, out of the \$250 billion in contractor payments last year, the GAO determined that \$100 billion was made in ways that made it virtually impossible for a payment to result in a computer match and tax levy. About \$66 billion of those payments were made with payment forms filled out by various federal agencies that left out key information. The FMS shouldn't

accept those payment forms, but they have so far. Key information is left out by agencies; nonetheless, checks are sent. That information which is left out includes the contractor's name or taxpayer identification number, which you have to have for a computer match. Another \$10 billion was paid on government-issued credit cards held by federal agencies, which means that the payments were directed to the bank administering the credit cards and the bank then paid the contractors, instead of direct payments to the relevant contractors. Since the agency payments did not name the contractors, they couldn't be matched against the IRS tax data. Still another \$25 billion of payments were made through wire transfers that also were directed to banks instead of contractors, and so did not trigger any computer matches with IRS data. Each of these problems can and should be addressed to increase the chances for computer matches identifying contractors with unpaid taxes. It should not be difficult to simply red flag the contractor to say that no payment should be made to that contractor, through a bank or otherwise, without the deduction for back taxes being made.

Second, of the \$150 billion in contractor payments that were subjected to the tax levy computer matches, the GAO found that too many failed to result in an actual levy because the IRS had failed to mail a 30-day notice to the relevant contractors warning them of an upcoming levy. After last year's hearing, to address the tax levy notice problem, the IRS initiated a new approach with DOD contractors. Instead of waiting for the first contract payment to mail a tax levy notice, the IRS instead evaluated the tax status of contractors as soon as they were awarded a contract and immediately sent tax levy notices to those contractors with unpaid taxes. This new approach apparently resulted in the mailing of 6,000 accelerated notices. That's a bit of progress, although we have to wait to see the extent to which this new approach solves the notice problem and it needs to be applied to civilian contractors as well.

Other approaches to the notice problem should also be considered. One possibility that should be explored is combining tax levy notices with the tax delinquency notices that are already mailed to contractors with unpaid taxes. Another possibility would be to amend the Prompt Payment Act to allow FMS and DOD to delay contract payments to tax delinquent contractors until the 30-day tax levy notice period expires and a levy can properly be placed on their payments. Another approach is to include a contract provision in the original contract that simply says if you owe back taxes, you waive your right to a levy notice. Alternatively, we can modify the law to say that notices of levies are not required on those contracts where back taxes are owed.

Federal contractors should not be allowed to get away with cheating on their taxes. Dodging taxes is never acceptable, but it is particularly galling when engaged in by folks who make their living from taxpayer dollars.

It is clear that we can make major progress in the tax levy program and ensure that deadbeat contractors start paying their tax debts. That progress has already begun. After the Subcommittee's hearing last year on DOD contractors, the IRS, DOD and FMS formed a joint task force to improve the DOD tax levy program. In the span of about a year, using

improvements initiated by this task force, DOD has increased its collections from \$1 million in 2003, to a likely total in 2005 of \$17 million. While \$17 million is still far short of the \$100 million that GAO thinks DOD ought to be collecting each year, and even farther from the \$3 billion owed by DOD contractors, it is a start.

The improvements made in the DOD tax levy program include the following:

–FMS and DOD have automated the tax levy computer matching system for 18 out of DOD’s 20 payment systems, up from just 1 system in 2004. The final 2 DOD payment systems are scheduled for automation during 2005.

–FMS is now conducting tax levy computer matches twice per week instead of once per week, resulting in more computer matches.

–The IRS has cleaned up the tax levy database by removing \$27 billion of uncollectable tax debt.

–The IRS has eliminated a policy that delayed tax levies on federal contractors for one year or until an IRS revenue agent was assigned to the relevant case.

–The IRS is now checking the tax status of DOD contractors as soon as a contract is awarded, instead of waiting for the first contract payment, so that tax levy notices can be mailed earlier.

–In October, DOD will begin requiring everyone who files an application with the Central Contractor Register to become a potential bidder on federal contracts to consent to having their taxpayer identification numbers validated by the IRS. The end result will be a more accurate and complete database of contractor TINs.

Each of these steps is moving us toward a more effective tax levy program, but a lot more needs to be done, including ensuring timely tax levy notices, barring payments to contractors using agency forms that lack key information needed for tax levy computer matches, and barring contractors with unpaid taxes from getting paid via government-issued credit cards or wire transfers. Even better would be putting a hold on contract awards to contractors owing an undisputed amount of unpaid taxes.

Last year, Senator Coleman and I introduced legislation to improve the tax levy program by strengthening taxpayer identification numbers. We reintroduced this bill in this Congress as S. 679. In the meantime, the IRS, DOD and FMS have voluntarily taken some of the steps called for in that bill, which we appreciate. Senator Coleman and I are now planning to introduce a more comprehensive bill to address the broader spectrum of problems that impede the tax levy program.

Most federal contractors provide valuable goods or services, and do so while paying their taxes. Other contractors, however, take payment in taxpayer dollars, while dodging the taxes owed to Uncle Sam. This tax dodging hurts honest taxpayers, honest businesses, and our country as a whole. Effective use of the federal tax levy program is necessary to help keep the tax dodger's hand out of the taxpayer's wallet.

I commend Senator Coleman for his leadership on this important issue. I look forward to the testimony today.