

Opening Statement
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Chairman
Permanent Subcommittee on Investigations
Hearing On
Civilian Contractors Who Cheat on Their Taxes
And What Should Be Done About It
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Good morning and welcome to today's hearing.

This hearing is about tax cheats – not your everyday tax delinquents, but rather federal contractors who do not pay their fair share of taxes, even though they receive billions of dollars from American taxpayers each year. The Subcommittee's efforts – in concert with the hard work of Government Accountability Office – have revealed that 33,000 federal contractors at civilian agencies owe back taxes amounting to a whopping \$3.3 billion. Some of these delinquent contractors provide crucial services for some of our most critical agencies such as the Departments of Justice and Homeland Security.

To get a sense of the problem, let's review of handful of egregious cases:

- A contractor for the Justice Department was paid more than \$700,000 this year, even though it owes more than \$2 million in back taxes. Over the last few years, as the company refused to pay its proper share of taxes, it withdrew literally millions of dollars from its bank accounts.
- A contractor, that provides security guard services to the Department of Homeland Security, owes more than \$400,000 in unpaid taxes.

In addition to the company's tax debt, the owner has repeatedly failed to file individual income taxes and diverted the employees' payroll taxes to a foreign bank account to build a house overseas. Despite that, the federal government paid this company more than \$200,000 last year.

- A health care company provides services for the Department of Veteran Affairs and HHS, and was paid more than \$300,000 from the federal government this year alone. That company owes more than \$18 million in back taxes. While the company was cheating the American taxpayers, the owner of the company bought multi-million dollar properties and a fleet of luxury cars.

These are just a handful of the 33,000 government contractors that failed to play by the rules. Our hearing today will show just how widespread this problem is. We will also examine the

considerable obstacles that prevent the government from collecting back taxes from federal contractors.

But first, it will be helpful to review how we got here. Last year, this Subcommittee – with the GAO – uncovered disturbing evidence that 27,000 Defense Department contractors owed three billion dollars in unpaid taxes. To make matters worse, GAO determined that the government's program to collect unpaid taxes from federal contractors, which is called the Federal Payment Levy Program, simply wasn't working. The Federal Payment Levy Program should have collected more than \$100 million from those contractors. Unfortunately, of the \$100 million dollars it should have collected, it obtained a paltry \$680,000.

In February of last year, I requested that the IRS, Financial Management Service, the Department of Defense and other affected agencies establish the Federal Contractor Tax Compliance Task Force, which would identify and resolve problems that frustrated the Federal Payment Levy Program. I am pleased to report that, as a direct result of the Task Force's efforts, tax levy collections from Defense contractors have increased dramatically. For instance, in all of 2003, back taxes recovered from Defense contractors amounted to a mere \$680,000.

In the first seven months of this year, however, that number has risen to more than \$11.5 million. At that rate, the government will recover \$17.25 million in unpaid taxes by the end of 2005. That is an increase of more than 2,500% in just two years.

One of the principal problems we identified was that many federal contractors provided false taxpayer identification numbers when they registered with the government. To remedy this problem, Senator Levin and I and other interested Senators introduced the Central Contractor Registry Act to ensure that federal contractors' taxpayer identification numbers would be validated by the IRS.

In light of the problems found with Defense contractors, we asked GAO to determine if similar problems also existed in other federal departments and agencies. In response to our request, GAO conducted an extensive analysis and prepared an alarming report, which we are releasing today.

As I mentioned earlier, GAO's report reveals that 33,000 civilian contractors, who receive billions of dollars from the U.S. government in contract payments each year, currently owe \$3.3 billion in unpaid taxes. Even worse, most of these contractors withheld payroll taxes in trust for their employees and then failed to pay those taxes to the Internal Revenue Service – as a result, they cheated not only the American people, but their own employees as well.

Some of these employers fraudulently used the withheld taxes for their business or personal use. GAO's investigation found contractors who bought luxury cars, multi-million dollar properties, and vacation homes, even though they owed hundreds of thousands of dollars in unpaid taxes.

One significant problem is Section 6103 of the Internal Revenue Code, which is designed to promote tax compliance by protecting honest taxpayers from having their names and other personal information disclosed.

That privacy provision has been turned on its head and covers tax cheats who do not file their returns or do not pay their taxes. These tax cheats act with impunity because Section 6103 prevents the IRS from disclosing their identities. As a result, federal contract officers cannot determine if a contractor owes taxes before signing a contract.

Even the President of the United States is not immune from contracting with a tax cheat. In one case examined by GAO, the Executive Office of the President contracted with a medical, dental and hospital equipment company that owes nearly \$2 million in unpaid taxes. In 2004, the company was paid over \$900,000. While the Financial Management Service collected \$6,000 in unpaid tax from some of these payments, it is not screening all such payments, and therefore, it missed the opportunity to collect an additional \$133,000 from this company.

This is but one of the fifty worst examples that GAO identified in their investigation. Many of these cases demonstrate a pattern of continuing fraud and abuse in which some contractors use every available means to delay or avoid paying their taxes. In fact, 27 of the 50 cases GAO investigated demonstrated a pattern of avoidance. For example, over a twenty-year period, one contractor has repeatedly not paid taxes, and accumulated a tax debt of more than \$900,000. He declared bankruptcy and reopened his business under a new name. In 2004, the federal government paid this delinquent contractor more than \$1 million.

In another case, a building maintenance company that owes nearly \$1 million in unpaid tax entered into an installment agreement with IRS and then defaulted on the agreement. The company then made the IRS an offer in compromise to settle the tax debt. IRS rejected the offer, and this company has avoided any tax levy for more than 5 years.

In another case, the IRS entered into an installment agreement with a court reporting service for the Department of Justice who owes over \$400,000 in unpaid tax. Last year, the company paid a mere \$2,000 pursuant to the agreement. At that rate, the tax debt will be paid off in a little over 200 years.

Other examples that GAO identified involving potential fraud included:

- An armed security guard services company that has contracts with the Department of Justice and the Environmental Protection Agency owes nearly \$400,000 in unpaid taxes. In 2004, the company was paid about \$500,000. The owner of the company is under indictment for embezzlement and money laundering.
- A doctor who works for the Veterans Administration owes nearly \$700,000 in unpaid tax and was paid over \$180,000 in 2004. The doctor's payments should have been levied to collect \$27,000; however, none of the payments were levied.

- A building maintenance services company that has numerous contracts with federal agencies including the Department of the Treasury, owes over \$700,000 in unpaid taxes. The company was paid over \$4 million in 2004 and nearly \$100,000 was offset for its unpaid taxes. However, they should have been levied for \$630,000.

Under these circumstances, we must bar certain companies and individuals from receiving federal contracts. When individuals or companies demonstrate flagrant disregard for the tax system through a pattern of repeated and continuing abuse, it is appropriate to publish their names and bar their receipt of federal contracts.

The GAO report that is being released today found serious problems in the contractor payment system that permit these abuses to continue.

For instance, the GAO found that the Financial Management Service, which makes payments to contractors for the federal government, does not check all contractor payments to determine if taxes are owed. In addition, contractor payments that should be checked have inaccurate or incomplete information and cannot be matched to the Internal Revenue Service's list of delinquent taxpayers. FMS failed to update agency location codes and ensure that agencies submitted payment documentation that was complete and valid. As a result, FMS did not match these payments and irrevocably lost the opportunity to collect an additional \$50 million in back taxes.

FMS is the lead agency for the Federal Payment Levy Program. FMS should not hide behind the mantra that FMS it is simply the paying agent for the federal government and must rubber stamp federal agencies' payments. This position completely abdicates FMS' true leadership and managerial responsibilities for the program. I am concerned that FMS has placed the prompt payment of contractors ahead of recognized accounting principles that require complete and accurate documentation.

Let me be clear. The system in place requires FMS to identify tax cheats – and levy their payments. The Contracting agency and GSA have no ability to identify the tax cheats, or to bar them from doing business with the government. When FMS fails to do its job, the system fails – and the system and FMS are failing today.

As the government's paying agent, FMS has clear responsibility for ensuring adherence to basic requirements that must be met before making disbursements. I fully expect Commissioner Gregg and FMS to aggressively resolve the shortcomings identified by GAO. FMS must ensure that contractors are screened for unpaid taxes. FMS must ensure that agency documentation is complete before disbursements are made and it must regularly update agency location codes. FMS must take the lead on requiring civilian agencies and departments to register their contractors in the Central Contractor Registry, as required by the Federal Acquisition Regulations and directed by the Office of Management and Budget. Without this proper exercise of responsibility, billions of tax dollars will continue to be paid to tax delinquent contractors without being levied. This is simply not acceptable.

On the first panel this morning we will hear from GAO representatives on the results of our request to determine if there are tax delinquent federal contractors working for civilian departments and agencies. Last year, their hard work resulted in the identification of 27,000 DOD contractors who owed \$3 billion in unpaid taxes, including 47 contractors who had flagrantly abused the tax system.

On the second panel we will hear from IRS and FMS concerning the actions they have taken or plan to take to ensure that civilian contractors pay the taxes that they owe. I would like to make it clear that I am pleased with the results that the Federal Contractor Tax Compliance Task Force has achieved to date and that the Commissioners of IRS and FMS have agreed to continue the work of the task force.

