



Highlights of [GAO-07-742T](#), a testimony before the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives

Why GAO Did This Study

Since 1990, GAO has periodically reported on high-risk federal programs that are vulnerable to fraud, waste, and abuse. Two such high-risk areas are managing federal contracts more effectively and assessing the efficiency and effectiveness of federal tax administration. Weaknesses in the tax area continue to expose the federal government to significant losses of tax revenue and increase the burden on compliant taxpayers to fund government activities. Over the last several years, the Senate Permanent Subcommittee on Investigations requested GAO to investigate Department of Defense (DOD), civilian agency, and General Services Administration (GSA) contractors that abused the federal tax system. Based on that work GAO made recommendations to executive agencies including to improve the controls over levying payments to contractors with tax debt—many of which have been implemented—and referred 122 contractors to IRS for further investigation and prosecution.

As requested, this testimony will highlight the key findings from prior testimonies and related reports. This testimony will (1) describe the magnitude of tax debt owed by federal contractors, (2) provide examples of federal contractors involved in abusive and potentially criminal activity related to the federal tax system, and (3) describe current law and proposed federal regulations for screening contractors with tax debts prior to the award of a contract.

www.gao.gov/cgi-bin/getrpt?GAO-07-742T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory Kutz at (202) 512-7455 or kutzg@gao.gov.

TAX COMPLIANCE

Thousands of Federal Contractors Abuse the Federal Tax System

What GAO Found

In our previous audits and related investigations, we reported that thousands of federal contractors had substantial amounts of unpaid federal taxes. Specifically, about 27,000 DOD contractors, 33,000 civilian agency contractors, and 3,800 GSA contractors owed about \$3 billion, \$3.3 billion, and \$1.4 billion in unpaid taxes, respectively. These estimates were understated because they excluded federal contractors that understated their income or did not file their tax returns; however, some contractors may be counted in more than one of these groups.

As part of this work, we conducted more in-depth investigations of 122 federal contractors and in all cases found abusive and potentially criminal activity related to the federal tax system. Many of these 122 contractors were small, closely held companies that provided a variety of goods and services, including landscaping, consulting, catering, and parts or support for weapons and other sensitive programs for many federal agencies including the departments of Defense, Justice, and Homeland Security. These contractors had not forwarded payroll taxes withheld from their employees and other taxes to IRS. Willful failure to remit payroll taxes is a felony under U.S. law. Furthermore, some company owners diverted payroll taxes for personal gain or to fund their businesses. A number of owners or officers of the 122 federal contractors owned significant personal assets, including a sports team, multimillion dollar houses, a high-performance airplane, and luxury vehicles. Several owners gambled hundreds of thousands of dollars at the same time they were not paying the taxes that their businesses owed.

Examples of Abusive and Potentially Criminal Activity

Type of business	Unpaid tax debt	Payments to contractor	Contractor activity
Custodial services for DOD	Over \$1 million	Over \$1 million	Owner bought a boat, several cars, and a home outside the country.
Temporary help for civilian agency	Nearly \$900,000	Over \$1 million	Owner followed pattern of over 20 years of closing businesses with tax debts, opening new ones, and incurring more tax debts.
Security under GSA contract	Over \$9 million	Over \$1 million	Owner made cash withdrawals to fund an unrelated business and purchase a men's gold bracelet worth over \$25,000.

Source: Previous GAO testimonies.

Federal law, as implemented by the Federal Acquisition Regulation (FAR), does not now require contractors to disclose tax debts or contracting officers consider tax debts in making contracting decisions. Federal contractors that do not pay tax debts could have an unfair competitive advantage in costs because they have lower costs than tax compliant contractors on government contracts. GAO's investigation identified instances in which contractors with tax debts won awards based on price differential over tax compliant contractors.