



Highlights of [GAO-05-637](#), a report to congressional requesters

FINANCIAL MANAGEMENT

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

Why GAO Did This Study

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

What GAO Recommends

GAO makes 18 recommendations to FMS to improve the FPLP and increase by tens of millions of dollars annually the amounts levied from payments to contractors with unpaid federal taxes. GAO also recommends that the Internal Revenue Service (IRS) review and, if warranted, pursue collection or criminal investigation of the 50 case study contractors identified in this report. IRS agreed and FMS partially agreed. FMS did not agree that it should withhold payments to contractors without names or work with IRS to address challenges related to levying purchase card payments. GAO disagrees with FMS's assessment and reiterates support for all of its recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-05-637.

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

What GAO Found

FMS and IRS records showed that about 33,000 civilian agency contractors owed over \$3 billion in unpaid federal taxes as of September 30, 2004. All 50 civilian agency contractors we investigated had abusive and potentially criminal activity. For example, businesses with employees did not forward payroll taxes withheld from their employees to IRS. Willful failure to remit payroll taxes is a felony under U.S. law. Further, several individuals own multiple businesses with unpaid federal taxes—one individual owns about 20 businesses that did not fully pay taxes related to over 300 returns. Some contractors purchased or owned millions of dollars of property while they did not remit payroll taxes. These activities were identified for contractors at the Departments of Justice, Homeland Security, and Veterans Affairs; the National Aeronautics and Space Administration; and others agencies.

Examples of Abusive and Potentially Criminal Activity

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

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

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

Tens of billions of dollars in federal payments were not compared against tax debts for potential levy because FMS did not proactively manage and oversee the levy program. Until we brought it to FMS's attention, FMS did not know that it did not submit \$40 billion of contractor payments from some civilian agencies for potential levy. FMS also did not identify payment files that did not contain contractor tax identification numbers, names, or both, resulting in \$21 billion in payments to contractors that could not be levied. FMS also excluded billions of dollars from levy because of what it considered programming limitations without taking proactive steps to overcome those limitations. Further, civilian agency purchase card payments to contractors totaling \$10 billion could not be levied. Improvements at FMS could result in tens of millions of dollars of additional levies annually.