

**GAO**

Testimony

Before the Subcommittee on Oversight,  
Committee on Ways and Means, House of  
Representatives

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For Release on Delivery  
Expected at 10:00 a.m. EDT  
Tuesday, July 24, 2007

## TAX COMPLIANCE

# Thousands of Organizations Exempt from Federal Income Tax Owe Nearly \$1 Billion in Payroll and Other Taxes

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Highlights of [GAO-07-1090T](#), a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

## TAX COMPLIANCE

# Thousands of Organizations Exempt from Federal Income Tax Owe Nearly \$1 Billion in Payroll and Other Taxes

### Why GAO Did This Study

As of September 2006, nearly 1.8 million entities were recognized as tax exempt organizations by the Internal Revenue Service (IRS). As such, they do not have to pay federal income taxes. Exempt organizations are still required to remit amounts withheld from employees' wages for federal income tax, Social Security and Medicare, as well as other taxes.

Previous GAO work identified numerous government contractors, Medicare providers, and charities participating in the Combined Federal Campaign (CFC) with billions in unpaid federal taxes. Today's testimony, based on a report that we are releasing today, summarizes the results of work we performed at the request of Representative Ramstad, Ranking Member of this subcommittee, to audit exempt organizations. Specifically, this testimony covers whether and to what extent (1) exempt organizations have unpaid federal taxes, including payroll taxes; (2) selected case study organizations and their executives are involved in abusive or potentially criminal activity; and (3) exempt organizations with unpaid federal taxes received direct grants from certain federal agencies.

GAO reviewed unpaid taxes and exempt organization data from IRS and selected 25 case studies for audit and investigation. GAO also reviewed data from 3 major grant disbursement systems.

[www.gao.gov/cgi-bin/getrpt?GAO-07-1090T](http://www.gao.gov/cgi-bin/getrpt?GAO-07-1090T).

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](mailto:kutzg@gao.gov).

### What GAO Found

Nearly 55,000 exempt organizations had almost \$1 billion in unpaid federal taxes as of September 30, 2006, with charitable organizations being responsible for more than 85 percent of the \$1 billion in debt. About 1,500 of these entities each had over \$100,000 in federal tax debts, with some owing multi-million dollars in federal taxes. The majority of this debt represented payroll taxes and associated penalties and interest dating as far back as the early 1980s. Willful failure to remit payroll taxes is a felony under U.S. tax law. The \$1 billion figure is understated because some exempt organizations have understated tax liabilities or did not file tax returns.

GAO selected 25 exempt organizations for investigation based primarily on amount of tax debt and number of periods delinquent. In all 25 cases, we found abusive and potentially criminal activity, including repeated failure to remit payroll taxes withheld from employees. Officials diverted the money to fund their operations, including paying themselves salaries ranging from hundreds of thousands of dollars to over \$1 million. Many of the officials accumulated substantial assets, such as multimillion-dollar homes and luxury vehicles. Key officials and employees at 4 entities were engaged in criminal activities, including attempted bribery of an IRS official and illegal gambling. Despite repeatedly abusing the federal tax system, these entities continued to retain their exempt status. IRS does not have the authority to revoke an organization's exempt status because of unpaid federal taxes.

#### Examples of Abusive and Potentially Criminal Activity by Exempt Organizations

Type of organization	Tax debt	Organization activity
Health care	Nearly \$30 million	<ul style="list-style-type: none"> <li>Officials are related to several other for-profit entities, all with unpaid federal taxes.</li> <li>Paid millions in management fees to a related entity.</li> <li>Received millions in federal payments.</li> </ul>
Industry association	Over \$6 million	<ul style="list-style-type: none"> <li>Paid over 10 key officials salaries in excess of \$100,000 instead of paying payroll taxes.</li> <li>One official built a multimillion-dollar home and purchased luxury vehicles at the same time the exempt organization failed to pay payroll taxes.</li> </ul>
Group home/ educational institution	Almost \$8 million	<ul style="list-style-type: none"> <li>An official admitted to funding operations, including executive salaries, instead of paying taxes.</li> <li>Operations included large compensation packages to organization officials.</li> </ul>

Source: GAO analysis of IRS data and available public records.

Over 1,200 of these exempt organizations with unpaid federal taxes received over \$14 billion in federal grants in fiscal years 2005 and 2006. Six of the 25 exempt organizations GAO investigated received grants; of those 6 entities, 5 appear to have violated the False Statement Act by not disclosing their tax debt as required. For example, one entity that received millions of dollars in grants did not disclose unpaid taxes on multiple applications. Taxpayer privacy statutes prevent granting agencies from verifying an applicant's tax status with IRS unless the taxpayer authorizes such disclosure.

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Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss issues related to exempt organizations and their adherence to the federal tax system. This testimony builds on your concern about the \$290 billion annual federal tax gap. This testimony also builds on a large body of work, conducted over the past few years,<sup>1</sup> in which we investigated entities that have abused the federal tax system<sup>2</sup> while benefiting from doing business with the federal government. Our testimony, and the accompanying report that we are releasing today,<sup>3</sup> address whether organizations exempt from federal income taxes were delinquent in remitting payroll and other federal taxes to the Internal Revenue Service (IRS). All employers, regardless of tax exempt status, are required to withhold from their employees' wages payroll taxes for Social Security, Medicare, and other federal taxes. Willful failure to remit payroll taxes is a felony under U.S. law.

Exempt organizations are granted exemption from federal income taxes by statutes contained in the Internal Revenue Code (I.R.C.), most notably I.R.C. § 501(c). Income tax exemption is a significant benefit unavailable to the vast majority of taxpayers. To qualify, an organization's purpose and operations must meet the criteria explicitly contained in the I.R.C. While the range of types of exempt organizations varies greatly, from large national charities to local athletic leagues and social clubs, the majority of exempt organizations are charities, churches, and educational institutions

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<sup>1</sup>See GAO, *Tax Compliance: Thousands of Federal Contractors Abuse the Federal Tax System*, [GAO-07-742T](#) (Washington, D.C.: Apr. 19, 2007); *Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System*, [GAO-07-587T](#) (Washington, D.C.: Mar. 20, 2007); *Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes*, [GAO-06-755T](#) (Washington, D. C. : May 25, 2006); *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, [GAO-06-492T](#) (Washington, D.C.: Mar. 14, 2006); *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-05-637](#) (Washington, D.C.: June. 16, 2005); and *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-04-95](#) (Washington, D.C.: Feb. 12, 2004).

<sup>2</sup>We considered activity to be abusive when a 501(c) organization's actions (e.g., diversion of payroll tax funds) or inactions (e.g., failure to remit the annual form 990 return, which is the basis of review of whether an organization continues to meet requirements for exempt status ) 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.

<sup>3</sup>GAO, *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), released today, July 24, 2007.

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that qualify for their exemption under I.R.C. § 501(c)3. Many exempt organizations also receive the added benefit of being able to provide a tax deduction to their contributors, meaning the donors can deduct the amount of the donation on their individual income tax returns. This statutory privilege, subsidized by the federal government, encourages donations to these organizations and aids them in raising revenue.

Our previous work on a small portion of the nation's exempt organizations, specifically those that participated in the federal government's Combined Federal Campaign,<sup>4</sup> indicated that some of these exempt organizations were ignoring their payroll and other federal tax obligations. Based on this previous work and at the request of Representative Ramstad, Ranking Member of this subcommittee, we expanded our audit to include all organizations considered actively exempt by IRS. We also investigated whether tax delinquent exempt organizations were receiving additional federal support in the form of grants. Today's testimony covers whether and to what extent (1) exempt organizations have unpaid federal taxes, including payroll taxes; (2) selected case study organizations and their executives are involved in abusive or potentially criminal activity; and (3) exempt organizations with unpaid federal taxes received direct grants from certain federal agencies.

To determine the extent to which exempt organizations have unpaid federal taxes, including payroll taxes, we matched IRS's unpaid tax data as of September 30, 2006 to IRS's database of exempt organizations as of September 30, 2006.<sup>5</sup> To identify specific instances of abusive and potentially criminal activities by selected exempt organizations and their executives, we performed investigative work on a nonrepresentative selection of 25 exempt organizations. We selected these 25 organizations using primarily the amount of tax debt and number of delinquent tax periods as selection factors. The investigative work included obtaining and analyzing tax, financial, criminal history, and other public records. We also reviewed the statutory authority provided in I.R.C. § 501 and interviewed IRS officials on their process for revoking tax exempt status.

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<sup>4</sup>GAO-06-755T, and GAO, *Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes*, GAO-06-887 (Washington, D.C.: July 28, 2006).

<sup>5</sup>To ensure reliability of data in IRS's Unpaid Assessments file and Exempt Organization database, we considered the results of our annual IRS financial audits, interviewed IRS officials, performed electronic testing of specific data elements, or a combination of these. For additional information on our scope and methodology and tests of data reliability, see app. I of our accompanying report, GAO-07-563.

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To determine the extent to which exempt organizations with tax debt received federal grants,<sup>6</sup> we matched the data set of tax delinquent exempt organizations we identified from our first objective to selected agencies' grant disbursement data for fiscal years 2005 and 2006.<sup>7</sup> We reviewed six grant applications of selected exempt organizations with tax debts that received federal grant payments in fiscal years 2005 and 2006 to determine whether they reported federal tax debt as required. We also interviewed grant officials at selected federal agencies on whether they considered tax debts in grant award decision making. For further details on our scope and methodology, see appendix I of the accompanying report.<sup>8</sup>

We conducted our audit work from August 2006 through March 2007 in accordance with U.S. generally accepted government auditing standards. We performed our investigative work, conducted during the same period, in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

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## Summary

While the vast majority of exempt organizations pay their fair share of federal taxes, tens of thousands abused the federal tax system. Our analysis of IRS data shows that nearly 55,000 exempt organizations owed nearly \$1 billion in unpaid payroll and other federal taxes as of September 30, 2006. Nearly 40,000 of the 55,000 delinquent exempt organizations were charitable, or 501(c)(3), organizations. These organizations owed almost \$830 million of the nearly \$1 billion in delinquent taxes. Seventy-one percent of the nearly \$1 billion in unpaid taxes owed by tax exempt organizations consists of payroll taxes and

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<sup>6</sup>For purposes of this audit, grants include formula grants, project grants, and direct payments for specified use as classified by the General Services Administration in the *Catalogue of Federal Domestic Assistance*. We excluded Medicaid from formula grants and Medicare from direct payments for specified use.

<sup>7</sup>Grant data we analyzed came from the Department of Education's Grant Administration and Payment System, the Department of the Treasury's Financial Management Service's Automated Standard Application Payment System, and the Department of Health and Human Services' Payment Management System. These three systems processed the majority of federal grants excluding Medicare and Medicaid during fiscal years 2005 and 2006.

<sup>8</sup>[GAO-07-563](#).

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related penalties and interest dating as far back as 1981.<sup>9</sup> Over \$600 million of the nearly \$1 billion is accounted for by about 1,500 exempt organizations that individually owed over \$100,000. Some of these entities owed more than \$10 million in unpaid federal taxes. Also, the nearly \$1 billion in delinquent taxes is understated because we did not include IRS data on tax debts for current periods and disputed debts because they may be routinely resolved or not represent a fully valid tax debt. Our estimate is also understated because the IRS data used in our analysis did not include, among other items, debts owed by organizations that did not file federal tax returns or underreported their tax liability, or for which IRS had not yet assessed the amount of the tax debt.

For all 25 cases that we investigated, we found abusive and potentially criminal activity related to the federal tax system, including failure to remit to IRS payroll taxes withheld from employees. Rather than fulfill their role as “trustees” of this money, these case study entities and their executives diverted the money for other purposes. Willful failure to remit these payroll taxes, which included amounts withheld from employee wages for income taxes, Social Security, and Medicare, is a felony. The failure to properly segregate payroll taxes can be a criminal misdemeanor offense.<sup>10</sup>

We found multiple instances in our case studies in which the payroll taxes were diverted to fund operations or to pay hundreds of thousands of dollars in compensation to the organization’s top officials. In one case, over \$1 million in compensation was paid to the organization’s top official at the same time that the exempt organization owed millions of dollars in delinquent taxes. Many of the top officials of selected case study entities owned significant personal assets, including multimillion-dollar homes and luxury vehicles. Other top officials of the exempt organizations in our case studies neglected to remit millions of dollars in delinquent taxes while at the same time paying millions of dollars in management fees to related entities. We also found several instances in which the same individuals

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<sup>9</sup>Generally, there is a 10-year statutory collection period beyond which IRS is prohibited from attempting to collect tax debt. However, the 10-year time may be suspended for a variety of reasons, including for periods during which the taxpayer is involved in a collection due process appeal, litigation, or a pending offer in compromise or installment agreement.

<sup>10</sup>I.R.C. § 7202, 7215, and 7512 (b). Organization officials deemed by IRS to be personally liable for the withheld amounts not forwarded are assessed a civil monetary penalty known as a trust fund recovery penalty. I.R.C. § 6672.

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who were top officials of the tax exempt entities in our case studies also operated other tax exempt or taxable (for-profit) entities with significant delinquent tax debts. For instance, one of our case study exempt organizations, with over \$10 million in tax debt, was affiliated with several other for-profit entities, providing a variety of services from health care to management services, that were also delinquent in paying their federal taxes. The related for-profit entities owed more than \$15 million in additional tax debts, primarily payroll taxes. Despite repeatedly abusing the federal tax system, all the exempt organizations in our case studies continued to retain their exempt status. We found that existing federal statutes do not authorize IRS to use tax debt as a cause for revocation of an organization's exempt status. However, IRS is allowed to revoke exempt status when it determines the organization has ceased to operate in a manner consistent with the purpose for which it was granted the tax exempt status or for other extraordinary circumstances, such as when an organization engages in more than inconsequential illegal activities.

We also found that more than 1,200 of the exempt organizations with over \$72 million in tax debt received over \$14 billion in direct federal grants in fiscal years 2005 and 2006. Of the more than 1,200 exempt organizations that received grants, over 1,150 were charitable organizations. These organizations owed approximately \$70 million in tax debt and received over \$12 billion of the \$14 billion in grants. Further, the \$14 billion in grant disbursements going to exempt organizations is substantially understated because our audit did not include all federal agencies that provided grants and did not cover federal grants disbursed by state or local governments, known as pass-through grants. According to our analysis of the data from the Federal Assistance Award Data System, pass-through grants accounted for about 80 percent of total federal grants. Of our 25 tax exempt case study entities, 6 received federal grants. Our limited audit of grant applications submitted by these 6 case study entities found that 5 of the 6 appeared to have violated the False Statement Act<sup>11</sup> by not disclosing their tax debts in their applications even though they were required to do so. The strict taxpayer privacy statute poses a significant challenge to federal granting agencies in determining the accuracy of representations made by organizations seeking grants. Specifically, federal granting agencies cannot

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<sup>11</sup>18 U.S.C. § 1001 provides criminal penalties for those who knowingly and willfully (1) falsify, conceal, or cover up by any trick, scheme, or device a material fact; (2) make any materially false, fictitious, or fraudulent statement or representation; or (3) make or use any false writing or document knowing that the documents contain any materially false, fictitious, or fraudulent statement or entry.

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verify an applicant's tax status with IRS unless the taxpayer specifically authorizes such disclosure.<sup>12</sup>

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## Exempt Organizations Had Nearly \$1 Billion in Unpaid Federal Taxes

As of September 2006, nearly 55,000 exempt organizations had nearly \$1 billion in unpaid payroll and other federal taxes. Almost 40,000 of the 55,000 delinquent exempt organizations were charitable, or 501(c)(3), organizations that owed almost \$830 million of the nearly \$1 billion in unpaid payroll and other federal taxes. The amount of taxes owed by exempt organizations ranged from \$101 to \$16 million, and the number of delinquent tax periods ranged from a single period<sup>13</sup> to more than 80 tax periods.<sup>14</sup> However, the dollar amount of federal taxes owed by exempt organizations is understated because some organizations underreported their tax liability or failed to file a return altogether.

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## Characteristics of Unpaid Taxes by Exempt Organizations

As shown in figure 1, about 71 percent of the nearly \$1 billion in unpaid federal taxes is composed of payroll taxes and related penalties and interest. About 19 percent, or over \$180 million, is related to annual reporting penalties. IRS imposes reporting penalties on entities that did not file annual returns, failed to file in a timely manner, or filed inaccurate returns.<sup>15</sup> The remaining 10 percent of the nearly \$1 billion in delinquent taxes consists of unrelated business income, excise, and other types of taxes.

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<sup>12</sup>Federal taxpayers can request or consent to the disclosure of their tax information. I.R.C. § 6103(c).

<sup>13</sup>A "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.

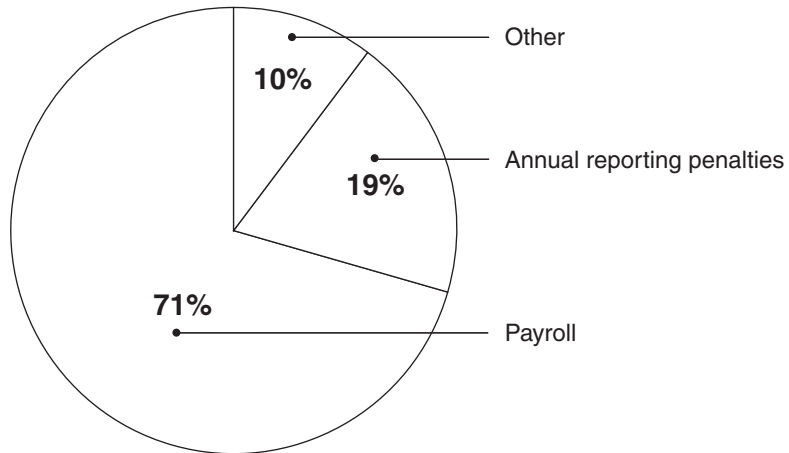
<sup>14</sup>As described later in this testimony, a case study consists in some cases of multiple related entities, some or all of which have tax debts. The number of tax periods and the accumulated tax debts cited here pertain solely to the exempt organization. The number of tax periods and the accumulated tax debts cited later in this testimony pertain to the accumulated tax periods and tax debts of the exempt organization and its related entities.

<sup>15</sup>Generally, the tax code requires exempt organizations with \$25,000 or more of revenues to file annual returns (i.e., Form 990/990EZ).



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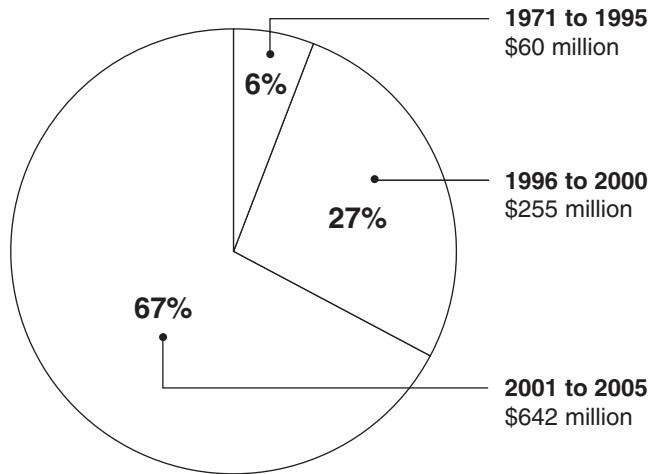
**Figure 1: Unpaid Federal Tax Debt of Exempt Organizations by Tax Type**



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

A significant amount of the unpaid federal taxes owed by exempt organizations had been outstanding for several years. As reflected in figure 2, while the majority of the nearly \$1 billion in unpaid federal taxes was from tax periods 2001 through 2005, about a third of the unpaid taxes were from tax periods prior to 2001. While there is a 10-year statutory collection period beyond which IRS is prohibited from attempting to collect tax debt, the 10-year time may be suspended for a variety of reasons, including for periods during which the taxpayer is involved in a collection due process appeal, litigation, or a pending offer in compromise or installment agreement. As a result, figure 2 includes taxes that are for tax periods from more than 10 years ago.

**Figure 2: Age of Federal Tax Debt Owed by Exempt Organizations**



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

Our analysis of IRS data found that nearly 1,500 of the almost 55,000 delinquent exempt organizations owed in total over \$600 million of the nearly \$1 billion unpaid federal taxes of exempt organizations we identified. All of these nearly 1,500 exempt organizations owed over \$100,000 each, with some owing more than \$10 million. Another 8,400 owed from \$10,000 to \$100,000 each. Although the largest group—nearly 45,000—owed less than \$10,000 in delinquent taxes, the majority of the debt in this group of exempt organizations related to payroll taxes withheld from employees and not remitted to the federal government and annual reporting penalties.

Although the nearly \$1 billion in unpaid federal taxes we identified as owed by exempt organizations as of September 30, 2006, is a significant amount, it understates the full extent of unpaid taxes. This amount does not include amounts due IRS from exempt organizations that did not file payroll taxes (nonfilers) and that underreported their payroll tax liability (underreporters). Also, we did not include exempt organization tax debt

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from 2006 tax periods, tax debt for entities owing \$100 or less, or tax debt for certain entities listed in IRS's database of exempt organizations.<sup>16</sup>

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## Selected Exempt Organizations Were Involved in Abusive and Potentially Criminal Activity Related to the Federal Tax System

For all 25 cases involving exempt organizations with delinquent tax debts that we audited and investigated, we found abusive activity, potentially criminal activity, or both related to the federal tax system. The amount of unpaid taxes associated with these cases ranged from over \$300,000 to nearly \$30 million. Table 1 highlights 5 of the 25 organizations we investigated with unpaid taxes. Appendix I provides a summary of the other 20 cases we examined. We are referring the 25 cases detailed in this testimony to IRS for further collection activity and criminal investigation, if warranted.

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<sup>16</sup>IRS's database of exempt organizations contained over 2.5 million entities. IRS does not consider all 2.5 million as currently tax exempt. We only included in our analysis the classifications of exempt organizations that IRS identified as currently tax exempt. This resulted in about 1.8 million entities. For additional information on our scope and methodology and tests of data reliability, see app. I of our accompanying report, [GAO-07-563](#).

**Table 1: Exempt Organizations with Unpaid Federal Taxes**

Case	Nature of work <sup>a</sup>	Unpaid federal tax amount <sup>b</sup>	Comments
1	Health care-related facilities	Nearly \$30 million	<ul style="list-style-type: none"> <li>This case consists of an exempt organization and multiple for-profit related entities with tax debt.</li> <li>The entities owe mostly payroll taxes dating back to the late 1990s.</li> <li>While failing to pay its taxes:               <ul style="list-style-type: none"> <li>The exempt organization paid millions of dollars in management fees to a contractor that is listed in public records as an affiliate of the exempt organization.</li> <li>The charity received millions of dollars of its funding from federal government programs.</li> </ul> </li> <li>While the entities owed taxes, a top official owned an offshore entity and a residence valued at over \$500,000.</li> <li>Federal, state, and local tax liens were filed against the charity for over \$10 million.</li> </ul>
2	Industry association	Over \$6 million	<ul style="list-style-type: none"> <li>Tax debts are mostly payroll taxes dating back to the late 1990s.</li> <li>An officer acknowledged the tax debt and the decision to fund operations, including salaries to over 10 officers in excess of \$100,000, rather than pay the tax liability.</li> <li>During the time the organization incurred payroll tax debt, a top officer owned a multimillion-dollar home and purchased luxury vehicles.</li> <li>IRS assessed a Trust Fund Recovery Penalty (TFRP) against one official and placed a tax lien on the organization.</li> </ul>
3	Health care-related facilities	Over \$15 million	<ul style="list-style-type: none"> <li>Tax debts are mostly payroll taxes dating back to the early 2000s.</li> <li>At the same time the organization failed to pay its taxes, the top official               <ul style="list-style-type: none"> <li>received more than \$1 million in annual compensation and benefits and</li> <li>made several hundred thousand dollars in cash transactions at banks and casinos.</li> </ul> </li> <li>Millions in federal tax liens have been placed against the organization and IRS is in the process of assessing a TFRP.</li> </ul>
4	Social club	Over \$1 million	<ul style="list-style-type: none"> <li>The tax debt, mostly payroll taxes, dates back to the late 1990s.</li> <li>This organization and former officials pled guilty to conducting an illegal gambling business.</li> <li>Despite the guilty pleas, the organization continues to operate as an exempt organization.</li> <li>The organization was also involved in cash transactions not reported to IRS.</li> <li>As of September 30, 2006, a TFRP had not been assessed because IRS concluded that no one could be held liable.</li> <li>Federal tax liens were filed against the entity.</li> </ul>

Case	Nature of work <sup>a</sup>	Unpaid federal tax amount <sup>b</sup>	Comments
5	Services to children	Over \$500,000	<ul style="list-style-type: none"> <li>• This organization's tax debt dates back to the late 1980s.</li> <li>• The top official of the organization was convicted of attempting to bribe an IRS employee.</li> <li>• This same official retained a position in the organization, which continues to operate as an exempt organization.</li> <li>• Organization officials allegedly requested that some payments to it be made in cash.</li> <li>• IRS assessed TFRPs against the organization's top officials.</li> <li>• Federal tax liens were filed against the entity.</li> </ul>

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

<sup>a</sup>As described earlier in this testimony, a case study consists in some cases of multiple related entities, some or all of which have tax debts. The number of tax periods and the accumulated tax debts cited earlier in this testimony pertain solely to the exempt organization. The number of tax periods and the accumulated tax debts cited here pertain to the accumulated tax periods and tax debts of the exempt organization and its related entities.

<sup>b</sup>Rounded dollar amount of unpaid federal taxes as of September 30, 2006.

The above cases illustrate how some officials of delinquent exempt organizations abused the federal tax system for their own benefit. These officials started multiple exempt organizations and failed to remit taxes, paid large management fees to related entities, paid high salaries and accumulated significant assets, or were involved in criminal activity all the while failing to remit payroll and other taxes to the federal government.

Despite continuing to abuse the federal tax system, all of the 25 case study organizations we investigated retained their tax exempt status. Existing federal statutes do not authorize IRS to revoke exempt status based on an organization's tax delinquency. However, IRS can revoke an organization's exempt status when it determines that the organization has ceased to operate in a manner consistent with the purpose for which it was granted the tax exempt status or for other extraordinary circumstances, such as when an organization engages in more than inconsequential illegal activities or pays officials excessive compensation.

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## Exempt Organizations with Unpaid Federal Taxes Received Billions in Federal Grant Payments

Based on our analysis, we determined that of the nearly 55,000 exempt organizations with federal tax debt, more than 1,200 received over \$14 billion in federal grants from the Department of Health and Human Services (HHS),<sup>17</sup> the Department of Education, the Department of Energy, the National Aeronautics and Space Administration, and other federal agencies in fiscal years 2005 and 2006. The more than 1,200 exempt organizations owed over \$72 million in tax debt yet received substantial amounts in federal grants. Of the more than 1,200 exempt organizations that were delinquent in taxes yet received grants, over 1,150 were charitable organizations that owed approximately \$70 million in unpaid federal taxes. These charitable organizations received over \$12 billion of the \$14 billion in grants disbursed to tax delinquent exempt organizations. Additionally, our estimate of the over \$14 billion in federal grants disbursed to exempt organizations with federal tax debt is likely understated because our audit did not include all federal agencies that provided grants and did not cover pass-through grants.

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## Exempt Organizations with Tax Debt Misrepresented Their Tax Status to Granting Agencies

Organizations that apply for federal grants are required to complete a Standard Form (SF) 424, "Application for Federal Assistance," to provide granting agencies with entity information, such as name, employer identification number, address, and a descriptive title of the project for which the grant will be used. The SF424 also requires that the grant applicant provide information as to whether the applicant has any delinquent federal debts. The instructions that accompany the SF424 define federal debt to include taxes owed. The applicant is required to certify that the information provided on the SF424 is true and correct.

We examined information provided on the SF424 for six of our case study tax exempt organizations that received grants, all of which had substantial tax debts outstanding. We found that five of the six that received federal grants failed to disclose their federal tax debts on the SF424s filed with the granting agencies. The six entities applied for and received over \$13 million in total grant payments in fiscal years 2005 and 2006. In a recent 3-year time span, one of the exempt organizations we audited applied for multiple grants to provide community services. Even though the entity had an outstanding balance of unpaid federal taxes, the entity

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<sup>17</sup>The HHS amount excludes Medicare and Medicaid payments. For additional information on our scope and methodology and tests of data reliability, see app. I of our accompanying report, [GAO-07-563](#).

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did not disclose its tax liability on the SF424s. The organization subsequently received several million dollars in grant payments during 2 recent fiscal years. Figure 3 provides excerpts of an SF424 for this organization where the applicant appears to have violated the False Statements Act<sup>18</sup> by not disclosing its delinquent tax debt.

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<sup>18</sup> 18 U.S.C. § 1001.

**Figure 3: Excerpt of SF424 Showing Failure to Declare Delinquent Tax Debt**

The image shows two sections of a Standard Form 424 (SF424) application. The top section, titled 'APPLICATION FOR FEDERAL ASSISTANCE', includes fields for 'DATE SUBMITTED', 'DATE RECEIVED BY STATE', 'DATE RECEIVED BY FEDERAL AGENCY', and 'TYPE OF APPLICATION'. The 'TYPE OF APPLICATION' section is checked for 'Non-Construction'. The middle section, '5. APPLICANT INFORMATION', contains fields for 'Legal Name', 'Address', 'Organizational Unit', and 'Name and telephone number of person to be contacted'. The bottom section includes a table for 'e. Other', 'f. Program Income', and 'g. TOTAL', followed by a declaration '17. IS THE APPLICANT DELINQUENT ON ANY FEDERAL DEBT?' with a checked 'No' box. Below this is a signature block with fields for 'Type Name of Authorized Representative', 'Title', 'Telephone Number', and 'Date Signed'. The signature block is signed by the 'Executive Director'. Annotations with arrows point to these sections: 'Applicant provides application information' points to the top section; 'Applicant attests to having no delinquent federal debt' points to the declaration box; and 'Applicant attests that information provided is true and correct by signing application' points to the signature block.

Source: HHS.

We found that while granting agencies can ask prospective grantees for consent to verify federal tax debt information with IRS, granting agencies did so only in a few cases where the grant applicant disclosed having federal debts. Agencies did not confirm with IRS the accuracy of applicant information related to federal tax debts because of strict taxpayer privacy laws. Officials at three granting agencies informed us that procedurally, if tax debt were declared on the SF424, the agencies would request further information, including consent to verify tax debt with IRS, to determine the financial responsibility of the applicant and whether any action needs to be taken, including withholding grant payments until a payment plan has been entered into with IRS. Without accurate debt information,



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granting agencies are limited in their ability to fully evaluate whether the grantee is a responsible party and should receive the grant, whether additional action needs to be taken, or a combination of these.<sup>19</sup>

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## Concluding Observations

The vast majority of exempt organizations pay their fair share of federal taxes. However, our work has shown that tens of thousands of exempt organizations and their officers have taken advantage of the opportunity to avoid paying their federal taxes, in part because IRS does not have the authority to revoke exempt status for failure to pay taxes. In many cases, officers of these delinquent organizations are responsible for diversion of payroll tax money—a felony offense—to pay their substantial salaries and accumulate substantial personal wealth. It is likely that many of these exempt organizations have provided significant and positive services to those in need. Nevertheless, it is also important that they comply with federal tax law in order for the federal government to collect the funds to which it is entitled to finance critical government priorities, and to help improve the overall level of compliance with the nation’s tax laws.

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Mr. Chairman and Members of the Subcommittee, this concludes my statement. I would be pleased to answer any questions that you or other members of the committee may have at this time.

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## Contacts and Acknowledgments

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-7455 or [kutzg@gao.gov](mailto:kutzg@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony.

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<sup>19</sup>Further actions granting agencies can take include placing restrictions on the funding, requiring that the prospective grantee enter into a payment agreement with IRS, or denying the grant.

# Appendix I: Exempt Organizations with Unpaid Federal Taxes

Table 1, in the main portion of the testimony, provides data on 5 detailed case studies. Table 2 provides details of the remaining 20 exempt organizations we selected as case studies. As with the 5 cases discussed in the body of this testimony, we also found abuse, potential criminal activity, or both related to the federal tax system during our audit and investigations of these 20 case studies. The case studies primarily involved exempt organizations with unpaid payroll taxes, one for as many as 14 years.

**Table 2: Exempt Organizations with Unpaid Federal Taxes**

Case <sup>a</sup>	Nature of work	Unpaid federal tax amount <sup>b</sup>	Comments
6	Community services	Nearly \$3 million	<ul style="list-style-type: none"> <li>• Tax debts were mostly payroll taxes dating back to the late 1990s.</li> <li>• The state fined this organization for employing convicted felons in positions of public trust.</li> <li>• An entity employee engaged in criminal activity while employed by the entity.</li> <li>• Although this organization has ceased operations, a similar business has replaced it operating out of the same facility.</li> <li>• Federal tax liens were filed against the entity.</li> </ul>
7	Health care-related facilities	Over \$6 million	<ul style="list-style-type: none"> <li>• This case consists of several related entities with tax debt and with related executives that share financial and other operational ties.</li> <li>• Combined, these related entities owe mostly payroll taxes dating back to the late 1990s.</li> <li>• Combined, the entities received over \$20 million annually from government-funded programs.</li> <li>• Several of the exempt organizations appear to pay management fees that total in the millions to a related entity.</li> <li>• Federal tax liens were filed against the entities.</li> </ul>
8	Community services	Over \$1 million	<ul style="list-style-type: none"> <li>• Entity officials claim they were unaware they had not paid payroll taxes for several years.</li> <li>• Entity officials recently chose to close the entity rather than pay the tax.</li> <li>• Entity received nearly \$3 million in federal grants during a recent 2-year period.</li> <li>• A top official received compensation of nearly \$100,000.</li> <li>• Despite owing taxes, this entity did not declare federal tax debt in its grant application.</li> <li>• Federal tax liens were filed against the entity.</li> </ul>

**Appendix I: Exempt Organizations with  
Unpaid Federal Taxes**

<b>Case<sup>a</sup></b>	<b>Nature of work</b>	<b>Unpaid federal tax amount<sup>b</sup></b>	<b>Comments</b>
9	Group home	Nearly \$8 million	<ul style="list-style-type: none"> <li>Entity owes mostly payroll tax from the early 1990s.</li> <li>A key official knew of the growing tax debt, but the entity chose to fund operations rather than pay the taxes. While incurring the tax debt, key officials owned multimillion-dollar properties.</li> <li>Entity filed for bankruptcy.</li> <li>A Trust Fund Recovery Penalty (TFRP) has been assessed against a key official.</li> <li>Federal, state, and local tax liens were filed against the entity for several million dollars.</li> </ul>
10	Educational services	Over \$3 million	<ul style="list-style-type: none"> <li>Entity owes mostly payroll taxes dating back to the early 2000s.</li> <li>Despite owing taxes, this entity did not declare federal tax debt in its grant application. The entity received several million dollars in federal grants in a recent year.</li> <li>IRS seized some of the organization's assets in the mid-2000s.</li> <li>A large TFRP has been assessed against several officials.</li> <li>Federal tax liens were filed against the entity.</li> </ul>
11	Health care facility	Over \$500,000	<ul style="list-style-type: none"> <li>Entity received local funding on the condition that it would be current in paying its payroll taxes.</li> <li>After IRS placed levies on the organization for failing to remit mostly payroll taxes for over 3 years, the entity lost its local funding.</li> <li>While the entity incurred the tax debt the top official of the entity               <ul style="list-style-type: none"> <li>was compensated by the entity close to \$200,000 for management services as a sole proprietor,</li> <li>owed the entity nearly \$200,000 for overbudget expenditures and unpaid rents,</li> <li>had the entity's license to operate suspended because of violations of regulations,</li> <li>owed individual income tax, and</li> <li>filed for personal bankruptcy.</li> </ul> </li> <li>IRS assessed a TFRP against this top official.</li> <li>Federal and state tax liens have been filed against the entity and this official.</li> </ul>
12	Community services	Over \$300,000	<ul style="list-style-type: none"> <li>This entity received over \$2 million in federal grants.</li> <li>Entity pays a \$75,000 annual salary to a relative of the executive director.</li> <li>Despite owing taxes, this entity did not declare federal tax debt in its grant application.</li> </ul>
13	Social services	Over \$800,000	<ul style="list-style-type: none"> <li>Entity received nearly \$400,000 in federal grants during a recent 2-year period while owing payroll tax dating back to the early 2000s.</li> <li>Previous top official, responsible for incurring the debt, was convicted of a felony.</li> <li>IRS placed a TFRP on the previous top official.</li> <li>Federal tax liens were filed against the entity.</li> </ul>

**Appendix I: Exempt Organizations with  
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<b>Case<sup>a</sup></b>	<b>Nature of work</b>	<b>Unpaid federal tax amount<sup>b</sup></b>	<b>Comments</b>
14	Group homes	Over \$3 million	<ul style="list-style-type: none"> <li>• This case consists of multiple exempt organizations with tax debt. These entities owe mostly payroll tax dating back to the late 1990s.</li> <li>• Entities make and receive interest-free loans to and from other related entities and key officials.</li> <li>• Related key officials are annually compensated over \$300,000 from multiple entities.</li> <li>• One key official owes individual income tax.</li> <li>• Federal tax liens have been filed against some of the related entities and related key officials.</li> <li>• IRS placed a large TFRP on one of the related key officials.</li> <li>• One of the entities entered into multiple installment agreements with IRS and was out of compliance on at least one agreement.</li> </ul>
15	Health care-related facility	Nearly \$2 million	<ul style="list-style-type: none"> <li>• Entity has twice filed for bankruptcy, and the top official filed for personal bankruptcy. During this time the entity failed to remit mostly payroll tax dating back to the late 1990s.</li> <li>• IRS assessed TFRPs against key officials who are each compensated over \$100,000 annually.</li> <li>• Federal tax liens have been filed against the entity totaling over \$1 million.</li> </ul>
16	Services to children	Over \$1 million	<ul style="list-style-type: none"> <li>• Entity owes mostly payroll tax dating back to the mid-1990s. The top official of this entity is also an official for another for-profit entity with tax debt.</li> <li>• This top official <ul style="list-style-type: none"> <li>• has a history of personal and business bankruptcies;</li> <li>• incurs tax debt, files for bankruptcy, reincorporates as another entity, and incurs additional tax debt; and</li> <li>• runs a separate company that provides services to the exempt organization. The associated costs are significantly greater than those of similar children's services organizations in the same region.</li> </ul> </li> <li>• IRS assessed TFRPs against key officials.</li> <li>• Federal tax liens have been filed against the top official.</li> </ul>
17	Social services	Over \$1 million	<ul style="list-style-type: none"> <li>• Entity owes mostly payroll taxes dating back to early 2000s.</li> <li>• IRS placed tax liens on this organization.</li> <li>• IRS assessed a TFRP against an organization official.</li> </ul>
18	Rehabilitation services	Over \$1 million	<ul style="list-style-type: none"> <li>• Entity accumulated tax debt over several years dating back to the late 1990s.</li> <li>• During this time period, organization officials withdrew several hundred thousand dollars in cash from entity bank accounts.</li> <li>• Related key officials were annually compensated close to \$200,000 in total.</li> <li>• IRS assessed TFRPs against key officials. Some payments have been made, but the majority of the tax remains unpaid.</li> <li>• Federal tax liens have been filed against the entity.</li> </ul>

**Appendix I: Exempt Organizations with  
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<b>Case<sup>a</sup></b>	<b>Nature of work</b>	<b>Unpaid federal tax amount<sup>b</sup></b>	<b>Comments</b>
19	Educational services	Over \$1 million	<ul style="list-style-type: none"> <li>• This entity owes mostly payroll tax dating back to the mid-1990s.</li> <li>• A top official owns an expensive home and has recently filed for personal bankruptcy.</li> <li>• IRS assessed a TFRP against organization officials.</li> <li>• Federal tax liens were filed against the entity.</li> </ul>
20	Services to the elderly	Over \$3 million	<ul style="list-style-type: none"> <li>• Entity owes mostly payroll tax for tax periods dating back to the late 1980s.</li> <li>• IRS assessed a TFRP against organization officials.</li> <li>• Federal tax liens were filed against the entity.</li> </ul>
21	Community services	Nearly \$3 million	<ul style="list-style-type: none"> <li>• Entity reported on recent financial statements cash and cash equivalents of over several million dollars. At the same time, the entity owed mostly payroll tax dating back to the mid-1990s.</li> <li>• While the entity was incurring the tax debt, <ul style="list-style-type: none"> <li>• the top official received compensation of over \$250,000 and</li> <li>• several other employees received compensation from \$75,000 to \$200,000.</li> </ul> </li> <li>• A key official owns an expensive home in an exclusive neighborhood and has been investigated or indicted for various violations of civil laws.</li> <li>• Federal tax liens have been filed against the entity.</li> </ul>
22	Education services	Over \$2 million	<ul style="list-style-type: none"> <li>• Entity owes mostly payroll tax dating back to the mid-1990s. In addition, entity owes nontax debt totaling several million dollars.</li> <li>• Federal and state tax liens have been filed against the entity.</li> <li>• IRS assessed a TFRP against key officials, one of whom also has unpaid federal tax debt dating back to the early 1990s.</li> </ul>
23	Children's services	Over \$2 million	<ul style="list-style-type: none"> <li>• While failing to remit mostly payroll taxes dating back to the early 2000s, <ul style="list-style-type: none"> <li>• the entity received over \$2 million in federal grants in recent years,</li> <li>• a key official received compensation of over \$100,000, and</li> <li>• the entity entered into multiple payment plans with the IRS, and was out of compliance on at least one.</li> </ul> </li> <li>• Despite owing taxes, this entity did not declare federal tax debt in its grant application.</li> <li>• IRS assessed large TFRPs against key officials.</li> <li>• Federal tax liens were filed against the entity.</li> </ul>
24	Health care services	Over \$5 million	<ul style="list-style-type: none"> <li>• Entity owes mostly payroll tax dating back to the early 2000s.</li> <li>• Key official received compensation of over \$200,000.</li> <li>• IRS has not assessed a TFRP against any individual.</li> <li>• Federal tax liens were filed against the entity.</li> </ul>

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**Appendix I: Exempt Organizations with  
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<b>Case<sup>a</sup></b>	<b>Nature of work</b>	<b>Unpaid federal tax amount<sup>b</sup></b>	<b>Comments</b>
25	Educational services	Over \$300,000	<ul style="list-style-type: none"><li>• Entity received over \$2 million in federal grants during a recent 2-year period while owing mostly payroll tax dating back to the late 1990s.</li><li>• Despite owing taxes, this entity did not declare federal tax debt in its grant application.</li><li>• Entity did not file payroll tax returns for several years, although it made payments for some periods. IRS is considering a request from the entity for an offer in compromise in which the entity would pay only a portion of the unpaid tax debt.</li></ul>

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

<sup>a</sup>As described earlier in this testimony, a case study consists in some cases of multiple related entities, some or all of which have tax debts. The number of tax periods and the accumulated tax debts cited earlier in this testimony pertain solely to the exempt organization. The number of tax periods and the accumulated tax debts cited here pertain to the accumulated tax periods and tax debts of the exempt organization and its related entities.

<sup>b</sup>Rounded dollar amount of unpaid federal taxes as of September 30, 2006.

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