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FINANCIAL MANAGEMENT

Thousands of GSA Contractors Abuse the Federal Tax System

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Highlights

Highlights of GAO-06-492T, a testimony before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

In February 2004 and again in June 2005, GAO testified that some Department of Defense (DOD) and civilian agency federal contractors abused the federal tax system with little consequence. Previous problems we identified with contractors with unpaid taxes have led to concerns over whether any interagency contractors, such as those on the General Services Administration's (GSA) federal supply schedule, failed to pay their taxes. GSA, through its federal supply schedule and other interagency contracts, arranges for federal agencies to purchase billions of dollars of goods and services directly from private vendors. GAO was asked to determine if GSA contractors, including both contractors that were paid by GSA and GSA interagency contractors, have unpaid federal taxes, and if so, to (1) determine the magnitude of tax debts owed by GSA contractors; (2) identify examples of GSA contractors that have tax debts and are also engaged in potentially abusive, fraudulent, or criminal activities; and (3) determine whether GSA screens contractors for tax debts and criminal activities prior to awarding contracts and at the exercise of any government contract options.

www.gao.gov/cgi-bin/getrpt?GAO-06-492T.

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 Steve Sebastian at (202) 512-3406.

What GAO Found

Over 3,800 GSA contractors had tax debts totaling about $1.4 billion as of June 30, 2005. This represented approximately 10 percent of the number of GSA contractors during fiscal year 2004 and the first 9 months of fiscal year 2005.

GAO investigated 25 GSA contractors with abusive and potentially criminal activity. These businesses 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. These contractors worked for a number of federal agencies including the departments of Defense, Justice, and Homeland Security.

A number of owners or officers of the 25 GSA contractors have significant personal assets, including commercial properties, houses worth over $1 million, and luxury vehicles. In addition, several of the owners of these GSA contractors 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
Emergency supplies	Over $700 ,000	Up to $100,000	Company loaned hundreds of thousands of dollars to company officer at same time company was not paying its taxes.
Security services	Over $9 million	At least $1 million	Company owner made cash withdrawals to fund an unrelated business and purchase a men's gold bracelet worth over $25,000.
Security services	Nearly $2 million	At least $1 million	Company repeatedly underpaid taxes to fund business while company owner reported personal income of nearly $1 million

Source: GAO's analysis of IRS, FMS, GSA, public, and other records.

Neither federal law, as implemented by the Federal Acquisition Regulation (FAR), nor GSA policies require contracting officers to specifically consider tax debts in making contracting decisions either at initial award or when considering options to extend. In addition, federal law generally prohibits the disclosure of taxpayer data, and consequently contracting officers have no access to tax data directly from the IRS. GSA contractors that do not pay tax debts could have an unfair competitive advantage in costs because they may have lower costs than tax compliant contractors on government contracts. This is especially true in wage-based businesses that provide homogenous types of goods and services. GAO's investigation identified instances in which contractors with tax debts won awards based on price differential over tax compliant competing contractors.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss General Services Administration (GSA) contractors that have abused the federal tax system while doing business with the federal government. In hearings held by this subcommittee in February 2004 and again in June 2005,[1] we testified that some Department of Defense (DOD) and civilian agency federal contractors abused the federal tax system with little consequence. In 2005, we designated interagency contracting, in which GSA plays a prominent role, as a new high-risk area.[2] This designation is partly based on the fact that interagency contracting[3] tends to create an incentive for the agency awarding the contracts to focus more on increasing contracting volume that generate fees than on compliance with sound contracting policy and required procedures (see app. II for further details on GSA's contracting role).

This testimony continues a body of work which has identified federal contractors with unpaid taxes. Our prior work gave rise to concerns over whether GSA interagency contractors, such as those on GSA's federal supply schedule, have also failed to pay their fair share of taxes.[4] As a result, you asked us to determine if GSA contractors have unpaid federal taxes,[5] and if so, to (1) determine the magnitude of tax debts owed by GSA

[1] GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-414T (Washington, D.C.: Feb. 12, 2004), and *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-683T (Washington, D.C.: June 16, 2005).

[2] See GAO, *High-Risk Series*, *An Update*, GAO-05-207 (Washington, D.C.: January 2005).

[3] Interagency contracts are those in which one federal agency (typically GSA) awards the contract, such as a federal supply schedule contract, and other federal agencies use the contracts, frequently paying a fee to do so.

[4] See GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-95 (Washington, D.C.: Feb. 12, 2004), and *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-637 (Washington, D.C.: June 16, 2005).

[5] For purposes of this report, GSA contractors include both contractors that were paid by GSA and GSA interagency contractors. GSA-paid contractors are contractors paid by GSA finance centers for goods and services. These goods and services may be used by GSA internally or may be purchased by GSA for the benefit of other agencies (such as GSA global supply purchases of commercial items for sale to federal agencies). GSA interagency contractors are contractors awarded contracts by GSA (such as federal supply schedule and governmentwide acquisition contracts) from which agencies routinely acquire services and products for their procurement needs.

contractors; (2) identify examples of GSA contractors that have tax debts and are also engaged in potentially abusive, fraudulent, or criminal activities; and (3) determine whether GSA screens contractors for tax debts and criminal activities prior to awarding contracts and at the exercise of any government contract options.

To identify GSA contractors with unpaid federal taxes, we obtained and analyzed the Internal Revenue Service (IRS) tax debt data as of June 30, 2005. We matched the identities of contractors with IRS tax debts to federal contractors that were either paid or awarded contracts by GSA to contract with federal agencies during fiscal year 2004 and the first 9 months of fiscal year 2005. To illustrate indications of abuse or potentially criminal activity, based on our data mining, we selected 25 GSA contractors for a detailed audit and investigation. For these 25 contractors, we reviewed copies of automated tax transcripts and other tax records (for example, revenue officer's notes) and performed additional searches of criminal, financial, and public records. To determine whether GSA contracting officers are required to consider tax debts or other criminal activities, we examined the Federal Acquisition Regulation (FAR) and GSA regulations, policies and procedures for conducting responsibility determinations on prospective contractors. We also discussed acquisition policies and procedures used to award contracts with GSA officials and, as part of these discussions, we determined whether contracting officers specifically consider tax debts or perform background investigations in determining whether a prospective contractor is a responsible source before the contract is awarded and before the option to extend the contract is exercised. For details on our scope and methodology, see appendix I.

We conducted our audit work from June 2005 through January 2006 in accordance with U.S. generally accepted government auditing standards. We performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Summary

During fiscal year 2004 and the first 9 months of fiscal year 2005, thousands of GSA contractors abused the federal tax system with little consequence.[6] Specifically, our analysis of data provided by the

[6] We considered activity to be abusive when a contractor's actions or inactions, though not illegal, 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.

Department of Treasury's Financial Management Service (FMS), GSA, and the IRS indicates that over 3,800 GSA contractors, or about 10 percent of all GSA contractors, had tax debts totaling about $1.4 billion as of June 30, 2005.[7] The unpaid taxes included corporate income, payroll,[8] excise, and unemployment taxes.

We found instances of abusive or potentially criminal activity related to the federal tax system through our audit and investigation of 25 GSA contractor case studies. These 25 contractors provided a variety of goods and services, including building maintenance, security services, and computer services. During fiscal year 2004 and the first 9 months of fiscal year 2005, the contractors were tasked by multiple agencies, including the departments of Defense, Justice, Homeland Security, and Veterans Affairs to perform work under a GSA contract.

The 25 contractors owed primarily payroll taxes, with some dating back to the mid-1990s. These payroll taxes included amounts withheld from employee wages for Social Security, Medicare, and individual income taxes. However, rather than fulfilling their role as "trustees" and forwarding these amounts to IRS, many of these GSA contractors diverted the money for personal gain or to fund the business. Willful failure to remit payroll taxes is a criminal felony offense[9] while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense.[10] In one case study, the contractor did not pay its tax liability at the time the company was making a loan to a company officer for hundreds of thousands of dollars in the 1990s. The company subsequently filed for bankruptcy. After the company's bankruptcy was discharged in the late 1990s, the company failed again to remit all of its payroll taxes. At the same time of owing payroll taxes, the company officer who received the loan acquired a luxury vehicle and purchased a residential property currently valued in the millions of dollars. Similarly, a number of owners

[7] Because many GSA contractors are interagency contractors, some of the approximately 3,800 contractors described in this report may also have been included in our reports concerning DOD and civilian federal contractors that abuse the federal tax system.

[8] Payroll taxes are amounts that employers withheld from employees' wages for federal income taxes, Social Security, and Medicare but failed to remit to IRS, as well as the related employer matching contributions for Social Security and Medicare taxes. Employers are responsible for remitting payroll taxes to IRS and are liable for any outstanding balance.

[9] 26 U.S.C. § 7202.

[10] 26 U.S.C. § 7215 and 26 U.S.C. §7512 (b).

or officers in the other 24 case studies had significant personal assets, including commercial properties, houses worth over $1 million, and luxury vehicles. Despite owning significant assets, the owners or officers did not pay the delinquent taxes of their businesses, and sometimes did not pay hundreds of thousands of dollars of their own individual income taxes. Several owners also gambled hundreds of thousands of dollars at the same time they were not paying the taxes that their businesses owed.

The Federal Acquisition Regulation (FAR) limits awards of contracts to responsible prospective contractors. A responsible prospective contractor is a contractor that meets seven specific criteria,[11] including adequate financial resources and a satisfactory record of integrity and business ethics. However, neither federal law, as implemented by the FAR, nor GSA implementing policy specifically require contracting officers to take into account a contractor's tax debt when assessing whether a prospective contractor is responsible. In policies issued to implement the FAR, GSA's guidance does not discuss whether or how tax debts should be considered when making a determination of responsibility. We also found that the FAR does not require, and GSA has not issued a policy on, assessing a current contractor's tax debts at the time the government exercises an option to extend a contract. As a result, no review is systematically performed by GSA to determine if such contractors have unpaid taxes at the time a contract is awarded or when an option to extend a contract is exercised by the government.

Due to the lack of specific responsibility criteria related to tax debts, limited GSA access to tax information, and lack of other procedures to assess contractor tax debts, GSA ultimately awarded contracts, including supply schedule contracts that other federal agencies may use to acquire services and products for their procurement needs, to businesses with significant tax debts. Federal law generally prohibits the disclosure of taxpayer data, and consequently contracting officers have no access to tax data directly from the IRS. Contracting officers can obtain some tax debt information by checking publicly available data sources to determine if IRS or state agencies have filed tax liens against a tax debtor's assets. However, liens that IRS places on the company and/or its officers are not available at a single publicly available database, and IRS does not always file liens against tax debtors.

[11] FAR 2.101; 9.104-1.

Finally, in wage-based businesses that provide homogeneous goods and services, GSA contractors that owe tax debts have an unfair advantage in price competition because they do not bear the same costs, such as payroll taxes, that tax compliant contractors do on government contracts.

Magnitude of Unpaid Taxes of GSA Contractors

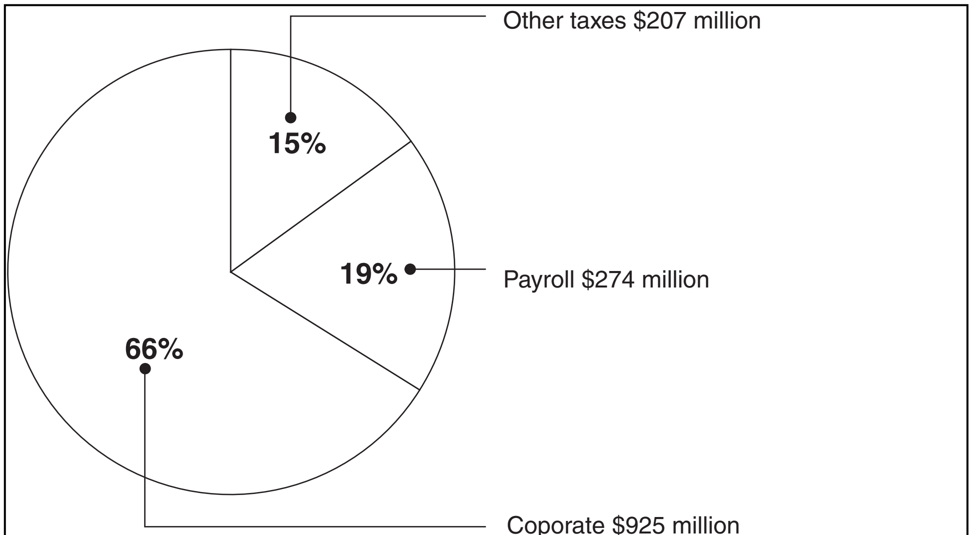
Over 3,800 GSA contractors had about $1.4 billion in unpaid federal taxes as of June 30, 2005.[12] This represents approximately 10 percent of GSA contractors during fiscal year 2004 and the first 9 months of fiscal year 2005. We took a conservative approach to identifying the amount of tax debt owed by GSA contractors, and therefore the amount is likely understated.

Characteristics of Contractors' Unpaid Federal Taxes

As shown in figure 1, 85 percent of the approximately $1.4 billion in unpaid taxes owed by GSA contractors was comprised of corporate income and payroll taxes. The other 15 percent of taxes included excise, unemployment, individual income, and other types of taxes. Unlike our previous reports on contractors with tax debts, a larger percentage of taxes owed by GSA contractors was comprised of corporate income taxes, which are unpaid amounts that corporations owe on the income of their business. This was due to a handful of GSA contractors that owed a significant amount of corporate income tax debts as of June 2005. Excluding this handful of cases, payroll taxes make up about 40 percent of the outstanding taxes owed by GSA contractors.

[12] Our estimate of GSA contractors with tax debt as of June 30, 2005, (1) excluded tax debts that have not been agreed to by the tax debtor or affirmed by the court, (2) tax debts from calendar year 2005, and (3) tax debts of $100 or less.

Figure 1: Type of Federal Tax Debt Owed by GSA Contractors



Source: GAO analysis of GSA, Treasury, and IRS data as of June 30, 2005.

Unpaid payroll taxes include amounts that an employer withholds from an employee's wages for federal income taxes, Social Security, and Medicare—but does not remit to IRS—and the related matching contributions of the employer for Social Security and Medicare. Employers who do not remit payroll taxes to the federal government are subject to civil and criminal penalties.

The amount of unpaid federal taxes we identified among GSA contractors—$1.4 billion—is likely understated. First, to avoid overestimating the amount owed by government contractors, we intentionally limited our scope to tax debts that were affirmed by either the contractor or a tax court for tax periods prior to 2005.[13] We did not include the most current tax year because recently assessed tax debts that appear as unpaid taxes may involve matters that are routinely resolved between the taxpayer and IRS, with the taxes paid, abated,[14] or both within

[13] We eliminated from our analysis all tax debt coded by IRS as not having been agreed to by the taxpayer (for example, by filing a balance due return) or a tax court. For financial reporting, those cases are referred to as compliance assessments.

[14] Abatements are reductions in the amount of taxes owed and can occur for a variety of reasons, such as to correct errors made by IRS or taxpayers or to provide relief from interest and penalties. 26 U.S.C. § 6404.

a short period. We eliminated these types of debt by focusing on unpaid federal taxes for tax periods prior to calendar year 2005 and eliminating tax debt of $100 or less.[15]

Also limiting the completeness of our estimate of the unpaid federal taxes of GSA contractors is the fact that the IRS tax database reflects only the amount of unpaid taxes either reported by the contractor on a tax return or assessed by IRS through its various enforcement programs. The IRS database does not reflect amounts owed by businesses and individuals that have not filed tax returns and for which IRS has not assessed tax amounts due. During our review, we identified instances from our case studies in which GSA contractors failed to file tax returns for a particular tax period and, therefore, were listed in IRS records as having no unpaid taxes for that period. Further, our analysis did not attempt to account for businesses or individuals that purposely underreported income and were not specifically identified by IRS. According to IRS, underreporting of income is the largest component of the estimated $345 billion annual gross tax gap. IRS estimates that underreporting accounts for more than 80 percent of the total gross tax gap. Consequently, the true extent of unpaid taxes for these businesses and individuals is not known.

GSA Contractors Involved in Abusive and Potentially Criminal Activity Related to the Federal Tax System

As discussed previously, businesses with employees are required by law to collect, account for, and transfer income and employment taxes withheld from employees' wages to IRS. Businesses that fail to remit payroll taxes to the federal government are liable for the amounts withheld from employees, and IRS can assess a trust fund recovery penalty (TFRP) equal to the total amount of taxes not collected or not accounted for and paid against individuals who are determined by IRS to be "willful and responsible" for the nonpayment of withheld payroll taxes.[16] In addition to civil penalties, criminal penalties exist for an employer's failure to turn over withheld employee payroll taxes to IRS. Willful failure to remit payroll taxes is a criminal felony offense punishable by imprisonment of not more than 5 years,[17] while the failure to properly segregate payroll

[15] 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.

[16] 26 U.S.C. § 6672.

[17] 26 U.S.C. § 7202.

taxes can be a criminal misdemeanor offense punishable by imprisonment of up to a year.[18]

Our audit and investigation of the 25 case-study business contractors showed substantial abuse or potential criminal activity as all had unpaid payroll taxes and have diverted those funds for personal or business use. The 25 case-study contractors typically operate in wage-based industries, providing security, building maintenance, computer services, and personnel services for GSA and the departments of Defense, Homeland Security, Justice, and Veterans Affairs. The types of contracts that were awarded to these contractors included products and/or services related to law enforcement, disaster relief, and national security. The amount of unpaid taxes associated with these case studies ranged from approximately $100,000 to over $9 million. Furthermore, we determined that several of the case studies had unpaid state and local taxes where state and local taxing authorities had filed multiple tax liens against them. Subsequent to the award of the most recent contract by GSA, one case study company and its owner were debarred from future federal contracts for illegal activity unrelated to their failure to pay their payroll taxes.

Table 1 highlights 10 case studies with unpaid taxes. Our investigations revealed that, despite their companies owing substantial amounts of taxes to the IRS, some owners had substantial personal assets—including commercial real estate, interest in a chain store, or multiple luxury vehicles. Further, several owners owned homes worth over $1 million.

See appendix III for the details on the other 15 GSA contractor case studies. We are referring the 25 cases detailed in our report to IRS so that it can determine whether additional collection action or criminal investigation is warranted.

[18] 26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

Table 1: GSA Contractors with Unpaid Federal Taxes

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
1	Emergency supplies	Up to $100,000	Over $700,000	• Company made large loans to a company officer at same time the company was not paying its taxes. • IRS assessed a Trust Fund Recovery Penalty against owner. • Company filed for bankruptcy protection owing substantial state and federal taxes. • The owner owned multiple real properties, including a million dollar home, and a luxury vehicle while company owed taxes. • Company had a federal tax lien at time GSA awarded a federal supply schedule contract.
2	Security services	At least $1 million	Over $9 million	• Company filed for bankruptcy in 2000s. • At the time company was not remitting all of its payroll taxes to IRS, the owner withdrew large amounts of funds from the company for personal use. • Owner used over $100,000 on gambling. • Company submitted false reports on a government contract. • Owner is being investigated for fraud.
3	Building maintenance	Up to $100,000	Over $700,000	• Company affiliated with two other related entities with tax debt. • Company filed for bankruptcy in 2000s. • Company did not file some recent payroll tax returns. • Owner made large cash withdraws totaling tens of thousands of dollars during the time little or no payroll taxes were remitted to IRS. • At the same time that the company was remitting little of its payroll taxes to IRS, the owner bought a luxury automobile, owned a number of rental properties, and had partial ownership in a chain store. • Owner owes over $100,000 in personal income taxes.
4	Security services	At least $1 million	Nearly $2 million	• Tax debt is primarily unpaid payroll taxes. • Company repeatedly underpaid payroll taxes to fund company operations. • At the time company was underpaying payroll taxes, owner's reported personal income was nearly $1 million. • Company and IRS are negotiating installment agreement to pay unpaid taxes. • Owner owns residential property, commercial real estate, and land worth over $1 million. • Owner owes over $200,000 in personal income taxes.
5	Building maintenance	Up to $100,000	Over $2 million	• Company owes over $2 million in unpaid payroll taxes for more than 10 tax periods. • Owner used unremitted payroll taxes to fund the business. • Owner owns multiple commercial and residential properties.

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
6	Moving services	At least $100,000	Over $2 million	• Company claimed payroll taxes were not paid due to employee embezzlement. • Company filed offer in compromise with IRS for about 5 percent of its outstanding tax balance, which IRS rejected. • The owners own homes cumulatively valued over $1 million and own several luxury vehicles. • Spouse of one of the owners recently received about $1.5 million in cash for sale of house.
7	Building maintenance services	At least $100,000	Over $1 million	• Company owes payroll taxes for about 20 tax periods. • IRS placed federal tax liens on company from late 1990s to early 2000s. • Owner owes over $250,000 in personal income taxes.
8	Building maintenance services	At least $1 million	Over $100,000	• Almost all taxes owed are unpaid payroll taxes. • The owner maintains two residential properties valued at over $1million in total. • Federal and state tax liens were filed against the company.
9	Human resource services	At least $100,000	Over $400,000	• IRS reported company's tax debts to Treasury for continuous levy on federal contractor payments. • Owner owns multiple real properties and several luxury vehicles. • At the time owner did not remit all taxes owed to IRS, the owner made multiple large cash withdraws at gambling casinos. • Company obtained contract for hurricane relief efforts.
10	Public communications	Up to $100,000	Over $2 million	• Almost all taxes owed are unpaid payroll taxes. • The owner owns residential properties valued at about $1 million. • At the time the company did not pay all of its payroll taxes, the owner made about $500,000 of cash withdrawals at gambling casinos.

Source: GAO's analysis of IRS, FMS, GSA, public, and other records.

The following provides illustrative detailed information on several of these cases.

- Case 1: This contractor provides emergency supplies for civilian agencies. At the same time the company was not paying its taxes, the company made a loan to a company officer for hundreds of thousands of dollars. The company subsequently filed for bankruptcy owing a substantial amount of federal and state taxes. After the company came out of bankruptcy, the company again failed to remit all of its taxes, including payroll taxes. IRS assessed a trust fund recovery penalty against the company and the owner for willful failure to remit payroll taxes.
- Case 2: The company provided security services for a civilian agency. Our investigative work indicates that an owner of the company made multiple

cash withdrawals, totaling close to $1 million, while the contractor owed payroll taxes. The company's owner used the cash withdrawals to fund an unrelated business and purchase a men's gold bracelet worth over $25,000. The company's owner has been investigated for fraud.

- Case 4: The company provides security services for a civilian agency. Our investigative work indicates that the owner of the company did not make tax deposits because the company did not have the funds to pay employee costs or other business expenses. However, we found that the company owner owns multiple properties worth over $1 million. The owner also owes IRS approximately $200,000 for personal income taxes.

Tax Debts Are Generally Not Considered When Awarding Contracts

Federal law implemented in the FAR, and GSA internal policies do not require GSA contracting officers to examine tax debt when awarding contracts, nor do they provide guidance as to what role, if any, tax debt should play in determining whether prospective contractors meet the general criteria of responsible contractors. Also, due to a statutory restriction on disclosure of taxpayer information, even if tax debts specifically were to be considered in the awarding of contracts, no coordinated or independent mechanism exists for contracting officers to obtain complete information on contractors that have unpaid tax debt. Therefore, GSA does not screen contractors for tax debts prior to awarding contracts to GSA-paid contractors and GSA interagency contractors, and ultimately, contractors with unpaid federal taxes receive contracts from the federal government.

Contractors with Federal Tax Debts Are Not Explicitly Prohibited from Doing Business with the Federal Government

Federal law implemented in the FAR and GSA internal policies do not expressly prohibit a contractor with unpaid federal taxes from being awarded contracts from the federal government. Although the FAR requires that federal agencies only do business with responsible contractors, it does not specifically require federal agencies to deny the award of contracts to businesses and individuals that have unpaid taxes, unless the contractor was specifically debarred or suspended by a debarring official for specific actions, such as conviction for tax evasion.

As part of the contractor responsibility determination for prospective contractors, the FAR requires contracting officers to determine whether a prospective contractor meets several specified standards, including adequate financial resources and a satisfactory record of integrity and business ethics. However, the FAR does not require contracting officers to consider tax debt in making this determination.[19] Similarly, GSA policies in implementing the FAR do not provide any additional guidance to GSA contracting officers on whether or how tax debts should be considered when making a determination of financial responsibility.[20] According to GSA officials, contracting officers may consider delinquent tax debts as part of their overall determination of a prospective contractor's financial capability; however, the focus of such evaluation is on determining whether the contractor has the financial capability to deliver the products and services. Thus, there is no expectation that the contracting officer will consider tax compliance when evaluating whether companies have the integrity or ethics to perform the contract. In addition, according to GSA officials, the determination for financial capability of the contract is only applicable when awarding new contracts.[21] Thus, if the contractor does not pay its tax debts after the contract award, no consideration of this will be made by GSA contracting officers for the duration of the contract or at the subsequent exercise of any options to extend, which for certain GSA Supply Schedule contracts can last up to 20 years.

The FAR specifies that unless compelling reasons exist, agencies are prohibited from soliciting offers from, or awarding contracts to, contractors that are debarred, suspended, or proposed for debarment for various reasons, including tax evasion.[22] Conviction for tax evasion is cited as one of the causes for debarment, while commission, i.e., indictment, for

[19] The government may suspend a contractor suspected of tax evasion, upon adequate evidence, and debar a contractor for a conviction or civil judgment for commission of tax evasion. Further, prospective contractors are required to certify in their bids or proposals whether they or their principals, within the preceding 3 years, were convicted or had civil judgments rendered against them for commission of tax evasion, and whether they or their principals are presently indicted or otherwise criminally or civilly charged with commission of tax evasion.

[20] GSA provides guidance to GSA contracting officers in the General Services Administration Acquisition Manual (GSAM), Acquisition Letters, and Procurement Information Bulletins.

[21] The FAR does not require a responsibility determination when an agency exercises options to extend a contract. For one contract file we reviewed, the contractor filed for bankruptcy prior to GSA's action to extend. GSA exercised the option without consideration of the bankruptcy. GSA subsequently could not recover over $100,000 in audit disallowances pursuant to the bankruptcy ruling.

[22] Prior to awarding a contract, contracting officers are required to consult a governmentwide list, called the Excluded Parties List System (EPLS), of contractors that have been debarred, suspended, or declared ineligible for government contracts, and review the prospective contractor's self-certification of debarment and suspension.

tax evasion is cited as a cause for suspension. However, the deliberate failure to remit taxes, in particular payroll taxes, while a felony offense, will likely not result in a company being debarred or suspended unless the contractor was indicted or convicted of the crime. During our work, we found that none of the contractors described in this testimony, nor the 97 contractors we reported in our previous work, have been charged with tax evasion,[23] despite having abusive and potentially criminal activities related to the tax system.

Restrictions on Tax Data Hamper Making Contractor Responsibility Determinations

Current law restricts contracting officers' access to tax debt information unless reported by prospective contractors themselves or disclosed in public records. Consequently, contracting officers do not have ready access to information on unpaid tax debts to assist in making contractor responsibility determinations with respect to financial capability, ethics, and integrity.

Contracting officers do not have a coordinated and independent mechanism to obtain accurate tax debt information on contractors that abuse the tax system. Federal law does not permit IRS to disclose taxpayer information, including tax debts.[24] Thus, unless the taxpayer provides consent,[25] certain tax debt information can only be discovered from public records when IRS files a federal tax lien against the property of a tax debtor.[26] However, contracting officers are not required to obtain credit reports, which provides public record information, and when credit reports are obtained, GSA contracting officers generally focus on the contractor's credit score and not necessarily any liens or other public information. In addition, public record information is limited because IRS does not file tax liens on all tax debtors, and, while IRS has a central repository of tax liens, contracting officers do not have access to that information. Further, the listing of a federal tax lien in the credit reports of businesses or individuals may not be a reliable indicator of a contractor's

[23] GAO-04-95, GAO-05-637.

[24] 26 U.S.C. § 6103.

[25] For example, contractors must provide IRS consent to validate taxpayer identification numbers (TINS) provided by the contractors in the Central Contractor Registration system. GSA officials stated that the contractor is not registered into the system until the TIN is validated with IRS records.

[26] Under section 6321 of the Internal Revenue Code, IRS has the authority to file a lien upon all property and rights to property, whether real or personal, of a delinquent taxpayer.

tax indebtedness because of deficiencies in IRS's internal controls that have resulted in IRS not always releasing tax liens from property when the tax debt has been satisfied.[27]

Unless reported by prospective contractors themselves, contracting officers face significant difficulties obtaining or verifying tax compliance information on prospective contractors. For example, in one contractor file we reviewed, a GSA official did inquire about a federal tax lien with a prospective contractor. The prospective contractor provided documentation to GSA demonstrating the satisfaction of the tax liability covered by that lien. However, because the GSA official could not obtain information from the IRS on tax debts, this official was not aware that the contractor had other unresolved tax debts unrelated to this particular tax lien.

GSA Contractors Not Required to Undergo Further Determination of Responsibility or Background Investigation

GSA interagency contractors are not only approved to do business with GSA, but with all federal agencies. The FAR does not require agencies that use contracts awarded by other agencies to perform additional background or other investigation to validate the awarding agencies' determination that the contractors are responsible. Agency officials at the four agencies at which we inquired—the departments of Justice, State, and Veterans Affairs, and the National Aeronautics and Space Administration— generally stated that they did not perform additional background or other investigations when using contractors selected for interagency contracts. These officials informed us that they had assumed GSA performed all the screening necessary to ensure that the contractors were responsible contracting sources. Consequently, when GSA awards interagency contracts to contractors with tax debt, contractors with tax debts will be given an opportunity to do business with other federal agencies for the duration of the GSA contract.

[27] GAO, *IRS Lien Management Report: Opportunities to Improve Timeliness of IRS Lien Releases*, GAO-05-26R (Washington, D.C.: Jan. 10, 2005).

Contractors with Tax Debts Have Unfair Cost Advantage in Contract Competition

GSA contractors with tax debts have an unfair advantage in costs when competing with contractors that pay their taxes. This is particularly true for wage-based industries that provide relatively basic types of goods and services, such as security and moving services. The most egregious abuse, not remitting employee payroll taxes, saved these companies over 15 percent of the employee's wages. Clearly, contractors that do not pay their taxes do not bear the same costs that tax compliant contractors have when competing on contracts. As a result, when in direct competition for homogenous types of goods and services in wage-based businesses, these contractors could offer prices for their goods and services that are lower than their tax compliant competitors. Our investigations showed that some GSA contractors that did not fully pay their payroll taxes were issued task orders based solely on price over competing contractors that did not have any tax debts. The following provides information on these cases.

Case 1: A GSA Schedule contractor was competitively awarded a task order from the GSA schedule in the late 1990s to provide temporary personnel services over another GSA contractor that was compliant with its taxes. The task order award was based solely on the hourly cost of the temporary employee. At the time, the contractor had owed taxes for at least 10 years. This contractor had a history of incurring payroll taxes on one company, then upon being assessed a trust fund recovery penalty on that company but making little or no payments, closing that company and starting another. The owner later renewed the contract under a new company name and Taxpayer Identification Number.

Case 2: A GSA Schedule contractor was issued two competitive task orders for services related to moving office furniture and equipment. On both task orders, the contractor's offer for services was significantly less than three competing offers on the first order and two competing offers on the second order. The contractor owed about $700,000 in unpaid taxes (mostly payroll taxes) while its competitors did not owe any unpaid taxes. Because the contractor did not pay its payroll taxes, a significant cost in a wage-based business, the contractor's cost structure provided the contractor more flexibility in setting its price in the competition for federal contracts.

Concluding Comments

There is widespread concern today about contractor fraud and related ethics problems in federal government contracting. However, except for contractors charged with or convicted of tax evasion, no laws or policies exist today that prevent GSA contractors with abusive and potentially criminal activity related to the federal tax system from being awarded contracts and doing business with federal agencies. Aside from any general concerns about the federal government doing business with contractors that do not pay their taxes, allowing these contractors to do business with the federal government while not paying their taxes could create an unfair competitive advantage for these contractors. In essence, the current contract award process fails to encourage contractors to pay these taxes. This causes a disincentive to contractors to pay their fair share of taxes, and could lead to further erosion in compliance with the nation's tax system.

Appendix I: Objectives, Scope, and Methodology

Our objectives were to (1) determine the magnitude of tax debts owed by GSA contractors; (2) identify examples of GSA contractors that have tax debts and are also engaged in potentially abusive, fraudulent, or criminal activities; and (3) determine whether GSA screens contractors for tax debts and criminal activities prior to awarding contracts and at the exercise of any government contract options.

To identify the magnitude of unpaid taxes owed by GSA contractors, we first identified the federal contractors that were either GSA interagency contractors or that were paid by GSA. To identify GSA-paid contractors, we obtained from the Department of the Treasury's Financial Management Service (FMS) the Payments, Claims, and Enhanced Reconciliation (PACER) database containing all Automated Clearing House (ACH) and check payments made by FMS on behalf of GSA to federal contractors during fiscal year 2004 and the first 9 months of fiscal year 2005.[1] To identify contractors screened by GSA's Federal Supply Service (FSS), we obtained and analyzed GSA data on Multiple Award Schedule (MAS) contracts and other FSS award contracts as recorded in the Federal Supply Service Automated Supply System (FSS-19). To identify contractors screened by GSA's Public Buildings Service (PBS), we obtained and analyzed GSA data from its Pegasys and FPDS-NG systems. To identify contractors screened by GSA's Federal Technology Service, we obtained and analyzed GSA data from its Pegasys system.

To identify GSA contractors with unpaid federal taxes, we obtained and analyzed the Internal Revenue Service (IRS) unpaid assessment data as of June 30, 2005. We matched the GSA screened and/or paid contractor records to the IRS unpaid assessment data using the taxpayer identification number (TIN) field. We also matched data obtained from competing bidders (those who were not awarded the task order) to the IRS assessment database using the TIN field to determine whether they owed tax debt. To avoid overestimating the amount owed by contractors with unpaid tax debts and to capture only significant tax debts, we excluded from our analysis tax debts and payments meeting specific criteria to establish a minimum threshold in the amount of tax debt and in the amount of payments to be considered when determining whether a tax debt is significant. The criteria we used to exclude tax debts are as follows:

[1] Although the GSA Kansas City finance center does make contractor payments on behalf of other agencies, they were able to identify those payments made for GSA contracts.

- tax debts that IRS classified as compliance assessments or memo accounts for financial reporting,[2]
- tax debts from calendar year 2005 tax periods, and
- contractors with total unpaid taxes of $100 or less.

The criteria above were used to exclude tax debts that might be under dispute or generally duplicative or invalid, and tax debts that are recently incurred. Specifically, compliance assessments or memo accounts were excluded because these taxes have neither been agreed to by the taxpayers nor affirmed by the court, or these taxes could be invalid or duplicative of other taxes already reported. We excluded tax debts from calendar year 2005 tax periods to eliminate tax debt that may involve matters that are routinely resolved between the taxpayer and IRS, with the taxes paid or abated within a short period. We further excluded tax debts of $100 or less because they are insignificant for the purpose of determining the extent of taxes owed by GSA contractors.

To identify indications of abuse or potentially criminal activity, we selected 25 GSA contractors for a detailed audit and investigation. The 25 contractors were chosen using a non-representative selection approach based on our judgment, data mining, and a number of other criteria. Specifically, we narrowed the 25 contractors with unpaid taxes based on the amount of unpaid taxes, number of unpaid tax periods, amount of payments reported by GSA and FMS,[3] indications that owner(s) might be involved in multiple companies with tax debts, and selection of contractors doing business with a variety of federal agencies.

We obtained copies of automated tax transcripts and other tax records (for example, revenue officer's notes) from IRS as of June 30, 2005, and reviewed these records to exclude contractors that had recently paid off their unpaid tax balances and considered other factors before reducing the number of businesses to 25 case studies. We performed additional searches of criminal, financial, and public records. In cases where record

[2] Under federal accounting standards, unpaid assessments require taxpayer or court agreement to be considered federal taxes receivables. Compliance assessments and memo accounts are not considered federal taxes receivable because they are not agreed to by taxpayers or the courts.

[3] Amount of payments reported by FMS and amounts reported by GSA could differ because contractors that have been pre-approved by GSA to do business with the government also receive payments from disbursing entities other than FMS, for example, Department of Defense or the U.S. Army Corps of Engineers.

searches and IRS tax transcripts indicate that the owners or officers of a business are involved in other related entities[4] that have unpaid federal taxes, we also reviewed the related entities and the owner(s) or officer(s), in addition to the original business we identified. For the selected 25 cases, our investigators also contacted some contractors, performed interviews, and reviewed contract files to determine the extent of price competition and to identify bidders on competitively awarded contracts.

To determine the extent to which contracting officers are to consider tax debts or other criminal activities, we examined the Federal Acquisition Regulation (FAR) and GSA policies and procedures for conducting responsibility determinations on prospective contractors, including specific guidance on responsibility determinations and periodic reviews focusing on the quality of contract awards. We discussed acquisition policies and procedures used to award contracts with officials from the Office of Chief Acquisition, FSS, FTS, and PBS. As part of these discussions, we asked whether contracting officers specifically consider tax debts or perform background investigations to determine whether a prospective contractor is a responsible source before the contract is awarded. We also discussed with GSA officials whether any review is performed by the contracting officer at the option to extend the contract. Additionally, we interviewed an official from GSA's Kansas City Credit and Finance Center to determine how the center makes financial determination recommendations and the role, if any, that tax debts have on that recommendation.

To obtain an understanding of what steps other federal agencies take to screen GSA supply schedule contractors for tax debts or other criminal activities, we interviewed procurement agency officials at selected civilian agencies (including the National Aeronautics and Space Administration and the departments of Justice, State, and Veterans Affairs). We selected these agencies based on a number of criteria, including national security concerns and amount of payments to contractors, especially those with tax debts. As part of these discussions, we determined the level of reliance agencies placed on GSA's contractor qualification determinations in awarding contracts, even for sensitive contracts such as security, to contractors that have been approved by GSA as responsible sources.

[4] We define related entities as entities that share common owner(s) or officer(s), a common TIN, or a common address.

We conducted our audit work from June 2005 through January 2006 in accordance with U.S. generally accepted government auditing standards, and we performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Data Reliability Assessment

For the IRS unpaid assessments data, we relied on the work we performed during our annual audits of IRS's financial statements. While our financial statement audits have identified some data reliability problems associated with the coding of some of the fields in IRS's tax records, including errors and delays in recording taxpayer information and payments, we determined that the data was sufficiently reliable to address this report's objectives. Our financial audit procedures, including the reconciliation of the value of unpaid taxes recorded in IRS's masterfile to IRS's general ledger, identified no material differences.

For Payments, Claims, and Enhanced Reconciliation (PACER) database, we interviewed FMS officials responsible for the database and reviewed documentation provided by FMS supporting quality reviews on its databases. In addition, we performed electronic testing of specific data elements in the database that we used to perform our work.

To help ensure reliability of GSA-provided data, we interviewed GSA officials concerning the reliability of the data provided to us. In addition, we performed electronic testing of specific data elements in the databases that we used to perform our work and performed other procedures to ensure the completeness of the contract data provided by GSA. We also reviewed the results of the GSA Inspector General's audit of the system's internal controls completed in support of GSA's fiscal year 2004 consolidated and combined financial statements.

Based on our discussions with agency officials, review of agency documents, and our own testing, we concluded that the data elements used for this testimony were sufficiently reliable for our purposes.

Appendix II: Background

As the federal government's principal business agent, General Services Administration's (GSA) activities and programs are diverse and have governmentwide implications. Through its supply schedules and governmentwide acquisition contracts, GSA arranges for federal agencies to purchase billions of dollars of goods and services directly from private vendors. In addition, its telecommunication and computer services and real estate activities involve huge sums of money and extensive interaction with the private sector.

GSA provides goods and services and develops policy through a network of 11 regional offices and a central office in Washington, D.C. GSA's programs are generally run by its three service components—Federal Supply Service (FSS), Federal Technology Service (FTS), and Public Buildings Service (PBS).[1]

FSS assists federal agencies in acquiring a full range of products—including over 4 million commonly used commercial items, ranging from furniture, computers, tools, equipment, and motor vehicles. FSS also supports agencies in acquiring services, such as professional consulting, travel, transportation, and property management. FSS has followed a self-service business model, using contracts, called supply schedule contracts, that are designed to be flexible, simple to use, and consistent with commercial buying practices. FSS negotiates master contracts with vendors, seeking discounts off commercial list prices that are at least as favorable as the discounts offered to those vendors' most favored customers. Federal agencies can then use these supply schedule contracts to issue task orders from which goods and services are acquired.

FTS provides customers with telecommunications products and services—voice, data, and video—and a full range of IT products and services. Unlike FSS, FTS has followed a full-service business model, providing assisted procurement services to help agencies define and fill their IT and telecommunications requirements. FTS is a major user of the FSS supply schedule contracts as well as a range of contract vehicles FTS and other federal agencies have awarded—commonly known as governmentwide acquisition contracts.

[1] GSA is in the process of merging FSS and FTS into a new service component called Federal Acquisition Service.

PBS is the primary property manager for the federal government, utilizing government buildings and privately owned leased facilities.[2] In order to meet the office space needs for federal agencies, GSA hires and manages private sector professionals, such as architects, engineers, and contractors to design, renovate, and construct federal buildings. In addition, GSA leases space in cities and small towns when leasing is the practical answer to meeting federal space needs.

From a financing standpoint, GSA is unusual among federal agencies in that most of its funding does not come from direct appropriations from Congress. Instead, GSA's funding comes from fees GSA charges agencies for the goods and services provided and the rents from its buildings. As such, GSA must encourage other agencies to acquire goods and services from the contracts GSA has awarded to help cover its operating costs. In fiscal year 2004, GSA reported revenues of approximately $20 billion to cover the costs of its operations.

[2] Over 30 other executive branch agencies, including DOD and the departments of State, Veterans Affairs, and Transportation, have some level of authority to purchase, own, or lease office space or buildings.

Appendix III: Contractors with Unpaid Taxes

Table 1 in the main portion of this testimony provides data on 10 detailed case studies. Table 2 shows the remaining case studies that we audited and investigated. As with the 10 cases discussed in the body of this testimony, we also found substantial abuse or potentially criminal activity related to the federal tax system during our review of these 15 case studies. The case studies involving businesses with employees primarily involved unpaid payroll taxes. Several of the companies negotiated an installment or repayment agreement with the Internal Revenue Service (IRS) but subsequently defaulted on that agreement.

Table 2: GSA Contractors with Unpaid Federal Taxes

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
11	Commercial research	At least $100,000	Nearly $400,000	• Company repeatedly underpaid its payroll taxes since the 1990s and owes payroll tax debt for more than 15 tax periods. • Company diverted payroll taxes to fund business. • Company negotiating offer in compromise with IRS. • Owner owns a million dollar home. • Multiple state tax liens totaling more than $50,000 filed against the company.
12	Management consulting services	At least $1 million	Nearly $200,000	• Company in active repayment agreement with IRS. • Company awarded grants by Department of Housing and Urban Development.
13	Financial Related Services	Up to $100,000	Over $1 million	• Company tax debts cover more than 10 tax periods beginning in the 1990s. • Tax debt is primarily unpaid payroll taxes.
14	Web site development services	At least $100,000	Over $200,000	• Company sporadically made payroll tax payments in the early 2000s. • Company negotiated installment agreement in 2000s but subsequently defaulted on the agreement within the next year.
15	Information technology services	At least $100,000	Over $2 million	• Tax debt is unpaid payroll taxes covering nearly 15 tax periods. • The company is a chronic nonfiler of payroll taxes and repeatedly fails to remit payroll tax deposits. • IRS initiated litigation against company.
16	Data processing services	At least $1 million	Over $100,000	• Tax debt is unpaid payroll taxes covering about 10 tax periods. • Company attempted to establish installment agreement after offer in compromise for about $50,000 was rejected by IRS. • IRS assessed a Trust Fund Recovery Penalty against owner.

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
17	Elevator services	Up to $100,000	Over $800,000	• Company repeatedly underpaid its payroll taxes since the early 2000s. • Company entered into installment agreement with the IRS but subsequently defaulted. • IRS assessed owner Trust Fund Recovery Penalties of more than $300,000 for willful failure to pay payroll taxes. • Multiple state and local tax liens totaling more than $200,000 filed against the company.
18	Security services	At least $1 million	Over $2 million	• Company negotiated installment agreement with IRS but frequently late in payments. • Bank closed company's checking account because of suspected check kiting. • Owner owns million-dollar lakeside residence. • Multiple federal and state tax liens totaling over $2 million filed against the company since early 2000s.
19	Facilities management services	At least $1 million	Over $500,000	• Business affiliated with one other related entity with over $500,000 in unpaid taxes. • Tax debt largely consists of payroll taxes. • Company negotiated installment agreement with IRS in 2000s but defaulted on agreement the following year. • Owner leasing a luxury vehicle.
20	Manufacturing fixtures	At least $1 million	Over $100,000	• Owner owns commercial property worth nearly $2 million. • IRS assessed a Trust Fund Recovery Penalty against owner for willful failure to pay payroll taxes. • Multiple state and county tax liens filed against the company.
21	Computer consulting services	Up to $100,000	Over $100,000	• The company has not remitted payroll taxes or filed payroll tax returns to the IRS since early 2000s. • IRS reported company's tax debts to Treasury for continuous levy on federal contractor payments.
22	Security services	Up to $100,000	Over $3 million	• Tax debt is primarily unpaid payroll taxes covering nearly 15 tax periods. • Company attempted offer in compromise but was rejected by IRS. • Owner owned commercial properties and a yacht.
23	Communication equipment	Up to $100,000	Nearly $900,000	• Tax debt is primarily unpaid payroll taxes from the 1990s. • Company offered IRS to settle debt for about a third of what it owed, but IRS rejected the compromise offer. • Owner convicted of money laundering. • Multiple state tax liens filed against company totaling over $100,000.

Case study	Nature of work	Contract payments from October 2003 to June 2005	Unpaid federal tax	Comments
24	Computer processing services	At least $100,000	Over $1.7 million	• Company and IRS agreed to compromise debt in 2000s for about half of what it owed but the company defaulted on the agreement (no payments were made). • Company has not filed payroll tax returns subsequent to compromise agreement. • IRS assessed trust fund recovery penalty on owner for willful failure to remit payroll taxes. • Company officer was arrested for assault.
25	Human resources services	At least $100,000	Over $100,000	• Company affiliated with one other related entity that owed about $100 thousand in payroll taxes. • Company negotiated installment agreement in early 2000s but subsequently defaulted. • Company went out of business in 2000s. • Owner owns commercial property worth over $1 million, multiple residential properties, and a boat.

Source: GAO's analysis of IRS, FMS, GSA, public, and other records.

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