

Testimony

Before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate

For Release on Delivery Expected at 9:30 a.m. EST Thursday, February 12, 2004

FINANCIAL MANAGEMENT

Some DOD Contractors Abuse the Federal Tax System with Little Consequence

Statement of

Gregory D. Kutz Director, Financial Management and Assurance

Steven J. Sebastian Director, Financial Management and Assurance

John J. Ryan Assistant Director, Office of Special Investigations





Highlights of GAO-04-414T, a testimony before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate

Why GAO Did This Study

GAO addressed issues related to three high-risk areas including the Department of Defense (DOD) and the Internal Revenue Service (IRS) financial management and IRS collection of unpaid taxes. This testimony provides a perspective on (1) the magnitude of unpaid federal taxes owed by DOD contractors, (2) whether indications exist of abuse or criminal activity by DOD contractors related to the federal tax system, (3) whether DOD and IRS have effective processes and controls in place to use the Treasury Offset Program (TOP) in collecting unpaid federal taxes from DOD contractors, and (4) whether DOD contractors with unpaid taxes are prohibited by law from receiving federal contracts.

In a companion report issued today, GAO made recommendations to DOD for complying with statutory guidance and supporting IRS efforts in collecting unpaid taxes, to IRS for improving the effectiveness of collection activities, and to the Office of Management and Budget (OMB) to develop options for prohibiting awards to contractors that abuse the tax system. DOD and IRS partially agreed; OMB did not agree. DOD and OMB also did not agree with GAO's matters for congressional consideration that DOD report on its collections through TOP, and OMB report on policy options developed for contractors that abuse the tax system. GAO reiterated support for its recommendations as well as its suggestions to Congress.

www.gao.gov/cgi-bin/getrpt?GAO-04-414T

To view the full product, click on the link above. For more information, contact Gregory D. Kutz at (202) 512-9095 or kutzg@gao.gov, or Steven J. Sebastian at (202) 512-3406.

FINANCIAL MANAGEMENT

Some DOD Contractors Abuse the Federal Tax System with Little Consequence

What GAO Found

DOD and IRS records showed that over 27,000 contractors owed about \$3 billion in unpaid taxes as of September 30, 2002. DOD has not fully implemented provisions of the Debt Collection Improvement Act of 1996 that would assist IRS in levying up to 15 percent of each contract payment to offset a DOD contractor's federal tax debt. We estimate that DOD could have collected at least \$100 million in fiscal year 2002 had it and IRS fully utilized the levy process authorized by the Taxpayer Relief Act of 1997. As of September 2003, DOD had collected only about \$687,000 in part because DOD provides contractor payment information from only 1 of its 16 payment systems to TOP. In response to our draft report, DOD developed a schedule to provide payment information to TOP for all of its additional payment systems by March 2005.

Furthermore, we found abusive or potentially criminal activity related to the federal tax system through our audit and investigation of 47 DOD contractor case studies. The 47 contractors provided a variety of goods and services, including building maintenance, catering, dentistry, funeral services, and parts or support for weapons and other sensitive military programs. The businesses in these case studies owed primarily payroll taxes with some dating back to the early 1990s. These payroll taxes included amounts withheld from employee wages for Social Security, Medicare, and individual income taxes. However, rather than fulfill their role as "trustees" and forward these amounts to IRS, these DOD contractors diverted the money for personal gain or to fund the business.

For example, owners of two businesses each borrowed nearly \$1 million from their companies and, at about the same time, did not remit millions of dollars in payroll taxes. One owner bought a boat, several cars, and a home outside the United States. The other paid over \$1 million for a furnished home. Both contractors received DOD payments during fiscal year 2002, but one went out of business in 2003. The business, however, transferred its employees to a relative's company (also with unpaid taxes) and recently received payments on a previous contract.

IRS's continuing challenges in collecting unpaid federal taxes also contributed to the problem. In several case studies, IRS was not pursuing DOD contractors due to resource and workload management constraints. For other cases, control breakdowns resulted in IRS freezing collection activity for reasons that were no longer applicable. Federal law does not prohibit contractors with unpaid federal taxes from receiving federal contracts. OMB is responsible for providing overall direction to governmentwide procurement policies, regulations, and procedures, and is in the best position to develop policy options for prohibiting federal contracts to contractors that abuse the tax system.

Mr. Chairman, Members of the Subcommittee, and Representative Schakowsky:

Thank you for the opportunity to discuss payments to Department of Defense (DOD) contractors that abuse the federal tax system. Our related report, released today and developed at the request of this Subcommittee and Representative Schakowsky, addresses issues related to three high-risk areas: DOD and Internal Revenue Service (IRS) financial management and IRS collection of unpaid taxes. Since 1990, we have periodically reported on federal programs and operations that are high risk due to their greater vulnerabilities to fraud, waste, and abuse. As a result of the fraud and abuse identified in our series of testimonies and reports on DOD's purchase card program, you requested more comprehensive audits and investigations of controls over payments to DOD contractors.

DOD and IRS face a variety of high-risk challenges. Of the 26 areas on our governmentwide "high risk" list, 6 are DOD program areas, and the department shares responsibility for 3 other high-risk areas that are governmentwide in scope. Financial management, 1 of the 6 DOD program high-risk areas, has weaknesses, including nonintegrated and proliferating financial management systems, and fundamental flaws in the overall control environment. As we have documented in numerous reports, DOD's financial management problems leave it highly vulnerable to fraud, waste, and abuse. IRS high-risk areas include financial management weaknesses and difficulties in collecting unpaid taxes. Both areas continue to expose the federal government to significant losses of tax revenue and disproportionately increase the burden on compliant taxpayers to fund government activities.

Today, we will summarize our work on DOD payments to contractors that abuse the federal tax system. Our testimony will provide a perspective on (1) the magnitude of unpaid federal taxes owed by DOD contractors,

- (2) whether DOD and IRS have effective processes and controls in place to use the Treasury Offset Program (TOP) and Federal Payment Levy Program (FPLP) in collecting unpaid federal taxes from DOD contractors,
- (3) whether indications exist of abuse or criminal activity by DOD contractors related to the federal tax system, and (4) whether DOD

Page 1 GAO-04-414T

¹U.S. General Accounting Office, Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence, GAO-04-95 (Washington, D.C.: Feb. 12, 2004).

contractors with unpaid federal taxes are prohibited by law from receiving federal contracts.

Summary

The federal government will continue to miss opportunities to collect on hundreds of millions of dollars in unpaid federal taxes owed by DOD contractors until DOD begins to fulfill its responsibilities under the Debt Collection Improvement Act of 1996 (DCIA) by fully assisting IRS in its attempts to levy DOD contractor payments, and IRS fully utilizes its authority under FPLP. Based on DOD and IRS records, over 27,000 contractors registered in DOD's automated registration system had nearly \$3 billion in unpaid federal taxes as of September 30, 2002. DOD contractors receiving fiscal year 2002 payments from five of the largest Defense Finance and Accounting Service (DFAS) contract and vendor payment systems owed at least \$1.7 billion of this nearly \$3 billion.

As the largest purchaser of goods and services in the federal government, DOD payments to contractors totaled about \$183 billion in fiscal year 2002. We estimate that DOD, which functions as its own disbursing agent, could have offset payments and collected at least \$100 million in unpaid taxes in fiscal year 2002 if it had fully assisted IRS in effectively levying contractor payments. However, in the 6 years since passage of the Taxpayer Relief Act of 1997, DOD has collected only about \$687,000. DOD recently implemented a TOP payment reporting process for its contract payment system, which disbursed over \$86 billion to contractors in fiscal year 2002. However, DOD did not have formal plans or a schedule at the completion of our work for reporting payment information from its 15 vendor payment systems, which disbursed another \$97 billion to contractors in fiscal year 2002. In response to our draft report, DOD developed a schedule to provide payment information to TOP for all of its additional payment systems by March 2005. DOD did not have an organizational structure in place to implement a TOP reporting process at the remaining payment systems.

IRS faces a number of high-risk challenges. Due to resource and workload management constraints, IRS established policies that either exclude or delay putting a significant number of cases into the levy program. In addition to policy constraints, inaccurate or outdated information in IRS

Page 2 GAO-04-414T

 $^{^2}$ The act enhanced IRS's ability to collect unpaid federal taxes by authorizing IRS to continuously levy up to 15 percent of certain federal payments made to businesses and individuals.

systems prevent cases from entering the levy program. Our review of IRS collection efforts against DOD contractors selected for audit and investigation indicated that IRS attempts to work with the businesses and individuals to achieve voluntary compliance, pursuing enforcement actions such as levies of federal contract payments later rather than earlier in the collection process. For many of our case study contractors, this resulted in businesses and individuals continuing to receive federal contract payments without making any payments on their unpaid federal taxes.

We also found numerous instances of abusive or potentially criminal activity related to the federal tax system during our audit and investigation of 47 DOD contractor case studies. The 34 case studies involving businesses³ with employees had primarily unpaid payroll taxes, some dating to the early 1990s and some for as many as 62 tax periods.⁴ These payroll taxes included amounts withheld from employees for Social Security, Medicare, and individual income taxes. However, rather than fulfill their role as "trustees" and forward these amounts to IRS, these DOD contractors diverted the money for personal gain or to fund their businesses. The other 13 case studies involved individuals who had unpaid income taxes dating as far back as the 1980s. Several contractors in our study provided parts or services supporting weapons and other sensitive military programs.

Federal law does not prohibit a contractor with unpaid federal taxes from receiving contracts from the federal government. DOD contract awards of nearly \$165 billion represented nearly two-thirds of the federal government's contracting activity during fiscal year 2002. The criteria calling for federal agencies to do business only with responsible contractors do not require contracting officers to consider a contractor's tax noncompliance, unless the contractor has been suspended or debarred

Page 3 GAO-04-414T

³ A tax identification number (TIN) is a unique nine-digit identifier assigned to each business and individual that files a tax return. For businesses, the employer identification number (EIN) assigned by IRS serves as the TIN. For individuals, the Social Security number (SSN) assigned by the Social Security Administration serves as the TIN. Contractors register their TINs in the CCR database in either the TIN/EIN field or the SSN field. In our report, a contractor completing the TIN/EIN field is referred to as a business, while a contractor completing the SSN field is referred to as an individual.

⁴ A "tax period" varies by tax type. For example, the tax period for payroll and excise taxes is 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.

for tax evasion as explained later in our statement. Presently, the federal government has no coordinated process for identifying and determining the businesses and individuals that abuse the federal tax system and for conveying that information to contracting officers for use before awarding contracts.

As discussed in the report released today, we made recommendations to DOD for complying with DCIA and supporting IRS efforts under the Taxpayer Relief Act of 1997 in collecting unpaid taxes, to IRS for improving the effectiveness of collection activities, and to the Office of Management and Budget (OMB) to develop options for prohibiting federal contract awards to businesses and individuals that abuse the federal tax system. DOD and IRS partially agreed, and OMB did not agree with our recommendations. DOD and OMB also did not agree with our matters for congressional consideration that DOD report on its collections through the TOP, and OMB report on policy options developed and actions taken against contractors that abuse the federal tax system. We reiterated support for our recommendations as well as our suggestions to Congress.

DOD Contractors Owe Billions in Unpaid Federal Taxes

The nearly \$3 billion in unpaid federal taxes owed by over 27,000 contractors registered in DOD's Central Contractor Registration system (CCR) represented almost 14 percent of the registered contractors as of February 2003. In addition, DOD contractors receiving fiscal year 2002 payments from five of the largest DFAS contract and vendor payment systems represented at least \$1.7 billion of the nearly \$3 billion in unpaid federal taxes shown on IRS records. Data reliability issues with respect to DOD and IRS records prevented us from identifying an exact amount of unpaid federal taxes. Consequently, the total amount of unpaid federal taxes owed by DOD contractors is not known.

The type of unpaid taxes owed by these DOD contractors varied and consisted of payroll, corporate income, excise, unemployment, individual income, and other types of taxes. Unpaid payroll taxes include amounts that a business withholds from an employee's wages for federal income taxes, Social Security, Medicare, and the related matching contributions of the employer for Social Security and Medicare. As shown in figure 1, about 42 percent of the total tax amount owed by DOD contractors was for unpaid payroll taxes.

Page 4 GAO-04-414T

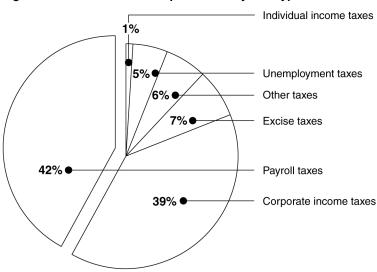


Figure 1: DOD Contractor Unpaid Taxes by Tax Type

Source: GAO analysis of DOD and IRS records.

Employers are subject to civil and criminal penalties if they do not remit payroll taxes to the federal government. When an employer withholds taxes from an employee's wages, the employer is deemed to have a responsibility to hold these amounts "in trust" for the federal government until the employer makes a federal tax deposit in that amount. To the extent these withheld amounts are not forwarded to the federal government, the employer is liable for these amounts, as well as the employer's matching Federal Insurance Contribution Act contributions for Social Security and Medicare. Individuals within the business (e.g., corporate officers) may be held personally liable for the withheld amounts not forwarded and assessed a civil monetary penalty known as a trust fund recovery penalty (TFRP). Failure to remit payroll taxes can also be a criminal felony offense punishable by imprisonment of more than a year, while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense punishable by imprisonment of up to a year.

Page 5 GAO-04-414T

The law imposes no penalties upon an employee for the employer's failure to remit payroll taxes since the employer is responsible for submitting the amounts withheld. The Social Security and Medicare trust funds are subsidized or made whole for unpaid payroll taxes by the general fund, as we discussed in a previous report.⁵ Over time, the amount of this subsidy is significant. As of September 1998, the estimated cumulative amount of unpaid taxes and associated interest for which the Social Security and Medicare trust funds were subsidized by the general fund was approximately \$38 billion.

A substantial amount of the unpaid federal taxes shown in IRS records as owed by DOD contractors had been outstanding for several years. As reflected in figure 2, 78 percent of the nearly \$3 billion in unpaid taxes was over a year old as of September 30, 2002, and 52 percent of the unpaid taxes was for tax periods prior to September 30, 1999.

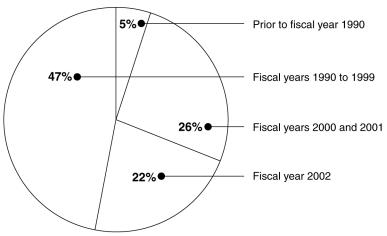


Figure 2: DOD Contractor Unpaid Taxes by Fiscal Year

Source: GAO analysis of DOD and IRS records.

Page 6 GAO-04-414T

⁵ U.S. General Accounting Office, *Unpaid Payroll Taxes: Billions in Delinquent Taxes and Penalty Assessments Are Owed*, GAO/AIMD/GGD-99-211 (Washington, D.C.: Aug. 2, 1999).

Our previous work⁶ has shown that as unpaid taxes age, the likelihood of collecting all or a portion of the amount owed decreases. This is due, in part, to the continued accrual of interest and penalties on the outstanding tax debt, which, over time, can dwarf the original tax obligation.

DOD and IRS Are Not Collecting Millions in Unpaid Federal Taxes from Contractors

Until DOD establishes processes to provide information from all payment systems to TOP, the federal government will continue missing opportunities to collect hundreds of millions of dollars in tax debt owed by DOD contractors. Additionally, IRS's current implementation strategy appears to make the levy program one of the last collection tools IRS uses. Changing the IRS collection program to (1) remove the policies that work to unnecessarily exclude cases from entering the levy program and (2) promote the use of the levy program to make it one of the first collection tools could allow IRS—and the government—to reap the advantages of the program earlier in the collection process.

DOD Is Not Fully Assisting in the Collection of Unpaid Taxes Owed by Its Contractors We estimate that DOD, which functions as its own disbursing agent, could have offset payments and collected at least \$100 million in unpaid taxes in fiscal year 2002 if it and IRS had worked together to effectively levy contractor payments. However, in the 6 years since the passage of the Taxpayer Relief Act of 1997, DOD has collected only about \$687,000. DOD collections to date relate to DFAS payment reporting associated with implementation of the TOP process in December 2002 for its contract payment system, which disbursed over \$86 billion to DOD contractors in fiscal year 2002.

Page 7 GAO-04-414T

⁶ U.S. General Accounting Office, Internal Revenue Service: Recommendations to Improve Financial and Operational Management, GAO-01-42 (Washington, D.C.: Nov. 17, 2000); Internal Revenue Service: Composition and Collectibility of Unpaid Assessments, GAO/AIMD-99-12 (Washington, D.C.: Oct. 29, 1998); and GAO/AIMD/GGD-99-211.

⁷ Mechanization of Contract Administration Services (MOCAS).

Although it has been more than 7 years since the passage of DCIA, 8 DOD has not fully assisted IRS in using its continuous levy authority for the collection of unpaid taxes by providing Treasury's Financial Management Service (FMS) with all DFAS payment information. IRS's continuous levy authority authorizes the agency to collect federal tax debts of businesses and individuals that receive federal payments by levying up to 15 percent of each payment until the debt is paid. Under TOP, FMS matches a database of debtors (including those with federal tax debt) to certain federal payments (including payments to DOD contractors). When a match occurs, the payment is intercepted, the levied amount is sent to IRS, and the balance of the payment is sent to the debtor. All disbursing agencies are to compare their payment records with the TOP database. Since DOD has its own disbursing authority, once DFAS is notified by FMS of the amount to be levied, DOD should deduct this amount from the contractor payment before it is made to the payee and forward the levied amount to the Department of the Treasury as described in figure 3.

Page 8 GAO-04-414T

⁸ Congress passed DCIA to maximize the collection of delinquent nontax debts owed to federal agencies. Under the regulations implementing DCIA, disbursing agencies, including DOD and others that independently disburse rather than having it done on their behalf by FMS, are required to compare their payment records with the TOP database. If a match occurs, the disbursing agency must offset the payment, thereby reducing or eliminating the nontax debt.

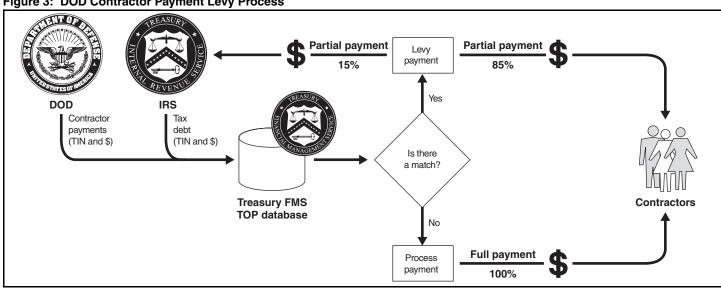


Figure 3: DOD Contractor Payment Levy Process

Source: GAO.

The TOP database includes federal tax and nontax debt, state tax debt, and child support debt. By fully participating in the TOP process, DOD will also aid in the collection of other debts, such as child support and federal nontax debt (e.g., student loans).

At the completion of our work, DOD had no formal plans or schedule to begin providing payment information from any of its 15 vendor payment systems to FMS for comparison with the TOP database. These 15 decentralized payment systems disbursed almost \$97 billion to DOD contractors from 22 different payment locations in fiscal year 2002. In response to our draft report, DOD developed a schedule to provide payment information to TOP for all of its additional payment systems by March 2005. As we have previously reported, DOD's business systems environment is stovepiped and not well integrated. DOD recently reported that its current business operations were supported by approximately 2,300 systems in operation or under development, and requested approximately

GAO-04-414T Page 9

⁹ U.S. General Accounting Office, DOD Business Systems Modernization: Continued Investment in Key Accounting Systems Needs to Be Justified, GAO-03-465 (Washington, D.C.: Mar. 28, 2003); DOD Business Systems Modernization: Important Progress Made to Develop Business Enterprise Architecture, but Much Work Remains, GAO-03-1018 (Washington, D.C.: Sept. 19, 2003).

\$18 billion in fiscal year 2003 for the operation, maintenance, and modernization of DOD business systems. In addition, DFAS did not have an organizational structure in place to implement the TOP payment reporting process. DOD recently communicated a timetable for implementing TOP reporting for its vendor payment systems with completion targeted for March 2005.

IRS Policies Exclude Cases from the Levy Program

IRS's continuing challenges in pursuing and collecting unpaid taxes also hinder the government's ability to take full advantage of the levy program. For example, due to resource constraints, IRS has established policies that either exclude or delay referral of a significant number of cases to the program. Also, the IRS review process for taxpayer requests, such as installment agreements or certain offers in compromise which IRS is legally required to consider, often takes many months, during which time IRS excludes these cases from the levy program. In addition, inaccurate or outdated information in IRS systems prevents cases from entering the levy program. Our audit and investigation of 47 case studies also showed IRS continuing to work with businesses and individuals to achieve voluntary compliance, and taking enforcement actions such as levies of federal contractor payments later in the collection process. We recently recommended that IRS study the feasibility of submitting all eligible unpaid federal tax accounts to FMS on an ongoing basis for matching against federal payment records under the levy program, and use information from any matches to assist IRS in determining the most efficient method of collecting unpaid taxes, including whether to use the levy program. ¹⁰ The study was not completed at the time of our audit. In earlier reviews, 11 we estimated IRS could use the levy program to potentially recover hundreds of millions of dollars in tax debt.

Although the levy program could provide a highly effective and efficient method of collecting unpaid taxes from contractors that receive federal payments, IRS policies restrict the number of cases that enter the program and the point in the collection process they enter the program. For each of

Page 10 GAO-04-414T

¹⁰ U.S. General Accounting Office, *Tax Administration: Federal Payment Levy Program Measure, Performance, and Equity Can Be Improved*, GAO-03-356 (Washington, D.C.: Mar. 6, 2003).

¹¹ U.S. General Accounting Office, *Tax Administration: IRS' Levy of Federal Payments Could Generate Millions of Dollars*, GAO/GGD-00-65 (Washington, D.C.: Apr. 7, 2000), GAO-03-356, and GAO-01-711.

the collection phases listed below, IRS policy either excludes or severely delays putting cases into the levy program.

- **Phase 1:** Notify taxpayer of unpaid taxes, including a demand for payment letter.
- **Phase 2:** Place the case into the Automated Collection System (ACS) process. The ACS process consists primarily of telephone calls to the taxpayer to arrange for payment.
- **Phase 3:** Move the case into a queue of cases awaiting assignment to a field collection revenue officer.
- **Phase 4:** Assign the case to field collections where a revenue officer attempts face-to-face contact and collection.

As of September 30, 2002, IRS listed \$81 billion of cases in these four phases: 17 percent were in notice status, 17 percent were in ACS, 26 percent were in field collection, and 40 percent were in the queue awaiting assignment to the field. At the same time these four phases take place, sometimes over the course of years, DOD contractors with unpaid taxes continue to receive billions of dollars in contract payments. IRS excludes cases in the notification phase from the levy program to ensure proper notification rules are followed. However, as we previously reported, once proper notification has been completed, IRS continues to delay or exclude from the levy program those accounts placed in the other three phases. 12 IRS policy is to exclude accounts in the ACS phase primarily because officials believed they lack the resources to issue levy notices and respond to the potential increase in telephone calls from taxpayers responding to the notices. Additionally, IRS excludes the majority of cases in the queue phase (awaiting assignment to field collection) from the levy program for 1 year. Only after cases await assignment for over a year does IRS allow them to enter the levy program. Finally, IRS excludes most accounts from the levy program once they are assigned to field collection because revenue officers said that the levy action could interfere with their successfully contacting taxpayers and resolving the unpaid taxes.

These policy decisions, which may be justified in some cases, result in IRS excluding millions of cases from potential levy. IRS officials that work on

Page 11 GAO-04-414T

¹² GAO-03-356.

ACS and field collection inventories can manually unblock individual cases they are working in order to put them in the levy program. However, by excluding cases in the ACS and field collection phases, IRS records indicate it excluded as much as \$34 billion of cases from the levy program as of September 30, 2002. In January 2003, IRS unblocked and made available for levy those accounts identified as receiving federal salary or annuity payments. However, other accounts remain blocked from the levy program. IRS stated that it intended to unblock a portion of the remaining accounts sometime in 2005. Additionally, \$32 billion of cases are in the queue, and thus under existing policy would be excluded from the levy program for the first year each case is in that phase. IRS policies, along with its inability to more actively pursue collections, both of which IRS has in the past attributed to resource constraints, combine to prevent many cases from entering the levy program. Since IRS has a statutory limitation on the length of time it can pursue unpaid taxes, generally limited to 10 years from the date of the assessment, these long delays greatly decrease the potential for IRS to collect the unpaid taxes.

We identified specific examples of IRS not actively pursuing collection in our review of 47 selected cases involving DOD contractors. In one case, IRS cited resource and workload management considerations. IRS is not currently seeking collection of about \$14.9 billion of unpaid taxes citing these considerations—about 5 percent of its overall inventory of unpaid assessments as of September 30, 2002. In another case, IRS cited financial hardship where the taxpayer was unable to pay. This puts collection activities on hold until the taxpayer's adjusted gross income (per subsequent tax return filings) exceeds a certain threshold. Some cases repeatedly entered the queue awaiting assignment to a field collection revenue officer and remained there for long periods.

IRS Delays in Processing and Inaccurate Records Exclude Cases from the Levy Program In addition to excluding cases for various operational and policy reasons as described above, IRS excludes cases from the levy program for particular taxpayer events such as bankruptcy, litigation, or financial hardship, as well as when taxpayers apply for an installment agreement or an offer in compromise. When one of these events take place, IRS enters a code in its automated system that excludes the case from entering the levy program. Although these actions are appropriate, IRS may lose opportunities to collect through the levy program if the processing of agreements is not timely or prompt action is not taken to cancel the exclusion when the event, such as a dismissed bankruptcy petition, is concluded.

Page 12 GAO-04-414T

Delays in processing taxpayer documents and errors in taxpayer records are long-standing problems at IRS and can harm both government interests and the taxpayer. Our review of cases involving DOD contractors with unpaid federal taxes indicates that problems persist in the timeliness of processing taxpayer applications and in the accuracy of IRS records. For example, we identified a number of cases in which the processing of DOD contractor applications for an offer in compromise or an installment agreement was delayed for long periods, thus blocking the cases from the levy program and potentially reducing government collections. We also found that inaccurate coding at times prevented both IRS collection action and cases from entering the levy program. For example, if these blocking codes remain in the system for long periods, either because IRS delays processing taxpayer agreements or because IRS fails to input or reverse codes after processing is complete, cases may be needlessly excluded from the levy program.

IRS Subordinates Use of the Levy Program to Other Collection Efforts

Although the nation's tax system is built upon voluntary compliance, when businesses and individuals fail to pay voluntarily, the government has a number of enforcement tools to compel compliance or elicit payment. Our review of DOD contractors with unpaid federal taxes indicates that although the levy program could be an effective, reliable collection tool, IRS is not using the program as a primary tool for collecting unpaid taxes from federal contractors. For the cases we audited and investigated, IRS subordinated the use of the levy program in favor of negotiating voluntary tax compliance with the DOD contractors, which often resulted in minimal or no actual collections.

DOD Contractors
Involved in Abusive or
Potentially Criminal
Activity Related to the
Federal Tax System

We selected for case study 47 businesses and individuals that had unpaid taxes and were receiving DOD contractor payments in fiscal year 2002. For all 47 cases that we audited and investigated, we found abusive or potentially criminal activity related to the federal tax system. Thirty-four of these case studies involved businesses with employees that had unpaid payroll taxes dating as far back as the early 1990s, some for as many as 62 tax periods. However, rather than fulfill their role as "trustees" of this money and forward it to IRS, these DOD contractors diverted the money for other purposes. The other 13 case studies involved individuals that had unpaid income taxes dating as far back as the 1980s. We are referring the 47 cases detailed in our related report to IRS for evaluation and additional collection action or criminal investigation.

Page 13 GAO-04-414T

Examples of Abusive or Potentially Criminal Activity Related to the Federal Tax System by Businesses Our audit and investigation of the 34 case study business contractors showed substantial abuse or potential criminal activity as all had unpaid payroll taxes and all diverted funds for personal or business use. In table 1, and on the following pages, we highlight 13 of these businesses and estimate the amounts that could have been collected through the levy program based on fiscal year 2002 DOD payments. For these 13 cases, the businesses owed unpaid taxes for a range of 6 to 30 quarters (tax periods). Eleven of these cases involved businesses that had unpaid taxes in excess of 10 tax periods, and 5 of these were in excess of 20 tax periods. The amount of unpaid taxes associated with these 13 cases ranged from about \$150,000 to nearly \$10 million; 7 businesses owed in excess of \$1 million. In these 13 cases, we saw some cases where IRS filed tax liens on property and bank accounts of the businesses, and a few cases where IRS collected minor amounts through the levying of non-DOD federal payments. We also saw 1 case in which the business applied for an offer in compromise, which IRS rejected on the grounds that the business had the financial resources to pay the outstanding taxes in their entirety, and 2 cases in which the businesses entered into, and subsequently defaulted on, installment agreements to pay the outstanding taxes. In 5 of the 13 cases, IRS assessed the owners or business officers with TFRPs, yet no collections were received from these penalty assessments.

Page 14 GAO-04-414T

Table 1: DOD Contractors with Unpaid Federal Taxes—Business

Case study	Goods or service and nature of DOD work	Unpaid federal tax amount ^a	Estimated fiscal year 2002 collections under effective tax levy ^b	Fiscal year 2002 DOD payments ^c	Comments
1	Base support and custodial services: provides dining, trash removal, security, cleaning, and recycling programs on military bases	Nearly \$10 million	\$527,000	\$3.5 million	State tax authorities levied the business bank account. The owner borrowed nearly \$1 million from the business. The owner bought a boat, several cars, and a home outside the United States. The business was dissolved in 2003 and transferred its employees to a relative's business, where it submitted invoices and received payments from DOD on a previous contract through August 2003.
2	Engineering research services: conducts studies for DOD	Over \$1 million	\$58,000	\$390,000	The owner paid \$1 million to purchase a house and furnishings in the mid-1990s. At around the same time, the owner borrowed nearly \$1 million from the business, and the business stopped paying its taxes in full. DOD awarded the business contracts totaling over \$600,000.
3	Aircraft-related goods: manufactures structural parts for DOD aircraft	Nearly \$2 million	\$50,000	\$336,000	The business received over 30 DOD contracts from 1997 through 2002 totaling nearly \$2 million.
4	Research services: provides research for DOD	Over \$700,000	\$13,000	\$86,000	DOD awarded the business a contract in 2002 for nearly \$800,000. Owner has over \$1 million in loans related to cars, real estate, and recreational activities, and owner also has a high-performance airplane.
5	Janitorial services: provides custodial services at a DOD facility	Over \$3 million	\$108,000	\$719,000	The business did not make tax payments after early 2001, and it made only partial payments prior to that dating back to the mid-1990s. The business also did not file corporate tax returns for 8 years.
6	Private security services: provides security guards at military bases	Nearly \$6 million	\$3,000	\$21,000	One of the business's officers, who owns a large boat, paid off a recreation-related loan in 1999. The business paid taxes while in bankruptcy, but largely stopped paying after emerging from bankruptcy.
7	Furniture sales and construction services: sells and installs office furniture at military installations	Over \$150,000	\$6,000	\$38,000	The owners used the business to pay personal expenses, such as house mortgage and credit cards. One owner is a retired military officer.
8	Custodial services: provides janitorial and housekeeping services at military installations	Over \$800,000	\$219,000	\$1.5 million	The business received numerous DOD contracts from 1998 through 2001 totaling nearly \$12 million. The business is linked to potential check fraud.

Page 15 GAO-04-414T

(Contin	(Continued From Previous Page)					
Case study	Goods or service and nature of DOD work	Unpaid federal tax amount ^a	Estimated fiscal year 2002 collections under effective tax levy ^b	Fiscal year 2002 DOD payments ^c	Comments	
9	Construction services: provides housing management services, including maintenance, repairs, and renovations, on military bases	Over \$1 million	\$357,000	\$2.4 million	The business owes DOD tens of thousands of dollars for an overpayment in early 2000.	
10	Base support services: provides landscaping and snow removal at a military base	Nearly \$1 million	\$33,000	\$217,000	The business was awarded contracts from 1999 through 2000 worth over \$1 million. The business owes taxes dating back to the early 1990s.	
11	Construction services: provides repairs to aircraft hangars at a military base	Over \$700,000	\$422,000	\$2.8 million		
12	Medical personnel services: provides nursing, pharmacy, physical therapy, and other skilled medical personnel in DOD facilities	Nearly \$6 million	\$698,000	\$4.7 million	Several federal and state tax liens have been placed against the owner.	
13	Aircraft-related goods: manufactures aircraft components for several DOD and civilian programs	Over \$400,000	\$29,000	\$194,000	The business was awarded numerous DOD contracts in a recent 4-year period totaling over \$300,000.	

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

Notes: Dollar amounts are rounded. The nature of unpaid taxes for businesses was primarily due to unpaid payroll taxes. A contractor registers in the CCR database with either an EIN or an SSN. In our report, any contractor registering with an EIN is referred to as a business, and any contractor registering with an SSN is referred to as an individual. An individual in CCR could be a business owner (i.e., sole proprietorship).

^aUnpaid tax amount as of September 30, 2002.

^bThe estimated collections under an effective tax levy use the assumptions that all unpaid federal taxes are referred to TOP at Treasury FMS and all fiscal year 2002 DOD payment information is provided to TOP. The collection amount is calculated on 15 percent of the payment amount up to the amount of unpaid taxes.

°DOD payments from MOCAS, One Bill Pay, Integrated Accounts Payable System (IAPS), Computerized Accounts Payable System (CAPS) Clipper, and CAPS Windows automated systems identified by GAO.

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

• Case # 1 - This base support contractor provided services such as trash removal, building cleaning, and security at U.S. military bases. The

Page 16 GAO-04-414T

business had revenues of over \$40 million in 1 year, with over 25 percent of this coming from federal agencies. This business's outstanding tax obligations consisted of unpaid payroll taxes. In addition, the contractor defaulted on an IRS installment agreement. IRS assessed a TFRP against the owner. The business reported that it paid the owner a six figure income and that the owner had borrowed nearly \$1 million from the business. The business also made a down payment for the owner's boat and bought several cars and a home outside the country. The owner allegedly has now relocated his cars and boat outside the United States. This contractor went out of business in 2003 after state tax authorities seized its bank account. The business transferred its employees to a relative's business, which also had unpaid federal taxes, and submitted invoices and received payments from DOD on a previous contract through August 2003.

- Case # 2 This engineering research contractor received nearly \$400,000 from DOD during 2002. At the time of our audit, the contractor had not remitted its payroll tax withholdings to the federal government since the late 1990s. In 1996, the owner bought a home and furnishings worth approximately \$1 million and borrowed nearly \$1 million from the business. The owner told our investigators that the payroll tax funds were used for other business purposes.
- Case # 3 This aircraft parts manufacturer did not pay payroll withholding and unemployment taxes for 19 of 20 periods through the mid- to late 1990s. IRS assessed a TFRP against several corporate officers, and placed the business in the FPLP in 2000. This business claims that its payroll taxes were not paid because the business had not received DOD contract payments; however, DOD records show that the business received over \$300,000 from DOD during 2002.
- Case # 5 This janitorial services contractor reported revenues of over \$3 million and had received over \$700,000 from DOD in a recent year. The tax problems of this business date back to the mid-1990s. At the time of our audit, the business had both unpaid payroll and unemployment taxes of nearly \$3 million. In addition, the business did not file its corporate tax returns for 8 years. IRS assessed a TFRP against the principal officer of the business in early 2002. This contractor employed two officers who had been previously assessed TFRPs related to another business.

Page 17 GAO-04-414T

- Case # 7 This furniture business reported gross revenues of over \$200,000 and was paid nearly \$40,000 by DOD in a recent year. The business had accumulated unpaid federal taxes of over \$100,000 at the time of our audit, primarily from unpaid employee payroll taxes. The business also did not file tax returns for several years, even after repeated notices from IRS. The owners made an offer to pay IRS a portion of the unpaid taxes through an offer in compromise, but IRS rejected the offer because it concluded that the business and its owners had the resources to pay the entire amount. At the time of our audit, IRS was considering assessing a TFRP against the owners to make them personally liable for the taxes the business owed. The owners used the business to pay their personal expenses, such as their home mortgage, utilities, and credit cards. The owners said they considered these payments a loan from the business. Under this arrangement, the owners were not reporting this company benefit as income so they were not paying income taxes, and the business was reporting inflated expenses.
- Case # 9 This family-owned and operated building contractor provided a variety of products and services to DOD, and DOD provided a substantial portion of the contractor's revenues. At the time of our review, the business had unpaid payroll taxes dating back several years. In addition to failing to remit the payroll taxes it withheld from employees, the business had a history of filing tax returns late, sometimes only after repeated IRS contact. Additionally, DOD made an overpayment to the contractor for tens of thousands of dollars. Subsequently, DOD paid the contractor over \$2 million without offsetting the earlier overpayment.
- Case # 10 This base support services contractor has close to \$1 million in unpaid payroll and unemployment taxes dating back to the early 1990s, and the business has paid less than 50 percent of the taxes it owed. IRS assessed a TFRP against one of the corporate officers. This contractor received over \$200,000 from DOD during 2002.

Examples of Abuse of the Federal Tax System by Individuals

Individuals are responsible for the payment of income taxes, and our audit and investigation of 13 individuals showed significant abuse of the federal tax system similar to what we found with our DOD business case studies. In table 2, and on the following pages, we highlight four of the individual case studies. In all four cases, the individuals had unpaid income taxes. In one of the four cases, the individual operated a business as a sole proprietorship with employees and had unpaid payroll taxes. Taxes owed

Page 18 GAO-04-414T

by the individuals ranged from four to nine tax periods, which equated to years. Each individual owed in excess of \$100,000 in unpaid income taxes, with one owing in excess of \$200,000. In two of the four cases, the individuals had entered into, and subsequently defaulted on, at least one installment agreement to pay off the tax debt.

Table 2: DOD Contractors with Unpaid Federal Taxes—Individual

Case study	Goods or service and nature of DOD work	Unpaid federal tax amount ^a	Estimated fiscal year 2002 collections under effective tax levy ^b	Fiscal year 2002 DOD payments ^c	Comments
14	Vehicle repair services: provides repair and painting for military vehicles	Over \$100,000	\$22,000	\$147,000	The business was investigated for paying employee wages in cash. Despite a substantial tax liability, the owner recently purchased a home valued at over \$1 million as well as a luxury sports car. The owner also owes a federal agency for child support.
15	Dentist: provides dental services at military facility	Over \$100,000	\$12,000	\$78,000	DOD recently increased the individual's contract by over \$80,000. The dentist's credit history included several credit card accounts that were identified for collection action.
16	Dentist: provides dental services at military facility	Over \$200,000	\$11,000	\$76,000	DOD awarded the individual a multiyear contract for over \$400,000. This individual paid income tax for only 1 year since 1993. The individual previously had a business that owes over \$100,000 in unpaid payroll and unemployment taxes going back to the early 1990s.
17	Training services: conducts management and leadership courses	Over \$100,000	\$2,000	\$12,000	This individual has not paid income taxes for 5 years.

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

Notes: Dollar amounts are rounded. Nature of unpaid taxes for individuals was primarily due to unpaid income taxes. A contractor registers in the CCR database with either an EIN or an SSN. In our report, any contractor registering with an EIN is referred to as a business, and any contractor registering with an SSN is referred to as an individual. An individual in CCR could be a business owner (i.e., sole proprietorship). For cases selected as individuals, we reviewed both the owner and related business information, if it could be identified.

^aUnpaid tax amount as of September 30, 2002.

^bThe estimated collections under an effective tax levy use the assumptions that all unpaid federal taxes are referred to TOP at Treasury FMS and all fiscal year 2002 DOD payment information is provided to TOP. The collection amount is calculated on 15 percent of the payment amount up to the amount of unpaid taxes.

°DOD payments from MOCAS, One Bill Pay, IAPS, and CAPS automated systems identified by GAO.

Page 19 GAO-04-414T

The following provides illustrative detailed information on these four cases.

- Case # 14 This individual's business repaired and painted military vehicles. The owner failed to pay personal income taxes and did not send employee payroll tax withholdings to IRS. The owner owed over \$500,000 in unpaid federal business and individual taxes. Additionally, the TOP database showed the owner had unpaid child support. IRS levied the owner's bank accounts and placed liens against the owner's real property and business assets. The business received over \$100,000 in payments from DOD in a recent year, and the contractor's current DOD contracts are valued at over \$60 million. In addition, the business was investigated for paying employee wages in cash. Despite the large tax liability, the owner purchased a home valued at over \$1 million and a luxury sports car.
- Case # 15 This individual, who is an independent contractor and works as a dentist at a military installation, had a long history of not paying income taxes. The individual did not file several tax returns and did not pay taxes in other periods when a return was filed. The individual entered into an installment agreement with IRS but defaulted on the agreement. This individual received \$78,000 from DOD during a recent year, and DOD recently increased the individual's contract by over \$80,000.
- Case # 16 This individual is another independent contractor who also works as a dentist on a military installation. DOD paid this individual over \$200,000 in recent years, and recently signed a multiyear contract worth over \$400,000. At the time of our review, this individual had paid income taxes for only 1 year since the early 1990s and had accumulated unpaid taxes of several hundred thousand dollars. In addition, the individual's prior business practice owes over \$100,000 in payroll and unemployment taxes for multiple periods going back to the early 1990s.
- Case # 17 DOD paid this individual nearly \$90,000 for presenting motivational speeches on management and leadership. This individual has failed to file tax returns since the late 1990s and had unpaid income taxes for a 5-year period from the early to mid-1990s. The total amount of unpaid taxes owed by this individual is not known because of the individual's failure to file income tax returns for a number of years. IRS placed this individual in the levy program in late 2000; however, DOD

Page 20 GAO-04-414T

payments to this individual were not levied because DFAS payment information was not reported to TOP as required.

See our related report¹³ for details on the other 30 DOD contractor case studies.

Contractors with Unpaid Taxes Are Not Prohibited by Law from Receiving Contracts from the Federal Government Federal law does not prohibit a contractor with unpaid federal taxes from receiving contracts from the federal government. Existing mechanisms for doing business only with responsible contractors do not prevent businesses and individuals with unpaid federal taxes from receiving contracts. Further, the government has no coordinated process for identifying and determining the businesses and individuals with unpaid taxes that should be prevented from receiving contracts and for conveying that information to contracting officers before awarding contracts.

In previous work, we supported the concept of barring delinquent taxpayers from receiving federal contracts, loans and loan guarantees, and insurance. In March 1992, we testified on the difficulties involved in using tax compliance as a prerequisite for awarding federal contracts. ¹⁴ In May 2000, we testified in support of H.R. 4181 (106th Congress), which would have amended DCIA to prohibit delinquent federal debtors, including delinquent taxpayers, from being eligible to contract with federal agencies. ¹⁵ Safeguards in the bill would have enabled the federal government to procure goods or services it needed from delinquent taxpayers for designated disaster relief or national security. Our testimony also pointed out implementation issues, such as the need to first ensure that IRS systems provide timely and accurate data on the status of taxpayer accounts. However, this legislative proposal was not adopted and there is no existing statutory bar on delinquent taxpayers receiving federal contracts.

Page 21 GAO-04-414T

¹³ GAO-04-95.

¹⁴ U.S. General Accounting Office, Tax Administration: Federal Contractor Tax Delinquencies and Status of the 1992 Tax Return Filing Season, GAO/T-GGD-92-23 (Washington, D.C.: Mar. 17, 1992).

¹⁵ U.S. General Accounting Office, Debt Collection: Barring Delinquent Taxpayers From Receiving Federal Contracts and Loan Assistance, GAO/T-GGD/AIMD-00-167 (Washington, D.C.: May 9, 2000).

Federal agencies are required by law to award contracts to responsible sources.¹⁶ This statutory requirement is implemented in the FAR, which requires that government purchases be made from, and government contracts awarded to, responsible contractors only. To effectuate this policy, the government has established a debarment and suspension process and established certain criteria for contracting officers to consider in determining a prospective contractor's responsibility. Contractors debarred, suspended, or proposed for debarment are excluded from receiving contracts and agencies are prohibited from soliciting offers from, awarding contracts to, or consenting to subcontracts with these contractors, unless compelling reasons exist. Prior to award, contracting officers are required to check a governmentwide list of parties that have been debarred, suspended, or declared ineligible for government contracts, ¹⁸ as well as to review a prospective contractor's certification ¹⁹ on debarment, suspension, and other responsibility matters. Among the causes for debarment and suspension is tax evasion.²⁰ In determining whether a prospective contractor is responsible, contracting officers are also required to determine that the contractor meets several specified standards, including "a satisfactory record of integrity and business ethics." Except for a brief period during 2000 through 2001, contracting officers have not been required to consider compliance with federal tax laws in making responsibility determinations.²¹

Page 22 GAO-04-414T

¹⁶ 10 U.S.C. § 2305 (b) and 41 U.S.C. § 253b (2000).

¹⁷ 48 C.F.R. § 9.103 (a).

¹⁸ Contractors included on the list as having been declared ineligible on the basis of statutory or regulatory procedures are excluded from receiving contracts under the conditions and for the period set forth in the statute or regulation. Agencies are prohibited from soliciting offers from, awarding contracts to, or consenting to subcontracts with these contractors under these conditions and for that period.

 $^{^{\}rm 19}$ Such certification is required only for contracts exceeding the simplified acquisition threshold.

²⁰ 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.

Neither the current debarment and suspension process nor the requirements for considering contractor responsibility effectively prevent the award of government contracts to businesses and individuals that abuse the tax system. Since most businesses and individuals with unpaid taxes are not charged with tax evasion, and fewer still convicted, these contractors would not necessarily be subject to the debarment and suspension process. None of the contractors described in this report were charged with tax evasion for the abuses of the tax system we identified.

A prospective contractor's tax noncompliance, other than tax evasion, is not considered by the federal government before deciding whether to award a contract to a business or individual. Further, no coordinated and independent mechanism exists for contracting officers to obtain accurate information on contractors that abuse the tax system. Such information is not obtainable from IRS because of a statutory restriction on disclosure of taxpayer information.²² As we found in November 2002,²³ unless reported by prospective contractors themselves, contracting officers face significant difficulties obtaining or verifying tax compliance information on prospective contractors.

Page 23 GAO-04-414T

²¹ In December 2000, a controversial revision to the FAR was issued that required contracting officers to consider a prospective contractor's compliance with several areas of law, including tax, in determining a satisfactory record of integrity and business ethics. This revision was revoked in December 2001 after having been effectively suspended for many federal agencies earlier in 2001.

²² 26 U.S.C. § 6103 (2000).

²³ U.S. General Accounting Office, Government Contracting: Adjudicated Violations of Certain Laws by Federal Contractors, GAO-03-163 (Washington, D.C.: Nov. 15, 2002).

Moreover, even if a contracting officer could obtain tax compliance information on prospective contractors, a determination of a prospective contractor's responsibility under the FAR when a contractor abused the tax system is still subject to a contracting officer's individual judgment. Thus, a business or individual with unpaid taxes could be determined to be responsible depending on the facts and circumstances of the case. Since the responsibility determination is largely committed to the contracting officer's discretion and depends on the contracting situation involved, there is the risk that different determinations could be reached on the basis of the same tax compliance information. On the other hand, if a prospective contractor's tax noncompliance results in mechanical determinations of nonresponsibility, de facto debarment could result. Further, a determination that a prospective contractor is not responsible under the FAR could be challenged.²⁴

Because individual responsibility determinations can be affected by a number of variables, any implementation of a policy designed to consider tax compliance in the contract award process may be more suitably addressed on a governmentwide basis. The formulation and implementation of such a policy may most appropriately be the role of OMB's Office of Federal Procurement Policy. The Administrator of Federal Procurement Policy provides overall direction for governmentwide procurement policies, regulations, and procedures. In this regard, OMB's Office of Federal Procurement Policy is in the best position to develop and pursue policy options for prohibiting federal contract awards to businesses and individuals that abuse the tax system.

Concluding Comments

Thousands of DOD contractors that failed in their responsibility to pay taxes continue to get federal contracts. Allowing these contractors to do substantial business with the federal government while not paying their federal taxes creates an unfair competitive advantage for these businesses and individuals at the expense of the vast majority of DOD contractors that do pay their taxes. DOD's failure to fully comply with DCIA and IRS's continuing challenges in collecting unpaid taxes have contributed to this

Page 24 GAO-04-414T

²⁴ For example, if the prospective contractor is a small business, the nonresponsibility determination would be reviewed by the Small Business Administration, which could issue a Certificate of Competency stating that the prospective contractor is responsible for the purpose of receiving and performing a specific government contract. A determination of nonresponsibility could also be protested through the bid protest process.

unacceptable situation, and have resulted in the federal government missing the opportunity to collect hundreds of millions of dollars in unpaid taxes from DOD contractors. Working closely with IRS and Treasury, DOD needs to take immediate action to comply with DCIA and thus assist in effectively implementing IRS's legislative authority to levy contract payments for unpaid federal taxes. Also, IRS needs to better leverage its ability to levy DOD contractor payments, moving quickly to use this important collection tool. Beyond DOD, the federal government needs a coordinated process for dealing with contractors that abuse the federal tax system, including taking actions to prevent these businesses and individuals from receiving federal contracts.

Our related report on these issues released today includes nine recommendations to DOD, IRS, and OMB. Our DOD recommendations address the need to comply with the DCIA by supporting IRS efforts under the Taxpayer Relief Act of 1997 to collect unpaid federal taxes. Our IRS recommendations address improving the effectiveness of IRS collection activities through earlier use of the Federal Payment Levy Program and changing or eliminating policies that prevent businesses and individuals with federal contracts from entering the levy program. Our OMB recommendation addresses developing and pursuing policy options for prohibiting federal contract awards to businesses and individuals that abuse the federal tax system. In written comments on a draft of our report, DOD and IRS officials partially agreed with our recommendations. OMB officials did not agree with our recommendation to develop policy options for prohibiting federal contract awards to businesses and individuals that abuse the federal tax system.

Our report also suggests that Congress consider requiring DOD to periodically report to Congress on progress in providing its payment information to TOP for each of its contract and vendor payment systems, including details of the resulting collections by system and in total for all contract and vendor payment systems during the reporting period. In addition, our report suggests that Congress consider requiring that OMB report to Congress on progress in developing and pursuing options for prohibiting federal government contract awards to businesses and individuals that abuse the federal tax system, including periodic reporting of actions taken. DOD and OMB did not agree with our matters for congressional consideration.

We continue to believe all of our recommendations and matters for congressional consideration constitute valid and necessary courses of

Page 25 GAO-04-414T

action, especially in light of the identified weaknesses and the slow progress of DOD to fully implement the offset provisions of the DCIA since its passage more than 7 years ago.

Mr. Chairman, Members of the Subcommittee, and Ms. Schakowsky, this concludes our prepared statement. We would be pleased to answer any questions you may have.

GAO Contacts and Staff Acknowledgments

For future contacts regarding this testimony, please contact Gregory D. Kutz at (202) 512-9095 or kutzg@gao.gov, Steven J. Sebastian at (202) 512-3406 or sebastians@gao.gov, or John J. Ryan at (202) 512-9587 or ryanj@gao.gov. Individuals making key contributions to this testimony included Tida Barakat, Gary Bianchi, Art Brouk, Ray Bush, William Cordrey, Francine DelVecchio, K. Eric Essig, Kenneth Hill, Jeff Jacobson, Shirley Jones, Jason Kelly, Rich Larsen, Tram Le, Malissa Livingston, Christie Mackie, Julie Matta, Larry Malenich, Dave Shoemaker, Wayne Turowski, Jim Ungvarsky, and Adam Vodraska.

(192118) Page 26 GAO-04-414T

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

GAO's Mission

The General Accounting Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through the Internet. GAO's Web site (www.gao.gov) contains abstracts and full-text files of current reports and testimony and an expanding archive of older products. The Web site features a search engine to help you locate documents using key words and phrases. You can print these documents in their entirety, including charts and other graphics.

Each day, GAO issues a list of newly released reports, testimony, and correspondence. GAO posts this list, known as "Today's Reports," on its Web site daily. The list contains links to the full-text document files. To have GAO e-mail this list to you every afternoon, go to www.gao.gov and select "Subscribe to e-mail alerts" under the "Order GAO Products" heading.

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. General Accounting Office 441 G Street NW, Room LM Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000

TDD: (202) 512-2537 Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Public Affairs

Jeff Nelligan, Managing Director, NelliganJ@gao.gov (202) 512-4800 U.S. General Accounting Office, 441 G Street NW, Room 7149 Washington, D.C. 20548

