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United States Government Accountability Office
Washington, DC 20548

November 16, 2007

The Honorable Joseph I. Lieberman
Chairman
The Honorable Susan M. Collins
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Carl Levin
Chairman
The Honorable Norm Coleman
Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Subject: *Tax Compliance: Some Hurricanes Katrina and Rita Disaster Assistance Recipients Have Unpaid Federal Taxes*

Since February 2004, we have issued a series of reports detailing how some organizations and individuals, including defense, civilian agency, and General Services Administration (GSA) contractors; tax-exempt (not-for-profit) organizations; and Medicare physicians, abused the federal tax system at the same time they were doing business with or receiving benefits from the federal government.¹ While we performed this work it came to our attention that some organizations and individuals that were recipients of federal grants and other direct assistance were also abusing the tax system. Thus, you asked us to perform additional work and report specifically on organizations and individuals that abuse the federal tax system at the same time they receive federal grants or other similar types of federal assistance, known as direct payments for specified use (direct assistance) programs.²

Based on your request, we completed a forensic audit and related investigations of unpaid federal taxes owed by recipients of the Federal Emergency Management Agency's (FEMA) Individuals and Households Program (IHP) following hurricanes Katrina and

¹See related GAO products at the end of this report.

²As classified by GSA's *Catalog of Federal Domestic Assistance*, published annually pursuant to 31 U.S.C. § 6104 and OMB Circular No. A-89, *Federal Domestic Assistance Program Information* (Aug. 17, 1984).

Rita.³ IHP is a federal direct assistance program authorized by the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act), as amended by the Disaster Mitigation Act of 2000. We conducted our audit of IHP concurrently with our broader audit of federal grant and direct assistance recipients that have unpaid federal taxes, which you also requested. We will be reporting the results of that work separately.

The specific objectives of our work were to (1) determine, to the extent practical, the estimated magnitude of federal taxes owed by individuals receiving IHP disaster assistance benefit payments following hurricanes Katrina and Rita and (2) provide illustrative examples of abusive or criminal activity related to the federal tax system by IHP recipients with unpaid federal taxes.

To estimate the magnitude of unpaid federal taxes owed by IHP disaster relief assistance recipients following hurricanes Katrina and Rita, we matched the Internal Revenue Service's (IRS) tax debts as of September 30, 2005, with IHP disaster assistance benefit payments made for hurricanes Katrina and Rita maintained in FEMA's National Emergency Management Information System. We used only taxes assessed for tax periods prior to 2005 to ensure that our analysis included only taxes owed prior to when the hurricanes struck. To be conservative in our estimate, we further excluded from our analysis tax debts that had not been agreed to by the tax debtor or affirmed by the court and tax debts of \$100 or less. To provide examples of the extent and nature of abuse or potential criminal activity related to the federal tax system by IHP recipients with unpaid federal taxes, we performed more in-depth investigative work on a nonrepresentative selection of five IHP recipients. These cases were selected based on amounts owed in federal taxes from the top 10 percent of the IHP recipient population. For these five cases, we reviewed copies of automated tax transcripts and other tax records (for example, revenue officers' notes) and performed additional investigative research on available criminal, financial, and public records.

We conducted our work from January 2007 through August 2007. We performed our audit in accordance with U.S. generally accepted government auditing standards. The investigative portion of our work was completed in accordance with investigative standards established by the President's Council on Integrity and Efficiency.

Results in Brief

While about 95 percent of all IHP recipients of disaster relief assistance following hurricanes Katrina and Rita paid their federal taxes, tens of thousands owed federal taxes at the time of the disaster. We identified about 80,000 of the 1.5 million individuals (about 5 percent) who received disaster assistance benefits for hurricanes Katrina and Rita and owed over \$700 million combined in unpaid federal taxes prior to those hurricanes. However, our estimates of the taxes owed by these recipients is understated in that we did not include amounts owed by individuals who have not filed tax returns or who have failed to report the full amount of taxes due (referred to as nonfilers and

³IHP provides temporary housing or financial assistance to eligible victims.

underreporters) and for whom IRS has not determined that specific tax debts are owed. FEMA officials stated that they do not screen disaster applicants for tax debts. FEMA officials stated that there is no law or regulation that requires FEMA to screen IHP applicants prior to providing disaster assistance.

The five IHP recipients with which we chose to illustrate abusive and criminal activity related to the federal tax system had tax debts ranging from about \$400,000 to over \$2 million. Our investigation found that a number of these individuals had a history of failing to file tax returns for several years prior to the hurricane disasters. We also found instances in which IHP recipients attempted to transfer property to avoid IRS seizure. For example, one IHP recipient in the oil and gas industry forged a third party's signature to illegally transfer land. Another IHP recipient, a lawyer, transferred a large quantity of stock to a family member while IRS was taking collection actions against the lawyer.

We received written comments on a draft of this report from the Department of Homeland Security (DHS). In its written comments, DHS stated that FEMA's administration of disaster assistance programs to victims of hurricanes Katrina and Rita with tax liabilities was consistent with federal law and policy. As recognized in our draft report, DHS is not required to screen applicants for tax debts (see the Agency Comments and Our Evaluation section of this report). We have reprinted DHS's written comments in their entirety in the enclosure. In addition, IRS and DHS provided technical comments on the draft report, which we incorporated as appropriate.

Background

Making landfall in late August 2005, Hurricane Katrina devastated much of the Gulf Coast; the storm surge caused major or catastrophic damage along the coastlines of Alabama, Mississippi, and Louisiana. In September 2005, Hurricane Rita caused further devastation, making landfall on the Louisiana and Texas Gulf Coasts. These two hurricanes left more than 1,500 dead, affected 90,000 square miles, caused more than \$80 billion in damage, and forced mass evacuations. An estimated 600,000 households were displaced, and FEMA has reported that over 50,000 households remained in temporary housing 2 years later.

The Stafford Act grants the principal authority for the President to provide assistance in mitigating, responding to, and preparing for disasters and emergencies such as earthquakes, hurricanes, floods, tornadoes, and terrorist acts. The mission of FEMA, within DHS, which administers the Stafford Act, is to reduce loss of life and property and protect the nation from all types of hazards through a comprehensive, risk-based emergency management program. Section 408 of the Stafford Act, 42 U.S.C. § 5174, is the general authority for the President to provide assistance to individuals and households. This section encompasses housing assistance as well as "other needs" assistance, which includes medical, dental, funeral, personal property, transportation, and other financial assistance for certain needs arising from a major disaster. These two types of assistance are administered by FEMA under IHP. IHP provides housing and "other needs"

assistance in the forms of direct assistance (the provision of temporary housing units) and financial assistance (grant funding for temporary housing and other disaster-related needs) to eligible disaster victims.

Our previous forensic audits and related investigations found significant control weaknesses in FEMA's disaster relief program. In several hearings, we testified that control weaknesses in FEMA's IHP have left the government vulnerable to significant fraud, waste, and abuse. In February 2006, we testified that specific control weaknesses in IHP resulted in improper expedited assistance payments and nonexistent controls left the government vulnerable to substantial fraud and abuse related to IHP.⁴ Several months later, in June 2006, we testified on additional work performed whereby we projected that the weak or nonexistent controls resulted in an estimated \$600 million to \$1.4 billion dollars in potentially fraudulent and improper IHP payments or about 16 percent of the first \$6 billion of IHP disbursements for hurricanes Katrina and Rita.⁵ In December 2006, we again testified that FEMA made nearly \$17 million in potentially improper rental assistance payments, fraudulent rental assistance payments, or both to individuals after they had moved into FEMA trailers.⁶ Based on this work, we referred to the Katrina Fraud Task Force thousands of cases of individuals we believe received fraudulent and improper payments of IHP benefits.

Magnitude of Unpaid Taxes Owed by IHP Recipients

While about 95 percent of all IHP recipients of hurricanes Katrina and Rita assistance did not have unpaid federal taxes, we identified tens of thousands of IHP recipients with unpaid federal taxes. We identified about 80,000 of the nearly 1.5 million registrants (about 5 percent) who received IHP disaster assistance payments for hurricanes Katrina and Rita and had over \$700 million in unpaid federal taxes at about the time the hurricanes struck. Most of the taxes owed by these IHP recipients were individual federal income taxes. In addition, as reflected in figure 1, about two-thirds of unpaid federal taxes were for tax periods through calendar year 2000.⁷

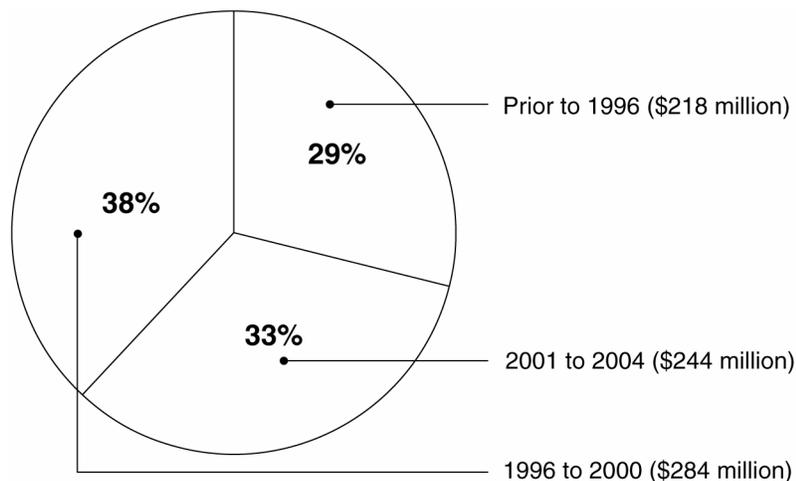
⁴GAO, *Expedited Assistance for Victims of Hurricanes Katrina and Rita: FEMA's Control Weaknesses Exposed the Government to Significant Fraud and Abuse*, GAO-06-403T (Washington, D.C.: Feb. 13, 2006).

⁵GAO, *Hurricanes Katrina and Rita Disaster Relief: Improper and Potentially Fraudulent Individual Assistance Payments Estimated to Be Between \$600 Million and \$1.4 Billion*, GAO-06-844T (Washington, D.C.: June 14, 2006).

⁶GAO, *Hurricanes Katrina and Rita Disaster Relief: Continued Findings of Fraud, Waste, and Abuse*, GAO-07-252T (Washington, D.C.: Dec. 6, 2006).

⁷There is a 10-year statute of limitations beyond which IRS is prohibited from attempting to collect tax debt. The 10-year time may be suspended for a variety of reasons, including for periods during which the taxpayer is involved in a collection due process appeal, litigation, or a pending offer in compromise or installment agreement. As a result, fig. 1 includes taxes that are for tax periods from more than 10 years ago.

Figure 1: IHP Recipients with Unpaid Federal Taxes (by Tax Year) as of September 30, 2005



Source: GAO analysis of FEMA and IRS data as of September 30, 2005.

Although \$700 million in unpaid taxes owed by IHP participants as of September 30, 2005, is a substantial amount, this amount understates the full extent of unpaid federal taxes for these individuals. To avoid overestimating the amount owed, we limited our scope to federal tax debts that were affirmed by either the individual or a tax court for tax periods prior to 2005. We did not include any debts incurred during the most current tax year to avoid including any tax debts that were assessed subsequent to the hurricanes. We also purposely excluded recently assessed tax debts that appear as unpaid taxes because they may involve matters that will be routinely resolved between the taxpayer and IRS. We further excluded tax debts of less than \$100 because they are insignificant for the purpose of determining the extent of taxes owed.

Our estimate is also likely to be understated because the IRS tax database we used to derive our estimate reflects only the amount of unpaid taxes either reported by an individual or organization on a tax return or assessed by IRS through its various enforcement programs. The IRS database does not reflect amounts owed by organizations and individuals that have not filed tax returns and for which IRS has not assessed tax amounts due. For example, during our audit, we identified instances from our case studies in which individuals failed to file tax returns for a particular tax period and IRS had not assessed taxes for these tax periods. Consequently, while these individuals may have additional unpaid taxes, they were listed in IRS records as having no unpaid taxes for that period. Further, our analysis did not attempt to account for individuals who purposely underreported income and were not specifically identified by IRS as owing the additional taxes. According to IRS, underreporting of income accounted for more than 80 percent of the estimated \$345 billion annual gross tax gap.⁸

⁸According to IRS, nonfilers and underpayment of taxes constituted the rest of the gross tax gap.

Federal law and regulations do not prohibit IHP applicants that owe tax debts from receiving disaster assistance from the federal government. In fact, Office of Management and Budget (OMB) policy is to allow disaster loans to individuals with federal tax debts.⁹ Consistent with this policy, FEMA officials stated that they do not screen disaster applicants for tax debts. FEMA officials stated that there is no law or regulation that requires FEMA to screen IHP applicants prior to providing disaster assistance.

Examples of IHP Recipients Involved in Abusive and Criminal Activity Related to Federal Tax System

The five IHP recipients with which we chose to illustrate abusive and criminal activity related to the federal tax system had tax debts ranging from about \$400,000 to over \$2 million. A number of these individuals had a history of failing to file tax returns for several years. Two IHP recipients also attempted to transfer property to avoid IRS seizure. Table 1 highlights the five cases of IHP recipients we investigated with unpaid taxes.

Table 1: Descriptions of Five IHP Recipients with Unpaid Federal Taxes Investigated for Possible Abusive and Criminal Activity

Case	Nature of work	Unpaid tax amount ^a	Comments
1	Doctor	\$2 million	<ul style="list-style-type: none"> • FEMA recipient received several thousand dollars in disaster assistance. • FEMA recipient has a history of repeated failures to pay income tax and filing late returns, spanning back to the 1980s. • FEMA recipient’s return in the early 2000s reported income of several hundred thousand dollars, but recipient did not report income in recent years. • Recipient had unreported gambling winnings totaling over a quarter of a million dollars at the same time that the recipient owed federal taxes. • FEMA recipient was charged with illegally dispensing a controlled substance.
2	Doctor	\$2 million	<ul style="list-style-type: none"> • FEMA recipient received IHP assistance of several thousand dollars. • FEMA recipient did not file required tax returns for several years. • FEMA recipient said the reason for not filing returns was that the recipient was overwhelmed with the filing process and decided to wait for IRS to seek the returns. • IRS filed several tax liens against recipient’s property.

⁹OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables* (Revised November 2000).

Case	Nature of work	Unpaid tax amount ^a	Comments
3	Contractor	\$500,000	<ul style="list-style-type: none"> • FEMA recipient received IHP assistance of several thousand dollars. • FEMA recipient has over a 10-year history of tax problems. • While owing taxes, FEMA recipient earned compensation up to \$300,000 prior to the hurricane. • FEMA recipient purchased numerous vehicles, including a luxury vehicle. • IRS filed multiple tax liens against taxpayer's assets.
4	Attorney	\$400,000	<ul style="list-style-type: none"> • FEMA recipient received over a thousand dollars in disaster assistance. • FEMA recipient has a history of repeated noncompliance with paying federal individual and employer payroll taxes,^b spanning back to the late 1980s and did not file tax returns for several years. • Recipient transferred ownership of a large quantity of stock to a family member while IRS was taking collection actions against the recipient. • IRS filed tax liens against recipient.
5	Oil and gas entrepreneur	\$400,000	<ul style="list-style-type: none"> • FEMA recipient received several thousand dollars in disaster assistance. • FEMA recipient's annual income prior to the hurricane was from \$50,000 to \$100,000. • FEMA recipient has a history of repeated federal tax noncompliance dating back to the early 1990s. • FEMA recipient forged a third party's signature to illegally transfer land to avoid IRS seizure.

Source: GAO's analysis of IRS records, IHP assistance payments, and other records.

^aRounded dollar amount of unpaid federal taxes as of September 30, 2005.

^bPayroll taxes include employee's income taxes and Social Security and Medicare taxes withheld from an employee's paycheck. Employers are to collect and remit these taxes to the federal government. Employers are deemed to have a fiduciary responsibility to hold withheld funds "in trust" for the federal government until the employer makes a federal tax deposit in that amount. The employer's owners or officers may be held personally liable for these amounts and may be subject to civil and criminal penalties for failure to remit payroll taxes.

Our previous forensic audits and related investigations found significant control weaknesses in FEMA's disaster relief program that have left the government vulnerable to significant fraud, waste, and abuse. Our review of FEMA data found that in several of these cases, the IHP recipient received disaster assistance without FEMA inspection of the claimed damaged property or after the inspection actually found no damage to the property. As a result, FEMA was at risk of paying disaster assistance to recipients that were not entitled to such benefits. For these five cases, we did not make a determination of potential fraud related to the disaster relief program because it was not included in the scope of this work.

Agency Comments and Our Evaluation

On October 26, 2007, we received written comments on a draft of this report from the Department of Homeland Security (DHS). In its written comments, DHS stated that FEMA's administration of disaster assistance programs to victims of hurricanes Katrina and Rita with tax liabilities was consistent with federal law and policy. As recognized in our draft report, DHS is not required to screen applicants for tax debts. We have reprinted DHS's written comments in their entirety in the enclosure. In addition, IRS and DHS provided technical comments on the draft report, which we incorporated as appropriate.

As agreed with your offices, unless you publicly release its contents earlier we plan no further distribution of this report until 30 days from its date. At that time, we will send copies of this report to the Secretary of Homeland Security and the Acting Commissioner of Internal Revenue. We will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-6722 or kutzg@gao.gov if you have any questions concerning this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is written in a cursive style with a large, stylized initial "G".

Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigation

Enclosure - 1

Comments from the Department of Homeland Security

U.S. Department of Homeland
Security
Washington, DC 20528



**Homeland
Security**

October 26, 2007

Mr. Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Kutz:

RE: Draft Letter of Correspondence GAO-08-101R, Tax Compliance: Some Hurricanes Katrina and Rita Disaster Assistance Recipients Have Unpaid Federal Taxes (GAO Job Code 192258)

The Department of Homeland Security appreciates the opportunity to review and comment on the draft letter of correspondence referenced above. The U.S. Government Accountability Office (GAO) sought to determine the magnitude of federal taxes owed by individuals receiving disaster assistance benefit payments made under the Individual and Housing Program (IHP) following hurricanes Katrina and Rita. GAO also sought to provide examples of abusive or criminal activity related to the federal tax system by IHP recipients with unpaid federal taxes. The letter of correspondence contains no recommendations; so action on the part of the Department is not warranted.

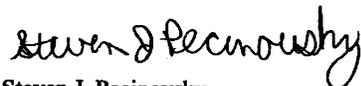
The Federal Emergency Management Agency's (FEMA's) administration of disaster assistance programs involving Hurricanes Katrina and Rita recipients with tax liabilities has been consistent with federal law and policy. Disaster assistance provided to individuals with outstanding tax debts does not constitute the same type of potential improper payments or fraud that was the subject of other GAO reports and investigations regarding controls within FEMA's disaster relief programs. Additionally, disaster assistance payments are not considered to be taxable income and are therefore not subject to the IRS continuous levy program.

The results in brief section notes that "FEMA officials stated that there is no law or regulation that requires FEMA to screen IHP applicants prior to providing disaster assistance." However, the draft does not cite the two existing portions of the law and federal regulations indicating that we are not required to do such screening:

- Robert T. Stafford Disaster Relief and Emergency Assistance Act, P.L. 93-288, as amended, 42 U.S.C. 5121-5206, and Related Authorities (June 2007)- “Assistance not income- Federal major disaster and emergency assistance provided to individuals and families under this Act, and comparable disaster assistance provided by States, local governments, and disaster assistance organizations, shall not be considered as income or a resource when determining eligibility for or benefit levels under federally funded income assistance or resource-tested benefit programs.” 42 U.S.C. Sec. 5155(d),
- 44 C.F.R. Sec. 206.110 (g) – Emergency Management and Assistance (Revised October 1, 2006) – “Exemption from Garnishment – All assistance provided under this subpart is exempt from garnishment, seizure, encumbrance, levy, execution, pledge, attachment, release of waiver. Recipients of rights under this provision may not reassign or transfer the rights. The exemptions do not apply to FEMA recovering assistance fraudulently obtained or misapplied.”

The Department of Homeland Security and FEMA remain committed to the effective and efficient administration of federal disaster relief programs, including the prevention of fraud, waste and abuse.

Sincerely,



Steven J. Pecinovsky
Director
Departmental GAO/OIG Liaison Office

MMcP

Related GAO Products

Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly \$1 Billion in Payroll and Other Taxes. [GAO-07-1090T](#). Washington, D.C.: July 24, 2007.

Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly \$1 Billion in Payroll and Other Taxes. [GAO-07-563](#). Washington, D.C.: June 29, 2007.

Tax Compliance: Thousands of Federal Contractors Abuse the Federal Tax System. [GAO-07-742T](#). Washington, D.C.: April 19, 2007.

Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System. [GAO-07-587T](#). Washington, D.C.: March 20, 2007.

Internal Revenue Service: Procedural Changes Could Enhance Tax Collections. [GAO-07-26](#). Washington, D.C.: November 15, 2006.

Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes. [GAO-06-887](#). Washington, D.C.: July 28, 2006.

Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes. [GAO-06-755T](#). Washington, D.C.: May 25, 2006.

Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System. [GAO-06-492T](#). Washington, D.C.: March 14, 2006.

Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence. [GAO-05-683T](#). Washington, D.C.: June 16, 2005.

Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence. [GAO-05-637](#). Washington, D.C.: June 16, 2005.

Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence. [GAO-04-414T](#). Washington, D.C.: February 12, 2004.

Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence. [GAO-04-95](#). Washington, D.C.: February 12, 2004.

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