

GAO

Report to the Committee on Homeland
Security and Governmental Affairs,
U.S. Senate

November 2007

TAX COMPLIANCE

Federal Grant and Direct Assistance Recipients Who Abuse the Federal Tax System





Highlights of [GAO-08-31](#), a report to the Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

Since February 2004, GAO has reported that weaknesses in the federal programs and controls that allowed thousands of federal contractors, tax exempt entities, and Medicare providers to receive government money while owing taxes. GAO was asked to determine if these problems exist for entities who receive federal grants or direct assistance and (1) describe the magnitude of taxes owed, (2) provide examples of grant recipients involved in abusive and potentially criminal activity, and (3) assess efforts to prevent delinquent taxpayers from participating in such programs.

To perform this work, GAO analyzed data from the Internal Revenue Service (IRS), three of the largest grant and direct assistance payment systems, representing over \$460 billion in payments in fiscal years 2005 and 2006, and the Housing and Urban Development (HUD) Section 8 tenant-based housing program. GAO investigated 20 cases to provide examples of grant recipients involved in abusive activity.

What GAO Recommends

GAO recommends that the Office of Management and Budget (OMB) assess the need to require federal agencies to conduct inquiries into the tax debt status of applicants where appropriate. GAO also recommends IRS evaluate the 20 referred cases with high tax debts and abusive and potential criminal activity for appropriate additional collection and investigation action. IRS and OMB agreed with our recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-31](#). For more information, contact Greg Kutz at (202) 512-6722 or kutzg@gao.gov.

TAX COMPLIANCE

Federal Grant and Direct Assistance Recipients Who Abuse the Federal Tax System

What GAO Found

While most recipients of payments federal grant and direct assistance programs pay their federal taxes, tens of thousands of recipients collectively owed \$790 million in federal taxes as of September 30, 2006. This included over 2,000 individuals and organizations that received \$124 billion of payments directly from the federal government and who owed more than \$270 million of unpaid taxes (almost 6 percent of such recipients) and about 37,000 landlords participating in HUD's Section 8 tenant-based housing program who owed an estimated \$520 million of unpaid taxes (almost 4 percent of such landlords). The \$790 million estimate is likely substantially understated because GAO's analysis excluded the 80 percent of federal grants that are directly given to state and local governments which, in turn, disburse the grants to the ultimate recipients.

GAO selected 20 grant and direct assistance recipients with high tax debt for a more in-depth investigation of the extent and nature of abuse and criminal activity. For all 20 cases GAO found abusive and potential criminal activity related to the federal tax system, including failure to remit individual income taxes and/or payroll taxes to IRS. Rather than fulfill their role as "trustees" of payroll tax money and forward it to IRS, these grant recipients diverted the money for other purposes. Willful failure to remit payroll taxes is a felony under U.S. law. Individuals associated with some of these recipients diverted the payroll tax money for their own benefit or to help fund their businesses. GAO referred these 20 cases to IRS for additional collection and investigation action, as appropriate.

Examples of Abusive and Potentially Criminal Activity by Grant and Direct Assistance Recipients

Nature of work	Unpaid tax amount as of September 2006	Activity
Housing	Over \$3 million	Landlord was convicted of illegally transferring property to defraud creditors.
Social Services	Over \$1 million	While failing to pay its taxes, the grant recipient paid hundreds of thousand of dollars to a relative for services contracts.
Social Services	Over \$400,000	Recipient investigated for using grant funds to purchase luxury car, lakefront condominium, and Caribbean trips.

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

Federal law and current governmentwide policies do not prohibit individuals and organizations with unpaid taxes from receiving grants or direct assistance. Several federal agencies established policies against awarding grants to tax delinquent applicants; however, federal agencies do not verify applicants' certification that they do not owe taxes. Further, federal law generally prohibits the disclosure of taxpayer data to federal agencies. Eleven grant recipients that GAO investigated appeared to have made false statements by not disclosing their tax debt as required. Further, agencies that award grants are not required to inquire as to recipients' tax debt status prior to providing direct assistance payments.

Contents

Letter		1
	Results in Brief	4
	Background	7
	Grant and Direct Assistance Recipients Owe About \$790 Million in Taxes	8
	Examples of Selected Recipients of Grants and Direct Assistance Involved in Abusive and Criminal Activity Related to Federal Tax System	11
	Federal Agencies Do Not Prevent Delinquent Taxpayers from Participating in Federal Grant or Direct Assistance Programs	15
	Conclusion	18
	Recommendations for Executive Action	18
	Agency Comments and Our Evaluation	19
Appendix I	Scope and Methodology	20
Appendix II	Grant and Direct Assistance Recipients with Unpaid Taxes	24
Appendix III	Comments from the Internal Revenue Service	27
Appendix IV	GAO Contact and Staff Acknowledgments	29
Related GAO Products		30
Tables		
	Table 1: Examples of Grant and Direct Assistance Recipient Entities with Unpaid Federal Taxes	11
	Table 2: Grant/Direct Assistance Recipient Entities with Unpaid Federal Taxes	24

Abbreviations

ASAP	Automated Standard Application Payment System
CFDA	Catalog of Federal Domestic Assistance
FAADS	Federal Assistance Awards Data System
GAPS	Grant Administration and Payment System
GSA	General Services Administration
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IRS	Internal Revenue Service
OMB	Office of Management and Budget
PIC	Public Housing Information Center
PMS	Payment Management System
SF	Standard Form
TIN	Taxpayer Identification Number
TFRP	Trust Fund Recovery

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.



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

This report continues a series of audits and investigations we have performed at your request to help address the large tax gap facing our nation. The tax gap represents the difference between what taxpayers should pay on a timely basis and what the Internal Revenue Service (IRS) collected through voluntary compliance and enforcement activities. To help address the tax gap, beginning in February 2004, we have issued a series of reports detailing how some organizations and individuals abused the federal tax system at the same time they were doing business with or receiving benefits from the federal government and the lack of agency controls to prevent such abuses from occurring.¹ We determined there are few consequences of abusing the tax system for these organizations and individuals, which included defense, civilian agency, and General Services Administration (GSA) contractors; tax-exempt (not-for-profit) organizations (including charities participating in the Federal government's Combined Federal Campaign); and Medicare physicians. While we performed this work it came to our attention that some organizations and individuals who were recipients of federal grants were also abusing the tax system. Thus, you asked us to perform additional work and report specifically on organizations and individuals who abuse the federal tax system at the same time they receive federal grants or other

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

similar types of federal assistance known as direct payments for specified use² (direct assistance) programs.

Based on your request, we initiated a forensic audit and related investigations to determine, to the extent practical, whether recipients of federal grants and direct assistance have unpaid federal taxes. Because the vast majority of federal grants and direct assistance programs, an estimated 80 percent of awarded funds, are administered and disbursed through state and local governments,³ detailed payment data on the final recipients needed for us to perform an electronic match with IRS taxpayer delinquency files are not available at the federal level.⁴ Thus, the specific objectives of our work were to (1) determine to the extent practical the magnitude of federal taxes owed by individuals and organizations receiving grants and direct assistance administered and disbursed at the federal level and to further determine, using a selected case study of a federal direct assistance program that administers and disburses payments at the state and local level, tax debts owed by state and local recipients of such programs; (2) provide examples of grant and direct assistance recipients involved in abusive or criminal activity related to the federal tax system; and (3) assess efforts by awarding agencies to prevent delinquent taxpayers from participating in federal grant and direct assistance programs.⁵

To determine to the extent practical the magnitude of taxes owed by individuals and organizations receiving grants or direct assistance administered at the federal level, we utilized disbursements data from

²As classified by the General Services Administration's *Catalog of Federal Domestic Assistance* (CFDA), published annually pursuant to 31 U.S.C. 6104 and OMB Circular No. A-89, *Federal Domestic Assistance Program Information* (Aug. 17, 1984). We excluded Medicaid and Medicare programs from this audit because we are conducting separate reviews on Medicare and Medicaid program providers owing delinquent taxes.

³They are defined as state, county, city, or township governments; special district governments (e.g., public housing authorities and local transit authorities); independent school districts; and state-controlled institutions of higher education.

⁴Detailed information on payments, including social security and taxpayer identification numbers, for the ultimate recipients of grants and direct payments administered at subfederal levels is maintained by thousands of state and local governmental entities throughout the country.

⁵Our audit also included a detailed assessment of tax debts owed by recipients who received hurricane disaster assistance under the Federal Emergency Management Agency's Individual and Households Disaster Assistance Program (IHP), but we will be reporting the results from this work separately.

three of the largest federal payment systems⁶ that processed payments for the majority of federal grant and direct assistance excluding Medicare and Medicaid during fiscal years 2005 and 2006. For our case study of recipients receiving federal payments at the state and local levels, we selected the Department of Housing and Urban Development's (HUD) Section 8 tenant-based housing assistance program, a direct assistance program to aid low-income families, because this program is a large federal program that is administered at the state or local government level. To determine the extent to which grant and direct assistance recipients had unpaid federal taxes, we utilized IRS unpaid tax data as of September 30, 2006. Using the Taxpayer Identification Number (TIN), we electronically matched IRS's tax debt data to payment and other management information that represented payments to the various grant and direct assistance recipients we identified.

To illustrate indications of abuse or criminal activity related to the federal tax system in grant and direct assistance programs, based on our data mining, we performed investigative work on a nonrepresentative selection of 20 organizations and individuals that participated in federal grant and direct assistance programs during fiscal years 2005 and 2006. We selected these organizations and individuals based upon factors such as the amount of tax debt and the number of delinquent tax periods. Our investigative work included reviewing tax records and performing additional searches of criminal, financial, and other public records.

To determine the actions that responsible federal agencies take to prevent individuals and organizations with significant tax delinquencies from receiving grants and direct assistance, we examined governmentwide and selected agency policies and procedures, reviewed selected application files, and interviewed officials from the Office of Management and Budget (OMB); IRS; and Departments of Agriculture, Education, Health and Human Services (HHS), Homeland Security, and HUD. For details on our scope and methodology, see appendix I.

We conducted our audit between January 2007 and August 2007. We performed our work in accordance with U.S. generally accepted government auditing standards. The investigative portion of our work was

⁶Data we analyzed represented grant and direct assistance payments from the Department of Education's Grant Administration and Payment System, the Department of the Treasury's Automated Standard Application Payment System, and the Department of Health and Human Services' Payment Management System.

completed in accordance with investigative standards established by the President's Council on Integrity and Efficiency.

Results in Brief

While most recipients of payments from federal grant and direct assistance programs pay their federal taxes, our comparison of IRS unpaid assessments with disbursements made from three of the largest federal grant and direct assistance payment systems and disbursement-related data for the HUD Section 8 tenant-based housing assistance program found that tens of thousands of recipients collectively owed about \$790 million in federal taxes as of September 30, 2006:

- Over 2,000 grant and direct assistance recipients who received certain payments directly from three of the major federal grant and direct assistance payment systems during fiscal years 2005 and 2006 (almost 6 percent of such recipients) owed more than \$270 million of unpaid taxes.
- About 37,000 landlords who participated in HUD's Section 8 tenant-based housing direct assistance program during fiscal years 2005 and 2006 (almost 4 percent of landlords participating in HUD's tenant-based program) had an estimated \$520 million of unpaid federal taxes as of September 30, 2006.

Our estimates of the taxes owed by grant and direct assistance participants are likely substantially understated for a number of reasons. For example, most federal grant and direct assistance programs whose funds are disbursed through the three federal payment systems we reviewed are provided to state and local governments who disburse funds to the ultimate recipient (an estimated 80 percent of awarded funds) and were thus excluded from our analysis. Except for our case study involving the HUD Section 8 tenant-based program that provides direct assistance through public housing agencies to landlords who make available housing units to approved low-income families who select dwelling units

(landlords to rent from) in the private market,⁷ our audit did not include disbursements made to state and local governments because detailed information on the ultimate recipients was not practical to obtain. In addition, our estimate does not include amounts owed by organizations and individuals that have not filed tax returns or that have failed to report the full amount of taxes due (referred to as nonfilers and underreporters) and for which IRS has not determined that specific tax debts are owed. According to IRS, underreporting of income accounts for more than 80 percent of the more than \$345 billion annual gross tax gap.

We found numerous cases of abusive and criminal activity related to the federal tax system in our audit and investigation of 20 organizations and individuals that we selected based on the large amount of federal taxes owed and other factors. Of these 20 cases, 14 involved organizations that received federal grants. All 14 grant recipient organizations failed to properly remit to IRS payroll taxes withheld from employees. Rather than fulfill their role as “trustees” of this money and forward it to IRS as required by law, these case study entities and their executives diverted the money for other purposes. In one example, a nonprofit organization that provides social services received over 1 million dollars in grants while owing hundreds of thousands of dollars of unpaid payroll taxes. Instead of paying payroll taxes, executives misappropriated grant funds for expensive clothing, luxury vehicles, and lavish trips to the Caribbean.

We also found tax abuse in the other six cases that involved landlords who benefited from federal housing subsidies provided under HUD’s Section 8 tenant-based housing program. For example, we identified one participating landlord who was delinquent in paying federal income tax and had also not properly maintained rental housing to acceptable living standards. This landlord has been delinquent in paying federal income taxes since the mid-1990s and owed over a million dollars of federal taxes.

⁷In the HUD Section 8 tenant-based program (also referred to as the Housing Choice Voucher Program), HUD pays rental subsidies so eligible families can afford decent, safe, and sanitary housing. The program is generally administered by state or local governmental entities called public housing agencies (PHAs). Families select and rent units that meet program housing quality standards. PHAs then review the lease arrangement for purposes such as determining whether the rent is reasonable; the housing unit meets HUD’s housing quality standards; and the landlord is approvable, which includes, among other things, whether the landlord has been debarred, suspended, or otherwise disqualified from participating in HUD programs. If the PHA approves a family’s unit and tenancy, the PHA contracts with the landlord to make rent subsidy payments on behalf of the family. HUD provides housing assistance funds to the PHA who then pays the landlord.

Another participating landlord was convicted of money laundering and other criminal activities.

Federal agencies do not prevent individuals and organizations with tax debts from receiving federal grant payments. Federal law and current governmentwide policies for administering grants, as reflected in OMB Circulars, do not prohibit individuals and organizations with unpaid taxes from receiving grants, nor do they require awarding agencies to verify applicants' disclosures of existing federal debt delinquencies in grant applications. Although several federal grant-awarding agencies had policies against awarding grants to tax delinquent applicants, we found no evidence that agencies enforce their policies. Specifically, those agencies that told us they would not award a grant to an applicant with unpaid taxes could not provide any examples where grant officials denied a grant based on an applicant's self-disclosed tax delinquencies or required applicants to make repayment arrangements. Even if requirements to verify applicant disclosures did exist, absent consent from the taxpayer, federal law generally prohibits IRS from disclosing taxpayer data and, consequently, federal agencies have no access to tax data directly from IRS. For example, as we stated earlier, 14 cases that we investigated for indications of abuse and potential criminal activity were grant recipients and were required to submit applications prior to award of the grant.⁸ Of these 14 cases, 11 grant recipients submitted grant applications at the same time they were delinquent in paying their taxes. Our review of those grant applications found that these 11 grant recipients appear to have made false statements by not disclosing their tax debts in their applications even though they were required to do so.

Based on our review of landlords participating in HUD's Section 8 tenant-based housing program, a direct assistance program to aid low-income families obtain affordable housing, our audit found that HUD and its local housing authorities are neither required nor do they attempt to prevent individuals and organizations with federal tax debts from participating as landlords in the tenant-based housing program or receiving federal rental subsidies. Specifically, HUD regulations do not prohibit landlords with federal tax debts from receiving HUD subsidized rental payments. Agency regulations do, however, permit local housing authorities to reject

⁸The other six cases involve HUD landlords. These six cases were not required to submit a similar application that required the applicant to disclose whether they were delinquent on any federal debt or not.

landlords who have not paid state or local real estate taxes, fines, or assessments.

We are recommending that the Director, Office of Management and Budget, assess the need to require federal agencies that award certain grants and other direct assistance, where appropriate, to conduct proactive inquiries that would help determine if applicants had unpaid federal tax debt, including obtaining applicant consent to inquire as to tax debt status from the IRS, and consider the result of those inquiries in the award determinations. We are also recommending that the Acting Commissioner of Internal Revenue evaluate the 20 referred cases detailed in this report with high tax debts and potential abusive and criminal activity for appropriate additional collection action and criminal investigation as warranted.

IRS provided written comments to a draft of this report and OMB provided oral comments. Both IRS and OMB agreed with our recommendations. See the Agency Comments and Our Evaluation section of this report for a discussion of agency comments from OMB and IRS. We have reprinted the IRS written comments in appendix III.

Background

A federal grant is an award of financial assistance from a federal agency to an organization to carry out an agreed-upon public purpose. A Direct Payment for Specified Use (direct assistance) is an award of financial assistance from the federal government to individuals, private firms, and other private institutions to encourage or subsidize a particular activity by conditioning the receipt of the assistance on a particular performance by the recipient. As such, federal grants and direct assistance programs do not include solicited contracts for the procurement of goods and services for the federal government.

Based on our analysis of fiscal years 2004 and 2005 data from the Federal Assistance Award Data System (FAADS),⁹ federal agencies collectively awarded grants and direct assistance of approximately \$300 billion annually.¹⁰ Further analysis of the FAADS data indicates that approximately 80 percent of federal grants and direct assistance consist of

⁹The FAADS is a central collection of federal financial assistance award transactions data compiled by the Bureau of the Census.

¹⁰Estimated annual awards exclusive of Medicare and Medicaid.

federal funds provided to state and local governments, which, in turn, disburse funds to the ultimate recipients. Consequently, only about 20 percent of awarded funds are provided directly from the federal government to the organization that ultimately spends the money.

Governmentwide policies affecting the award and administration of grants to nongovernmental entities are covered in OMB Circular No. A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*. OMB Circular No. A-102, *Grants and Cooperative Agreements with State and Local Governments*, provides governmentwide guidance for administering grants provided to state and local governments and prescribes similar procedures as those included in Circular No. A-110. Direct assistance programs are not subject to the same governmentwide policies as grants; procedures governing the application and award processes for direct assistance are prescribed in guidance and regulations promulgated by the cognizant federal agency responsible for administering the program.

Most grant applicants that apply directly to the federal government are required to complete an Application for Federal Assistance, Standard Form (SF) 424. The SF 424 provides federal agencies with entity information, such as name, employer identification number, address, and a descriptive title of the project for which the grant will be used. The applicant is required to certify that the information provided on the SF 424 is true and correct and whether the applicant is currently delinquent on any federal debt.

Grant and Direct Assistance Recipients Owe About \$790 Million in Taxes

While most federal grant and direct assistance recipients pay their federal taxes, we identified tens of thousands of grant and direct assistance recipients that collectively owed about \$790 million in federal taxes as of September 2006. These tax debts were owed by entities who received federal payments directly from federal payment systems during fiscal years 2005 and 2006 and individuals who participated in HUD's Section 8 tenant-based housing program as landlords during fiscal years 2005 and 2006. We used IRS's September 2006 unpaid assessments file data to calculate the amount of taxes owed at or about the time the various grant recipients received their grant payments. Specifically, we found

- 2,000 of about 32,000 recipients (about 6 percent) who received federal grant and direct assistance benefits directly from three of the largest federal payment systems had more than \$270 million of unpaid federal

taxes. About \$110 million of the \$270 million in unpaid taxes represents unpaid payroll taxes.

- 37,000 of over 1 million landlords (about 4 percent) participating in the HUD Section 8 program had about \$520 million of unpaid federal taxes. Most of these tax debts were unpaid individual income taxes.

In our audit, we found that grant recipients had a substantial amount of unpaid payroll taxes.¹¹ Employers may be 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 fiduciary responsibility to hold these funds "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, 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 employed by the employer (e.g., owners or 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).¹² Willful failure to remit payroll taxes can also be a criminal felony offense punishable by imprisonment of up to 5 years,¹³ while the failure to properly segregate payroll tax funds can be a criminal misdemeanor offense punishable by imprisonment of up to a year.¹⁴ 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 federal government's general fund. Thus, personal income taxes, corporate income taxes, and other government revenues are used to pay for these shortfalls to the Social Security and Medicare trust funds.

¹¹Payroll taxes include income taxes, Social Security and Medicare taxes, and the employer's matching share of Social Security and Medicare, withheld from an employee's paycheck. Employers are to collect and remit these taxes to the federal government. Even though a grant-receiving entity may be exempt from paying income taxes, it still is required to collect and submit payroll taxes for all employees.

¹²26 U.S.C. § 6672.

¹³26 U.S.C. § 7202.

¹⁴26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

Although grant and direct assistance recipients had about \$790 million in unpaid federal taxes as of September 30, 2006, this amount likely understates the full extent of unpaid taxes for these or other organizations and individuals. For example, except for our case study involving HUD's Section 8 tenant-based housing program, our estimate of grant and direct assistance recipients was limited to data from three of the largest government payment systems and thus did not include all federal grant and direct assistance disbursements. Further, our analysis of the three payment systems did not include recipients of payments who received their payments through state and local government entities. Based on our analysis of data from the FAADS, we estimated that payments paid by the federal government to final recipients account for only about 20 percent of the total grant and direct assistance funds awarded by the federal government. The remaining 80 percent of grant and direct assistance funds are provided to states and local governments, which, in turn, disburse them to the ultimate recipient.

Further, to avoid overestimating the amount owed, we limited our scope to tax debts that were affirmed by either the taxable entity or a tax court for tax periods prior to 2006. We did not include the most current tax year because recently assessed tax debts that appear as unpaid taxes may involve matters that are routinely resolved between the taxpayer and IRS, with the taxes paid, abated, or both within a short period. We eliminated these types of debt by focusing on unpaid taxes for tax periods prior to calendar year 2006 and eliminating tax debt of \$100 or less.

The IRS tax database reflects only the amount of unpaid taxes either reported by the 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. Further, our analysis did not attempt to account for organizations or individuals that 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.¹⁵ Consequently, the full extent of unpaid taxes for grant and direct assistance participants is not known.

¹⁵According to IRS, nonfilers and underpayment of taxes comprised the rest of the gross tax gap.

Examples of Selected Recipients of Grants and Direct Assistance Involved in Abusive and Criminal Activity Related to Federal Tax System

For all 20 cases of grant and direct assistance recipients we investigated for examples of abusive and criminal activity related to the federal tax system based on the large amount of tax debt and number of delinquent tax periods, we found in all cases evidence that indicated the existence of such abusive and criminal activities. Of these 20 cases, 14 cases were not-for-profit organizations that received grant payments and also had unpaid payroll taxes, some dating as far back as the 1990s. For example, one educational institution failed to submit employee payroll withholding taxes several times within a 3-year period and accumulated an unpaid tax liability of almost \$4 million. For the cases of payroll tax delinquencies we investigated, officials responsible for these organizations failed to fulfill their role as “trustees” of employees’ payroll tax withholdings and forward this money to IRS as required by federal tax laws. Instead, these officials diverted the withholdings to fund the organizations’ operations or for personal benefits, such as their own salaries or extravagant vacations. The other 6 cases involved individuals who owed individual income taxes and who also received government subsidy payments through HUD’s Section 8 low-income housing program. In one of these cases, the landlord attempted to evict renters who were instructed by IRS to pay the rent directly to IRS instead of the landlord. In all 20 cases, we saw significant evidence of IRS collection activity occurring, but in only a couple of cases did we see action related to investigating these entities and individuals for criminal violations of federal tax laws.

Table 1 highlights 10 cases of grant recipients we investigated with unpaid taxes. The other 10 cases are summarized in appendix II.

Table 1: Examples of Grant and Direct Assistance Recipient Entities with Unpaid Federal Taxes

Case	Type of case	Nature of work	Unpaid tax amount ^a	Comments
1	Grant	Educational services	Nearly \$1 million	<ul style="list-style-type: none"> • Tax debt is mostly unpaid payroll taxes from the early 2000s. • Grant recipient received tens of thousands of dollars in grants. • Officials of grant recipient claimed payroll taxes were embezzled by an agency contracted to provide services to the grant recipient. • Grant recipient acquired a million-dollar building when it had a similar amount of tax liability. • Grant recipient offered to repay 50 percent of the debt in installments over several years. • Officer owned several luxury vehicles. • Despite owing taxes, the grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).

Case	Type of case	Nature of work	Unpaid tax amount ^a	Comments
2	Grant	Health education	Over \$300,000	<ul style="list-style-type: none"> • Tax debts consist of unpaid payroll taxes. • Grant recipient received about \$1 million in grants. • Officer's salary at over \$100,000 is almost double the average of service organizations in the area. In addition, officer has generous travel expenses and other perks. • Grant recipient owns property with fair market value over \$2 million. • Grant recipient offered compromise for two-thirds of the debt to be paid over a period of more than a decade. • During appeal of TFRP, officer refinanced residence and used proceeds to pay credit card debts. • Officer owns luxury vehicle. • IRS assessed penalties against entity officials for willful failure to pay payroll taxes.
3	Grant	Health services	Nearly \$1 million	<ul style="list-style-type: none"> • Grant recipient has incurred continuing payroll tax deposit deficiencies since early 2000s. • Grant recipient received tens of thousands of dollars in grant funds. • Grant recipient owns commercial property with an appraised value over \$1 million. • IRS filed numerous tax liens against grant recipient's property. • IRS assessed penalties against one officer for willful failure to pay payroll taxes.
4	Low-income housing subsidy	Housing services	Over \$3 million	<ul style="list-style-type: none"> • Landlord investigated for mortgage fraud. • Landlord was convicted for illegally transferring property to defraud creditors. • Landlord owns luxury vehicles, multiple real estate properties, and an extensive investment portfolio.
5	Low-income housing subsidy	Housing services	Over \$1 million	<ul style="list-style-type: none"> • Landlord has not filed required tax returns for over a decade. • Landlord has never made estimated tax payments. • Landlord did not report income information forms to IRS. • Rental property is in extreme disrepair and has poor sanitation conditions including piles of trash, beer cans, and human waste throughout the yard.
6	Low-income housing subsidy	Housing services	Over \$500,000	<ul style="list-style-type: none"> • Landlord has a related business owing hundreds of thousands of dollars in payroll taxes. • Landlord has attempted to avoid collection of IRS levies. • Landlord owns luxury vehicle.

Case	Type of case	Nature of work	Unpaid tax amount ^a	Comments
7	Grant	Medical care	Over \$500,000	<ul style="list-style-type: none"> • Tax debts largely consist of unpaid payroll taxes from the early 2000s. • Grant recipient received about \$1 million in grants. • Grant recipient could not provide to other auditors documentation for over \$1 million in program costs. • Grant recipient did not fund its pension plan. • Official of grant recipient received hundreds of thousands of dollars in consulting fees from grantee. • Official owes tens of thousands in individual income taxes. • IRS assessed penalties against grant recipient officials for willful failure to pay payroll taxes. • Despite owing taxes, the grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).
8	Grant	Medical care	Nearly \$100,000	<ul style="list-style-type: none"> • Tax debts largely consist of unpaid payroll taxes. • Grant recipient received about \$1 million in grants. • Recipient official was convicted of theft. • Auditor found questionable costs totaling tens of thousands of dollars. • Despite owing taxes, the grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).
9	Grant	Social services	Over \$1 million	<ul style="list-style-type: none"> • Tax debts largely consist of unpaid payroll taxes. • Not-for-profit grant recipient received over \$3 million of grant funds. • While failing to pay payroll taxes, the grant recipient organization paid a relative of an entity official hundreds of thousands of dollars for service contract. • Key official's salary exceeded \$100,000 a year. • Grant recipient did not fully fund its pension plan. • IRS previously assessed penalties against one officer for willful failure to pay payroll taxes while employed at a previous not-for-profit entity. • An independent auditor's report stated there is substantial doubt regarding the entity's ability to continue operating. • Federal grant agency sought sanctions against grantee and its officials for improper funds control and ineffective program oversight. • Despite owing taxes, the grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).

Case	Type of case	Nature of work	Unpaid tax amount ^a	Comments
10	Grant	Social services	Over \$400,000	<ul style="list-style-type: none"> • Tax debts largely consist of unpaid payroll taxes. • Grant recipient received over \$1 million in federal grants. • Grant recipient official had prior conviction for tax evasion. • Official received an annual salary in excess of \$100,000 yet reported tens of thousands of dollars less to IRS. • Grant recipient official was investigated for using grant funds to purchase expensive clothing, luxury vehicle, lakefront property, private school tuition, and lavish trips to the Caribbean and elsewhere. • Despite owing taxes, the grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).

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

^aRounded dollar amount of unpaid federal taxes as of September 30, 2006.

The following provide illustrative detailed information on several of these cases:

Case 4: This landlord participating in the Section 8 tenant-based housing program was involved in a fraudulent real estate transaction in addition to owing over \$3 million in delinquent income taxes. The landlord was indicted on mortgage fraud and racketeering for attempting to sell real estate at an inflated price using false appraisals. Previously, the landlord's family member was convicted of conspiracy to commit mail fraud, wire fraud, and money laundering in a scheme to sell fraudulent vacation club memberships. In addition, the landlord was charged with fraudulent conveyance of over \$3 million worth of property to defraud creditors.

Case 7: This grant recipient organization, which provides medical care to low-income families, has experienced financial problems throughout most of the 2000s and has several hundred thousand dollars in delinquent payroll taxes. During these years, while failing to properly fund its employee pension plan, the grant recipient paid hundreds of thousands of dollars in consulting fees to a former employee. Grant recipient could not document to other auditors over a million dollars in expenses relating to grants. Grant recipient has not made required contributions totaling tens of thousands of dollars to its pension plan. In addition, IRS assessed a TFRP against key grant recipient officials.

Case 9: This not-for-profit grant recipient has been in operation since the 1980s to provide social services to disadvantaged individuals and families and has another closely related not-for-profit entity that also received

federal grants. The recipient has over \$1 million in unpaid payroll taxes dating back to the early 2000s, and IRS has placed several tax liens against the grantee's property. The grant recipient has had recurring financial problems and an independent audit report raised concerns about the entity's ability to continue operating. The recipient has also been cited for commingling funds among related grant recipients and for not having a functioning Board of Directors as represented to the granting agency. The recipient has been recommended for disbarment.

Case 10: This not-for-profit grant recipient stopped making payroll tax deposits for several years beginning mid-2000s, accumulating unpaid payroll taxes totaling several hundreds of thousands of dollars. IRS filed liens against grantee assets and assessed the exempt organization with payroll tax violation penalties and interest totaling tens of thousands of dollars. A key grant recipient officer had a prior conviction for tax evasion and was again investigated for improperly using grant funds to purchase expensive clothing, a luxury vehicle, and lavish vacations and to pay taxes assessed from a prior tax evasion conviction. A key grantee officer had numerous individual income tax delinquencies.

Federal Agencies Do Not Prevent Delinquent Taxpayers from Participating in Federal Grant or Direct Assistance Programs

Neither federal law nor current governmentwide policies for administering federal grants or direct assistance prohibit applicants with unpaid federal taxes from receiving grants and direct assistance from the federal government. Even if such requirements did exist, absent consent from the taxpayer, federal law generally prohibits IRS from disclosing taxpayer data and, consequently, federal agencies have no access to tax data directly from IRS. Moreover, federal agencies we reviewed do not prevent organizations and individuals with unpaid federal taxes from receiving grants or direct assistance for the specific programs they administer.

With regard to administering federal grants, federal law and current governmentwide policies, as reflected in OMB Circulars, do not prohibit individuals and organizations with unpaid taxes from receiving grants.¹⁶ OMB Circulars provide only general guidance with regard to considering existing federal debt in awarding grants. Specifically, the Circulars state

¹⁶The OMB Circulars are OMB Circular No. A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations* (Amended September 30, 1999) and OMB Circular No. A-102, *Grants and Cooperative Agreements with State and Local Governments* (Amended August 29, 1997).

that if an applicant has a history of financial instability, or other special conditions, the federal agency may impose additional award requirements to protect the government's interests.¹⁷ However, the Circulars do not specifically require federal agencies to take into account an applicant's delinquent federal debt, including federal tax debt, when assessing applications. While they require grant applicants to self-certify in their standard government application (SF 424) whether they are currently delinquent on any federal debt, including federal taxes, the Circulars contain no provision instructing the agencies to verify such certifications or describing how such verification should be done. No assessment of tax debt is required by OMB on a sampling or risk-based assessment.

Although current governmentwide policies do not require it, federal agencies, such as HHS and Department of Education, have policies against awarding grants to applicants that owe federal debts. These policies state that a grant may not be awarded until the debt is satisfied or arrangements are made with the agency to which the debt is owed. However, awarding agencies rely extensively on applicants' self-certifications that they are not delinquent on any federal debt, including tax debt. Certain agencies, such as HHS, stated that they check credit reports to see if the grant applicant has any outstanding tax liens prior to award of the contract. While it is difficult to validate the agencies' assertions, none of these agencies could provide us examples where grant officials denied a grant based on self-disclosed tax delinquencies or required applicants to make repayment arrangements with the agency to which debt was owed.

Even if requirements to verify applicants' disclosures did exist, federal law poses a significant challenge to federal granting agencies in determining the accuracy of representations made by organizations applying for grants. Specifically, the law does not permit IRS to disclose taxpayer information, including tax debts, to federal agency officials unless the taxpayer consents.¹⁸ Thus, unless an applicant provides consent requesting that IRS provide taxpayer information to federal agencies, certain tax debt information generally can only be discovered from public records when

¹⁷In contrast, governmentwide policies for managing federal loan, loan guarantees, and other credit programs promulgated in OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables* (November 2000) specifically require agencies to determine if an applicant is delinquent on any federal debt, including tax debt, and specifies using credit bureaus as a screening tool.

¹⁸26 U.S.C. § 6103.

IRS files a tax lien against the property of a tax debtor. Further, representatives of one federal agency that has attempted to develop an approved consent form discovered that IRS may not accept certain signed consent forms because a requirement for an applicant to sign a consent form as a precondition to the agency's acceptance of the application may be considered a form of duress and thus raise a disclosure issue. Notwithstanding, while information on filed tax liens is generally publicly available, IRS does not file tax liens on all tax debtors nor does IRS have a central repository of tax liens to which grant-awarding agencies have access. Further, available information on tax liens may not be current or accurate because other studies have shown that IRS has not always released tax liens from property when the tax debt has been satisfied.¹⁹

Of the 20 organizations and individuals that we selected for additional investigation of abuse and criminal activity, 14 were grant recipients that were required to submit an application in order to be awarded a grant.²⁰ In our review of the grant applications for the 14 grant cases, we found that 11 applicants certified in their applications that they were not currently delinquent in any federal debt, even though IRS had current tax assessments on file for these entities at the time the applications were filed.²¹ As a result, these 11 cases appear to have violated the False Statements Act because they did not declare their existing tax debt in their applications even though they were required to do so.²²

Direct assistance programs are generally not subject to the same governmentwide guidance for grants. Instead, the cognizant federal agencies implement the necessary regulations for administering the program. With regard to our HUD's Section 8 tenant-based program case study, HUD regulations do not require local housing authorities to identify

¹⁹GAO, *IRS Lien Management Report: Opportunities to Improve Timeliness of IRS Lien Releases*, GAO-05-26R (Washington, D.C.: Jan. 10, 2005) and GAO, *Financial Audit: IRS's Fiscal Years 2006 and 2005 Financial Statements*, GAO-07-136 (Washington, D.C.: Nov. 9, 2006).

²⁰The other six cases involve HUD landlords. These six cases were not required to submit a similar application that required the landlords to disclose whether they were delinquent on any federal tax debts or not.

²¹For the other three applicants, IRS did not levy tax assessments until after applications were filed for two applicants and available information did not permit us to determine the debt status for the other applicant.

²²18 U.S.C. § 1001.

whether landlords who participate in HUD's housing assistance program and receive housing subsidies have outstanding federal tax delinquencies or prohibit payments if such delinquencies are identified. HUD regulations do permit local housing authorities to deny program participation if a landlord has not paid state or local real estate taxes, fines, or assessments. HUD regulations, however, do not require local housing authorities to deny the landlord from participating in the HUD program if the landlord owes any delinquent federal debts, including federal taxes.

Conclusion

Because about 80 percent of all federal grants and direct assistance are administered and disbursed through state and local governments, the extent to which all final recipients of these federal payments owe taxes is not known. However, our limited audit has demonstrated that tens of thousands of grant and direct assistance recipients have taken advantage of the opportunity to avoid paying \$790 million in federal taxes. At the same time they failed to pay their federal taxes, these individuals and organizations benefited by receiving billions of dollars of federal grants or direct assistance benefits. With regard to grants, allowing individuals and organizations to receive federal grants while not paying their federal taxes is not fair to the vast majority of grant applicants that pay their fair share of taxes. This practice causes a disincentive to individuals and organizations to pay their fair share of taxes and could lead to further erosion in compliance with the nation's tax system.

Recommendations for Executive Action

We recommend that the Director, Office of Management and Budget, assess the need to issue guidance requiring federal agencies that award certain grants and other direct assistance, where appropriate in relation to the potential adverse effect on potential applications, to take the following two actions:

- Conduct actions that would help determine if applicants had unpaid federal tax debt, including obtaining applicant consent to inquire as to tax debt status from IRS; this could be achieved through sampling or other risk-based assessments.
- Consider the result of those inquiries in the award determinations.

We also recommend that the Acting Commissioner of Internal Revenue evaluate the 20 referred cases detailed in this report for appropriate additional collection action or criminal investigation as warranted.

Agency Comments and Our Evaluation

We received written comment from IRS and oral comments from OMB on the draft of this report. Both IRS and OMB agreed with the draft report's recommendations. OMB also provided technical comments on the draft report, which we incorporated as appropriate. We have reprinted IRS's written comments in their entirety in Appendix III.

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 Acting Commissioner of Internal Revenue, the Director of the Office of Management and Budget, interested congressional committees, and other interested parties. 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.



Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Appendix 1: Scope and Methodology

To address our first objective to describe the magnitude of tax debt owed, we obtained and analyzed federal payment databases from the Department of the Treasury's Automated Standard Application Payment System (ASAP), the Department of Education's Grant Administration and Payment System (GAPS), and the Department of Health and Human Services' (HHS) Payment Management System (PMS) for fiscal years 2005 and 2006. These three agencies process grant and other assistance program payments on behalf of many federal agencies and, in fiscal years 2005 and 2006, processed over \$460 billion in grant and direct assistance payments, excluding Medicare and Medicaid. Our analysis of data, however, was limited because approximately 80 percent of federal grant and direct assistance payments are paid to state and local governments,¹ which then disburse funds to final recipients. Because identifying information on the final recipients of payments provided at the state and local level is not available at the federal level, our analysis was limited to those payments provided directly by the federal government to final recipients. We estimated these direct payments to final recipients represented about 20 percent of total federal grant and direct assistance payments.

Because identifying information for final recipients of payments provided at the state and local levels was not available at the federal level and not practical for us to obtain, we selected one major federal program that disburses funds at the local level for a case study analysis. For this case study, we selected the Department of Housing and Urban Development's (HUD) Section 8 tenant-based low-income housing program, a program classified as a direct assistance program, which provides rental assistance to low-income families by providing supplemental rental payments directly to landlords participating in the rental assistance program. We obtained and analyzed an extract from HUD's Public Housing Information Center (PIC) database, which HUD represented to be the most complete data source available on low-income assisted households in HUD's public housing or voucher programs, that contained identifying information on landlords who participated in HUD's program during fiscal years 2005 and 2006.

To identify recipients of grants and direct assistance with unpaid federal taxes, we obtained the Internal Revenue Service's (IRS) September 30,

¹As defined as state, county, city, or township governments; special district governments (e.g., public housing authorities and local transit authorities); independent school districts; and state-controlled institutions of higher education.

2006, unpaid assessments files and electronically matched these files with the various grant and direct assistance recipients identified in the above databases using the taxpayer identification number. To avoid overstating the amount of unpaid taxes owed by grant recipients and to capture only significant tax debt, we excluded tax debts meeting specific criteria. The criteria we used to exclude tax debts are as follows:

- tax debts IRS classified as compliance assessments or memo accounts for financial reporting,²
- tax debts from calendar year 2006 tax periods, and
- grant recipients with total unpaid taxes of \$100 or less.

The criteria above were used to exclude tax debts that might be under dispute or generally duplicative or invalid and tax debts that are incurred after the dates the entities received grant payments. Compliance assessments or memo accounts were excluded because these taxes have neither been agreed to by the taxpayers nor affirmed by the court, or these taxes could be invalid or duplicative of other taxes already reported. We excluded tax debts from calendar year 2006 tax periods to eliminate tax debt that may involve matters that are routinely resolved between the taxpayers and IRS, with the taxes paid or abated within a short period. We also excluded tax debts of \$100 or less because they are insignificant for the purpose of determining the extent of taxes owed by grant recipients.

To identify examples of grant and direct assistance recipients involved in abusive or potential criminal activity related to the federal tax system, we selected 20 recipients using a nonrepresentative selection approach based on data-mining results, our judgment, and a number of other criteria, including the amount of unpaid taxes and the number of unpaid tax periods. We obtained and reviewed copies of automated tax transcripts and other tax records (for example, revenue officers' notes) from IRS. For the selected cases, we performed searches of criminal, financial, and public records. Because our investigations were generally limited to publicly available information, our audit of the 20 cases may not have identified all related parties or all significant assets or income (such as

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

personal bank data, entities established to hide assets, etc.) that the recipient individuals or entities, including key officials, own or receive.

To determine actions federal agencies take to prevent individuals and organizations with significant unpaid federal taxes from either being approved for or receiving grant or direct assistance payments, we reviewed governmentwide and agency-specific policies and procedures for awarding grants and benefits from the respective programs. We also interviewed officials from the Office of Management and Budget and the Departments of Agriculture, Education, Homeland Security, HHS, and HUD on whether tax debts are considered in their decisions to approve award applications. In addition, to test whether grant applicants properly disclosed their current tax delinquencies when submitting applications, we requested and reviewed the grant applications for our 14 cases that applied for grants.³

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

Data Reliability Assessment

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

For the GAPS, ASAP, and PMS data, we interviewed officials from Education, Treasury, and HHS responsible for the databases. In addition, we performed electronic testing of specific data elements that we used to perform our work. HUD's PIC database has undergone several audits and quality improvements in recent years and was certified in fiscal year 2004 under HUD's Data Quality Improvement Program as providing accurate

³The other six cases were private landlords participating in HUD's Section 8 tenant-based housing program.

information for reporting on program performance under the Government Performance and Results Act. We held discussions with HUD's database administrators on input controls used to maintain data integrity for the data elements we used for our analysis and with HUD programmers to discuss the programming code HUD used to extract the data we used. We also performed electronic testing of the data elements we used and performed limited verification tests.

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

Appendix II: Grant and Direct Assistance Recipients with Unpaid Taxes

Table 1 provides data on 10 detailed case studies. Table 2 below provides details of the remaining 10 organizations and individuals we selected as case studies. As with the 10 cases discussed in the body of this report, we found evidence of abusive and potential criminal activity related to the federal tax system during our audit and investigations of these 10 case studies.

Table 2: Grant/Direct Assistance Recipient Entities with Unpaid Federal Taxes

Case	Type of case	Nature of work	Unpaid federal tax amount	Comments
11	Grant	Children's services	Over \$2 million	<ul style="list-style-type: none"> While failing to remit payroll taxes dating back to the early 2000s, grant recipient received over \$2 million in federal grants in recent years, key official received compensation of over \$100,000, and grant recipient entered into multiple payment plans with the IRS and was out of compliance on at least one. IRS assessed large penalties against key officers for willful failure to pay payroll taxes. Federal tax liens were filed against the grant recipient. Despite owing taxes, grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).
12	Grant	Community services	Over \$1 million	<ul style="list-style-type: none"> Grant recipient received nearly \$3 million in federal grants during a recent 2-year period. Grant recipient officials claim they were unaware they had not paid payroll taxes for several years. A top official received compensation of about \$100,000. Federal tax liens were filed against the grant recipient. Grant recipient officials recently chose to close the entity rather than pay the tax. Despite owing taxes, grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).
13	Grant	Community services	Over \$300,000	<ul style="list-style-type: none"> Grant recipient received over \$2 million in federal grants. Grant recipient pays an annual salary over \$70,000 to a relative of a key official. Despite owing taxes, this grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).

**Appendix II: Grant and Direct Assistance
Recipients with Unpaid Taxes**

Case	Type of case	Nature of work	Unpaid federal tax amount	Comments
14	Grant	Educational services	Nearly \$4 million	<ul style="list-style-type: none"> • Grant recipient received over \$3 million in grants. • Grant recipient failed to submit payroll deposits several times over a 3-year period. • Former key employee investigated for fraud allegations. • Evidence that officials of grant recipient were removing assets to avoid foreclosure and erasing computer memories to avoid prosecution. • IRS assessed penalties against entity officials for willful failure to pay payroll taxes. • Despite owing taxes, the grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).
15	Grant	Educational services	Over \$3 million	<ul style="list-style-type: none"> • Grant recipient received several million dollars in federal grants in a recent year. • Grant recipient owes mostly payroll taxes dating back to the early 2000s. • IRS seized some of the grant recipient's assets. • IRS assessed large penalties against several officials for willful failure to pay payroll taxes. • IRS filed federal tax liens against the entity. • Despite owing taxes, grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).
16	Grant	Educational services	Over \$300,000	<ul style="list-style-type: none"> • Grant recipient received over \$2 million in federal grants during a recent 2-year period while owing payroll taxes dating back to the late 1990s. • Grant recipient did not file payroll tax returns for several years, although it made payments for some periods. IRS is considering a request from the grant recipient for an offer in compromise in which the grantee would pay only a portion of the unpaid payroll taxes. • Despite owing taxes, grant recipient did not declare federal tax debt in its grant application, an apparent violation of the False Statements Act (18 U.S.C. § 1001).
17	Low-income housing subsidy	Housing services	Nearly \$2 million	<ul style="list-style-type: none"> • Landlord did not file required tax returns for several years. • During the same time the landlord failed to file tax returns, a brokerage firm reported over \$3 million in sales of securities. • Landlord was involved in multiple real estate transactions during the time the landlord failed to file tax returns. • While owing taxes, the landlord transferred ownership of real property to a third party who mortgaged the property to pay off landlord's nontax debt.

**Appendix II: Grant and Direct Assistance
Recipients with Unpaid Taxes**

Case	Type of case	Nature of work	Unpaid federal tax amount	Comments
18	Low-income housing subsidy	Housing services	Over \$1 million	<ul style="list-style-type: none"> • Landlord did not file required tax returns for several years. • Landlord made several hundred thousand dollars in cash withdrawals during a period while not filing taxes. • Landlord was convicted of willful failure to file tax returns and sentenced to 3 years probation. • Landlord violated HUD rental property standards. • Landlord's property that had significant environmental violations was foreclosed on and sold.
19	Low-income housing subsidy	Housing services	Over \$500,000	<ul style="list-style-type: none"> • Landlord has not paid withholding, estimated payments, or filed tax returns the majority of years since early 1990s. • Landlord's spouse had not filed a personal tax return since early 2000s. • IRS has placed several hundreds of thousands in liens on landlord property.
20	Grant	Social services	Over \$800,000	<ul style="list-style-type: none"> • Grant recipient received nearly \$400,000 in federal grants during a recent 2-year period while owing payroll tax dating back to the early 2000s. • Previous top official responsible for incurring the debt was convicted of a felony. • IRS assessed penalties on the previous top officer for willful failure to pay payroll taxes. • Federal tax liens were filed against the grant recipient.

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

^aRounded dollar amount of unpaid federal taxes as of September 30, 2006.

Appendix III: Comments from the Internal Revenue Service



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

October 23, 2007

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

Dear Mr. Kutz:

I have reviewed the draft Government Accountability Office (GAO) report titled: "Tax Compliance: Federal Grant and Direct Assistance Recipients Who Abuse the Federal Tax System" (GAO-08-31).

Your report offers two recommendations. The first recommendation is directed solely to the Office of Management and Budget (OMB). You recommend the Director, OMB assess the need to require federal agencies to conduct proactive inquiries into the tax debt status of award applicants where appropriate. We realize the importance and potential benefits of considering unpaid federal tax debt in the award determinations, and will support OMB's assessment efforts. With regard to your second recommendation, we agree to evaluate the 20 referred cases detailed in the report for appropriate additional collection action or criminal investigation as warranted. We will work with your staff to secure additional information on the 20 cases.

If you have any questions, or if you would like to discuss this response in more detail, please contact Frederick W. Schindler, Director, Collection Policy at (202) 283-7650.

Sincerely,


Linda E. Stiff
Acting Commissioner

Enclosure

Enclosure

Recommendation:

Evaluate the 20 referred cases detailed in this report for appropriate additional aggressive collection action and criminal investigation as warranted.

Response:

The IRS will work with your office to secure additional information on the 20 cases identified in your audit with indications of abuse or potential criminal activity. We plan to review each of these case files and refer them for additional action as appropriate.

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Greg D Kutz, (202) 512-6722, or kutzg@gao.gov

Staff Acknowledgments

In addition to the individual named above, Erika Axelson, James Berry, Ray Bush, Bill Cordrey, Kenneth Hill, Aaron Holling, Wil Holloway, Mitchell Karpman, John Kelly, Rick Kusman, Tram Le, John Ledford, Barbara Lewis, Andrew McIntosh, Eduvina Rodriguez, John Ryan, Steve Sebastian, Robert Sharpe, Barry Shillito, Pat Tobo, and Matthew Valenta made key contributions to this report.

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.

GAO's Mission

The Government Accountability 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 GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "E-mail Updates."

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. Government Accountability Office
441 G Street NW, Room LM
Washington, DC 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

Congressional Relations

Gloria Jarmon, Managing Director, jarmong@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548