

SENATOR CARL LEVIN (D-MICH)

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

ON

**STIMULUS CONTRACTORS WHO CHEAT ON THEIR TAXES:
WHAT HAPPENED?**

May 24, 2011

The Subcommittee today is examining federal contractors who get paid with taxpayer dollars, but then fail to pay the taxes they owe. I commend my colleague Senator Coburn for taking the initiative to press forward on this issue.

Prior Subcommittee hearings on this and related topics have exposed as tax delinquents tens of thousands of federal contractors and service providers who collectively owe billions in unpaid taxes. The spotlight today is on businesses that received contract or grant funds under the American Recovery and Reinvestment Act. While the vast majority – well over 90% – of Recovery Act recipients are in compliance with federal requirements and are contributing to our economic recovery, a small portion, about 5%, have put taxpayer dollars in their pockets, while failing to meet their tax obligations. That 5% is about half the percentage of DOD contractors that an earlier report found had unpaid taxes, but it is nonetheless troubling. According to a report the Subcommittee is releasing today, that 5% translates into about 3,700 contractors and grant recipients, out of a total of about 63,000, that received over \$24 billion in stimulus dollars, while owing unpaid federal taxes of more than \$750 million.

Federal programs now exist to stop this type of abuse. One key program is the Federal Payment Levy Program, which was established over ten years ago to enable the federal government to identify federal payments being made to tax delinquents, and authorize the withholding of a portion of those payments to apply to the person's tax debt.

When the Subcommittee began looking at the federal contractor issue in 2004, the tax levy program was weighed down by bureaucratic requirements and red tape. In response to the Subcommittee's request, the key federal agencies, including the Internal Revenue Service (IRS), the Financial Management Service (FMS) at Treasury, and others, formed a government-wide task force to streamline the tax levy program. That task force has addressed many of the problems that have been identified by the Subcommittee.

As a result, the tax levy program has become energized. It has moved from covering only 10% to covering 100% of the payment systems at the Department of Defense. In addition, by September of this year, 100% of the \$400 billion in Medicare payments made each year will be screened for tax delinquents. Tax levy collections from tax delinquent federal contractors as a

whole have increased almost six-fold over the past six years – from about \$20 million in FY 2004 to \$115 million in FY 2010. Last year is the first time the tax levy program has collected over \$100 million from tax delinquent federal contractors in a single year. We applaud that progress. At the same time, that \$100 million per year has to be compared to the billions of dollars in unpaid tax debt still owed by federal contractors, which means there is still a lot more work to be done.

GAO selected 15 of the Recovery Act recipients that raised particular red flags for a closer look. GAO found that those 15 recipients alone were responsible for \$40 million in unpaid taxes. GAO also found that those 15 had engaged in abusive or potentially criminal activities, including failing to remit the payroll taxes that were taken out of employee paychecks but never sent to the IRS. Federal law requires employers to hold payroll tax money “in trust” for the IRS, and failure to remit those funds as required is a violation of civil and criminal law.

In one case, GAO identified a security company that received \$100,000 in federal funds yet owed over \$9 million in unpaid taxes. Those unpaid taxes were primarily payroll taxes from five years earlier that the company never forwarded to the IRS. The company had also been cited by the Department of Labor for violating federal labor laws.

In another case, GAO identified a social services company that owed over \$2 million in taxes, yet received more than \$1 million in federal funds. That company had defaulted on several installment agreements with the IRS which finally imposed a penalty on an executive who was personally responsible for nonpayment of the taxes owed. GAO found that this executive had numerous transactions with casinos totaling hundreds of thousands of dollar a year, indicating he had substantial funds to apply to the company’s tax debt yet failed to do so.

GAO also found that, while some of the recipients were subjected to the tax levy program, about \$315 million of the tax debt was not, because the Recovery Act funds had not been paid directly by the federal government to the tax delinquent businesses. Instead, in those cases, the federal government had paid the funds to a State, prime contractor, or grant recipient which, in turn, made payments to the ultimate recipients. The businesses that got their money from a State, prime contractor, or grant recipient were never screened by the federal tax levy program and so escaped having any portion of their funds withheld for payment of their tax debt. That gap in the tax levy program needs to be addressed.

In addition to hearing from GAO, we will hear today from the President’s Office of Federal Procurement Policy or OFPP, which sets contract policy for the Administration and is part of the Office of Management and Budget (OMB). President Obama became concerned about the issue of federal contractors with unpaid taxes while here in the Senate, and he hasn’t forgotten the issue. In addition to setting a policy against awarding federal contracts to tax delinquent companies, his Administration changed the Federal Acquisition Regulations to require businesses bidding on federal contractors to certify in writing if they have a tax debt of \$3,000 or more, so federal agencies would know about the problem when awarding contracts. His Administration also made nonpayment of tax grounds for debarring a business from bidding on any federal contract. In January 2010, the President also issued a memorandum which, among other matters, caused OMB to initiate an evaluation of whether federal contracting

officers and debarment officials were fully utilizing tax debt information. Today, we will hear more about those efforts.

Since the problem of federal contractors who get paid with taxpayer dollars while dodging their own tax obligations isn't going away, we need to do more to stop the abuse. One action we could surely take is a concerted effort to debar the really flagrant tax cheats from obtaining federal contracts and grants. In each of the hearings we've held on this topic, GAO has identified 15, 20, or 25 tax delinquent businesses that have essentially thumbed their noses at Uncle Sam. Some paid their taxes with bounced checks, repeatedly violated installment agreements, or re-incorporated as new a new company to escape past tax debt. Some business owners sported mansions, expensive cars, or other luxury assets indicating they had the money needed to repay the outstanding tax debt, but chose not to. While these egregious cases have been referred to the IRS and prosecutors, in most cases the companies and their owners have not been debarred from obtaining new federal contracts or grants. Starting with the cases flagged by GAO, this Administration ought to get on with an immediate effort to debar egregious tax cheats from competing against honest businesses that pay their fair share.

We should also consider requiring States, prime contractors, and grant recipients that receive federal funds to require their subcontractors or subrecipients to disclose tax debt, as described in the Federal Acquisition Regulations, and then prohibit those States, prime contractors, and grant recipients from dispensing federal taxpayer dollars to those with outstanding tax debt. Tax deadbeats should not be getting taxpayer dollars, and they shouldn't be allowed to compete against honest businesses that meet their tax obligations. I look forward to hearing from the witnesses today about these and other ideas to stop the abuse.

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