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Testimony

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

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## RECOVERY ACT

# Thousands of Recovery Act Contract and Grant Recipients Owe Hundreds of Millions in Federal Taxes

Statement of Gregory D. Kutz, Director  
Forensic Audits and Investigative Service



**G A O**

Accountability \* Integrity \* Reliability

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Chairman Levin, Ranking Member Coburn, and Members of the Subcommittee:

Thank you for the opportunity to discuss the results of our most recent report, which we are releasing today, on American Recovery and Reinvestment Act of 2009 (Recovery Act) contract and grant recipients that owe federal taxes.<sup>1,2</sup> Collectively, individuals, businesses, and other entities owed the U.S. government about \$330 billion in known unpaid taxes, including interest and penalties, as of September 30, 2010, according to the Internal Revenue Service (IRS). IRS enforcement of the nation's tax laws continues to be on our High-Risk List.<sup>3</sup> The Recovery Act appropriated \$275 billion to be distributed for federal contracts, grants, and loans.<sup>4</sup> According to [www.Recovery.gov](http://www.Recovery.gov) (Recovery.gov) data on federal spending, as of March 25, 2011, about \$191 billion of that amount had been paid out.<sup>5</sup> As far back as 1992, we have said that Congress should consider whether tax compliance should be a prerequisite for receiving a federal contract.<sup>6</sup> Federal law does not prohibit the awarding of contracts or grants to entities because they owe federal taxes and does not permit IRS to disclose taxpayer information, including unpaid federal taxes, to federal agencies unless the taxpayer consents. Because of the potential that some Recovery Act recipients also have unpaid federal taxes you asked us to investigate this issue.

My statement today is based on our most recent report regarding tax delinquent federal contractors and grantees. Our report and my statement address two issues: (1) the magnitude of known tax debt owed by

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<sup>1</sup>GAO, *Recovery Act: Thousands of Recovery Act Contract and Grant Recipients Owe Hundreds of Millions in Federal Taxes*, [GAO-11-485](#) (Washington, D.C.: Apr. 28, 2011).

<sup>2</sup>For the purposes of this report, we refer to prime recipients, subrecipients, and vendors as recipients of Recovery Act funds.

<sup>3</sup>GAO, *GAO's 2011 High-Risk Series: An Update*, [GAO-11-394T](#) (Washington, D.C.: Feb. 17, 2011).

<sup>4</sup>Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009).

<sup>5</sup>Recovery.gov is a Web site created under the Recovery Act in order to track and publicly disclose the projects and activities for which Recovery Act funds were expended or obligated and information concerning the amount and use of funds by nonfederal recipients. It includes spending at the prime recipient level, as well as certain subrecipients.

<sup>6</sup>GAO, *Tax Administration: Federal Contractor Tax Delinquencies and Status of the 1992 Tax Return Filing Season*, [GAO/T-GGD-92-23](#) (Washington, D.C.: Mar. 17, 1992).

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Recovery Act contract and grant recipients; and (2) examples of Recovery Act contract and grant recipients who have known unpaid federal taxes. To determine, to the extent possible, the magnitude of known tax debt owed by Recovery Act contract and grant recipients, we identified contract and grant recipients from Recovery.gov and compared them to known tax debts as of September 30, 2009, from IRS.<sup>7</sup> To provide examples of Recovery Act recipients with known unpaid federal taxes, we chose a nonrepresentative selection of 30 Recovery Act contract and grant recipients, which were then narrowed to 15 based on a number of factors, including the amount of taxes owed and the number of delinquent tax periods. These case studies serve to illustrate the sizable amounts of taxes owed by some organizations that received Recovery Act funding and cannot be generalized beyond the cases presented. Our work was performed in accordance with generally accepted government auditing standards and with standards for investigations prescribed by the Council of the Inspectors General on Integrity and Efficiency.

My testimony today summarizes our findings on each of the two issues discussed in our report. Specifically, we found the following:

- *Thousands of Recovery Act contract and grant recipients owe hundreds of millions in federal taxes:* At least 3,700 Recovery Act contract and grant recipients—including prime recipients, subrecipients, and vendors—are estimated to owe more than \$750 million in known unpaid federal taxes as of September 30, 2009, and received over \$24 billion in Recovery Act funds. This represented nearly 5 percent of the approximately 80,000 contractors and grant recipients in the data from Recovery.gov as of July 2010 that we reviewed. The estimated amount of known unpaid federal taxes is likely understated because IRS databases do not include amounts owed by recipients who have not filed tax returns or understated their taxable income and for which IRS has not assessed tax amounts due. In addition, our analysis does not include Recovery Act contract and grant recipients who are noncompliant with or not subject to Recovery Act reporting requirements. Our analysis also does not include contract and grant recipients that were not registered in the Central

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<sup>7</sup>Specifically, we obtained all of the fourth quarterly contract and grant recipient reports made available on July 30, 2010, as well as all reports from prior quarterly submissions that were marked as “final” by the recipients.

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Contractor Registration (CCR).<sup>8</sup> Because Recovery.gov does not contain taxpayer identification numbers (TIN), we used CCR to identify the TIN for each contract and grant recipient. We were not able to match about 17,000 of the 80,000 recipients in Recovery.gov to the CCR database. As such, those 17,000 recipients were not included in our analysis.

- *Examples of Recovery Act recipients with unpaid federal taxes engaged in abusive or potentially criminal activity:* For the 15 cases we selected for further review, we found abusive or potentially criminal activity, i.e., recipients had failed to remit payroll taxes to IRS. Federal law requires employers to hold payroll tax money “in trust” before remitting it to IRS. Failure to remit payroll taxes can result in civil or criminal penalties under U.S. law. The amount of unpaid taxes associated with these case studies were about \$40 million, ranging from approximately \$400,000 to over \$9 million. IRS has taken collection or enforcement activities (e.g., filing of federal tax liens) against all 15 of these recipients. Our analysis and investigation found that only 1 of these 15 Recovery Act recipients was subject to the new Federal Acquisition Regulation requirement for certification of tax debts in relation to their Recovery Act awards.<sup>9</sup> Because that contractor was current on its repayment agreement, the contractor was not required to disclose its tax debts. The other 14 recipients were grant recipients or contract subrecipients. However, 1 of the 14 companies that recently filed an Online Representations and Certifications Application improperly stated that the company had not been notified of any delinquent federal taxes (greater than \$3,000) within the preceding 3 years. We did not identify any circumstances (e.g., current repayment agreement) that would allow the company to make such certification. We have referred all 15 recipients to IRS for

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<sup>8</sup>CCR is the primary registrant database for the U.S. federal government. According to the Federal Acquisition Regulation 4.1102, prospective contractors shall be registered in the CCR database prior to award of a contract or agreement. Entities applying for grant awards from the federal government also need to register in CCR. All Recovery Act prime recipients were to register in the CCR database.

<sup>9</sup>On May 22, 2008, the Civil Agency Acquisition Council and the Defense Acquisition Regulations Council amended the FAR by adding conditions regarding delinquent federal taxes and the violation of federal criminal tax laws. The FAR rule requires offerors on federal contracts to certify whether or not they have, within a 3-year period preceding the offer, been convicted of or had a civil judgment rendered against them for, among other things, violating federal criminal tax law, or been notified of any delinquent federal taxes greater than \$3,000 for which the liability remains unsatisfied. This certification is made through the Online Representations and Certifications Application Web site, [orca.bpn.gov](http://orca.bpn.gov).

further investigation, if warranted. Table 1 provides summary information on 3 of our 15 case study examples of Recovery Act contractors and grant recipients with known unpaid federal taxes.

**Table 1: Examples of Recovery Act Contract and Grant Recipients with Known Unpaid Taxes**

Nature of work	Total Recovery Act awards <sup>a</sup>	Known unpaid federal taxes <sup>b</sup>	Comments
Construction	Over \$1 million	Over \$700 thousand	<ul style="list-style-type: none"> <li>• Company primarily owes payroll taxes from the mid 2000s. The company generally did not make any federal tax deposits during that time.</li> <li>• Company received multiple Recovery Act awards.</li> <li>• At the same time that the company was not paying its federal tax deposit, a company executive had hundreds of thousands of dollars in casino transactions.</li> <li>• According to IRS records, a company executive admitted to paying other creditors while neglecting to pay payroll taxes. IRS assessed a Trust Fund Recovery Penalty (TFRP) against a key executive for failure to pay payroll taxes.</li> <li>• IRS established an installment agreement with the company to make monthly payments of over \$1,000.</li> <li>• Federal government awarded the company millions of dollars in nonstimulus funds in the late 2000s.</li> <li>• IRS filed federal tax liens against this company.</li> </ul>
Social services	Over \$1 million	Over \$2 million	<ul style="list-style-type: none"> <li>• Nonprofit organization primarily owes payroll taxes from the mid to late 2000s. Nonprofit organization did not make any federal tax deposits for several periods.</li> <li>• On multiple occasions, the nonprofit organization defaulted on installment agreements with IRS. IRS records also indicated that the nonprofit organization may have submitted an offer in compromise to delay IRS collection efforts.</li> <li>• An executive was assessed a TFRP. IRS records indicated that this executive was responsible for numerous questionable business expenses. In addition, the executive had numerous transactions with casinos totaling hundreds of thousand of dollars each year. IRS records also indicated that IRS assessed a TFRP on this executive for another entity that went defunct.</li> <li>• IRS records indicated that the nonprofit organization failed to meet employee payroll obligations on numerous occasions in the late 2000s.</li> <li>• According to one executive, the nonprofit received millions of dollars in government grants.</li> <li>• IRS filed federal tax liens against this organization.</li> </ul>

Nature of work	Total Recovery Act awards <sup>a</sup>	Known unpaid federal taxes <sup>b</sup>	Comments
Technical services	Over \$100 thousand	Over \$4 million	<ul style="list-style-type: none"> <li data-bbox="743 489 1395 646">• Company owes payroll taxes from the mid to late 2000s. For several periods, the company did not make any tax deposits. According to IRS records, the company claimed it did not make tax deposits because the government did not give the company an abatement on its taxes.<sup>c</sup></li> <li data-bbox="743 657 1395 814">• IRS assessed a TFRP against a company executive, who owns real estate valued at an estimated \$4 million. This executive also purchased a luxury vehicle at the same time the company was not paying its payroll taxes. The company executive reported hundreds of thousands of dollars in adjusted gross income in a recent tax return.</li> <li data-bbox="743 825 1395 951">• IRS established an installment agreement with the company to make monthly payments of tens of thousands of dollars. IRS records indicated that the company provided unique and essential services to the government.</li> <li data-bbox="743 961 1395 1010">• Federal government awarded the company millions of dollars in nonstimulus funds in the late 2000s.</li> <li data-bbox="743 1020 1395 1050">• IRS filed federal tax liens against this company.</li> </ul>

Source: GAO's analysis of IRS and Recovery.gov records.

Note: All dollar amounts are rounded.

<sup>a</sup>Total Recovery Act awards are based on contractor and grantee recipient reports as of July 2010.

<sup>b</sup>Rounded known unpaid tax amount as of September 30, 2009. Known unpaid tax amount does include penalty and interest.

<sup>c</sup>Abatements are reductions in the amount of taxes owed and can occur for a variety of reasons, such as to correct errors made by IRS or taxpayers or to provide relief from interest and penalties.

Additional examples of Recovery Act contract and grant recipients with known unpaid taxes can be found in our report.

Chairman Levin, Ranking Member Coburn, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

## Contacts

For additional information about this testimony, please contact Gregory D. Kutz at (202) 512-6722 or [kutzg@gao.gov](mailto:kutzg@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement.

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