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H.R. 1870, THE CONTRACTOR TAX ENFORCEMENT ACT; AND H.R. 1865, AMENDS TITLE 31 OF THE UNITED STATES CODE BY AUTHORIZING A PILOT PROGRAM FOR LOCAL GOVERNMENTS TO OFFSET FEDERAL TAX REFUNDS TO COLLECT LOCAL TAX DEBTS

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION, AND PROCUREMENT

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

H.R. 1870

TO AMEND TITLE 31, UNITED STATES CODE, TO PROHIBIT DELINQUENT FEDERAL DEBTORS FROM BEING ELIGIBLE TO ENTER INTO FEDERAL CONTRACTS, AND FOR OTHER PURPOSES

AND ON

H.R. 1865

TO AMEND TITLE 31, UNITED STATES CODE, TO ALLOW CERTAIN LOCAL TAX DEBT TO BE COLLECTED THROUGH THE REDUCTION OF FEDERAL TAX REFUNDS

APRIL 19, 2007

Serial No. 110–31

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H.R. 1870, THE CONTRACTOR TAX ENFORCEMENT ACT; AND H.R. 1865, AMENDS TITLE 31 OF THE UNITED STATES CODE BY AUTHORIZING A PILOT PROGRAM FOR LOCAL GOVERNMENTS TO OFFSET FEDERAL TAX REFUNDS TO COLLECT LOCAL TAX DEBTS

THURSDAY, APRIL 19, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
ORGANIZATION, AND PROCUREMENT,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:10 p.m. in room 2154, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the subcommittee) presiding.

Present: Representatives Towns, Bilbray, Platts, and Duncan.

Also present: Representative Ellsworth.

Staff present: Michael McCarthy, staff director; Velvet Johnson, counsel; Cecelia Morton, clerk; John Brosnan, minority senior procurement counsel; Edward Kidd and Kristina Husar, minority professional staff members; John Cuaderes and Larry Brady, minority senior investigators and policy advisors; and Benjamin Chance, minority clerk.

Mr. TOWNS. Welcome to today's legislative hearing on two bills related to tax collection. One bill is the Contractor Tax Enforcement Act, which would prohibit award of contracts to companies that are seriously delinquent in paying taxes. We will also examine a bill introduced by Representative Tom Davis of Virginia, which authorizes a pilot program of local governments to offset Federal tax refunds to collect local tax debts.

I ask unanimous consent that the gentleman from Virginia, Mr. Moran, and the gentleman from Indiana, Mr. Ellsworth, participate in today's hearing. Both have been working on the issue we will consider today. Without objection, so ordered.

As American citizens file their taxes this week, they expect the Government to enforce the tax laws fairly and efficiently. Efficiency means that one part of the Government shouldn't pay out money to people or businesses that owe tax debts until those tax delinquencies are cured. Unfortunately, the Government frequently writes checks to people, even as their tax debts go uncollected. These two bills are designed to stop that.

Contractors owe the Federal Government billions of dollars in delinquent taxes. My bill seeks to close this tax gap. GAO studies over the past few years have identified more than 50,000 contractors owing nearly $8 billion—that is B as in boy—unpaid Federal taxes.

If the sheer size of those numbers doesn't take your breath away, the details certainly will.

One of the largest categories of tax debts is unpaid payroll taxes. These are amounts deducted from workers' paychecks for Social Security, Medicare, and individual income taxes, but never forwarded to the IRS.

Companies that don't remit these withholdings are defrauding not only the taxpayer, but also their own employees. Yet, these companies are receiving millions of dollars in Federal contracts.

One alarming example involved a contractor that provided services such as trash removal, building cleaning, and security to U.S. military bases. Although the company had revenues of over $40 million in 1 year, with over 25 percent of this coming from Federal agencies, it owed outstanding payroll taxes and defaulted on an IRS installment agreement. Meanwhile, the owner was receiving a six figure income and had borrowed nearly $1 million from the business. The business also made a down payment for the owner's boat and bought several cars and a home outside the country.

The Contractor Tax Enforcement Act would stop these egregious practices by requiring that tax compliance be a prerequisite for receiving a Federal contract. This bill would prohibit new awards to contractors who are seriously delinquent in paying taxes and authorize the IRS to inform contracting officers of the delinquency status of the applicants.

I realize the administration has proposed a rule that is similar in many ways to my bill, but I do believe the administration's proposal does not go far enough. For example, it relies on self-certification by contractors that they are complying with tax laws, but has no verification of this fact through the IRS.

Based on the examples we have found, I don't think we can simply take some of these companies at their word. With a mounting Federal budget deficit and rising obligations, the Federal Government cannot afford to leave billions of dollars in tax revenue uncollected.

But these benefits of my bill go beyond just collecting more money for the Government. The bill will provide a level playing field for contractors that comply with our laws, who have to compete with companies that have lower costs because they are dodging their taxes. This is a serious concern that I have heard from responsible contractors over the years who support approaches like mine that target the bad actors, rather than pose burdensome requirements on all contractors.

I look forward to hearing from our witnesses and gaining their perspectives as we work together to find a workable solution to something that we can all agree is a continuing problem.

Let me say that I am pleased to co-sponsor this bill with Tom Davis of Virginia, who, of course, has had a special interest in this for a long, long time. It is my honor to work with him on it.

[The texts of H.R. 1870 and 1865 follow:]

110TH CONGRESS
1ST SESSION

H. R. 1870

To amend title 31, United States Code, to prohibit delinquent Federal debtors from being eligible to enter into Federal contracts, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 17, 2007

Mr. TOWNS (for himself, Mr. WAXMAN, Mrs. MALONEY of New York, Mr. KUCINICH, and Mr. MURPHY of Connecticut) introduced the following bill; which was referred to the Committee on Oversight and Government Reform, and in addition to the Committee on Ways and Means, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

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A BILL

To amend title 31, United States Code, to prohibit delinquent Federal debtors from being eligible to enter into Federal contracts, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Contractor Tax En-
5 forcement Act".

SEC. 2. AMENDMENTS TO PROVISION REGARDING DELINQUENT FEDERAL DEBTORS.

Section 3720B of title 31, United States Code, is amended—

(1) in the section heading, by adding at the end "**OR CONTRACTS**";

(2) in subsection (a)—

(A) by inserting "or be eligible to enter into a Federal contract with the agency" after "administered by the agency";

(B) by inserting ", including" after "debt" the first place such term appears;

(C) by striking "(other than" the second place such words appear;

(D) by striking the closing parenthesis after "1986"; and

(E) by inserting "and be eligible to enter into Federal contracts" after "loan guarantees"; and

(3) by adding at the end the following:

"(c)(1) The head of any Federal agency that administers a Federal loan or loan guarantee program or that issues a request for proposals for a Federal contract shall require each applicant for a Federal loan or loan guarantee and each entity that submits a proposal to enter into a contract with the agency to submit with the loan

1 or loan guarantee application or the contract proposal a
2 form authorizing the Secretary of the Treasury to disclose
3 to the head of the agency information limited to describing
4 whether the applicant or prospective contractor has an
5 outstanding debt under the Internal Revenue Code of
6 1986 in delinquent status (as defined in this section).

7 "(2) Not later than 30 days after the date of the en-
8 actment of this subsection, the Secretary shall develop and
9 make available to all Federal agencies a standard form,
10 the purpose which shall be to authorize the disclosure de-
11 scribed in paragraph (1).

12 "(d) For purposes of this section:

13 "(1) The term 'contract' means a binding
14 agreement entered into by a Federal agency for the
15 purpose of obtaining supplies, materials, equipment,
16 or services, but does not include—

17 "(A) a contract to assist the agency in the
18 performance of disaster relief authorities, as
19 designated in standards prescribed by the Sec-
20 retary of the Treasury; or

21 "(B) a contract designated by the head of
22 the agency as necessary to the national security
23 of the United States.

24 "(2) The term 'person' includes—

"(A) any partnership with a partner who has been assessed a penalty under section 6672 of the Internal Revenue Code of 1986 with respect to a debt which is in delinquent status as described in paragraph (3); and

"(B) any corporation with an officer or a shareholder who holds 25 percent or more of the outstanding shares of corporate stock in that corporation who has been assessed a penalty under section 6672 of the Internal Revenue Code of 1986 with respect to a debt that is in delinquent status as described in paragraph (3).

"(3) A debt under the Internal Revenue Code of 1986 shall be considered to be in delinquent status if it has not been paid within 180 days of an assessment of a tax, penalty, or interest under the Internal Revenue Code of 1986. Such a debt does not include a debt that is being paid in a timely manner pursuant to an agreement under section 6159 or section 7122 of the Internal Revenue Code of 1986.".

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110TH CONGRESS
1ST SESSION

H. R. 1865

To amend title 31, United States Code, to allow certain local tax debt to be collected through the reduction of Federal tax refunds.

IN THE HOUSE OF REPRESENTATIVES

APRIL 17, 2007

Mr. TOM DAVIS of Virginia (for himself, Mr. TURNER, Mr. TOWNS, Mr. MORAN of Virginia, and Mr. BILBRAY) introduced the following bill; which was referred to the Committee on Oversight and Government Reform, and in addition to the Committee on Ways and Means, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

---

A BILL

To amend title 31, United States Code, to allow certain local tax debt to be collected through the reduction of Federal tax refunds.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. PILOT PROGRAM FOR EXPANDING TAX REFUND REDUCTION PROVISION TO INCLUDE CERTAIN LOCAL TAX DEBT.

(a) PILOT PROGRAM.—Section 3720A of title 31, United States Code (relating to reduction of tax refund

1 by amount of debt) is amended by adding at the end the
2 following:

3 "(j) PILOT PROGRAM FOR COLLECTION OF PAST-
4 DUE LEGALLY ENFORCEABLE LOCAL GOVERNMENT TAX
5 OBLIGATIONS.—

6 "(1) IN GENERAL.—Upon receiving notice dur-
7 ing the pilot program period from any eligible State
8 on behalf of a local government that a named person
9 owes a past-due, legally enforceable tax obligation to
10 the local government, the Secretary of the Treasury
11 shall, under such conditions as may be prescribed by
12 the Secretary, determine whether any amounts, as
13 refunds of Federal taxes paid, are payable to such
14 person. If the Secretary of the Treasury finds that
15 any such amount is payable, he shall—

16 "(A) reduce such refunds by an amount
17 equal to the amount of such debt;

18 "(B) pay the amount of such reduction to
19 the State for purposes of payment by the State
20 to the local government on behalf of which the
21 State submitted the notice;

22 "(C) notify the State of the person's name,
23 taxpayer identification number, address, and
24 the amount collected; and

"(D) notify the person due the refund that the refund has been reduced by an amount necessary to satisfy a past-due, legally enforceable tax obligation.

"(2) PRIORITIES FOR OFFSET.—

"(A) Any overpayment (as defined in section 6401 of the Internal Revenue Code of 1986) by a person shall be reduced pursuant to this subsection—

"(i) after such overpayment is reduced (I) with respect to any liability for any internal revenue tax on the part of the person who made the overpayment; (II) with respect to past-due support (as defined in section 464(c) of the Social Security Act); (III) with respect to any past-due, legally enforceable debt owed to a Federal agency; and (IV) with respect to any past-due, legally enforceable State income tax obligation (as defined in section 6402(e) of the Internal Revenue Code of 1986); and

"(ii) before such overpayment is credited to the future liability for any Federal internal revenue tax of such person.

"(B) If the Secretary receives notice from one or more States of more than one tax obligation subject to paragraph (1) that is owed by such person to any local government, any overpayment by such person shall be applied against such debts in the order in which such notices were filed.

"(3) NOTICE; CONSIDERATION OF EVIDENCE.—No State may take action under this subsection on behalf of a local government until the local government certifies to the State that the local government—

"(A) has notified the person owing the past-due, legally enforceable tax obligation by certified mail with return receipt that the State proposes to take action pursuant to this section;

"(B) has given such person at least 60 days to present evidence that all or part of such liability is not past-due or not legally enforceable;

"(C) has considered any evidence presented by such person and has determined that an amount of such debt is past-due and legally enforceable; and

"(D) has satisfied such other conditions as the Secretary may prescribe to ensure that the determination made under subparagraph (C) is valid and that the local government has made reasonable efforts to obtain payment of such tax obligation.

"(4) DEFINITION OF PAST-DUE, LEGALLY ENFORCEABLE TAX OBLIGATION.—In this subsection, the term 'past-due, legally enforceable tax obligation' means a tax debt—

"(A)(i) which resulted from—

"(I) a judgment rendered by a court of competent jurisdiction which has determined an amount of tax to be due; or

"(II) a determination after an administrative hearing which has determined an amount of tax to be due; and

"(ii) which is no longer subject to judicial review; or

"(B) which resulted from a tax which has been assessed but not collected, the time for redetermination of which has expired, and which has not been delinquent for more than 10 years.

"(5) ELIGIBLE STATE.—

"(A) In this subsection, the term 'eligible State' means a State selected by the Secretary under subparagraph (B).

"(B) The Secretary shall select at least three, and not more than five, States to participate in the pilot program under this subsection. The Secretary may consider a State for selection only if it participates in the procedure applicable under section 6402(e) of the Internal Revenue Code of 1986 (relating to collection of past-due, legally enforceable State income tax obligations).

"(C) The Secretary should consider the following States for selection under this paragraph:

"(i) Illinois.

"(ii) Iowa.

"(iii) Louisiana.

"(iv) New York.

"(v) Ohio.

"(vi) Virginia.

"(6) REGULATIONS.—The Secretary shall issue regulations prescribing the time and manner in which States must submit notices of past-due, legally enforceable tax obligations and the necessary infor-

1 mation that must be contained in or accompany
2 such notices. The regulations shall specify the types
3 of taxes and the minimum amount of debt to which
4 the reduction procedure established by paragraph
5 (1) may be applied. The regulations may require
6 States to pay a fee to reimburse the Secretary for
7 the cost of applying such procedure, and such fee
8 may be reimbursed by local governments to States in
9 accordance with applicable State law. Any fee paid
10 to the Secretary pursuant to the preceding sentence
11 shall be used to reimburse appropriations which bore
12 all or part of the cost of applying such procedure.
13 "(7) ERRONEOUS PAYMENT TO STATE.—Any
14 State receiving notice from the Secretary that an er-
15 roneous payment has been made to such State with
16 respect to a notice by the State on behalf of a local
17 government under paragraph (1) shall pay promptly
18 to the Secretary, in accordance with such regulations
19 as the Secretary may prescribe, an amount equal to
20 the amount of such erroneous payment (without re-
21 gard to whether any other amounts payable to such
22 State under such paragraph have been paid to such
23 State).
24 "(8) PILOT PROGRAM.—

"(A) PERIOD OF PILOT PROGRAM.—Subject to subparagraph (B), this subsection shall apply only during 2009 and 2010.

"(B) EXTENSION AND EXPANSION OF PILOT PROGRAM.—

"(i) This subsection applies after 2010 to any State described in clause (ii) unless, before December 31, 2010, the Secretary submits to Congress a report containing a determination that the pilot program has negatively affected Federal revenue or Federal revenue collection processes.

"(ii) In applying this subsection after 2010, the term 'eligible State' means any State participating in the procedure applicable under section 6402(e) of the Internal Revenue Code of 1986 (relating to collection of past-due, legally enforceable State income tax obligations).

"(k) TREATMENT OF PAYMENTS MADE TO STATES.—The Secretary may provide that, for the purposes of determining interest, the payment of any amount withheld under subsection (j) to a State shall be treated

as a payment to the person or persons making the overpayment.".

(b) DISCLOSURE OF CERTAIN INFORMATION TO AGENCIES OF STATES REQUESTING REFUND OFFSETS FOR PAST-DUE, LEGALLY ENFORCEABLE TAX OBLIGATIONS.—Paragraph (10) of section 6103(l) of the Internal Revenue Code of 1986 is amended—

(1) in the paragraph heading, by inserting after "6402" the following: "OR UNDER SUBSECTION (j) OF SECTION 3720A OF TITLE 31, UNITED STATES CODE";

(2) in subparagraph (A), by inserting after "6402" the following: "or subsection (j) of section 3720A of title 31, United States Code,"; and

(3) in subparagraph (B)—

(A) by striking "section 6402 is" and inserting "section 6402 or under subsection (j) of section 3720A of title 31, United States Code, is"; and

(B) by striking "section 6402." and inserting "section 6402 or under subsection (j) of section 3720A of title 31, United States Code.".

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Mr. TOWNS. At this time I would like to yield to the gentleman from Indiana for remarks at this time.

Mr. ELLSWORTH. Thank you, Mr. Chairman.

I didn't prepare a statement, but I would like to thank you for allowing me to join you today for such an important issue and to talk about this subject.

When I had Mr. Kutz in my office a few weeks ago, one of the first things, when I was elected to Congress, that really caught my attention, the amount of outstanding taxes for people that were still getting Government contracts. I don't think the people in Indiana appreciate it. I pay my taxes, I am sure everybody in the audience pays their taxes, and so should the people that are receiving Government contracts.

I appreciate your letting me be a part of this hearing. I look forward to the testimony.

Mr. TOWNS. Thank you very much.

It is a longstanding policy of this committee that we swear our witnesses in.

[Witnesses sworn.]

Mr. TOWNS. Let the record reflect that all responded in the affirmative.

Let me introduce the panel, and we will move forward.

Gregory Kutz is a Managing Director of the Government Accountability Office. He leads GAO's Forensic Audits and Special Investigations Unit, which conducts the most complex investigations of fraud, waste, and abuse. Mr. Kutz has managed GAO's work on contractors' abuse of the Federal tax system and he has prior experience with financial and operational management issues at the Internal Revenue Service.

Paul Denett is the Administrator of the Office of Federal Procurement Policy at OMB, where he is the point person for the administration on issues of Federal contracting and acquisition. He has held a number of posts as a senior executive in acquisition in the Federal Government and the private sector.

Russell George is the Treasury Inspector General for Tax Administration, which means he is responsible for audits and investigations of the Internal Revenue Service. Before becoming an Inspector General, he served for several years as staff director of this subcommittee. Welcome back.

Your entire statement is in the record, gentlemen, of course, and I would like to ask that each witness summarize your testimony in the time provided. Of course, most of you know how the light works. The yellow light means your time is running down and getting close to the end, and the red light means that you are now violating the rules and that you are going overboard. We will try to be a little flexible and generous with the time, but we do want you to be able to try to get it in within 5 minutes.

I would like to clarify my remarks. Tom Davis has not yet signed on as a co-sponsor of my bill, H.R. 1870, but I am hoping that he will do it in the very near future. Of course, knowing him, and he believes in good government, it is the kind of bill that he would want to be identified with. Let me just say that and leave it alone.

At this point I would like to start with you, Mr. Kutz, and just come right down the line.

STATEMENTS OF GREGORY D. KUTZ, MANAGING DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; PAUL A. DENETT, ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT; AND J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

STATEMENT OF GREGORY D. KUTZ

Mr. KUTZ. Mr. Chairman and Congressman Ellsworth, thank you for the opportunity to discuss Government contractors with tax problems.

My testimony today summarizes our past work on Department of Defense, civilian agency, and GSA contractors. Specifically, our past investigations identified 27,000 DOD contractors with $3 billion of unpaid taxes, 33,000 civilian agency contractors with $3.3 billion of unpaid taxes, and 3,800 GSA contractors with $1.4 billion of unpaid taxes. These numbers are substantially understated because they exclude under-reporting of income and non-filing of required tax returns, which we have seen in certain contractors. According to the IRS, under-reporting of income is the largest component of the over $300 billion net tax gap.

As part of our work we performed in-depth investigations of 122 of these contractors, including the owners, officers, and any related companies. For all 122 cases, we found abusive and potentially criminal activity related to the Federal tax system. Many of these companies had unpaid payroll taxes, which, as you mentioned, Mr. Chairman, represent amounts withheld from an employee's wages for Social Security, Medicare, and individual income taxes. Willful failure to remit payroll taxes to the IRS is a felony.

Most of the individuals that we investigated have made careers out of not paying their Federal taxes. Schemes used to avoid paying taxes include: under-reporting of income and non-filing of required tax returns; large cash withdrawals and loans to owners and officers that were never repaid; closing the entity with tax debt and opening another with a similar name at the same address; and large cash transfers to foreign bank accounts or to purchase a home in the Caribbean.

Some of the owners of the contractors that we investigated were simply poor business managers. Rather than pay their taxes, they chose to pay their utility bill or the rent. However, many accumulated substantial personal wealth at the same time they failed to pay their Federal taxes.

The posterboard shows examples of the multi-million-dollar homes and luxury vehicles that we identified. They are also shown on the monitor. Other interesting assets include: a professional sports franchise, a shopping mall, a high-performance aircraft, and a $25,000 men's bracelet.

Our current and past investigations have shown that failure to pay Federal taxes isn't the only problem these individuals have. For example, we identified substantial other debt, including State and local taxes, personal income taxes, and delinquent student

loans and child support payments. Criminal activity included assault, embezzlement, money laundering, burglary, and check fraud.

The companies we investigated were typically small-to mid-sized and closely held. Industries ranged from building maintenance, construction, and manufacturing, to security, weapons systems, and health care. Ironically, these potential felons are doing business with the Department of Justice and Homeland Security.

These facts bring us to the key question of this hearing: what is being done to prevent the most egregious contractors from doing business with the Federal Government? For the 122 cases that we investigated, the answer is nothing. Current Federal law does not prohibit tax deadbeats from getting Federal contracts.

In conclusion, we strongly support prohibiting contractors with serious tax problems from doing business with the Federal Government. It is a matter of fairness, ethics, and just plain common sense. The vast majority of Federal contractors pay their Federal taxes, and I expect they would support a law that prevents tax cheats from getting Government contracts.

Also, if we can't trust these contractors to pay their Federal taxes, then how can we trust them to secure Federal buildings, manufacture parts for the space shuttle, and provide health care to our wounded warriors?

Mr. Chairman, I believe most of your constituents would find it hard to believe that the hard-earned money we collect from honest American taxpayers is being used to bankroll deadbeat Government contractors.

Mr. Chairman, this ends my statement. I look forward to your questions.

[The prepared statement of Mr. Kutz follows:]

United States Government Accountability Office

GAO

Testimony

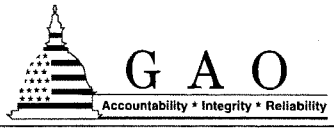
Before the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives

For Release on Delivery
Expected at 1:00 p.m. EDT
Thursday, April 19, 2007

TAX COMPLIANCE

Thousands of Federal Contractors Abuse the Federal Tax System

Statement of Gregory D. Kutz, Managing Director
Forensic Audits and Special Investigations



GAO-07-742T

April 19, 2007

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Highlights

Highlights of GAO-07-742T, a testimony before the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives

TAX COMPLIANCE

Thousands of Federal Contractors Abuse the Federal Tax System

Why GAO Did This Study

Since 1990, GAO has periodically reported on high-risk federal programs that are vulnerable to fraud, waste, and abuse. Two such high-risk areas are managing federal contracts more effectively and assessing the efficiency and effectiveness of federal tax administration. Weaknesses in the tax area continue to expose the federal government to significant losses of tax revenue and increase the burden on compliant taxpayers to fund government activities. Over the last several years, the Senate Permanent Subcommittee on Investigations requested GAO to investigate Department of Defense (DOD), civilian agency, and General Services Administration (GSA) contractors that abused the federal tax system. Based on that work GAO made recommendations to executive agencies including to improve the controls over levying payments to contractors with tax debt—many of which have been implemented—and referred 122 contractors to IRS for further investigation and prosecution.

As requested, this testimony will highlight the key findings from prior testimonies and related reports. This testimony will (1) describe the magnitude of tax debt owed by federal contractors, (2) provide examples of federal contractors involved in abusive and potentially criminal activity related to the federal tax system, and (3) describe current law and proposed federal regulations for screening contractors with tax debts prior to the award of a contract.

www.gao.gov/cgi-bin/getrpt?GAO-07-742T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory Kutz at (202) 512-7455 or kutzg@gao.gov.

What GAO Found

In our previous audits and related investigations, we reported that thousands of federal contractors had substantial amounts of unpaid federal taxes. Specifically, about 27,000 DOD contractors, 33,000 civilian agency contractors, and 3,800 GSA contractors owed about $3 billion, $3.3 billion, and $1.3 billion in unpaid taxes, respectively. These estimates were understated because they excluded federal contractors that understated their income or did not file their tax returns; however, some contractors may be counted in more than one of these groups.

As part of this work, we conducted more in-depth investigations of 122 federal contractors and in all cases found abusive and potentially criminal activity related to the federal tax system. Many of these 122 contractors were small, closely held companies that provided a variety of goods and services, including landscaping, consulting, catering, and parts or support for weapons and other sensitive programs for many federal agencies including the departments of Defense, Justice, and Homeland Security. These contractors had not forwarded payroll taxes withheld from their employees and other taxes to IRS. Willful failure to remit payroll taxes is a felony under U.S. law. Furthermore, some company owners diverted payroll taxes for personal gain or to fund their businesses. A number of owners or officers of the 122 federal contractors owned significant personal assets, including a sports team, multimillion dollar houses, a high-performance airplane, and luxury vehicles. Several owners gambled hundreds of thousands of dollars at the same time they were not paying the taxes that their businesses owed.

Examples of Abusive and Potentially Criminal Activity

Type of business	Unpaid tax debt	Payments to contractor	Contractor activity
Custodial services for DOD	Over $1 million	Over $1 million	Owner bought a boat, several cars, and a home outside the country.
Temporary help for civilian agency	Nearly $900,000	Over $1 million	Owner followed pattern of over 20 years of closing businesses with tax debts, opening new ones, and incurring more tax debts.
Security under GSA contract	Over $9 million	Over $1 million	Owner made cash withdrawals to fund an unrelated business and purchase a men's gold bracelet worth over $25,000.

Source: Previous GAO testimonies.

Federal law, as implemented by the Federal Acquisition Regulation (FAR), does not now require contractors to disclose tax debts or contracting officers consider tax debts in making contracting decisions. Federal contractors that do not pay tax debts could have an unfair competitive advantage in costs because they have lower costs than tax compliant contractors on government contracts. GAO's investigation identified instances in which contractors with tax debts won awards based on price differential over tax compliant contractors.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss our past work on government contractors that have failed to pay their federal taxes. Our remarks today are based on work that we have performed over the last several years for the Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs. In hearings held before that Subcommittee over the last several years,[1] we testified that federal contractors at the Department of Defense (DOD), selected civilian agencies, and the General Services Administration (GSA) abused the federal tax system with little consequence. As requested, this testimony highlights the key findings from those testimonies and related reports. Specifically, this testimony will (1) describe the magnitude of tax debts that were owed by federal contractors at the time of our previous testimonies and related reports, (2) provide examples of federal contractors involved in abusive and potentially criminal activity related to the federal tax system, and (3) discuss current law and proposed changes to the Federal Acquisition Regulation (FAR) concerning contractor tax debt.

To address our objectives, we reviewed prior findings from GAO audits of federal contractors that have abused the federal tax system. Our audit work was performed in accordance with U.S. generally accepted government auditing standards. We performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Summary

In each of our audits and related investigations, we found thousands of federal contractors that had substantial amounts of unpaid federal taxes. Specifically, we testified that about 27,000 DOD contractors, 33,000 civilian agency contractors, and 3,800 GSA contractors owed about $3

[1] GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-414T (Washington, D.C.: Feb. 12, 2004); *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-683T (Washington, D.C.: June 16, 2005); and *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, GAO-06-492T (Washington, D.C.: Mar. 14, 2006).

billion, $3.3 billion, and $1.4 billion in federal taxes, respectively.[2] Much of the unpaid taxes were payroll taxes.[3] However, each estimate of contractors' unpaid federal taxes is understated because IRS data do not reflect all amounts owed. Specifically, our estimates do not include amounts owed by contractors who 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 Internal Revenue Service (IRS) has not determined the amount owed.

We conducted more in-depth case study investigations of 122 federal contractors that appeared to demonstrate abusive or potentially criminal activity related to the federal tax system. We found that, in fact, each of the 122 federal contractors was involved in abusive and potentially criminal activity related to the tax system. Many of these case-study contractors were small, closely held companies that operated in wage-based industries; such as security; building maintenance; computer services; and personnel services for GSA, DOD, and the Departments of Homeland Security, Justice, and Veterans Affairs. The types of contracts that were awarded to these federal contractors included products or services related to weapon components, space and aircraft parts, law enforcement, disaster relief, and national security. Many were established businesses (such as corporations) that owed payroll taxes that include amounts withheld from their employees. However, rather than fulfill their role as "trustees" of these funds and forward them to IRS as required by law, these federal contractors diverted the funds for other purposes.[4]

At the same time that they were not paying their federal taxes, many individuals associated with our 122 cases bought or owned significant personal assets, including a sports team, a high-performance airplane, commercial properties, multimillion dollar homes, and luxury vehicles. In one case, the owner of a federal contracting firm purchased a number of

[2] Because federal contractors may do business with more than one federal agency, some federal contractors that owe tax debts may be included in more than one analysis concerning DOD, GSA, and civilian federal contractors that abuse the federal tax system. Because our analysis for each segment covered different time periods, we cannot provide an overall number of federal contractors with tax debts and the magnitude of such debts.

[3] Payroll taxes include amounts withheld from employee wages for Social Security, Medicare, and individual income taxes.

[4] Willful failure to remit payroll taxes is a criminal felony offense while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense. 26 U.S.C. §§ 7202, 7215 and 7512 (b).

multimillion-dollar properties, an unrelated business, and a number of luxury vehicles while his business failed to remit to IRS a substantial amount of payroll taxes. Several owners also gambled hundreds of thousands of dollars at the same time they were not paying the federal taxes that their businesses owed. Further, several of the owners or officers of the businesses with unpaid federal taxes were investigated or indicted for nontax offenses such as embezzlement, fraud, and money laundering.

Federal law does not prohibit a contractor with unpaid federal taxes from receiving contracts from the federal government. Currently, regulations calling for federal agencies to do business only with responsible contractors do not require contracting officers to consider a contractor's tax delinquency. According to the FAR, a responsible prospective contractor is a contractor that meets certain specific criteria,[5] including having adequate financial resources and a satisfactory record of integrity and business ethics. However, the FAR does not currently require contracting officers to take into account a contractor's tax debt when assessing whether a prospective contractor is responsible. As a result, the FAR does not currently require contracting officers to determine if federal contractors have federal unpaid taxes at the time a contract is awarded. Further, federal law generally prohibits the disclosure of taxpayer data to contracting officers. Thus, contracting officers do not have access to tax data directly from IRS unless the contractor provides consent. In March 2007, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council proposed to amend the FAR to require prospective contractors to disclose whether they have, within a 3-year period preceding their offer, been notified of any delinquent taxes that remain unsatisfied or whether they have received notice of any tax lien filed against them that remains unsatisfied or has not been released.[6] The proposed rule also includes, among other things, delinquent taxes and unresolved liens as causes for suspension or debarment.

Finally, we also reported that for wage-based businesses that provide goods and services, federal contractors with unpaid federal taxes have an unfair advantage in price competition when competing against other businesses for federal contracts. Companies that do not pay their payroll tax, which is typically over 15 percent of the employees' wages, would

[5] FAR 2.101; 9.104-1

[6] Representations and Certifications – Tax Delinquency, 72 Fed. Reg. 15093 (proposed Mar. 30, 2007) (to be codified at 48 C.F.R. pts. 9 and 52).

have a significantly lower costs advantage and therefore have a substantive competitive advantage over their competitors. For example, we identified instances in which companies that had unpaid payroll taxes were competitively awarded contracts over companies that had paid their federal taxes.

As result of the work we performed for the Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs we made numerous recommendations to executive agencies to improve the controls over levying payments to contractors with tax debt, many of which the agencies have implemented. We also referred 122 contractors to IRS for further investigation and prosecution.

Federal Contractors Owe Billions of Dollars in Unpaid Federal Taxes

In each of our audits and related investigations, we found thousands of federal contractors that owed billions of dollars of federal taxes. Specifically,

- In February 2004, we testified that DOD and IRS records showed that about 27,000 DOD contractors owed nearly $3 billion in federal taxes. About 42 percent of this $3 billion represented unpaid payroll taxes.
- In June 2005, we testified that about 33,000 civilian agency federal contractors owed over $3.3 billion in federal taxes. Over a third of the $3.3 billion represented unpaid payroll taxes.
- In March 2006, we testified that over 3,800 GSA contractors owed about $1.4 billion in federal taxes. About one-fifth of the $1.4 billion represented unpaid payroll taxes.

Because federal contractors may do business with more than one federal agency, some federal contractors that owe tax debts may be included in more than one analysis concerning DOD, GSA, and civilian federal contractors that abuse the federal tax system.

In each of our audits, we found that government contractors owed a substantial amount of unpaid payroll taxes. Employers are subject to civil and criminal penalties if they do not remit payroll taxes to the federal government. When an employer withholds taxes from an employee's wages, the employer is deemed to have a 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 to the federal government, the employer is liable for these amounts, as well as the employer's matching Federal Insurance

Contribution Act contributions for Social Security and Medicare. Individuals employed by the contractor (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.[7] Willful failure to remit payroll taxes can also be a criminal felony offense punishable by imprisonment of up to 5 years,[8] while the failure to properly segregate payroll tax funds can be a criminal misdemeanor offense punishable by imprisonment of up to a year.[9] 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.

Although each of our estimates for taxes owed by federal contractors was a significant amount, it understates the full extent of unpaid taxes owed by these contractors. The IRS tax database reflected only the amount of unpaid federal taxes either reported on a tax return or assessed by IRS through its various enforcement programs. The IRS database did not reflect amounts owed by businesses and individuals that have not filed tax returns and for which IRS has not assessed tax amounts due. Our analysis did not attempt to account for businesses or individuals that did not file required payroll or other tax returns or that purposely underreported income and were not specifically identified by IRS as owing the additional federal taxes. According to IRS, underreporting of income accounted for more than 80 percent of the estimated $345 billion annual gross tax gap.[10]

As result of the work we performed for the Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs we made numerous recommendations to DOD and civilian agencies to improve their controls over levying payments to contractors with tax debt. Many of those recommendations have been

[7] 26 U.S.C. § 6672.

[8] 26 U.S.C. § 7202.

[9] 26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

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

implemented and have resulted in additional collections of unpaid tax debt. We also referred 122 contractors to IRS for further investigation and prosecution.

Examples of Federal Contractors Involved in Abusive and Potentially Criminal Activity Related to the Federal Tax System

In our previous testimonies, we discussed the results of our in-depth audits and related investigations of 122 federal contractors with outstanding tax debt. For each of these 122 federal contractors, we found instances of abusive or potentially criminal activity related to the federal tax system.[11] Many of our case study contractors were small, closely held companies that operated in wage-based industries, such as security, weapon components, space and aircraft parts, building maintenance, computer services, and personnel services. These 122 federal contractors provided goods and services to a number of federal agencies including DOD, GSA, the National Aeronautics and Space Administration, and the Departments of Homeland Security, Justice, and Veterans Affairs. The types of contracts that were awarded to these contractors also included products or services related to variety of government functions including law enforcement, disaster relief, and national security.

Most of the contractors in our case studies owed payroll taxes, with some federal tax debts dating back nearly 20 years. However, rather than fulfilling their role as "trustees" and forwarding these funds to IRS, many of these federal contractors used the funds for personal gain or to fund their contractor operations.

Our investigations also revealed that some owners or officers of our case study federal contractors with unpaid taxes were associated with other businesses that had unpaid federal taxes. For example, we reported that one of our case study contractors had a 20-year history of opening a business, failing to remit taxes withheld from employees to IRS, and then closing the business, only to start the cycle all over again and incur more tax debts almost immediately through a new business. We also found that a number of owners or officers of our case study contractors had significant personal assets, including a sports team, commercial properties, multimillion dollar houses, and luxury vehicles. Several owners also gambled hundreds of thousands of dollars at the same time they were not paying the taxes that their businesses owed. Despite owning

[11] We considered activity to be abusive when a federal contractor's actions or inactions, though not illegal, took advantage of the existing tax enforcement and administration system to avoid fulfilling federal tax obligations and were deficient or improper when compared with behavior that a prudent person would consider reasonable.

substantial assets and gambling significant amounts of money, the owners or officers did not ensure the payment of the delinquent taxes of their businesses, and sometimes did not pay their own individual income taxes. Table 1 provides summary information on 10 of our 122 case study contractors that we discussed in our previous testimonies and related reports.

Table 1: Summary Information on 10 Federal Contractors with Unpaid Federal Taxes

Case	Nature of work	Federal payments[a]	Unpaid federal tax[b]	Comments
Case 1	Base support and custodial services for DOD	Over $1 million	Nearly $10 million	• State tax authorities levied the business bank account. • The owner borrowed nearly $1 million from the business. • The owner bought a boat, several cars, and a home outside the United States • The business was dissolved in 2003 and transferred its employees to a relative's business, where it submitted invoices and received payments from DOD on a previous contract through August 2003.
Case 2	Research services for DOD	Up to $100,000	Over $700,000	• DOD awarded the business a contract in 2002 for nearly $800,000. • Owner had over $1 million in loans related to cars, real estate, and recreational activities. • Owner owned a high-performance airplane.
Case 3	Vehicle repair services for DOD	Over $100,000	Over $100,000	• The business was investigated for paying employee wages in cash. • Owner purchased million dollar home and luxury sports car while owing a substantial tax liability. • Owner owed child support.
Case 4	Health-care-related services for Departments of Veterans Affairs and Health and Human Services	Over $100,000	Over $18 million	• Business was affiliated with many other health care-related facilities, including nursing and convalescent homes. • Business and related entities owed taxes covering over 80 tax periods. • Owner purchased multimillion-dollar properties, an unrelated business, and a number of luxury vehicles at the same time the business was not fully paying its payroll taxes. • Owner owned other real estate holdings including residential and commercial properties valued in the tens of millions of dollars.
Case 5	Security guard services to Departments of Homeland Security and Veterans Affairs	Over $100,000	Over $400,000	• Business had not filed all required tax returns for several years. • Business owed taxes covering over 25 tax periods. Tax debt amount also included owner's individual income taxes totaling tens of thousands of dollars. • Owner had repeatedly failed to file personal income tax returns. • Owner diverted unpaid payroll taxes to a foreign bank account to build a house overseas.
Case 6	Armed security guard services to several federal agencies including the Department of Justice and the Environmental Protection Agency	Over $100,000	Nearly $400,000	• Business owed over $200,000 in payroll taxes for almost 10 tax periods. • Business did not file income tax returns in the early 2000s. • Officer of the business was convicted for stealing hundreds of thousands of dollars from the business. • The owner was indicted for embezzlement and money laundering.

Case	Nature of work	Federal payments[a]	Unpaid federal tax[b]	Comments
Case 7	Payroll and temporary employment services to the Department of Housing and Urban Development	Over $1 million	Nearly $900,000	• The owner's history of delinquency stretched nearly 20 years and covered multiple businesses. • The owner typically incurred payroll taxes on one business, was assessed a trust fund penalty on that business but made no or little payments, closed the business, started another company, and repeated the same pattern. In at least one case, the owner closed the business and immediately established a new business with a similar name at the same address that provided the same services. • The owner rented office space in an expensive area of a major metropolitan city and purchased a luxury automobile at the same time the business was not remitting all of the payroll taxes.
Case 8	Security services under a GSA contract	Over $1 million	Over $9 million	• Business filed for bankruptcy in 2000s. • At the time business was not remitting all of its payroll taxes to IRS, the owner withdrew large amounts of funds from the company for personal use. • Owner used over $100,000 on gambling. • Business submitted false reports on a government contract. • Owner was investigated for fraud.
Case 9	Emergency supplies under a GSA contract	Up to $100,000	Over $700,000	• Business made large loans to a company officer at same time the business was not paying its taxes. • Business filed for bankruptcy protection owing substantial state and federal taxes. • The owner owned multiple real properties, including a million dollar home and a luxury vehicle, while business owed taxes. • Business had a federal tax lien at time GSA awarded a federal supply schedule contract.
Case 10	Human resource services under a GSA contract	Over $100,000	Over $400,000	• Owner owned multiple real properties and several luxury vehicles at the time the business owed taxes. • At the time owner did not remit all taxes owed to IRS, the owner made multiple, large cash withdrawals at gambling casinos. • Business obtained contract for hurricane relief efforts.

Source: Previous GAO testimonies on federal contractors with tax debts.(GAO-04-414T, GAO-05-683T, and GAO-06-492T.)

Notes: Dollar amounts are rounded. The information provided in this table has not been updated in the information provided from our original testimonies.

[a] Federal payments represent payments made by federal agencies to federal contractors for goods and services. Paymants for cases 1, 2, and 3 were made by four DOD contractor payment systems during fiscal year 2002. Payments for cases 4, 5, 6, and 7 were made by the Department of Treasury on behalf of other federal agencies during fiscal year 2004. Payments for cases 8, 9, and 10 were amounts reported by the Department of the Treasury and GSA from October 2003 through June 2004.

[b] Unpaid tax amount for cases 1, 2, and 3 are as of September 30, 2002. Unpaid tax amount for cases 4, 5, 6, and 7 are as of September 30, 2004. Unpaid tax amount for cases 8, 9, and 10 are as of June 30, 2005.

The following provides additional detailed information from our previous testimonies on case numbers 1, 4, and 8 summarized in table 1:

Case # 1: In February 2004, we testified on a business that had nearly $10 million in unpaid federal taxes, and was contracted by DOD to provide services such as trash removal, building cleaning, and security at U.S. military bases. The contractor reported that it paid the owner a six figure income and that the owner had borrowed nearly $1 million from the business. The owner bought a boat, several cars, and a home outside the country. This contractor went out of business in 2003 after state tax authorities seized its bank account for failure to pay state taxes. The contractor subsequently transferred its employees to a relative's business, which also had unpaid federal taxes, and continued submitting invoices and receiving payments from DOD on the previous contract.

Case # 4: In June 2005, we testified on a case that involved many related companies that provided health care services to the Department of Veterans Affairs (VA). During fiscal year 2004, these related companies received over $300,000 in federal contract payments. The related companies had different names, operated in a number of different locations, and used several different Taxpayer Identification Numbers (TIN).[12] However, they shared a common owner and contact address. At the time they were paid by VA, the businesses collectively owed more than $18 million in unpaid federal taxes—of which nearly $17 million was unpaid federal payroll taxes dating back to the mid-1990s. During the early 2000s, at the time when the owner's business and related companies were still incurring payroll tax debts, the owner purchased a number of multimillion dollar properties, an unrelated business, and a number of luxury vehicles. Our investigation also determined that real estate holdings registered to the owner totaled more than $30 million.

Case # 8: In March 2006, we testified on a GSA contractor that provided security services for a civilian agency. Our investigative work indicated that an owner of the company made multiple cash withdrawals, totaling close to $1 million, while owing payroll taxes. In addition, the company's owner also diverted the cash withdrawals to fund an unrelated business

[12]A TIN is a unique nine-digit identifier assigned to each business and individual that files a tax return. For businesses, the employer identification number assigned by IRS serves as the TIN. For individuals, the Social Security number, assigned by the Social Security Administration, serves as the TIN.

and purchased a men's gold bracelet worth over $25,000. The company's owner has been investigated for embezzlement and fraud.

Contractors with Unpaid Taxes Are Not Prohibited from Receiving Contracts from the Federal Government

Federal law and regulations, as reflected in the FAR, do not prohibit contractors with unpaid federal taxes from receiving contracts from the federal government. Although the FAR provides that federal agencies are restricted to doing business with responsible contractors, it does not require federal agencies to deny the award of contracts to contractors that abuse the federal tax system, unless the contractor was specifically debarred or suspended by a debarring official for specific actions, such as conviction for tax evasion.

The FAR specifies that unless compelling reasons exist, agencies are prohibited from soliciting offers from, or awarding contracts to, contractors who are debarred, suspended, or proposed for debarment for various reasons, including tax evasion.[13] Conviction for tax evasion is cited as one of the causes for debarment and indictment for tax evasion is cited as a cause for suspension. The deliberate failure to remit taxes, in particular payroll taxes, is a felony offense, and could result in a company being debarred or suspended if the debarring official determines it affects the present responsibility of the government contractor. Most of the contractors in our case studies owed payroll taxes, for which willful failure to remit payroll taxes, a criminal felony offense,[14] or failure to properly segregate payroll taxes, a criminal misdemeanor offense, may apply.[15] At the time of our review, none of the 122 federal contractors described in our previous case study work were debarred from government contracts, despite conducting abusive and potentially criminal activities related to the tax system.

As part of the contractor responsibility determination for prospective contractors, the FAR also requires contracting officers to determine whether a prospective contractor meets several specified standards, including determination as to whether a contractor has adequate financial

[13] Prior to awarding a contract, contracting officers are required to consult a governmentwide list, called the Excluded Parties List System (EPLS), of contractors that have been debarred, suspended, or declared ineligible for government contracts, and review the prospective contractor's self-certification of debarment and suspension.

[14] 26 U.S.C. § 7202.

[15] 26 U.S.C. § 7215 and 26 U.S.C. §7512 (b).

resources and a satisfactory record of integrity and business ethics. However, the FAR does not require contracting officers to consider tax debt in making this determination.

Restrictions on IRS Tax Disclosure and Failure to Use Available Tools Hamper Consideration of Tax Debts in Contractor Qualification Determinations

Because of statutory restrictions on the disclosure of taxpayer information, even if contracting officers were required to consider tax debts in contractor qualification determinations, contracting officers do not currently have access to tax debt information unless reported by prospective contractors themselves or disclosed in public records. Consequently, unless a prospective contractor consents, contracting officers do not have ready access to information on unpaid tax debts to assist in making contractor qualification determinations with respect to financial capability, ethics, and integrity.

Further, contracting officers do not routinely obtain and use publicly available information on contractor federal tax debt in making contractor qualification determinations. Federal law generally does not permit IRS to disclose taxpayer information, including tax debts.[16] Thus, unless the taxpayer provides consent,[17] certain tax debt information generally can only be discovered from public records when IRS files a federal tax lien against the property of a tax debtor.[18] However, contracting officers are not required to obtain credit reports. In the instances where they are obtained, contracting officers generally focus on the contractor's credit score rather than any liens or other public information showing federal tax debts. However, while the information is available, IRS does not file tax liens on all tax debtors nor does IRS have a central repository of tax liens to which contracting officers have access. Further, the available information on tax liens may be of questionable reliability because of

[16] 26 U.S.C. § 6103.

[17] For example, contractors must provide IRS the consent to validate TINs provided by the contractors in the Central Contractor Registration system. GSA officials stated that a contractor is not registered into the system until the TIN is validated with IRS records.

[18] Under section 6321 of the Internal Revenue Code, IRS has the authority to file a lien upon all property and rights to property, whether real or personal, of a delinquent taxpayer.

deficiencies in IRS's internal controls that have resulted in IRS not always releasing tax liens from property when the tax debt has been satisfied.[19]

Contractors with Tax Debts Have Unfair Advantage in Contract Competition

Federal contractors who owe tax debts have an unfair competitive advantage over contractors who pay their fair share. This is particularly true for federal contractors in wage-based industries, such as security and moving services. By not paying the employee taxes, these contractors keep their payroll tax, which is typically over 15 percent of each employee's wages, thereby reducing the contractor's costs. In this way, contractors who do not pay their taxes do not bear the same costs that tax compliant contractors have when competing on contracts. As a result, tax delinquent contractors can set prices for their goods and services lower than their tax compliant competitors.

In March 2006, we testified that we found some GSA contractors who did not fully pay their payroll taxes who were awarded contracts based on price over competing contractors that did not have any unpaid federal taxes. Federal contractors' tax debts were not considered in contract award decisions. For example, a GSA Schedule contractor was awarded two contracts for services related to moving office and equipment furniture. On both contracts, the contractor's offer for services was significantly less than three competing bids on the first contract and two competing bids on the second contract. The contractor owed about $700,000 in taxes (mostly payroll taxes) while its competitors did not owe any federal taxes.

[19] GAO, *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).

Proposed FAR Rule Would Require Prospective Contractors to Provide Tax-Related Certifications

The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (councils) have proposed to amend the FAR to require prospective contractors 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 violating any tax law or failing to pay any tax, or been notified of any delinquent taxes for which they still owe the tax. In addition, the prospective contractor will be required to certify whether or not they have received a notice of a tax lien filed against them for which the liability remains unsatisfied or the lien has not been released. The proposed rule also adds the following as additional causes for suspension or debarment: delinquent taxes, unresolved tax liens, and a conviction of or civil judgment for violating tax laws or failing to pay taxes.

By issuing the proposed rule on tax delinquency, the councils have acknowledged the importance of delinquent tax debts in the consideration of contract awards. The proposed rule requires offerors to certify whether they have or have not, within a 3-year period preceding the offer, been notified of any unresolved or unsatisfied tax debt or liens. Contracting officers generally cannot verify whether prospective contractors certifying that they have not received notice of unresolved or unsatisfied tax debts actually owe delinquent federal taxes, unless that information is disclosed in public records or unless the offeror provides consent for IRS to disclose its tax records. In March 2006, we testified that in one contractor file we reviewed, a GSA official did ask the prospective contractor about a federal tax lien. The prospective contractor provided documentation to GSA demonstrating the satisfaction of the tax liability covered by that lien. However, because the GSA official could not obtain information from the IRS on tax debts, this official was not aware that the contractor had other unresolved tax debts unrelated to this particular tax lien.

Concluding Comments

Over the past several years, we have testified that thousands of federal contractors failed in their responsibility to pay billions of dollars of federal taxes yet continued to get federal contracts. This practice is inconsistent with the fundamental concept that those doing business with the federal government should be required to pay their federal taxes. With the serious fiscal challenges facing our nation, the status quo is no longer an option. Increasing federal revenues by enhanced contractor requirements to pay their taxes would likely increase contractor tax compliance. Federal law seeking to achieve these objectives should provide flexibility to agencies, such as exceptions for contractors critical to national security. Due process and other safeguards should be built into the system to ensure

that contractors that pay their federal taxes are not inadvertently denied federal contracts. We look forward to working with the Subcommittee on this important matter.

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

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Mr. TOWNS. Thank you very much, Mr. Kutz.

Let me yield to the ranking member at this time for any opening statement or any comments he might have.

Mr. BILBRAY. Thank you, Mr. Chairman. I apologize for my tardiness, but the California Delegation, being a small, intimate group of 53 members, can drag on sometimes.

I would like to say that this is an issue that we need to address. If nothing else, we need to air the issue.

As somebody who grew up in a family that was involved with a tax practitioner business, I always try to remind all of us what the Government may think we owe and what we do owe many times is two distinctly different things. I think we need to make clear here that no one is proposing, hopefully, that we pre-determine what somebody, even a contractor, owes without the due process of the review process that the tax codes allow. We are talking about people here who have basically ignored a liability that has been adjudicated or authorized and identified.

I think, Mr. Chairman, when we talk about people that feel that the tax code doesn't apply to them, child support laws don't apply to them, we are really talking about a segment of society that really has promulgated this culture of corruption that somehow everybody is breaking the rules so it is OK for me to break the rules. I think that it is quite well within our realm to consider the fact that being a contractor in any form, let alone with Government and especially the Federal Government, is not a right, it is a privilege, and that, even if it was a right, those rights can be negated by the violation of the law by not fulfilling the requirements, the minimum standards of requirements that apply across the board to the general population.

I look forward to working with you, Mr. Chairman, on this item. I think that we need to make sure that a good idea addressing a bad problem is implemented in the appropriate way.

In all fairness, as we address this concern, we have to remember that not everything we do to address a grievous wrong is the right thing to do. We have to do it the right way in the right manner to take care of the problem without creating bigger problems.

I really think that this is something that is long overdue to be addressed. I appreciate the chance of your having this hearing, Mr. Chairman. I look forward to the rest of the testimony.

Mr. TOWNS. Thank you very much, Congressman Bilbray.

Mr. Denett.

STATEMENT OF PAUL A. DENETT

Mr. DENETT. Chairman Towns, Representative Bilbray, and members of the subcommittee, I appreciate the opportunity to appear before you today to discuss how the Federal acquisition system can be used to improve tax compliance by Federal contractors.

The administration agrees with the subcommittee's goals to reduce contractor tax delinquency and improve tax compliance. This is a shared value and responsibility that requires Government-wide attention, and, as the Administrator for Federal Procurement Policy, I will discuss ways the community is increasing compliance and address the practical issues associated with implementing the proposed Contractor Tax Enforcement Act.

Increasing tax compliance: following the February 2004, report by the Government Accountability Office regarding Defense contractors that abused the Federal tax system, the Office of Management and Budget participated on the Federal Contractor Tax Compliance Task Force to improve the sharing of information between the Internal Revenue Service and other Federal agencies, specifically the Department of Defense, for the purpose of collecting unpaid taxes.

The Task Force, which has become a semi-permanent entity dedicated to improving contractor tax compliance, made significant and permanent improvements to policies and processes that directly result in increased debt collection.

For example, IRS and other Federal agencies now share information electronically to identify contractors that should be subject to the Treasury Department's Federal payment levy program. Delinquent contractors are identified, and their Government payments levied. Alternatively taxpayer identification numbers, TINs, that are entered in the central contractor register data base, which is the Government's principal repository for contractor banking information, are validated to ensure that contractors subject to the levy program are correctly identified, ensuring that the names and TINs of the contractor match, increase the number of payments available for levy.

The IRS is now using data from the Federal procurement data system to identify contractors with outstanding tax debts, which will assist the IRS in prioritizing future offset actions and increase tax debt recovery.

Implementation of the proposed Contractor Enforcement Act: as I understand it, the proposed Contractor Tax Enforcement Act would prohibit delinquent Federal debtors, generally those who have not paid the tax, penalty, or interest within 180 days of assessment, from being eligible for Federal contracts. While I fully support the objective of the bill to increase tax compliance, I am concerned that implementation of this, as written, would result in a de facto debarment executed without regard to the suspension and debarment due process requirements provided in the Federal Acquisition Regulation [FAR].

Suspension or debarment is a serious remedy designed to protect the Government from conducting business with non-responsible contractors when this is in the Government's interest. The FAR establishes due process requirements to preserve transparency and fairness and afford both the Government and the contractor discrete rights throughout the process. These rights are necessary to ensure that the Government's interests are protected and that the nature and seriousness of the contractor's action warrant suspension or debarment. These decisions are made on a case-by-case basis by an informed official, and a decision against a contractor is not a punishment for non-responsibility but is a means for us to protect the Government.

The proposed legislation appears to be inconsistent with the established process for suspension or debarment; however, a recently proposed change to the FAR provides much-needed support for ensuring that tax delinquencies are properly considered prior to contract award.

The proposed regulatory solution: on March 30, 2007, a proposed change to the FAR was published in the Federal Register. The proposed rule requires prospective contractors to certify whether or not they have been convicted of or have had a civil judgment rendered against them for violating any tax law, failing to pay any tax, or have been notified of any delinquent taxes for which the liability remains unsatisfied within a 3-year period preceding the offer.

Additionally, the proposed FAR change adds the following list of causes for debarment or suspension: delinquent taxes, not restricted to Federal taxes, about which the offer has been notified and that remain unpaid; unresolved tax liens; and convictions or civil judgments for violating tax laws or failing to pay taxes.

Once this rule is finalized, the appropriate Federal officials may used tax delinquency as sufficient grounds for debarment or suspension, in accordance with the established process in the FAR for protecting the Government's interest.

Mr. Chairman and members of the subcommittee, OFPP is committed to ensuring that Government contracts are awarded to responsible, law-abiding contractors who take their tax obligations seriously. The acquisition community is taking affirmative steps to raise the visibility of contractor tax delinquency, improve the ability of the Government to recover that debt, and ensure that contractors seeking Federal business disclose their tax liabilities and are accountable for their tax delinquencies.

I feel the progress we have made as a community and the proposed change to the FAR preclude the need for the additional legislation.

This concludes my remarks. I am happy to answer any questions you may have.

[The prepared statement of Mr. Denett follows:]

STATEMENT OF PAUL A. DENETT
ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY
BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION, AND PROCUREMENT
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

April 19, 2007

Chairman Towns, Representative Bilbray, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss how the federal acquisition system can be used to improve tax compliance by federal contractors. The administration agrees with the Subcommittee's goal to reduce contractor tax delinquency and improve tax compliance. This is a shared value and responsibility that requires government-wide attention, and as the Administrator for Federal Procurement Policy, I will discuss ways the community is increasing compliance and address the practical issues associated with implementing the proposed Contractor Tax Enforcement Act.

Increasing Tax Compliance

Following the February 2004 report by the Government Accountability Office regarding defense contractors that abuse the federal tax system, the Office of Management and Budget participated on the Federal Contractor Tax Compliance Task Force to improve the sharing of information between the Internal Revenue Service and other federal agencies, specifically the Department of Defense (DoD), for the purposes of collecting unpaid taxes. The Task Force, which has become a semi-permanent entity dedicated to improving contractor tax compliance, made significant and permanent

improvements to policies and processes that directly result in increased debt collection. For example:

- IRS and other federal agencies now share information electronically to identify contractors that should be subject to the Treasury Department's Federal Payment Levy Program (FPLP). Delinquent contractors are identified and their government payments levied.
- All Taxpayer Identification Numbers (TINs) that are entered in the Central Contractor Registration (CCR) database, the government's principal repository for contractor banking information, are validated to ensure that contractors subject to the FPLP are correctly identified. Ensuring that the name and TIN of the contractor match increases the number of payments available for levy.
- The IRS is now using data from the Federal Procurement Data System to identify contractors with outstanding tax debts, which will assist the IRS in prioritizing future offset actions and increasing tax debt recovery.

Implementation of the Proposed Contractor Tax Enforcement Act

As I understand it, the proposed Contractor Tax Enforcement Act would prohibit delinquent federal debtors – generally those who have not paid the tax, penalty, or interest within 180 days of assessment – from being eligible for federal contracts. While I fully support the objective of the bill to increase tax compliance, I am concerned that implementation of this, as written, would result in de facto debarments executed without regard to the suspension and debarment due process requirements provided in the FAR.

Suspension or debarment is a serious remedy designed to protect the government from conducting business with non-responsible contractors when this is in the government's best interest. The FAR establishes due process requirements to preserve transparency and fairness and afford both the government and the contractor discrete rights throughout the process. These rights are necessary to ensure that the government's interests are protected and that the nature and seriousness of the contractor's actions warrant suspension or debarment. These decisions are made on a case-by-case basis by an informed official and a decision against a contractor is not a punishment for non-responsibility, but a means to protect the government.

The proposed legislation appears to be inconsistent with the established process for suspension or debarment. However, a recently proposed change to the FAR provides much needed support for ensuring that tax delinquencies are properly considered prior to contract award.

Proposed Regulatory Solutions

On March 30, 2007, a proposed change to the FAR was published in the *Federal Register*. The proposed rule requires prospective contractors to certify whether or not they have been convicted of or had a civil judgment rendered against them for violating any tax law, failing to pay any tax, or been notified of any delinquent taxes for which the liability remains unsatisfied within a three-year period preceding the offer.

Additionally, the proposed FAR change adds the following to the list of causes for debarment or suspension:

- delinquent taxes (not restricted to Federal taxes) about which the offeror has been notified and that remain unpaid;
- unresolved tax liens; and
- conviction or civil judgment for violating tax laws or failing to pay taxes.

Once this rule is finalized, the appropriate federal officials may use tax delinquency as sufficient grounds for debarment or suspension in accordance with the established process in the FAR for protecting the government's interests.

Conclusion

Mr. Chairman and Members of the Subcommittee, OFPP is committed to ensuring that government contracts are awarded to responsible, law-abiding contractors who take their tax obligations seriously. The acquisition community has taken affirmative steps to raise the visibility of contractor tax delinquency, improve the ability of the government to recover that debt, ensure that contractors seeking federal business disclose their tax liabilities, and are accountable for their tax delinquencies. I feel the progress we have made as a community and the proposed change to the FAR preclude the need for additional legislation.

This concludes my prepared remarks. I am happy to answer any questions you might have.

Mr. TOWNS. Thank you very much, Mr. Denett.
Mr. George.

STATEMENT OF J. RUSSELL GEORGE

Mr. GEORGE. Thank you, Mr. Chairman. Let me at the outset say it is truly an honor to be here to work with your committee. As you noted earlier, I was staff director of this subcommittee over 12 years for approximately 7 years under the chairmanship of Steven Horn. It was truly an honor to work with you. Mr. Bilbray, we held field hearings up in your District, you may recall, and Mr. Platts, also, since we have interacted in my capacity as IG.

You are considering very important legislation that you may recall that we looked at the issue over 7 years ago in 2000 when Mr. Turner of Texas approached Mr. Horn about this very important area. I am so glad that you are bringing it back up today, sir.

I thank you for the opportunity to testify—Mr. Ellsworth, it is nice to meet you—on two legislative proposals related to tax collection. The policies embodied in them have the potential to affect efforts to increase voluntary compliance, as well as enforced revenue collection.

As mentioned, the contractor tax enforcement act would effectively make any person with an outstanding Federal tax debt ineligible to enter into a contract or to receive a loan from a Federal agency. In February 2006, the IRS estimated that, based on tax year 2001 data, the annual gross tax gap due to under-payment of taxes is $34 billion. Collecting additional taxes owed from potential Federal contractors could provide another means to help reduce the annual tax gap attributable to under-payment of Federal tax obligations.

This compliance check would also appear to support the Secretary of the Treasury's comprehensive strategy for reducing the tax gap.

Contractors receive an estimated $378 billion in Federal payments annually. It is for Congress and for the Department of the Treasury to consider whether, as a policy matter, eligibility for Federal contracts and loans should include tax compliance requirements.

While my office has not performed work directly on this matter, our limited review of such requirements in other contexts would lead us to anticipate that the impact on the IRS's other tax administration efforts should be minimal. This assumes that the proposed requirement is implemented in a manner similar to IRS's current practices.

The other draft bill before this subcommittee this afternoon would amend Title 31 of the United States Code to create a pilot program to examine the feasibility of collecting certain local tax debts. This proposal has the potential to assist local governments with their collection efforts based on experiences at the Federal level.

The Internal Revenue code requires that a taxpayer's overpayment be applied to any outstanding child support or non-tax Federal debt prior to issuing a refund or accrediting an overpayment to a future obligation. However, a tax overpayment must be offset

to an outstanding tax debt before it may be offset to non-tax debts or applied as a credit to a future tax period.

The IRS has facilitated these offsets since 1984. In 1996 this committee moved the Debt Collection Improvement Act, which authorized the Treasury Department to consolidate its offset programs. Starting on January 11, 1999, the Department's Financial Management Service, Treasury Department's Financial Management Service, began refund offsets to pay outstanding child support or Federal agency debts, while offset of Federal tax refunds for State income tax debts began in January 2000.

Since 1996, this program has collected $24 billion in outstanding debts. For example, in fiscal year 2005 the program collected $3 billion. Of that total, 90 percent of the collections were for overdue child support, Federal non-tax debt, and State income tax debt.

Given the nature of the proposal under consideration, it is unlikely that its enactment would adversely affect the IRS or Federal Tax Administration. The proposal would establish a pilot program for past due, legally enforceable local government obligations. If current practice in analogous circumstances is an accurate indication, it is likely that the proposed pilot program would operate through the Treasury offset program, and therefore affect the Financial Management Service but not the Internal Revenue Service.

Mr. Chairman and members of the subcommittee, thank you for the opportunity to provide background. I look forward to answering your questions.

[The prepared statement of Mr. George follows:]

HEARING BEFORE THE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION AND PROCUREMENT
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

April 19, 2007

Washington, DC

The Honorable J. Russell George
Treasury Inspector General for Tax Administration

STATEMENT OF

THE HONORABLE J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION AND PROCUREMENT
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

April 19, 2007

Chairman Towns, Ranking Member Bilbray, and Members of the Subcommittee, thank you for the opportunity to appear before the Subcommittee today to testify on two draft legislative proposals related to tax collection. The matters being considered are important to our system of tax administration. The policies embodied in them have the potential of affecting efforts to increase voluntary compliance as well as enforced revenue collection.

At the outset, I must note that the Secretary of the Treasury has delegated to the Assistant Secretary for Tax Policy exclusive authority to determine the Department's position on all tax policy matters. As Inspector General for Tax Administration (TIGTA), I am authorized under the Inspector General Act to review proposed legislation relating to Internal Revenue Service (IRS) programs and operations. My comments today, therefore, address prospectively the potential impact on IRS' tax administration efforts of the proposals the Subcommittee is considering. I have based my observations on TIGTA's prior reviews in somewhat analogous circumstances.

Contractor Tax Enforcement Act

The draft Contractor Tax Enforcement Act would effectively make any person with an outstanding Federal tax debt ineligible to enter into a contract with or to receive a loan from a Federal agency. The legislation would also authorize the Secretary of the Treasury to disclose to the head of a Federal agency information about whether a prospective contractor or a loan applicant has a delinquent outstanding debt under the Internal Revenue Code (I.R.C.).

In Fiscal Year (FY) 2002, the Department of Defense (DOD) awarded contracts totaling nearly $165 billion. Those awards are approximately 14 times more than the FY 2008 budget request for the IRS. DOD contract awards accounted for nearly two-thirds of the Federal Government's contracting activity in FY 2002. The sheer dollar value of Federal contracts makes contractor compliance with Federal tax obligations a serious matter.

There is significant room for improvement with contractor tax compliance. In 2004, the Government Accountability Office (GAO) reported that DOD and IRS records indicated that over 27,000 DOD contractors had nearly $3 billion in unpaid Federal taxes as of September 30, 2002. Of that debt, 78 percent was more than a year old. Among those contractors, over 25,600 were businesses that primarily owed unpaid payroll taxes.[1]

The GAO also estimated that the DOD, which functions as its own disbursing agent, could have offset payments and collected at least $100 million in unpaid taxes in FY 2002 if it had worked with the IRS to effectively levy contractor payments. The GAO further noted that its review of IRS collection efforts against DOD contractors selected by the IRS for audit and investigation indicated that the IRS attempted to work with the businesses and individuals to achieve voluntary compliance, pursuing enforcement actions such as levies of Federal contract payments later rather than earlier in the collection process. This resulted in many businesses and individuals continuing to receive Federal contract payments without making any payments on their unpaid Federal taxes.

In February 2006, the IRS estimated that, based on tax year 2001 data, the annual gross tax gap due to underpayment of tax obligations is $33.5 billion. Collecting additional taxes owed from potential Federal contractors could provide another means for helping to reduce the annual tax gap attributable to underpayment of Federal tax obligations. This compliance check would reduce opportunities for Federal contractors to avoid paying their tax obligations and would also support the Secretary of the Treasury's comprehensive strategy for reducing the tax gap.[2]

Federal Government contractors receive an estimated $377.5 billion in Federal dollars annually. For some, these Federal contracts represent a considerable share of their gross revenue. It is for Congress and the Department of the Treasury to consider whether, as a policy matter, contractor eligibility should include tax compliance requirements. TIGTA has not performed work directly on this matter; however, from our limited reviews of such requirements and their implementation in other contexts, we would anticipate that the impact on the IRS' other tax administration efforts would be fairly minimal if the proposed requirement is implemented in a manner similar to current practice regarding electronic return originators (EROs).

For example, the IRS' electronic filing (*e-file*) program offers taxpayers an alternative to filing a traditional paper tax return. The *e-file* program enables tax returns to be sent to the IRS in an electronic format via an authorized IRS *e-file* provider known as an Electronic Return Originator (ERO).

An ERO is the first point of contact for most taxpayers filing a tax return through the IRS' *e-file* program. An ERO originates the electronic submission of a return to the

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[1] *FINANCIAL MANAGEMENT: Some DOD Contractors Abuse the Federal Tax system with Little Consequence* (GAO-04-95, dated February 2004).
[2] *A Comprehensive Strategy for Reducing the Tax Gap* (U.S. Department of the Treasury – Office of Tax Policy, dated September 26, 2006).

IRS. The IRS is responsible for reviewing applications from individuals applying to participate in the *e-file* Program, as well as ensuring that the individuals who have been authorized to participate maintain a high degree of integrity and adhere to the highest professional and ethical standards.

To become an ERO, an applicant is required to prepare and submit to the IRS an Application to Participate in the IRS *e-file* Program (Form 8633), along with a fingerprint card. The IRS allows individuals who have a professional certification to send a copy of the certification in lieu of a fingerprint card. In order to qualify to merely transmit tax returns to the IRS electronically, not necessarily preparing those tax returns, applicants must meet the following criteria:

- An applicant must be a United States citizen or legal resident alien.
- An applicant must be 21 years of age as of the date of the application.
- An applicant must pass a criminal background check.
- A determination must be made as to whether individual and business tax returns were filed and taxes owed were paid.

EROs do not receive compensation from the Federal Government for submitting tax returns electronically to the IRS.

Pilot Program for Local Governments to Offset Federal Tax Refunds

Legislation to amend title 31 of the United States Code to test the feasibility and potential for collecting certain local tax debts has the potential to assist local governments with their collection efforts. Experience at the Federal level has demonstrated that such a program has significant collection potential.

I.R.C. §§ 6402(c) and (d) require a taxpayer's overpayment to be applied to any outstanding non-tax child support or Federal agency debt prior to crediting an overpayment to a future tax or to issuing a refund. However, a tax overpayment must be offset to an outstanding tax debt before it may be offset to non-tax debts or applied as a credit to a future tax period. The IRS has facilitated these offsets since 1984.

The Debt Collection Improvement Act (DCIA) of 1996[3] authorized the Department of the Treasury's Financial Management Service (FMS) to combine the IRS' Tax Refund Offset Program, which offset IRS refunds to outstanding debts, with the Treasury Offset Program (TOP). Effective January 11, 1999, FMS began initiating refund offsets to outstanding child support or Federal agency debts. These offsets are referred to as TOP offsets. A TOP offset reduces the amount of an IRS refund by the amount of the debt.

FMS established the TOP, a computer matching program, to carry out its responsibilities under the DCIA to collect Federal debt. The TOP compares the names

[3] Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321-358 (2006).

and taxpayer identification numbers (TINs) of debtors with the names and TINs of recipients of Federal payments. If there is a match, the Federal payment is reduced (levied) to satisfy the overdue debt.

FMS issues refunds for the IRS. A TOP offset occurs after the IRS has certified a refund to FMS for payment but before the FMS direct deposits or mails the refund check. The amount of a refund certified by the IRS to FMS for payment may not necessarily be the amount that is issued by FMS to the taxpayer. The taxpayer may receive less of a refund or none at all if the whole amount is offset.

FMS will issue a TOP offset notice to a taxpayer when a refund is reduced. If the refund is offset in part, the notice is issued at the time the remainder of the refund is direct deposited or is sent as an attachment with the paper check. If the refund is offset in full, a separate notice is sent within the same time frames. The notice informs the taxpayer of the amount of the offset, the agency(s) receiving the offset, and the agency's address and telephone number.

According to FMS, for FY 2005, payment types subject to offset included Office of Personnel Management retirement payments, IRS tax refunds, some vendor payments (Treasury disbursed and non-Treasury disbursed payments), Federal employee travel payments, some Federal salary payments, and Social Security benefit payments. Offset of Federal tax refunds for State income tax debts began in January 2000 when FMS started collecting State income tax debts by offsetting Federal income tax refunds, as authorized by the Internal Revenue Service Restructuring and Reform Act of 1998.[4]

As of September 30, 2005, the TOP database contained $255.5 billion in delinquent receivables. The largest component of TOP's delinquent debtor database was the $129.5 billion in Federal income tax debts submitted for continuous tax levy.

The TOP has collected a significant amount of outstanding debt. Since enactment of the DCIA in April 1996, $23.9 billion has been collected through the TOP. In FY 2005, total collections through the TOP were $3.1 billion. Total tax refund offset collections for child support debts, Federal non-tax debts and State income tax debts totaled $2.8 billion, accounting for 90 percent of the TOP's collections. Child support collections in FY 2005 totaled $1.58 billion, which was an increase of $96 million over FY 2004 collections. Also in FY 2005, total collections of State income tax debts by offsetting Federal tax refunds totaled $232 million, an increase of $14 million over the $218 million collected in FY 2004.

Given the nature of the proposal under consideration to allow certain local tax debt to be collected through the reduction of Federal tax refunds, it is unlikely that enactment of the proposal would affect the IRS or Federal tax administration. The proposal would establish a pilot program for collecting past-due, legally enforceable local government obligations. If current practice in analogous circumstances is an accurate

[4] Section 3711 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685.

indication, it is likely that the proposed pilot program would operate through the TOP and therefore affect the FMS but not the IRS.

The pilot program would require eligible States to notify the Secretary of the Treasury on behalf of a local government, under conditions prescribed by the Secretary, of individuals who owe past-due, legally enforceable tax obligations to the local government. If the Secretary of the Treasury finds that any such amount is payable, the Secretary may reduce the amount of a Federal tax refund by an amount equal to the debt owed to the local government. The Secretary would be authorized to pay the amount of the refund offset to the State and the State would pay the local government. It is also likely that the FMS would notify the taxpayer that a Federal tax refund has been reduced by an amount necessary to satisfy a past-due, legally enforceable tax obligation to the local government.

I hope my discussion of these two legislative proposals will assist you with your consideration of them. Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to provide background information for your consideration in evaluating these proposed measures. I would be pleased to answer any questions you may have at the appropriate time.

Mr. TOWNS. Thank you very much.

Let me thank all three of you for your testimony.

Let me begin with you, Mr. Denett. What is it that you do not like about the legislation?

Mr. DENETT. I don't like the fact that it deprives contractors of the due process that they normally would be afforded before they, in effect, were suspended or debarred, by prohibiting them from getting awards that, in effect, is like a debarment. We have careful steps where they have an opportunity to explain their side of it, go over the pros and cons, make sure everything is on the up and up before a decision is made to debar them so that they will not be able to get the award.

Systems have errors in them and they are imperfect, and I would hate to deprive anybody of an opportunity to explain their side of it before we made the decision that they would not be allowed to receive any contract from the Federal Government.

Mr. TOWNS. This would only apply to people who have actually received information in the course of due process taking place, and also we are talking about up to a certain amount, as well. I mean, you still think that we should do something else?

Mr. DENETT. I do. Again, we have been through this for many decades, a formal debarment process. I personally have been involved with a debarment process with several companies and, in fact, have debarred people. In the process of hearing directly from attorneys and companies, the circumstances involved with various things they are accused about, facts come out that you otherwise are not fully privy to, and you need to consider fully both sides before you take a significant action of barring them from any Government business.

Some of these companies are small business. If they don't have the opportunity to earn Federal dollars, they may not even be able to meet repayment schedules with IRS if they no longer have any income.

Mr. TOWNS. I guess you heard Mr. Kutz' testimony when he talked about in terms of the buying of boats, he talked about buying of luxury cars and homes and still not paying the taxes. I mean, I know you suggest a case-by-case basis, but that seems not to be working.

Mr. DENETT. Well, it is improving, and we collected $55 million through the levy program. Now that they are tapping into the FPDS there is going to be more and more matches. In Defense Department they are allowed to levy 100 percent of the money that is going to them through contracts. On the civilian side I think it is 15 percent. I think legislation may be ultimately proposed—I don't know if it is currently—to take 100 percent of money going to civilian contractors. I think all of that is a positive. It is a way to collect money. I find it deplorable when I see big houses and luxury boats and all that and people owe money. I mean, that is wrong. I am glad——

Mr. TOWNS. Especially this time of the year when I have to pay mine. I pay my taxes.

Mr. DENETT. I agree with you. I pay mine, too.

Mr. TOWNS. But doesn't it bother you when you hear about similar names at the same address, and, of course, they just change the name and continue to do business? Doesn't that bother you?

Mr. DENETT. Yes, it does bother me. I mean, I think it is wrong, and as we go through the due process I am describing, in those cases where they can't demonstrate that they should continue to get any Government business, they would be debarred and suspended and they would not get any further Government business.

Mr. TOWNS. Mr. Kutz, I would like to hear your comments on this.

Mr. KUTZ. Well, a couple of things. I mean, the people we are talking about here are fraudsters. These people are involved in tax fraud, basically. With respect to due process on the tax side—and I think the ranking member was talking about this—while I talked about the billions of dollars we found, that was agreed-to taxes. That was not disputable taxes. You have compliance assessments, as they are called, that are not agreed-to taxes. Everything that I talked about was taxes either agreed to by the taxpayer or determined in the IRS's favor in a court of law, so the due process has happened.

Mr. TOWNS. Happened.

Mr. KUTZ. I don't think necessarily the only solution to this is to go through the debarment process. Mr. George mentioned the Treasury offset program. You have tax and non-tax debt in that Treasury offset program that potentially one possible solution could be to systematically bump that against the central contract registry and show a notification to the central contract registry that someone is not eligible for a contract because they have a tax debt. So there are a lot of ways to do it. I think the implementation, there are a lot of ways to implement this. Hopefully at the highest level we can agree that we want to get these people out of the system. I think that is the key part of this testimony. There are various ways you can actually do it.

The progress also that was discussed is a lot of back-end process. The levy program is where we are actually after—they are in the system and being paid. We are collecting a couple of pennies on the dollar at the back end, which I think we need to continue to do, regardless of what we do at the front end. But the purpose of this hearing today, as I understand it, is to talk about the front end of the process.

Mr. TOWNS. Right. My time has expired, so I am going to yield to the ranking member.

Mr. BILBRAY. Thank you, Mr. Chairman. Mr. Chairman, let me just echo your concern about the changing names. As we are addressing this, we have to remember how some of these people operate in being able to avoid it. We have seen that, the abuses in the women in minority owned businesses and the way they use front people to be able to hide, basically, who is the power or the base, and that is going to be a big concern.

I think that when you talk about practical application, we are going to have to figure out how do we track these people and who are they. Can they get around? Are their Social Security numbers there? Do we have a way of tracking who is actually the contract and who is not?

Mr. George, you mentioned the issue of the offset from the Federal tax refunds, the 1865, and the potential for the collection there. Do you have any kind of number that we can grasp on that issue? Do you have an estimate at all of the kind of revenue source it could create for the local government if we can go back and tap that?

Mr. GEORGE. As I noted in my written testimony, GAO has estimated, as Greg, I believe, indicated, that DOD, which serves as its own dispersing agent, collected at least $100 million in unpaid taxes in fiscal year 2002. If it worked with the IRS, we estimate that at least that amount of money could be added.

Mr. BILBRAY. How much was that again? I am sorry.

Mr. GEORGE. We are estimating that $100 million in unpaid taxes in 2002 could have been collected if DOD had worked with the IRS to effectively levy contractor payments.

Federal Government contractors receive an estimated $377 billion in Federal dollars, alone, but as for the local governments, the Treasury offset program has collected, since the Debt Collection Improvement Act was passed in 1996, $24 billion.

Mr. BILBRAY. So we are talking about a nice——

Mr. GEORGE. A significant amount of money. No question about it.

Mr. BILBRAY. Nice bundle.

Mr. GEORGE. It is.

Mr. BILBRAY. I would just say to my colleagues, when we talk about issues like local government having first responder capabilities for homeland security and we talk about grants and providing Federal funds to local governments, here is an example where, if we just cooperate with them, we can help them get their own money back, and within their own jurisdictions, without all our strings and oversight problems that we have with the Federal Government, and to get the job done and protect the citizens by making sure that those who should be paying are finally paying the local communities, which really are the front line service providers for our citizens, contrary to what we like to think about here in Washington.

The challenge I have is that your concern about innocent people getting caught or being disbarred, or whatever. Can you see a way for us to make sure that doesn't happen? We are talking about somebody basically whose due process has been executed. The challenge is that we have misidentification of the individual? Does somebody get hit there? What is your concern there? And do you have any answers for this legislation to make the implementation of this legislation practical?

Mr. DENETT. Well, again, I think the new regulation that is on the street now—we are collecting comments from industry and the citizenry—will be a major step in the right direction, because heretofore we did not list all these tax things as a specified reason for debarment and suspension, so this will facilitate making those calls. A step in the right direction.

I think the IRS and others now tapping into the Federal procurement data system to see all of this nearly $400 billion awarded every year, any that have tax problems it will put flags on them and we will start to collect that money from them. Instead of them

getting the check, in he Defense Department's case they can take 100 percent of the check. Civilian agencies is 15 percent, but being considered to go up to 100 percent. I mean, that is substantial and will be a major improvement over what we have been doing in previous years.

Is it enough? I don't know. I think we need to get public comment and then try it and see what success we have with it.

Mr. BILBRAY. Mr. Chairman, just in closing, it tends to be a habit around here that we need props, and props are great for sending a message. Frankly, I don't care how big a house somebody has if they are skipping out on their taxes. I don't care if it is a little shack they are living in and they are drinking or taking drugs and there is no symbolism there.

I don't care if they are living in poverty. If they are not paying their fair share of taxes and they are competing against a business that is trying to get a contract that is paying their fair share of taxes, common decency says we have to quit rewarding the people that are breaking the rules and not paying their taxes, because that, de facto, punishes those who are playing by the rules.

Even if the guy playing by the rules lives in one of those big houses, he still has a right to be protected from unfair competition from those who aren't playing by the rules.

I yield back, Mr. Chairman.

Mr. TOWNS. Thank you very much.

I yield to the gentleman from Indiana, Mr. Ellsworth.

Mr. ELLSWORTH. Thank you, Mr. Chairman.

Is it a 5-minute rule?

Mr. TOWNS. Five minute rule, yes, unless you are the chairman or the ranking member.

Mr. ELLSWORTH. OK. I will keep an eye on my $29 men's bracelet I have on here, my Timex.

Mr. BILBRAY. Guess who is making the rules?

Mr. ELLSWORTH. Thank you very much.

I will ask you the first question. This is probably a pretty easy one. A person who knows they are going to not pay their taxes, would that not give them an advantage in a bid process if they knew on the end that they could low-ball that, knowing that they were not going in? Would you find that to be the case?

Mr. KUTZ. Yes, not just theoretically but in reality. We did drill down upon specific cases of especially wage-based industries where that had happened and taxpaying contractors were beat out by those that didn't pay their payroll and income taxes.

Mr. ELLSWORTH. Mr. Denett, you talked about a self-certification process that was in the works or in the hopper, you are thinking about implementing that. Is there a time? I have penned some legislation that did that. Is that on a timeframe that would be in place and implemented?

Mr. DENETT. It is on the street for comments now, published in the Federal Register. Comments are due by the end of May. We don't know if we are going to get ten comments or a thousand comments, but the normal cycle of reviewing the comments and then getting it finally issued, I would estimate we would have a rule out by November, perhaps sooner, based on my increased sensitivity to this subject and hearing some of what I am hearing today. It dis-

turbs me also, so I am going to be as aggressive as I can be with getting it implemented.

Mr. ELLSWORTH. I hope the commenters have to identify themselves, or we only get the ones from the contractors that are doing this. You are going to get a one-sided thing.

I will go ahead out on a limb here and say that the people in Indiana, I can comment for them that they would like the people also paying their taxes and fairly before they got another contract.

We talked about not doing this, that we wouldn't want anybody to not be awarded a contract unfairly. Do you have any numbers, the percentage of those that we have found that we checked on or held back from receiving a Federal contract that we then found that we were in the wrong, the Government was in the wrong and held them back unfairly, a percentage of how often that happens when we don't award a contract because they haven't paid any? Do we have examples of that where that has happened?

Mr. DENETT. I do not have any statistics on how often that happens.

Mr. ELLSWORTH. So you based your comments on we sure wouldn't want that to happen, so that is why we are not—I guess I am gathering here, when you said we wouldn't want anybody to go in default or not be awarded a contract if we found a mistake, that has not happened?

Mr. DENETT. I am told by various departments that this, in fact, has happened, but I do not have any specific example with me today, nor do I know what small percentage of times that, in fact, does happen.

Mr. ELLSWORTH. But it would be small, a small percentage?

Mr. DENETT. Yes. That would be my guess.

Mr. ELLSWORTH. OK. And, Mr. George, I will go to you. I am still in the green. I might get a couple more in.

In my former life in law enforcement we could find carpet fibers and DNA when we looked for them, and I am guessing that Jag and those big homes would be pretty easy to find, and I agree with the gentleman that I don't care what size house it is or what car. But how do you triage who you go after when you find these violations? I know it is going to cause your organization a burden to increase and roll it up, but wouldn't this money we take in help offset your costs or new employees? I am guessing we could hire quite a few employees for what we can make up.

Mr. GEORGE. Mr. Ellsworth, that is a very good point. In similar programs that the Treasury Department operates—again, obviously not dealing with contractors—they are allowed to assess fees to the people from whom they collect the money, and in some ways that helps offset or pay for the activity that the Government has to engage in. But it is important to note, too, that, depending upon how the contractor is organized, whether it is through an incorporated organization or whatever so they are going to be very aggressive, innovative in ways to help bring that about. That is something that I would request that this subcommittee consider.

Mr. ELLSWORTH. Would the self-certification that Mr. Denett was talking about then help solve that? Would that then, if they were found in violation when they self-certify, then they go to jail?

Mr. GEORGE. Well, honest thieves who self-certify it would help, but the dishonest ones——

Mr. ELLSWORTH. And then go to jail if they are caught self-certifying when that was not the case?

Mr. GEORGE. Well, I am not sure whether it require jail terms.

Mr. DENETT. There are criminal penalties for anybody who falsely certifies that information.

Mr. ELLSWORTH. OK.

Thank you, Mr. Chairman. Sorry for going over.

Mr. TOWNS. Thank you very much.

At this time I yield to the former chairman of this subcommittee from Pennsylvania, Mr. Platts.

Mr. PLATTS. Thank you, Mr. Chairman. I appreciate your holding this hearing. Does the 5-minute rule apply to former chairmen? I will try to stay within the 5-minutes here.

I do appreciate your holding the hearing and all of our witnesses. I think this is an issue that needs to be addressed head-on and is something that we didn't get to on our list, and I am glad that the chairman is taking the lead on it now with the new session.

The numbers to me are staggering, as one who does my best to pay every penny I owe and use an accountant to make sure it is right, that we have people doing business with the Federal Government that aren't.

I think a very important line is in the GAO report that says, Federal contractors that do not pay taxes could have an unfair competitive advantage in cost because they have lower cost than the tax-compliant contractors on Government contracts, because if you are paying your taxes you factor all that into your bid. The guy that is shorting the Federal Government isn't, so he gets the job and he is the one being unscrupulous to begin with.

I do have a couple of quick questions. The numbers addressed, the $3 billion, and if you total it up I understand maybe some of it is over 63,000 different contractors, DOD contractors, 33,000 civilian and agency contractors, and another almost 4,000 GSA, that $3 billion is from throughout the Federal Government, not just DOD contracts?

Mr. KUTZ. We did three different pieces. We did Defense, civilian agencies, and GSA.

Mr. PLATTS. So the $3 billion is the total of all of them?

Mr. KUTZ. No. There is $3 billion, $3.3, and $1.4, but there is overlap, so I would say at the end of the day you are talking about between $5 billion and $10 billion, but it is difficult to know. And keep in mind that is the known part.

Mr. PLATTS. Right.

Mr. KUTZ. We said those are agreed-to taxes.

Mr. PLATTS. Right.

Mr. KUTZ. It is very likely the bigger part is the unknown part.

Mr. PLATTS. Right.

DOD certainly has not done a very good job, and, as is referenced in Mr. George's testimony, in the 2002 fiscal year, where if they had worked more effectively with IRS, could have recouped it, and clearly haven't been very efficient.

Is there any department or agency that stands out as doing a good job of making sure—DOD I think is an example of what we

don't want to do. Is there an agency or department that, in dealing with contractors, is doing a good job?

Mr. KUTZ. Well, if I could address that, then Mr. George could followup with that, but what Mr. George was talking about was the back end of the process. This is levying contractors already in the system and taking 15 percent typically of their payments. No one was doing a very good job of that in the early 2000's. That is where most of the progress has been made, as Mr. Denett described. And there has been good progress. We are collecting now at least tens of millions, and over times hundreds of millions and billions on the back end of the process.

No one on the front end of the process is doing anything about the 122 cases I talked about. They all got in the system, basically——

Mr. PLATTS. So still today there is no one to point to?

Mr. KUTZ. No. These people can get in the system today.

Again, with respect to the self-certification, one point I would add is that these people are not voluntarily paying their taxes in a voluntary system. What leads us to conclude that they are going to voluntarily say I have a tax problem.

Mr. PLATTS. Yes. And I think that is right on point. If they are being unscrupulous in paying what they owe, the likelihood—I think it is important to point out in the legislation that for this background in large contracting to occur, I mean, the information shared by Treasury to the relevant department or agencies, because the person coming forward for the contract authorized the information to be shared. So if you don't want to have this tax issue addressed, you have that choice of not pursuing the contract, but if you pursue the contract, then under this bill you are going to authorize the Secretary of the Treasury to disclose your tax status, so you are agreeing voluntarily to have it disclosed, and thus then be relevant to whether you are getting the contract.

So I think that is an important part of this bill, that it is something that those who want the Federal business, want to have taxpayers fund their companies, they are agreeing to this procedure.

I hope we are able to move forward in a positive way and get to that front end, not just the collection, because I think that is an important part, but that will be less important if we stop, up front, stop and address the problem in the first instance.

Thank you, Mr. Chairman.

Mr. TOWNS. Thank you very much, Mr. Platts.

Let me ask a couple more questions here.

Mr. Denett, help me. How could the current suspension and debarment process guarantee uniform treatment of companies with similar tax situations? I mean, how can you guarantee me that they are going to be treated the same under the present structure?

Mr. DENETT. Well, in the sense that anybody who is repeatedly not paying their taxes and on the list, I can't speak for every debarment official, but if I am the person looking at that, then I would suspend and debar them. But once that is done, that applies throughout the whole Federal Government, so nobody would be allowed to make awards to them.

If you are saying, like, with every individual case that is being looked at would they reach the same conclusion in exactly the same

way? I guess I don't have an absolute way to say that would happen, but I think just the fact that——

Mr. TOWNS. This legislation would do that. It would make certain that people are treated fairly that fall into the category. That is my concern. I mean, I want everybody to be treated the same.

Mr. DENETT. Well, again, I am just concerned that it becomes a de facto debarment without giving them the normal debarment due process. I guess that is the procurement perspective that I am coming from. I don't think people should be debarred without having, under the Federal acquisition regulation, the process to have their opportunity to fully explain why they believe they should be allowed to continue to do Government service. Not the extreme cases that I am hearing Mr. Kutz describe, of super-sensitive ones or ones where it doesn't make sense, but there could be senses where it made sense to allow the person to continue to have Government business and pay off their debt.

Mr. TOWNS. You really think, when you talk about the Federal acquisition regulations, that we require prospective contractors to certify whether or not they are delinquent in their taxes or have a history of tax fraud, you think we can rely on that?

Mr. DENETT. We currently rely on certification for small business side standards, lots of other things. Again, there are criminal penalties if they sign and say that they don't have any tax delinquencies and they do. Then the Justice Department can pursue them.

We are working with the Justice Department now on a fraud task force where we are taking lots of steps to try to increase finding out people that are doing wrongdoing on all fronts. I think tax evasion would be included in that.

Mr. TOWNS. What if they find out that the IRS is not going to verify. Couldn't they just sort of put down anything? These are people that have already defrauded the Government.

Mr. DENETT. That is of concern to me, and I would be willing to work with the committee, with Treasury Department and GAO to see what we can do to create a level playing field, because I don't want people winning contracts because of an unfair advantage of they are not paying taxes. That is not right. I would be glad to work with everybody to see what solutions we can come up with, considering your legislation, the regulation that we have proposed, which I think will help, and just see what else we can come up with.

Mr. TOWNS. Let me just sort of throw this out for you, Mr. George and Mr. Kutz. What do you think really should happen?

Mr. GEORGE. Well, I would point out, and I note this in my submitted testimony, that there is an analogous program called the electronic return originator which the IRS uses to qualify people who want to submit electronic tax returns on behalf of taxpayers. There is an elaborate process, but elaborate meaning that it is thorough, but it is not so complicated that people can't engage in it, where the IRS requires people to not only submit certifications about taxes being paid, but even fingerprint cards. So there are examples of Government programs that would help, I think, allay some of the concerns that Mr. Denett has noted.

Mr. TOWNS. Mr. Kutz.

Mr. KUTZ. I think you have to have a fair system. Whatever is done has to be done systematically across the board. I agree with the concerns that different contracting officers would handle these cases differently.

You have to set the criteria in law and then apply it to everyone, so that if it is 180 days, as your bill says, if that is what is determined, or whatever it might be, that applies to everyone, and then you can prohibit those people from getting future Government contracts and you could use some of the existing tools out there such as what Mr. George mentioned earlier, the Treasury offset program and the central contract registry, which everyone that can get a Federal contract is supposed to be registered in this central contract registry. That is one place where you could do periodic systematic validations to determine if people have tax issues.

Mr. TOWNS. Right.

I yield to the ranking member.

Mr. BILBRAY. Yes, Mr. Chairman.

I think it should be agreed on that list should be reviewed so that, in a timely manner, if there is a problem contractors can be notified in time to be able to address the issue, rather than just rely on when they apply for a contract, because, let's face it, by that time any action taken is going to be onerous, at least from the contractor's point of view, because of the time lag to address those issues.

So GAO came up with 122 referrals to the IRS. Do you have any information for us of what is the outcome of those referrals?

Mr. KUTZ. Unfortunately, there have been no indictments or prosecutions that we are aware of. I think that gets back to one of the issues. When we look at payroll taxes, which is effectively stealing money, it is like stealing money from a 401(k) plan, and there is a law that calls it a felony. Those referrals, there is a lot of collection activity, kind of a lot of asking will you pay, etc. Very little aggressive action from a seizure standpoint, a levy standpoint, and we see little or no activity from a criminal standpoint. It is all civil.

Mr. BILBRAY. And let me just tell you I think that is an issue that Congress, as a whole, should be talking about, because this is a chronic problem across the board for the IRS. You have contractors out there that should be accruing these funds in the name of an employee and just sort of—it is easier to put it off, put it off, put it off, and once you start getting in the habit of doing that it is easy to ignore it until things get absolutely chronic.

Mr. Chairman, I think that we have at least been able to sensitize the system to the fact that this is an issue that needs to be addressed, and I appreciate the panelists being before us today.

I yield back.

Mr. TOWNS. Thank you very much.

Mr. Ellsworth.

Mr. ELLSWORTH. Thank you, Mr. Chairman.

Mr. Denett, debarrings—I don't know what the proper name is—debarments do go on, right? You do that?

Mr. DENETT. Yes.

Mr. ELLSWORTH. And so we have done those?

Mr. DENETT. Yes. I actually did one personally when I was at a department level, actually when I was at the Treasury Department.

Mr. ELLSWORTH. So they can do them down to that level, at the department level?

Mr. DENETT. That is where it is done.

Mr. ELLSWORTH. OK.

Mr. DENETT. Each department has their own debarring official and each one of them makes calls, and once they do it applies to the whole Government.

Mr. ELLSWORTH. How long is the due process? A red flag comes up on a company that is bidding on a Federal contract. We put it into due process mode. How long does it take before you determine yes, we can award this, or no, they can't have it, that due process security that you are talking about that you would hate to see them go without due process. How long is that, the hearing and the process when a flag goes up?

Mr. DENETT. My recollection, from the one that I personally did, which was years ago, it took about 60 days.

Mr. ELLSWORTH. And during that time, if it was a company that was purposefully defrauding us and not wanting to pay their taxes, would they still be awarded the Federal contract they were going after during that due process period? Is that possible? Or are they put on hold saying we have to investigate this?

Mr. DENETT. It depends if we are looking at this before an award or after an award. When we are doing it before an award, the contracting officer is trying to decide if a company that they are thinking of making the award to is responsible, and so there are several things they look at to decide if they are responsible. One of the things that we would like them to be considering is the position on taxes. That is before award.

Mr. ELLSWORTH. Right.

Mr. DENETT. And if you decide they are not responsible, you would not make award to them.

Then the next status is when somebody already has the award and you find out that they are tax delinquent or other serious, egregious things. You can examine it to see if they can be debarred and prohibited from future Government procurements.

Mr. ELLSWORTH. OK. Thank you.

Mr. Chairman, I have nothing further. Thank you very much.

Mr. TOWNS. Thank you very much, Mr. Ellsworth.

I yield to Congressman Duncan from Tennessee.

Mr. DUNCAN. Thank you, Mr. Chairman. Since I just got here, I will be very brief and just ask a couple of questions.

Mr. Kutz, you say in your statement that there ought to be a law that requires contractors to pay their taxes before participating in the Federal procurement system, but that we also should make sure that there is appropriate due process safeguards in the legislation. Do you think that you are satisfied with the due process safeguards in H.R. 1870?

Mr. KUTZ. Yes. I think that the due process relates to whether someone actually owes the tax and the flexibility allows, for example, the Secretary of Defense to waive the debarment for a contractor that provides a certain good or services that is necessary for na-

tional security, and there may be other flexibilities, but I believe the intent of what I have seen would get those issues. Disasters is another one I recall in your bill. Those are the kind of flexibilities we would think are important, so that you aren't just systematically prohibiting everyone, but you allow some flexibility.

Mr. DUNCAN. Now, as I understand it, this bill would treat the eligibility to treat for a Federal contract like the eligibility to receive a Federal loan or a loan insurance guarantee; is that correct?

Mr. KUTZ. Yes. This would amend the Debt Collection Improvement Act, which already requires that for loans.

Mr. DUNCAN. So it would put in tougher requirements for Federal contractors?

Mr. KUTZ. Yes.

Mr. DUNCAN. And doesn't it seem to you that it would be appropriate to do that, since most Federal contracts are bigger than the great majority of Federal loans or loan guarantees?

Mr. KUTZ. Could you repeat the question? I didn't hear the last part.

Mr. DUNCAN. Doesn't it make sense to you, or don't you think it is appropriate to treat Federal contractors a little tougher in that respect, because most of these Federal contracts are bigger certainly than most of the Federal student loans and things of that nature.

Mr. KUTZ. Yes. I think some of the members here have mentioned that it is a privileged——

Mr. DUNCAN. Right.

Mr. KUTZ [continuing]. To do business with the Government.

Mr. DUNCAN. That is what I am saying.

Mr. KUTZ. So you should be held to a higher standard than someone else.

Mr. DUNCAN. Sure.

Mr. KUTZ. I agree with that.

Mr. DUNCAN. Well, they have done a better job in expressing that than I did, but that is what I was getting at.

Mr. KUTZ. Yes.

Mr. DUNCAN. All right. Thank you very much.

Thank you, Mr. Chairman.

Mr. TOWNS. I yield to Congressman Platts.

Mr. PLATTS. Thank you, Mr. Chairman.

Just one final question. The FAR proposal that stands out there, I guess your perspectives on what this proposed legislation will do that goes farther than that. How do you view the two in comparison?

Mr. DENETT. Well, I think if the proposed legislation would prohibit making awards, so what I am saying is that would be a de facto debarment. The regulation that we have out for comment now in the Federal Register would give people an opportunity to make it clear for contracting officers that anybody who is tax delinquent, that is a cause for debarment, for irresponsibility, etc. It is not now currently listed.

Mr. PLATTS. Let me interrupt. If we take that approach, that makes it pretty subjective approach to this issue. One officer could deem this as a grounds for irresponsibility and not awarding the contract; somebody else may look at it and say, well, it is not that

much owed back or they will pay it eventually if you give them this contract. It would make it more subjective, wouldn't it, whereas this is more objective. If you owe, you are delinquent, you are prohibited. I mean, this would be more consistent. Is that a fair statement?

Mr. DENETT. I think that is a fair statement, but each case is different and sometimes there are circumstances where it would be in the Government's best interest to allow a contractor to receive an award so that they can earn the money to pay their tax delinquencies.

Mr. PLATTS. Well, the bill would not affect, if they were on a repayment schedule, they would not be prohibited. To be trying to pay $10 a week, $100 a month, whatever, how small or large, they could be doing that now and still get the contract under this bill. They would not be prohibited if they have a repayment schedule in place.

Mr. DUNCAN. Will the gentleman yield just for a moment?

Mr. PLATTS. Yes. I yield to the gentleman.

Mr. DUNCAN. That raised the question in my mind, Mr. Denett. Has that ever been put in as a condition of an award? When you say there are cases in which contractors should be given a contract so that they can pay their delinquent taxes, has that ever been put in the contract award, a condition like that?

Mr. DENETT. Not to my knowledge.

Mr. DUNCAN. We are going to give you this second contract, but we know you are delinquent, so you have to use a certain percentage of this money?

Mr. DENETT. I am not aware of that being put in any contract.

Mr. DUNCAN. I yield back.

Mr. PLATTS. And I assume there is no current authority to say we are going to give you this contract and this 10 percent we are going to pay right to the Treasury to make sure you are paying back?

Mr. DENETT. I mean, we have the system now where it has just been implemented where the payment officials in IRS check their data bases, and if there is any delinquency, rather than pay them the money, they can retain 100 percent of any going through a DOD contractor or 15 percent through any civilian.

Mr. PLATTS. So they can allow that now?

Mr. DENETT. It, in fact, is happening.

Mr. PLATTS. I was going to ask if that is commonly done.

Mr. DENETT. It is becoming more common.

Mr. PLATTS. That is good.

Mr. DENETT. I mean, it has just been instituted in the last year or so.

Mr. PLATTS. Coming back to my initial question, where that discretion is given, I can understand where there may be cases where it seems like in the Federal Government's best interest, that if you give them this contract then they will have a source of income and may be more likely to get those taxes. That, unfortunately, does not address the issue I raised with the GAO's statement to the law-abiding company that didn't violate the law in the first place that didn't get the contract because they were under-bid. That is an issue I think that we have to remember here, that this is also

about fairness to anybody competing for those contracts, because they are going to be put at a disadvantage. Even if it is in the Federal Government's interest, it is still not going to be a fair process because of the individual not being straight up in the bid.

Mr. DENETT. I think we need to take a real close look at that. I am looking forward to working with the committee and learning more from Treasury and IRS and the GAO so that my office gets even more up to speed on this issue, because I am disturbed about the uneven playing field. However, every case is different, and I am very reluctant for somebody to, in effect, be debarred without having a chance to explain to the contracting officer what their particular circumstance is.

Mr. PLATTS. I think the importance of this hearing and commend again the chairman, that is exactly what this hearing is about, to get the dialog developed as we go forward in trying to move a good piece of legislation.

I yield back.

Mr. KUTZ. May I make one comment on that?

Mr. PLATTS. If the chairman allows.

Mr. TOWNS. Yes.

Mr. KUTZ. With respect to those 120 cases we investigated, it is kind of interesting, because I have studied those and we have been doing them for several years, and when you look at the IRS enforcement of the tax code you saw the reason they were able to buildup 10 or 20 years of unpaid taxes, it was because that is just what happened. They kept saying IRS things are going to get better. Let us have more time. Give us more time. It is just worse.

Mr. PLATTS. That good faith wasn't rewarded.

Mr. KUTZ. I can't speak to the 122, but we have seen that. When I used to audit the IRS as their financial auditor, also, we saw it then, too, same thing. These are the bad 1, 2, 3 percent of society kind of thing, but, you give them time, they are going to continue to do the same thing over and over again. You keep asking the same, you don't get different results.

Mr. PLATTS. Well, thanks for the testimony, and each of you in your respective positions. Thanks for your service to your Nation and your fellow citizens.

Thanks, Mr. Chairman.

Mr. TOWNS. Thank you. Thank you very much.

Let me thank all of you for your testimony. Of course, this panel has been dismissed.

We will have a 30 minute recess. We have votes on and then we will return.

Thank you very much.

[Recess.]

Mr. TOWNS. The committee will come to order.

[Witnesses sworn.]

Mr. TOWNS. Let the record reflect that they responded in the affirmative.

Why don't we just move forward with you, Mayor Cornett, and come right down the line.

STATEMENTS OF MICK CORNETT, MAYOR, OKLAHOMA CITY, OK, REPRESENTING THE U.S. CONFERENCE OF MAYORS; BARBARA FORD-COATES, TAX COLLECTOR, SARASOTA COUNTY, FL, REPRESENTING THE NATIONAL ASSOCIATION OF COUNTIES AND THE NATIONAL ASSOCIATION OF COUNTY TREASURERS AND FINANCE OFFICERS; AND PATRICIA WETH, DEPUTY TREASURER, ON BEHALF OF THE HONORABLE FRANCIS O'LEARY, TREASURER, ARLINGTON COUNTY, VA

STATEMENT OF MAYOR MICK CORNETT

Mr. CORNETT. Thank you, Mr. Chairman. I appreciate the opportunity to come before this subcommittee on behalf of the Nation's mayors. My name is Mick Cornett. I am the mayor of Oklahoma City. I am also the chairman of the Mayors Urban Economic Policy Committee.

I am here today to show our support for proposed legislation that would create a 2-year pilot program to help local governments collect legally enforceable past due taxes by expanding the Federal tax offset program to include local tax debt. If enacted, this legislation would promote the kind of intergovernmental partnership that we have always believed should exist between the different levels of government. When we work together to achieve a common goal, particularly a goal as important as collecting past due taxes, all levels of government benefit, as well as the American people.

First of all, we want to commend you, Mr. Chairman, for your strong support you have shown for local governments on a wide range of issues over the years. Thank you also for your leadership on this proposed legislation, particularly for focusing attention on the need to expand Federal assistance to help local governments collect past due taxes.

We also want to commend the co-sponsors of this legislation: Representative Michael Turner, the former mayor of Dayton; Representative James Moran, the former mayor of Alexandria; Representative Tom Davis, the former county executive of Fairfax County; and Representative Bilbray, the former mayor of San Diego. Thank you for your support. These Members clearly understand the importance of intergovernmental partnership in addressing issues that affect all levels of government.

Last year during our annual meeting, Mayor Laura Miller of Dallas reminded us that local governments often find it difficult to collect past due taxes. Sometimes we spend an enormous amount of time and energy trying to go after delinquent taxpayers, and we are not always successful in collecting past due taxes, particularly when those taxpayers may have left the area or don't have the resources to pay those taxes. It not only places a financial strain on local governments, but it unfairly burdens members of the community who do choose to pay their taxes promptly.

Before I get too far into my testimony, I would like to share some background information on the delinquency problem in my city. Unlike some cities, Oklahoma City does not collect an income tax of any kind. We use property tax to fund our capital improvements through bond issues, and that property tax is actually collected by the county and distributed to us.

We are mainly funded by the sales tax, especially on the operations side. That is collected by the State and, again, distributed to us.

To prepare for this trip, I asked my staff to review our sales tax data to determine the delinquent rate. They reviewed our sales tax data for the last 6 months and came up with some estimates. From our review, we estimate that we have a delinquent sales tax rate somewhere between 5 and 7 percent, and so we believe it is safe to assume that our delinquent sales tax total is about $10 million a year.

Now, according to information provided by our county treasurer's office, in the 1st year property taxes are due that delinquent tax amount is about 5 percent of the total amount levied for the year. If you go back to fiscal year 2005–2006, that amount totaled about $2 million. If you look over a longer period of time, an 8-year average ending in 2005–2006, the delinquent property tax rate settles out at about 1.4 percent, or about $4 million out of the total of $284 million levied during that period.

Let me put that in perspective to show you some examples of what we would be able to do in our city if we were able to recapture those delinquent taxes.

On average, we can resurface a lane mile of road for about $200,000. If you use that $2 million estimate, that means that is about 10 lane miles of road that we could be resurfacing, and if you use the $4 million estimate, you could double that to 20 lane miles of streets.

Another good example of how those dollars could be used has to do with homeland security. In a post-9/11 world I know you all agree we need to increase our security. Indeed, the Federal Government is working closely with us to help secure our homeland. Many of our cities could use the funds currently due from delinquent taxes to hire new first responders. In Oklahoma City, the cost for me to hire a new fire fighter or a new police officer is about $60,000 a year. If you use the $2 million estimate, that is about 33 new fire fighters or police officers that we could use. And if you use the $4 million, we could hire approximately 67 new fire fighters or police officers.

Now, these are just a few examples of the critical public services that we could provide if we recaptured all or a significant portion of our past due taxes. And it is not true just for Oklahoma City, but cities and local governments all across the country.

We are excited that you are considering creating legislation to assist us in this effort.

During that annual meeting last June, Mayor Miller informed us about the Federal tax offset program and the original bipartisan bill, H.R. 3498, introduced by Representative Turner, Moran, and Davis. This bill would expand the program to include past due taxes owed to local governments. Under current law, the U.S. Department of Treasury is authorized to reduce a taxpayers' Federal tax overpayment refund by the amount that individual owes the State government in past due income taxes and child support obligations and send those funds to the appropriate State government.

We understand that 36 States and the District of Columbia currently participate in the program, and that pending legislation will

expand the program to authorize the Department of Treasury to reduce the Federal income tax refunds due a taxpayer by the amount of past due legally enforceable tax obligations that the taxpayer owes to a local government.

Mayors attending our annual meeting last year unanimously supported adopting the resolution of supporting H.R. 3498. We are pleased that this proposal has been re-introduced to the 110th Congress as 1865. Mr. Chairman, we stand ready to work with you in support of that bill.

In addition to participating in the Federal tax offset program, a number of States have their own State offset program. So far, 14 States are permitting local governments to submit their delinquent tax accounts to the State for collection against any State tax refund or any lottery winnings owed to taxpayers. The way this works is, prior to issuing a taxpayer refund the State checks to see if there are any claims for past due debts submitted by a local government, and if so the State will delay sending the refund of the lottery winnings or the taxes pending notice to the taxpayer. After appropriate notice is given, the State will reduce the delinquent taxpayer's refund or lottery winnings by the amount owed and send those funds to the local government. In many States, this has proven to be a low-cost, highly effective system.

We do have one recommendation that we would like to see you all consider, and we would ask for your consideration now or at a later date.

The proposed legislation would establish a pilot program for no less than three and no more than five States. While we understand your concern about proceeding with caution, we would recommend expanding the number of pilot programs to no less than four and no more than eight. We feel like this would allow for the pilot program to be established in at least two States in every region of the country—north, south, east, and west. Not only would that give more local governments a chance to participate; it would give Congress a better chance to see how this might work in different States and different regions of the country.

I want to thank you all for the opportunity to appear at this hearing. We appreciate your work and we appreciate your looking after us local governments, and remind everyone here that local governments are the ones closest to the people and we impact their lives every day.

Thank you.

[The prepared statement of Mayor Cornett follows:]

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Statement of
The Honorable Mick Cornett
Mayor of Oklahoma City, Oklahoma

on behalf of

The United States Conference of Mayors

before

The United States House of Representatives
Committee on Oversight and Government Reform
Government Management, Organization, and Procurement
Subcommittee

on

Proposed Legislation: To Amend the Federal Tax Offset Program to Include Local Tax Debt

Rayburn House Office Building, Room 2154
Washington, D.C.

Thursday, April 19, 2007

Thank you, Mr. Chairman. We appreciate the opportunity to come before this Subcommittee to offer comments on behalf of the nation's mayors. I am Mick Cornett, Mayor of Oklahoma City and Chairman of the U.S. Conference of Mayors Urban Economic Policy Committee. I am here today to offer our support for proposed legislation that would create a two-year pilot program to help local governments collect legally enforceable past-due taxes by expanding the Federal Tax Offset Program to include local tax debt.

If enacted, this legislation will promote the kind of intergovernmental partnership that we have always believed should exist between the different levels of government. When we work together to achieve a common goal, particularly a goal as important as collecting past-due taxes, all levels of government benefit, as well as the American people.

First we want to commend you, Mr. Chairman, for the strong support you have shown for local governments on a wide range of issues over the years. Thank you also for your leadership on the proposed legislation, particularly for focusing attention on the need to expand Federal assistance to help local governments collect past-due taxes.

We also want to commend the cosponsors of this legislation: Representative Michael Turner (OH), former Mayor of Dayton; Representative James Moran (VA), former Mayor of Alexandria; and Representative Tom Davis (VA), former County Executive of Fairfax County. Like you Mr. Chairman, these members clearly understand the importance of the intergovernmental partnership in addressing issues that affect all levels of government.

Last year during our annual meeting, Mayor Laura Miller of Dallas, Texas, reminded us that local governments often find it difficult to collect past-due taxes. Sometimes they end up investing an enormous amount of time and resources going after delinquent taxpayers and they are not always successful in collecting past-due taxes, particularly when taxpayers move from the area or when they don't have the resources to pay when they are located. This not only places a financial strain on local governments but it unfairly burdens members of the community who pay their taxes promptly.

Before I get too far into my testimony, let me share with you some background information on the delinquency problem in my city. Unlike some cities, Oklahoma City does not collect an income tax of any kind. We use property tax to fund capital improvements through bond issues. The property tax is actually collected by the County and distributed to us. We are mainly funded by the sales tax, which is collected by the state and again, distributed to us.

To prepare for this trip, I asked my staff to review our sales tax data to determine the delinquent rate. They reviewed our sales tax data for the last six months and came up with some estimates. From our review, we estimate that we have a delinquent sales tax rate somewhere between 5 percent and 7 percent. We believe it's safe to assume that our delinquent sales tax rate is closer to 6 percent or $10 million.

According to information provided by the Oklahoma County Treasurer's Office, in the first year property taxes are due, the delinquent taxes amount to about 5 percent of the total amount levied for the year. In FY 05-06, this amounted to a total of $2 million. Looking at this over a longer period, an eight-year average ending in FY 05-06, the delinquent property tax rate is 1.4 percent or about $4 million out of a total of $ 284 million levied during that period.

Let me put this in perspective by providing you some examples of what we would be able to do if we are able to recapture our delinquent taxes. On average, we can resurface one lane-mile of our city streets for approximately $200,000. If we use the $2 million estimate, we could resurface 10 lane-miles of streets and if we used the $4 million estimate, this would double to 20 lane-miles of streets.

Another good example would be in the area of homeland security. In our post-9/11 world, we all have felt the need to increase security and indeed the Federal Government is working with us to help us better secure our homeland. Many of our cities could use funds currently due from delinquent taxes to hire new first responders. In Oklahoma City the average cost to employ a new firefighter or police officer is about $60,000. Using the $2 million estimate, we could hire approximately 33 new firefighters or police officers and if we used the $4 million estimate, we could hire approximately 67 new firefighters or police officers.

These are just a few examples of some of the critical public services that we could provide if we recapture all or a significant portion of the past-due taxes. That's not only true for Oklahoma City but for cities, counties and states across our nation. We are excited that you are considering legislation to assist us with this effort.

During our annual meeting last June, Mayor Miller informed us about the Federal Tax Offset Program and the original bipartisan bill, H.R. 3498, introduced by Representatives Turner, Moran and Davis. The bill would expand the program to include past-due taxes owed to local governments. Under current law, the U.S. Department of the Treasury is authorized to reduce a taxpayer's federal tax overpayment refund by the amount an individual owes a state government in past-due income taxes and child support obligations, and send the funds to the appropriate state government.

We understand that 36 states and the District of Columbia currently participate in the program. The pending legislation will expand the program to authorize the Department of the Treasury to reduce the federal income tax refunds due a taxpayer by the amount of past-due legally enforceable tax obligations that the taxpayer owes to a local government. Mayors attending our annual meeting last year from across the nation unanimously adopted a resolution in support of H.R. 3498 and we are pleased that the proposal has been reintroduced in the 110th Congress as H.R. 1865. Mr. Chairman, we stand ready to work with you and all members of Congress in any way we can to ensure its passage.

In addition to participating in the Federal Tax Offset Program, a number of states have their own state offset programs. A total of 14 states permit local governments to submit their delinquent tax accounts to the state for collection against any state tax refund or any lottery winnings owed to taxpayers. The way this works is prior to issuing a taxpayer a refund, the state checks to see if there are any claims for past-due debt submitted by a local government. If so, the state will delay sending the refund or lottery winnings pending notice to the taxpayer. After appropriate notice is given, the state will reduce the delinquent taxpayer's refund or lottery winnings by the amount owed and send those funds to the local government. In many states this has proven to be a low-cost, highly effective program.

We do have one recommendation we would ask you to consider now and we may have more for your consideration at a later date. The proposed legislation would establish a pilot program for no less than three and no more than five states. While we understand the need to proceed with caution, we would recommend expanding the number of pilot programs to no less than four and no more than eight. This would allow for pilot programs to be established in at least two states in each region of the country: north, south east and west. Not only would this give more local governments the opportunity to participate, but it would give Congress a better feel for how the expansion would work in different states and regions of the country.

Again, thank you for the opportunity to participate in this hearing. We look forward to working with you to urge all members of Congress to support this legislation. I would be happy to answer any questions at the appropriate time.

Mr. TOWNS. Thank you very much, Mr. Mayor, for your testimony.

Mr. CORNETT. Thank you.

Mr. TOWNS. Ms. Barbara Ford-Coates is the elected tax collector of Sarasota County, FL. She is representing the National Association of Counties and National Association of County Treasurers and Finance Officers.

We are delighted to have you.

STATEMENT OF BARBARA FORD-COATES

Ms. FORD-COATES. Thank you, Mr. Chairman.

Chairman Towns, Ranking Member Bilbray I want to thank you for the opportunity to testify today. As the Chair has stated, my name is Barbara Ford-Coates, and I serve as president of the National Association of County Treasurers and Finance Officers. Our organization is affiliated with the National Association of Counties, and we represent all elected and appointed county treasurers, tax collectors, and finance officers in the United States.

On May 1st I will complete 23 years as tax collector for Sarasota County, FL, and I have been able to serve the public all these years only because we provide exceptional customer service to the public. If you can take someone's money and have them still leave the office with a smile on their face, it has to be exceptional service.

I also provide service to many governments, including the State of Florida, Sarasota County, four cities, a public hospital, the School Board, and numerous smaller taxing districts. We do all of this in a cost-effective, efficient manner.

I bring this up to emphasize that good government is a bipartisan issue. I happen to be the only elected Democrat in a county of over 360,000 people. My voters care about good government.

I applaud the committee for your interest in H.R. 1865 because it is a prime example of local, State, and Federal cooperation to provide cost-effective efficiencies. I thank the Chair and ranking member, especially, for sponsoring this bipartisan effort.

In particular, I want to point out that this bill is the antithesis of an unfunded mandate. The Federal Government would provide a service for local governments, and we would bear the cost. It is simply a win/win for government and the people we serve, or, as the ranking member said earlier, it is done the right way and in the right manner.

I won't take up your time with the details, since I know they are being adequately or perhaps more addressed by Mayor Cornett and Deputy Treasurer Weth, who have a deeper knowledge of those specifics than I do at this point.

But, simply put, the National Association of Counties and County Treasurers and Finance Officers are in full support of the legislation as proposed. However, I would like to mention that there are several things which appear in my written testimony which I hope we have the opportunity to discuss further with your staff and the staff of Treasury. These would increase flexibility and, we believe, make the program more effective.

This legislation is a model for building a collaborative intergovernmental partnership. The key features are that it is voluntary, fee based, designed to avoid creating an undue burden, and offers

both flexibility in implementation and a trigger to terminate the program if it does not achieve its objectives. It is an example of the golden rule: do unto others as you would have them do unto you.

However, I have heard that there also is a golden rule of federalism: those who coin the gold make the rules. With that in mind, I do want to take this opportunity to mention two areas of concern which are the result of recently enacted and proposed legislation. These examples of that other golden rule are troubling because they are coercive rather than cooperative byproducts of the Federal Government, understandably striving to reduce its own tax gap. These would require local officials to collect Federal taxes, implement new reporting software or procedures, or provide Federal tax advice without consultation or payment of the costs involved.

First, section 511 of the Tax Increase Prevention Act will soon require many counties to withhold 3 percent Federal taxes on nearly every payment for a service or product, from plumbing services to paper clips. This amounts to a Federal sales tax on county purchasing, will be very expensive for counties to implement, and will likely increase the costs of procurement and discourage contractors from bidding on county contracts.

I urge members of this subcommittee to join with Representative Kendrick Meek from my State of Florida to co-sponsor H.R. 1023 to repeal this unfunded mandate. And I would like to insert a copy of that legislation into the official hearing record, along with copies of our testimony and letters of support.

The proposal on 3 percent withholding was a result of inserting a Joint Committee on Taxation staff recommendation in the conference report after the bill had been passed by the House and Senate.

Another troubling example could stem from the recent proposal from the same source to require collectors of local taxes to determine whether our taxpayers can deduct items appearing on property tax bills. Then we would report that information to both the IRS and the taxpayer. The administrative burden would be enormous, and county officials charged with producing tax bills are, in the vast majority of cases, not qualified to make a determination of whether special assessments are deductible or non-deductible under the IRS code, nor do we have a method to collect the identity of property taxpayers or compel them to report Social Security numbers or taxpayer identification numbers as part of their property tax accounts.

I would like to insert a copy into the official hearing record, along with our letters of opposition to that possibility.

I thank you sincerely for your interest in good government. I know each of you has a local tax collector, treasurer, or finance officer to whom you are paying checks on a regular basis, and I urge you to continue to work with us in developing strategies to improve compliance with local, State, and Federal tax laws.

H.R. 1865 is a step down the path of intergovernmental cooperation and should serve as a model for any future efforts to close the Federal tax gap with the assistance of State and local government.

I thank you for the opportunity to provide testimony today and look forward to answering any questions.

[The prepared statement of Ms. Ford-Coates follow:]

Testimony of Barbara Ford-Coates, Tax Collector
Sarasota County, Florida

On behalf of the
National Association of Counties and
National Association of County Treasurers and Finance Officers

Before the U.S. House of Representatives
Committee on Oversight and Government Reform
Subcommittee on Government Management, Organization, and Procurement

April 19, 2007

Chairman Towns, Ranking Member Bilbray, members of the subcommittee:

Thank you for the opportunity to testify today. My name is Barbara Ford-Coates. I am the elected tax collector for Sarasota County, Florida, and serve as President of the National Association of County Treasurers and Finance Officers (NACTFO). NACTFO was founded in 1954 and is the only national organization in the country that represents all elected and appointed county financial officers. The objectives of our organization are to promote professional growth and encourage a high level of customer service to the general public in an efficient and effective manner. In pursuing these objectives, we are often proactive in federal legislation and regulations that affect county government, tax collection and treasury management.

NACTFO is an affiliate of the National Association of Counties (NACo), the only national organization that represents county governments in the United States. NACo was founded in 1935 and provides essential services to the nation's 3,066 counties. NACo advances issues with a unified voice before the federal government, improves the public's understanding of county government, assists counties in finding and sharing innovative solutions through education and research and provides value-added services to save counties and taxpayers money. In August 2006, NACo was named one of nine remarkable associations in the United States after a four-year study conducted by the American Society of Association Executives and The Center for Association Leadership.

I am testifying today on behalf of both NACo and NACTFO in support of legislation that should serve as a model for building a collaborative intergovernmental partnership. The federal government is not the only level of government that faces a tax gap; ensuring tax compliance is

also a challenge that we face at the local level. Those who shirk their legal responsibility to pay the taxes that fund local government services impose an expensive burden on their neighbors. The result is that the rest of us pay higher tax rates.

H.R. 1865 would create a pilot program to collect delinquent local government tax debt by reducing federal tax refunds. This is a modest proposal to expand an enforcement tool already available to the states. It builds on successful models in 14 states that are both participating in the Treasury Offset Program for state tax debts and have an in-state program for offsetting state tax refunds for local tax debts.

This is a fee-based service so there will be no cost to the federal treasury. The administrative burden will be minimal because local governments can only apply if their state is willing to serve as a conduit. Also, the Secretary of the Treasury has full authority to prescribe additional conditions to ensure that the debt is a past-due, legally enforceable tax obligation and that we have made reasonable efforts to obtain payment. Finally, the IRS can pull the plug if it determines that the pilot program has negatively affected federal revenue or revenue collection.

I would like to suggest three minor modifications which we believe will improve the legislation:

- First, we suggest that you reconsider the language limiting the Secretary's discretion in selecting states for the pilot program. There are several states not included in the list that both participate in the existing Treasury Offset Program for state tax debts and have an existing statewide offset program. For example, North Carolina has an existing statewide offset program that has returned $35.5 million to 275 participating cities and counties since inception of their statewide offset program in 2002. We believe the Secretary should have the discretion to take advantage of programs like North Carolina.

- Second, after expiration of the pilot program, we would like to clarify that the definition of an 'eligible State' does not prevent states without an income tax from participating. For example, my own state of Florida has no income tax but may wish at a future date to participate in order to collect property taxes on behalf of cities, counties, schools and other local taxing districts.

- Finally, I ask you to reconsider the requirement for notification by certified mail with return receipt. This is not necessarily the best or most cost-effective means of ensuring taxpayer notification. In my experience, many working taxpayers do not have the time to make a special trip to sign for certified mail.

In seeking enactment of this legislation we strive to follow the Golden Rule – Do Unto Others as You Would Have Them Do Unto You. First, H.R. 1865 would create exactly the opposite of an unfunded mandate. Rather than mandating expenditures by local government, the federal government would be providing a service to local governments for which we would pay the cost. Secondly, the legislation is designed to avoid creating an undue burden or administrative difficulty by building on existing mechanisms rather than creating a new program. It provides for the Treasury Department to have maximum flexibility in implementation. Finally, the legislation includes a trigger mechanism allowing the program to be terminated if it proves

detrimental for the federal government. It is truly a win/win for all government and therefore for all the people.

This is a refreshing departure from the unfortunate, but more familiar, Golden Rule of Federalism – Those Who Coin the Gold Make the Rules. The current focus on reducing the federal tax gap has already provided some troubling examples of coercive rather than cooperative federalism, with the federal government dictating practices to state and local governments rather than working in partnership with us to address our mutual challenges. Both recently enacted and proposed legislation would require local officials to collect federal taxes, implement new reporting software or procedures, or provide federal tax advice without consultation or payment of the costs involved.

An example is Section 511 of the Tax Increase and Prevention Act, which will soon require many counties to withhold federal taxes on nearly every payment for a service or product – from plumbing services to paper clips - with no minimum transaction and regardless of whether the payment is made by check or credit card. This is effectively a federal sales tax on county purchasing. It will be very expensive for counties to implement and will require programming changes to financial and accounting systems and the hiring of additional staff. It will also likely discourage contractors from bidding on government contracts and increase the costs of procurement.

This mandate is particularly egregious because it was inserted into the final version of an omnibus tax bill that had already passed both the House and Senate and was never subject to a formal vote, hearings or consultation with any state and local government officials or our national organizations. It will likely cost counties more to implement than it will yield for the federal government. I urge members of the subcommittee to cosponsor H.R. 1023 to repeal this unfunded mandate.

Another example is a recent recommendation of the Joint Committee on Taxation "to require State and local taxing jurisdictions to report to the IRS and taxpayers the amount of taxes paid (excluding nondeductible amounts)." In other words, the collectors of local taxes would have to determine deductibility for all our taxpayers. The administrative burden would be enormous and county officials charged with producing tax bills are, in the vast majority of cases, not qualified to make a determination of whether special assessments appearing on the tax bill are deductible or nondeductible under the IRS code. Nor do we have a method to collect the identity of property taxpayers or to compel them to report Social Security numbers or taxpayer identification numbers.

I urge you to resist such approaches and instead work with us in developing strategies to improve compliance with local, state and federal tax laws. H.R. 1865 is a step down the path of intergovernmental cooperation and should serve as a model for any future efforts to close the federal tax gap with the assistance of state and local government.

Thank you for the opportunity to provide testimony today. I look forward to answering any questions.

109TH CONGRESS, 2ND SESSION

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109-1102

Congress of the United States
JOINT COMMITTEE ON TAXATION
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AUG 03 2006

Honorable Charles E. Grassley
Chairman
Committee on Finance
United States Senate
135 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Grassley:

During the Joint Committee's organizational meeting on March 14, 2006, you and Senator Baucus expressed concerns about the magnitude of the shortfall between the amount of tax voluntarily and timely paid by taxpayers and the actual tax liability of taxpayers (the "tax gap"). Specifically, you requested that the staff of the Joint Committee on Taxation ("Joint Committee staff") develop possible options for reducing the tax gap beyond those contained in the Joint Committee staff report, *Options to Improve Tax Compliance and Reform Tax Expenditures* (JCS-2-05), January 27, 2005 (the "*Options* report").

The *Options* report contained proposals that touched on virtually every aspect of the tax law. Several of the proposals included in the *Options* report, or proposals substantially similar to those included in that report, were subsequently enacted in the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109-222 (2006)). Those proposals are: (1) impose withholding on payments made by government entities; (2) require partial payments with offers-in-compromise; (3) simplify taxation of minor children; (4) tax involvement by exempt organizations in tax-shelter transactions; (5) impose loan and redemption requirements on pooled financing bonds; and (6) amend information reporting requirements to include interest on tax-exempt bonds. Several proposals that are based on proposals from the *Options* report relating to tax-exempt organizations and charitable contributions have been passed by the Senate and the House. In addition, several other proposals from the *Options* report have been included in bills passed by the Senate, including proposals to address transactions lacking economic substance and limiting the deduction for personal use of company aircraft. Finally, in addition to proposals to reform tax expenditures, the *Options* report includes a variety of other proposals that may be expected to address tax gap issues and unintended consequences of present law, including proposals relating to the interaction of the child tax credit and the exclusion for foreign earned income, the transfer of property in the performance of services in order to prevent a mismatching of deductions and income inclusion, modifying the prohibited transactions rules relating to IRAs to address tax shelter issues, and the relationship between estate tax valuation and an heir's basis reporting.

This letter supplements the *Options* report with additional options for improving tax compliance. In addition to specific legislative proposals, several of these options require

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

additional investigation before a specific legislative proposal can be made. We have also included proposals previously included in the *Options* report that have been modified in the context of the current request.

Each option includes a description of present law, identification of the compliance issue, and either a description of the proposal or a discussion of possible legislative options. For those options requiring additional development, we have identified the issues under investigation and our efforts to resolve those issues.

In addition to continuing the development of proposals on this list, the Joint Committee staff will continue its practice of investigating and analyzing additional proposals to increase compliance and reduce the tax gap.

Sincerely,

Thomas A. Barthold
Acting Chief of Staff

ADDITIONAL OPTIONS TO IMPROVE TAX COMPLIANCE

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

August 3, 2006

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B. Reporting Requirements for Real Estate Taxes

Present Law

The Code allows taxpayers an itemized deduction for real estate taxes imposed by any State or local government or any foreign country.[32] Real estate taxes are deductible only if they are based on the assessed value of the real property and charged uniformly against all property under the jurisdiction of the taxing authority. Taxes are not deductible, however, if they are assessed against local benefits of a kind that tend to increase the value of the property assessed. For example, assessments for streets, sidewalks, water mains, sewer lines, and other like improvements imposed because of, and measured by some benefits inuring directly to the property against which the assessment is levied, are not deductible as taxes. Taxes are considered assessed against local benefits when the property subject to the tax is limited to property benefited.[33] Similarly, separate charges for services (such as trash collection) to specific property or people are not deductible, even if the charge is paid to the taxing authority.[34]

Present law does not require information reporting for the payment of real estate taxes. Local governments generally provide taxpayers with real estate tax statements, but the information provided on such statements varies by jurisdiction. In addition, mortgage lenders generally provide taxpayers with statements reflecting amounts paid from escrow accounts to local governments. However, the information provided on local government statements and mortgage lender statements is not furnished to the IRS.

Compliance Issue

The most recent published estimate of the size of the deduction for real estate taxes on owner-occupied residences is $19.9 billion for fiscal year 2006.[35] Studies have suggested that overstatements of this deduction result in significant Federal income tax losses.[36] One possible

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[32] Sec. 164.

[33] Treas. Reg. secs. 1.164-2, 1.164-4.

[34] See, e.g., Rev. Rul. 81-192, 1981-2 CB 63 (The word "taxes" has been defined as an enforced contribution, exacted pursuant to legislative authority in the exercise of the taxing power, and imposed and collected for the purpose of raising revenue to be used for public or governmental purposes and not as a payment for some privilege granted or service rendered.)

[35] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years, 2006-2010* (JCS-2-06), April 25, 2006.

[36] For example, a 1993 GAO study estimated that overstated real estate tax deductions resulted in a Federal income tax loss of approximately $400 million for the 1992 taxable year. General Accounting Office, *Tax Administration: Overstated Real Estate Tax Deductions Need to be Reduced*, (GAO/GGD-93-43) (February 1993). For purposes of comparison, the estimate of the size of the deduction for fiscal year 1992 was $11 billion. Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years, 1992-1996* (JCS-4-91), March 11, 1991.

reason for such overstatement is that taxpayers may not receive property tax bills that allow them to distinguish between deductible taxes, nondeductible taxes, and nondeductible fees for services (i.e., "user fees"). In addition, the absence of a reporting mechanism for real estate taxes may hinder the IRS's ability to identify taxpayers who are overstating the deduction for real estate taxes.

The GAO's 1993 study reported that user fees as a source of local revenue have increased primarily due to reductions in Federal revenue sharing and State or local laws that cap or restrict the growth in real estate taxes. In 1990, the National League of Cities reported that 76 percent of local governments surveyed increased fees for services and 43 percent established new fees.

The GAO study found that many of the local governments that charge user fees provide property tax bills to taxpayers that do not distinguish between user fees and taxes that are based on the assessed value of the real property. Due to this lack of information, taxpayers are likely to claim as a deduction the total amount paid to the taxing jurisdiction, which results in an overstatement of the deduction for taxes equal to the amount of the payment that relates to user fees.

Issues and Options

One option for reducing the overstatement of real estate tax deductions is to require State and local taxing jurisdictions to report to the IRS and taxpayers the amount of taxes paid (excluding nondeductible amounts). However, an information reporting requirement would impose administrative burdens on governmental entities that may outweigh the compliance benefits.[37] Thus, before imposing such a requirement, it would be appropriate to obtain updated data not only on the extent to which taxpayers are overstating the deduction for real estate taxes, but also the extent to which governments are currently providing taxpayers with real estate tax bills that clearly distinguish between nondeductible user fees and deductible real estate taxes. To assist with this determination, the Joint Committee staff has asked GAO to analyze a sample of local governments to determine the extent to which localities nationwide are charging use fees for services and whether such localities are providing taxpayers with real estate tax bills that clearly distinguish between deductible taxes and nondeductible amounts. In addition, we have asked GAO to coordinate with the IRS for purposes of initiating a study to determine the extent to which the deduction for real estate taxes is overstated and the extent to which such overstatement is related to taxpayers improperly claiming deductions for user fees.

An alternative option for improving compliance with the deduction is to require mortgage lenders to report to the IRS and taxpayers the amount of real estate taxes paid by taxpayers through escrow accounts. Many taxpayers pay their real estate taxes through a mortgage escrow account. In those cases, each payment from the account would include a prorated amount of the real estate taxes as well as any user fees. The escrow company generally sends taxpayers an

[37] Another issue that may affect whether any such proposal would be effective is the extent to which it could be expected that taxing jurisdictions who currently have separately stated fees for certain services, e.g., trash collection, would eliminate such fees and adjust general taxes in response to the proposal.

annual statement that shows one amount for all payments made to a taxing jurisdiction. If the annual statement does not provide taxpayers with a separate statement of user fees paid, it is difficult for taxpayers to determine the correct amount of the deduction for real estate taxes. Imposing an information reporting requirement on mortgage lenders that require an escrow for taxes could be expected to improve overall compliance with the deduction for taxes, albeit on a smaller scale than a broader proposal that imposes information reporting on governments. However, this alternative also would be less burdensome than imposing reporting requirements on localities because mortgage lenders are already required to file information reports with the IRS with respect to the amount of interest paid by taxpayers. In order to fully evaluate this option, the Joint Committee staff has also asked GAO to determine whether mortgage lenders are providing taxpayers with accurate information regarding real estate taxes paid.

NATIONAL ASSOCIATION OF COUNTY TREASURERS AND FINANCE OFFICERS

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February 9, 2007

The Honorable Charles Rangel
Chairman, House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

RE: "Additional Options to Improve Tax Compliance" Report,
August 3, 2006 by the staff of the Joint Committee on Taxation

Dear Chairman Rangel:

The National Association of County Treasurers and Finance Officers (NACTFO) appreciates the obvious time and effort which went into the above referenced report. NACTFO represents Tax Collectors, Treasurers and other Finance Officers in the counties of the United States. One of the objectives of NACTFO is to support legislation that is beneficial to county government while opposing legislation that is detrimental. Particularly important to NACTFO members is the attached Section I. – IMPROVED INFORMATION REPORTING; Sub-section B. – Reporting Requirements for Real Estate Taxes.

Sub-section B discusses real estate taxes and their deductibility or nondeductibility based on the IRS code as currently written. One possible option proposed on page 12 of the report is "to require State and local taxing jurisdictions to report to the IRS and taxpayers the amount of taxes paid (excluding nondeductible amounts). However, an information reporting requirement would impose administrative burdens on governmental entities that may outweigh the compliance benefits." NACTFO agrees that this would create an administrative burden and the following issues are of grave concern to its membership and the counties they represent:

1. Determination of Deductibility
   Although, as the report states, many tax bills do distinguish between taxes based on assessed value and those based on other criteria, county officials charged with producing tax bills and collecting taxes are, in the vast majority of cases, not qualified to make a determination of deductible versus nondeductible real estate taxes as they relate to the IRS code. Their expertise is in the efficient collection and distribution of funds; most are not CPA's or tax accountants who specialize in tax preparation advice. In many states, tax bills contain taxes from several taxing jurisdictions and the issuers of tax bills do not necessarily have full knowledge of the individual entity's methods in order to determine the deductibility of a tax.

**NATIONAL ASSOCIATION OF
COUNTY TREASURERS AND FINANCE OFFICERS**

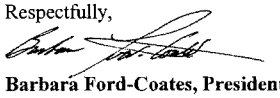
2. Property Owner Tax Identification Numbers
   Our county officials do not have a method to collect the identity of our property taxpayers nor do we have the authority to compel them to report Social Security numbers, Federal Employer Identification numbers, or some other distinguishing characteristic sufficient to report such information. Real estate is held in multiple ways that would make determination practically impossible.

Although not noted in the report, we understand there has been some discussion of local government providing specific notification to taxpayers. The cost depends on the specific information and reporting that would be requested. Since 70% of America's counties have populations less than 50,000 and limited budgets, this may create an undue hardship; an unfunded mandate. A simple informational phrase might not be as problematic for counties **if** they have the space available within their current mailing, however for smaller counties with limited resources, even that might be a significant burden.

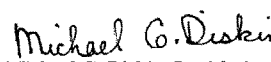
The members of NACTFO certainly understand the need for more accountability in reporting tax deductions and would support other efforts to ensure taxpayers comply with IRS tax codes. One suggestion would be to work with the various associations of professional tax preparers and the companies who provide tax preparation software. In summary, the National Association of County Treasurers and Finance Officers believes that the answers are not found within the current proposals to have local officials assist in the process by reporting as suggested in Sub-section B. To do so would be both burdensome and inefficient as outlined in the points above.

If NACTFO can be of any assistance in the efforts to find a solution to this question, please do not hesitate to contact either of us as noted below.

Respectfully,



Barbara Ford-Coates, President
Tax Collector, Sarasota County, Florida
941-861-8433, bfc@SarasotaTaxCollector.com



Michael G. Diskin, Legislative Committee Chairman
Treasurer, Essex County, New York
518-873-3317, MDiskin@co.essex.ny.us

U.S. Conference of Mayors
National Association of Counties
National League of Cities
Government Finance Officers Association

December 1, 2006

Senator Charles Grassley, Chairman
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, D.C. 20510

Senator Max Baucus, Ranking Member
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, D.C. 20510

VIA E-MAIL TO TAXGAP@FINANCE-REP.SENATE.GOV

Dear Chairman Grassley and Ranking Member Baucus:

On behalf of the U.S. Conference of Mayors (USCM), the National Association of Counties (NACo), the National League of Cities (NLC) and the Government Finance Officers Association (GFOA), national organizations representing city, county and state governments, we appreciate the opportunity to provide public comment on the Joint Committee on Taxation's report entitled "Additional Options to Improve Tax Compliance". In particular, we are very concerned that the proposal to "require state and local governments to report to taxpayers and the IRS the amount of real estate taxes paid" would impose a significant unfunded mandate on local governments.

While we support efforts to ensure that taxpayers comply with the federal tax code, we have numerous concerns about the prospect of a new reporting requirement on state and local government including the following:

- **City and county officials must not be charged with responsibility for determining which state and local taxes are or are not deductible.** This is a major concern of local government tax collectors, many of whom are not CPAs and whose responsibilities do not include federal income tax preparation. Aside from threshold concerns of jurisdiction and liability, there are also practical reasons why this would be infeasible. For example, officials may not be aware of the assessment method for items billed on behalf of another taxing jurisdiction or it may not be plainly evident whether or not a particular item is deductible under the federal tax code.

- **Reporting this information to the federal government would likely be a costly unfunded mandate.** Costs would vary significantly depending on the format required by the Treasury Department. Any reporting requirement that requires updating or replacing computer software and that takes time to compile and remit information would impose a considerable and ongoing unfunded mandate on county government. Additionally, the proposal would be overly burdensome on smaller governments who especially do not have the staff to implement these additional responsibilities. It should also be noted that the costs of the

intergovernmental mandate may outweigh the compliance benefits for the federal government, as the Joint Committee on Taxation acknowledges in its report, since nondeductible assessments are often a very small percentage of the overall tax bill.

- **Matching the identity of property taxpayers with federal income taxpayers would be extremely difficult and costly.** Municipalities, counties and states have no ability to require property taxpayers to provide their Social Security numbers or FEINs and could not provide this information to the IRS. Even if this information were available, the myriad of legal structures and combinations in which real estate can be held would frustrate efforts to match the deductions claimed against the original property tax bills.

We would be pleased to work with you to ensure local input in developing strategies to improve compliance with local, state and federal tax laws. However, any such effort must evolve from a true partnership among all levels of governments. Further, we would strongly urge against adopting federal rules that would unilaterally require local officials to collect federal taxes, implement new reporting software or procedures, or provide federal tax advice.

As you know, the initial "Options to Improve Tax Compliance and Reform Tax Expenditures" report included a proposal to require federal, state and local government entities to withhold three percent of nearly all payments to vendors for federal tax purposes; although this proposal never appeared in any legislation that passed the House or Senate or was vetted through any of the national organizations representing state and local governments, it was quietly slipped into the conference report and enacted into law as Section 511 of the Tax Increase Prevention and Reconciliation Act. This is an example of unilateral federal decision-making without meaningful intergovernmental consultation and we urge its repeal in the 110th Congress. In contrast, I hope that we can find a way to partner on future efforts to reduce our shared tax gap.

We applaud your bipartisan approach to identifying means of closing the federal tax gap. Tax avoidance is an acute problem facing not only the federal government, but also the nation's local and state governments. Individuals who shirk their legal responsibility to pay the taxes that fund local government services impose an expensive burden on their law-abiding neighbors who suffer the resulting higher tax rates. For this reason, we support legislation such as S. 3512 and H.R. 3498 that would expand the Treasury Offset Program to collect delinquent debts from taxpayers who are beyond the reach of local enforcement.

We would also support federal legislation to authorize states participating in the Streamlined Sales and Use Tax Agreement to require out-of-state sellers to collect and remit state and local sales taxes. We urge the Senate Finance Committee to consider these and other proposals to reduce local government tax gap in the 110th Congress.

We hope that you find these comments instructive and we look forward to working with you on this effort. Please feel free at any time to contact our staff listed below.

U.S. Conference of Mayors – Larry Jones, 202-861-6709/ljones@usmayors.org
National Association of Counties – Alysoun McLaughlin, 202-942-4254/amclaughlin@naco.org
National League of Cities – Alex Ponder, 202-626-3028/ponder@nlc.org
Government Finance Officers Association – Susan Gaffney, 202-393-8020/gaffney@gfoa.org

I

110TH CONGRESS
1ST SESSION

H. R. 1023

To repeal the imposition of withholding on certain payments made to vendors by government entities.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 13, 2007

Mr. MEEK of Florida (for himself and Mr. HERGER) introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To repeal the imposition of withholding on certain payments made to vendors by government entities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. REPEAL OF IMPOSITION OF WITHHOLDING ON CERTAIN PAYMENTS MADE TO VENDORS BY GOVERNMENT ENTITIES.

The amendment made by section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 is hereby repealed and the Internal Revenue Code of 1986 shall be applied as if such amendment had never been enacted.

○

Government Finance Officers Association (GFOA)
International City/County Management Association (ICMA)
National Association of Counties (NACo)
National Association of County Treasurers and Finance Officers (NACTFO)
National Association of State Auditors, Comptrollers and Treasurers (NASACT)
National Association of State Budget Officers (NASBO)
National Association of State Retirement Administrators (NASRA)
National Council on Teacher Retirement (NCTR)
National League of Cities (NLC)
United States Conference of Mayors (USCM)

Committee on Small Business
United States House of Representatives
Hearing on "The New Hidden Tax on Small Business"
March 22, 2007

Chairman Velásquez, Ranking Member Chabot, and members of the Small Business Committee:

Our bipartisan organizations representing state and local governments nationwide applaud your decision to hold this hearing and appreciate the opportunity to provide written testimony on Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA"). We applaud the committee for taking an interest in this critical federalism issue and urge you to cosponsor H.R. 1023, legislation introduced by Representatives Kendrick Meek (D-Florida) and Wally Herger (R-California) to repeal Section 511 of TIPRA.

Section 511 – which did not appear in either the House- or Senate-passed version of TIPRA but was used as a revenue-raiser in the conference agreement – will in effect impose a 3 percent federal sales tax on nearly every purchase made by a state and many counties and cities beginning in 2011. Businesses may claim this tax as prepayment of their federal income taxes in the following year. However, in effect, this tax will be only partially refundable for many small businesses. Our member state and local governments and public officials are extremely concerned about the impact this provision will have on competitive bidding for government contracts and the price that state and local governments will pay for purchases of goods and services. Many small businesses will simply refuse to do business with government; others will pass along the cost of this requirement.

The conference report on TIPRA acknowledges that Section 511 will impose an intergovernmental mandate with costs above the threshold of the Unfunded Mandates Reform Act. This will be the first time ever that federal tax withholding and reporting are imposed on the purchase of goods as well as services and the requirement only applies to the public sector. Aside from the increase in the cost of goods and services, it will also require states, cities and counties to reprogram or purchase new accounts

payable systems, hire additional staff and essentially serve as branch offices for the Internal Revenue Service. In addition, since there is no minimum transaction on this provision, even a state, county or city employee who buys a $10 screwdriver will have to pay the hardware store $9.70 and send the remainder to the IRS.

This provision of TIPRA is absurd. Most of its $7 billion in revenue occurs in the first year and is due to an accounting gimmick whereby tax payments are accelerated into the prior year. After 2011 the Joint Committee on Taxation has estimated that the annual increase in federal revenue will be less than $300 million per year. The costs for state and local governments to comply with the requirement will likely exceed that amount.

If you have any questions about the impact of this provision on state and local governments or our support for H.R. 1023, please contact our Washington Representatives:

Susan Gaffney, GFOA, 202-393-8020
Rob Carty, ICMA, 202-962-3560
Alysoun McLaughlin, NACo/NACTFO, 202-942-4254
Cornelia Chebinou, NASACT, 202-624-5451
Brian Sigritz, NASBO, 202-624-8439
Jeannine Markoe Raymond, NASRA, 202-624-1417
Leigh Snell, NCTR, 202-684-5236
Carolyn Coleman, NLC, 202-626-3023
Larry Jones, USCM, 202 861-6709

Government Finance Officers Association (GFOA)
International City/County Management Association (ICMA)
National Association of Counties (NACo)
National Association of County Treasurers and Finance Officers (NACTFO)
National Association of State Auditors, Comptrollers and Treasurers (NASACT)
National Association of State Budget Officers (NASBO)
National Association of State Retirement Administrators (NASRA)
National Council on Teacher Retirement (NCTR)
National League of Cities (NLC)
United States Conference of Mayors (USCM)

March 20, 2007

The Honorable Kendrick Meek
United States House of Representatives
Washington, DC 20515

The Honorable Wally Herger
United States House of Representatives
Washington, DC 20515

Dear Representative Meek and Representative Herger:

On behalf of the organizations listed above representing state and local governments nationwide, we are writing in support of H.R. 1023. This important bill would repeal section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) which requires federal, state, and local governments to withhold three percent from payments for goods and services.

Section 511 imposes a massive unfunded mandate on state and local governments and will cause significant administrative and other financial burdens since our members will have to retool their accounts payable systems to implement the new law. Additional cost will also be borne by state and local governments due to the fact that the costs for doing business with state and local governments will increase, and the private sector companies will pass those costs along.

This new withholding requirement is not merely a new mechanism for facilitating tax deposits. It shifts the burden of collection from the federal government to state and local governments at cost significant enough to violate the Unfunded Mandates Reform Act. While we support efforts to close the tax gap, we do not believe imposing costly withholding on state and local governments addresses non-compliance by federal contractors. We applaud your efforts to repeal this costly provision and look forward to working with you to rescind this unfunded mandate on state and local governments. Should you have any questions or would like additional information please contact our Washington representatives:

Susan Gaffney, GFOA, 202-393-8020
Rob Carty, ICMA, 202-962-3560
Alysoun McLaughlin, NACo/NACTFO, 202-942-4254
Cornelia Chebinou, NASACT, 202-624-5451
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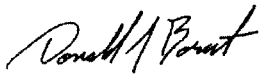
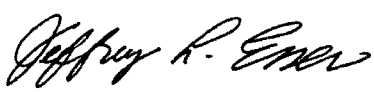
The Honorable Kendrick Meek
The Honorable Wally Herger
March 20, 2007
Page 2

Leigh Snell, NCTR, 202-684-5236
Carolyn Coleman, NLC, 202-626-3023
Larry Jones, USCM, 202 861-6709

Sincerely,



Donald Borut, Executive Director
NLC



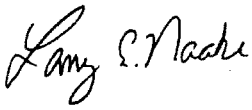
Jeffery L. Esser, Executive Director
GFOA

Glenda Chambers, Executive Director
NASRA

Thomas Cochran, Executive Director
USCM

Barbara Ford-Coates, President
NACTFO

James J. Mosman, Executive Director
NCTR



Larry E. Naake, Executive Director
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Robert J. O'Neill, Jr., Executive Director
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Scott D. Pattison, Executive Director
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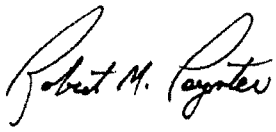

Robert M. Poynter, Executive Director
NASACT

Mr. TOWNS. Thank you very much for your testimony.

We also have today Patricia Weth, the deputy treasurer of Arlington County, VA.

STATEMENT OF PATRICIA WETH

Ms. WETH. Good afternoon, Mr. Chairman, Representative Bilbray, and Representative Duncan. I am Patricia Weth, deputy treasurer and legal counsel to the Arlington County Treasurer, Frank O'Leary.

Thank you for holding this important hearing today. I am here to ask your support, favorable consideration of H.R. 1865. I appreciate the subcommittee holding this hearing on the proposed pilot program legislation, which will greatly benefit your constituents, and I look forward to answering any of your questions that you may have on this legislation.

I also ask that the written testimony be entered into the record.

Like the Federal Government, State and local governments have tax gaps. Not everybody is willing to pay their taxes. The more each level of government can fairly collect the taxes that are owed, the less pressure there will be to increase taxes to the honest taxpayers who are paying their taxes timely.

The Federal offset program was created in the 1980's after legislation was passed to allow States to submit child support arrearages to the offset program to offset Federal tax refunds of deadbeat dads. Later the program was expanded to allow Federal Government agency debt. And in 2000, legislation was passed to allow the States to submit delinquent income tax debt into the program.

When my boss, Frank O'Leary, saw that States were allowed to submit State income tax debt, he thought that the logical and natural progression would be to allow local government tax debt into the program.

We have worked with bipartisan Members, numerous government associations, and the Treasury to refine this legislation and to ensure that there would be no additional cost to the Federal and State government. Without this legislation, local governments are forced to assess greater taxes on the honest taxpayers to make up for the loss in revenue for those who are not paying the taxes.

Under this legislation, the only cost is to the delinquent taxpayer, who is now forced to finally pay his outstanding tax obligation. In the proposed legislation for the pilot program, it does authorize Treasury and the States to charge to the local governments a fee to defray any administrative costs that they may have in processing these claims. Currently under the regulations, Treasury does collect a $25 fee from the State taxing authority for every claim where there is a refund match.

Last year the Commonwealth of Virginia received over $16 million for delinquent income tax debt. We estimate that Virginia local governments would recover between $65 and $70 million during its first year of participation in the program. Virginia treasurers have a great deal of collection tools given to us by the Virginia General Assembly, but I feel that this pilot program will benefit all local governments, but especially those local governments that do not have a vast amount of collection tools at their disposal.

This is a bipartisan good government bill. It makes an important step toward the coordination between three different levels of government to address the tax gap. It protects the honest taxpayer from any tax increase. The only cost is to the delinquent taxpayer, who now is finally paying his tax obligation.

Thank you for your consideration. I am happy to answer any questions regarding the legislation.

[The prepared statement of Ms. Weth follows:]

H.R. 1865 To amend Title 31, United States Code, to allow certain local tax debt to be collected through the reduction of Federal tax refunds

Subcommittee on Government Management, Organization, and Procurement
Committee on Oversight and Government Reform
United States House of Representatives

Francis X. O'Leary
Arlington County Treasurer
Arlington, Virginia

Delivered by Patricia A. Weth,
Deputy Treasurer for Litigation
Arlington, Virginia

April 19, 2007

INTRODUCTION

I am Frank O'Leary. As an elected official, I have had the pleasure and privilege of serving as the Arlington County Treasurer in Virginia for the last twenty-three (23) years. As Treasurer, I am sworn to collect the taxes for the county and this is a duty that I take very seriously. The delinquency rate for Arlington County is 1%. In February 2002, Deloitte & Touche claimed "Arlington County is the most effective collector of local revenue in the United States." I look for progressive methods to collect the taxes so that our taxpayers will trust that everyone is paying his or her fair share and to uphold my commitment to the citizens of Arlington County, Virginia.

Thank you for holding this important hearing this afternoon. I am here today to support the early and favorable consideration of HR ___, which is legislation to amend title 31, United States Code, to allow certain local tax debt to be collected through the reduction of federal tax refunds. I appreciate this Subcommittee conducting the hearing on the proposed pilot program legislation, which will benefit your constituents and I look forward to responding to any question you might have.

Mr. Chairman, like the federal government, state and local government have tax gaps- not everyone remits the taxes they owe. Consequently, as the nation's Taxpayer Advocate reports, better coordination between all the levels of government could play an important role in retaining trust in our respective tax systems. We believe the legislation, on which we have worked with Treasury and the states, represents a very positive step. The more each level of government can efficiently and fairly collect the taxes that are owed, then the less pressure there will be to have to raise taxes or fees to make up for those who do not pay their fair share.

BACKGROUND INFORMATION ON THE FEDERAL OFFSET PROGRAM

Financial Management Services (hereinafter "FMS"), which is a division of the United States Department of the Treasury (hereinafter "Treasury"), administers the Federal Offset Program (hereinafter "Program"). The Program was created in the 1980's after legislation was passed to allow states to submit child support arrearages to the Treasury to offset the federal tax refunds of the "deadbeat dads." Through legislation, the Program was subsequently widened to allow federal government agencies to submit debts to the Treasury to offset the federal tax refunds of the delinquent citizens. On January, 1, 2000, legislation became effective to allow states to submit delinquent income tax debt to the Federal offset program. The refund is offset in the following order of priority: 1) past-due federal income tax, 2) past-due state child support, 3) past-due federal government agency debt, and 4) past-due state income tax.

In the Commonwealth of Virginia, local governments may submit delinquent tax debt to the Virginia Department of Taxation for offset of the taxpayer's state income tax refund. I thought if the states could collect delinquent income tax debt from the taxpayer's federal tax refund, then this Program could be an efficient collection tool for local government to collect delinquent taxes. The federal tax refund is approximately five (5) times larger than the Virginia state tax refund. An offset of one taxpayer's federal tax refund would pay in full many of that taxpayer's delinquent tax debts. With the state refund offset, in some cases the past-due tax debt must be submitted for several years before the tax debt is paid in full.

We have worked with bipartisan members such as the staff of Congressman Moran, Congressman Davis and Congressman Turner, numerous government associations, and the staff of Treasury to refine the proposal to ensure it will have no cost to the federal government and it would make our local government tax systems more fair and equitable. Without this legislation, local governments are forced to assess greater taxes and fees on the honest taxpayers to make up for the loss of revenue of the taxpayers who are not paying their taxes.

This bipartisan legislation has the support of county and city treasurers and tax collectors in all fifty states. This legislation has the official support of the National Association of Counties, the Government Finance Officers Association, the Treasurers' Association of Virginia, the United States Conference of Mayors, the Association of Public Treasurers of the United States and Canada, and the Conference of State Court Administrators.

PROPOSED PILOT PROGRAM

This legislation creates a pilot program allowing the local governments of six states (Illinois, Iowa, Louisiana, New York, Ohio and Virginia) to collect past-due legally enforceable tax debts through reduced federal tax refunds. The pilot program would be effective for the years 2009 and 2010. The Secretary of the Treasury may end the pilot program at any time. After December 31, 2010, the Secretary of the Treasury may expand the pilot program to all states. The pilot program will allow time for FMS and the Treasury to study the pros and cons of allowing local government tax debts in the Program.

The legislation requires a local government filing a claim to certify to its state tax authority that the tax obligation is past-due and legally enforceable. The state taxing authority for each state will act as the clearinghouse for the local government tax debts. Currently, thirty-seven (37) states and the District of Columbia participate in the

Program. States participating in the Program have the proper computer software and technology required by FMS. For these thirty-seven (37) states and the District of Columbia, participation in the pilot program would simply be a matter of forwarding the electronic files of the local government tax debt to FMS. The legislation will alleviate administrative burden to FMS by requiring the state taxing authority to act as the clearinghouse. In this manner, FMS may keep the same number of clients (i.e. states and federal government agencies) in the Program.

The claiming local government must certify to the state taxing authority that it has properly notified the taxpayer of the claim and give the taxpayer an opportunity to pay the debt. After the state taxing authority, on behalf of the local government, sends the debt information to the Treasury, the Treasury will reduce the taxpayer's federal tax overpayment refund by the appropriate amount and send that amount to the state taxing authority. The state taxing authority will send that amount to the claiming local government.

Under the proposed pilot program, if the taxpayer owes more than one kind of debt that is subject to offset, the debts would be paid in the following order:

1) any federal internal revenue tax liability,
2) past-due state child support
3) past-due federal government agency debt,
4) past-due state income tax, and
5) past-due local government tax debt.

Local government tax debt shall be paid after the state and federal interests are satisfied.

Before a local government tax debt may be sent to the state taxing authority, the debt must be delinquent in accordance with the state law. Local government treasurers and collectors are required to send bills and delinquency notices to notify the taxpayer of the outstanding tax debt. In Arlington County, a bill is sent to the taxpayer at least fourteen days prior to the due date in accordance with the Code of Virginia. When the taxpayer fails to pay by the due date, I will send at least two delinquency notices to the taxpayer and my Compliance Division will contact the delinquent taxpayer by telephone. Several attempts are made to get the delinquent tax debt paid. The delinquent taxpayer has been put on notice of this outstanding debt.

Under the proposed legislation for the pilot program, the local government must certify to the state taxing authority that the taxpayer owes a past-due, legally enforceable tax debt. Further, the local government must certify to the state taxing authority that the local government has

1) notified the person owing the tax debt by certified mail return receipt requested the state taxing authority, on behalf of the local government, shall submit the debt to the Program;
2) given the taxpayer at least sixty (60) days to present evidence that the tax debt is not past-due or legally enforceable; and
3) considered all evidence submitted by the taxpayer.

Once the local government has followed these requirements, then the local government submits the debt to the state taxing authority, which will pass it on to Treasury.

FISCAL IMPACT OF THE PILOT PROGRAM

This proposed pilot program allows local government to collect delinquent tax debt in an efficient, low-cost manner while increasing revenue for the localities. The proposed legislation authorizes Treasury and the state taxing authority (when allowed by the state law) to collect a fee from the local government to offset any costs associated with processing a claim. In accordance with the regulations, Treasury is paid $25 by the state taxing authority for each taxpayer refund the state receives. The Treasury has set the fee of $25 in the regulations. This fee is the monetary amount Treasury has determined that it requires to cover Treasury's administrative costs. This proposed pilot program will have no additional cost to the federal government. The local government shall pay the federal government the fee of $25 for each offset refund in accordance with the regulations. The local government may reimburse the state government for the administrative cost pursuant to the state's law.

For the calendar year 2006, the Commonwealth of Virginia received over $16 million for delinquent income tax debt from the Program. From the Program for the calendar year of 2006, New York received over $31 million, Ohio received over $11 million, California received $1 million, Vermont received over $500,000.00 and Pennsylvania received over $5 million. I estimate that Virginia local governments would receive $65 to $70 million during for the first year of its participation in the Program. Virginia local government treasurers have many collection tools at their disposal as granted by the Virginia General Assembly. This pilot program would benefit all local governments, in especially those states with few collection tools for local government collectors.

If this legislation is passed, it will allow tax debt to be collected by the local government and will increase the local governments' revenue, thereby protecting the

honest taxpayer, who pays his taxes and pays timely, from increased taxes. This legislation has no cost to the federal or state government. Under this legislation, the only cost is to the delinquent taxpayer, who is finally made to pays his or her outstanding tax obligation.

ATTACHMENTS

I have attached to this written testimony several informative documents. The Question and Answers Regarding the Federal Offset Program, which was written as various questions arose and includes a sample certificate to be filed by the local government with the state taxing authority. The List of States Participating in the Federal Offset Program is attached. I have attached a report entitled Comparison of State Agencies and the District of Columbia's Net Collections from Treasury Offset Program for Calendar Years 2005 and 2006. This report from FMS shows the amount of funds collected for delinquent state income tax debt for each of the participating states for the calendar year 2005 and 2006.

CONCLUSION

This is a bipartisan, good-government bill. If the legislation is passed, it would allow federal, state and local government to work together. Local governments will be given an effective, powerful collections tool at no cost to the federal government or to the state governments participating in the Program. The state government and federal government will be compensated by the local government for the administrative burden. If the legislation is passed, local government would have a significant increase in revenue. The increase in revenue protects the honest taxpayers from an increase in taxes. Under this legislation, the only cost is to the delinquent taxpayer, who would finally be made to pay his or her outstanding tax obligation.

Good citizens, who pay their taxes, will appreciate that the federal government and the state government are assisting localities to help local government collect from the delinquents. Each citizen should share in paying his fair share of taxes.

QUESTIONS AND ANSWERS REGARDING THE FEDERAL OFFSET PROGRAM

Is it true that by allowing local governments to participate in the Federal Offset Program, a huge administrative burden will be passed on to Financial Management Service? (Financial Management Service is the division of the Department of Treasury which handles the Federal Offset Program.)

No, the program is deliberately designed not to be burdensome to Financial Management Service. Under the proposed legislation, the local governments will send their tax debt information to the appropriate state taxing authority. The state taxing authority will be the clearing house for the local governments. Thirty-eight states including Washington DC are currently participating in the Federal Offset Program and have the required computer programs in place. Nineteen states allow their localities to send their debt information to the state taxing authority to participate in the state's tax offset program. For nineteen states, it will be a simple matter of passing the information onto the Financial Management Services.

Will allowing local governments to participate in the Federal Offset Program increase the numbers of clients from its current seventy to potentially thousands of localities, thereby placing a huge administrative burden on Financial Management Service?

No, the client base stays the same. The state taxing authority will act as the clearing house for the local governments. All tax debt will be filtered through the participating state taxing authorities. A local government can participate in the program only if its state is involved in the Federal Offset Program.

Is it true that by allowing local governments to participate in the Federal Offset Program, a huge administrative burden will be passed on to the state taxing authority?

This is not true. The local governments will send their tax debt information to the state taxing authority, as they already do. The state taxing authority will be the clearing house for the local governments. Thirty-eight states are already participating in the Federal Offset Program and have the required computer programs in place. Under the current program, all data and funds are sent electronically, minimizing the administrative burden.

What does the state get out of the deal?

The state may charge a fee to the locality for simply passing the tax debt information to Financial Management Service. The amount a state may charge a locality varies from state to state. It depends upon what amount is allowed under the applicable state code.

Will the states be responsible for the fee due to the Financial Management Service for each account match?

The $25.00 fee, due to Financial Management Service, for each account match, will be paid by the local government. In addition, the states will receive the fee that they normally charge localities for collection under the existing state debt offset program.

Are the state taxing authorities required to send out notices to taxpayers via certified mail? Such a mailing process could be time-consuming and cost the states significant amounts.

No, the states will not be required to send out the notices via certified mail. In accordance with the proposed statute, the local governments **must** send out the certified mail notices on each delinquent tax account submitted to the Federal Offset Program.

By allowing local governments to participate in the Federal Offset Program, will the Department of Treasury be disclosing any information to the local governments?

No, the only information given to the local governments will be the account number, name of the taxpayer and the amount of the match on the refund. No other information will be provided to the local governments.

Can the local governments attempt to collect for parking tickets, library fees, park and recreation fees, court fees, and other miscellaneous debt?

No. The local governments can submit only delinquent tax debt.

Will allowing local governments to participate in the Federal Offset Program significantly lower the amount of funds that the federal government, states' child support agencies and the state taxing authorities can collect?

Absolutely not. The proposed legislation places the local governments in the fifth tier in order of payment from the federal tax refund. Four other government entities must be paid before the local governments can receive any funds. The order of priority is as follows: 1) federal income tax, 2) state child support agencies, 3) federal government agencies, 4) state income tax, and, finally, 5) local government delinquent taxes.

Can a local government participate in the Federal Offset Program if its state is not participating in the Federal Offset Program?

No. A local government can only participate in the Federal Offset Program if its state is participating in the program. The local governments must rely on the computer programs and systems that the state taxing authorities have implemented for participation in the Federal Offset Program.

When will local government send the tax account for participation in the Federal Offset Program?

Tax accounts will not be submitted for collection by the Federal Offset Program until, at least, sixty days after the certified mail notice is mailed to the debtor, in accordance with the statute. This time period allows the citizen ample time to successfully dispute or pay the tax bill. No state taxing authority will submit a local government tax debt to Financial Management Service until the sixty day period from the certified mailing to the taxpayer has elapsed.

Can a citizen dispute or pay a bill after the certified notice has been mailed to them and after the account has been sent for participation in the Federal Offset Program?

Absolutely.

Is due process afforded the citizens under this proposed legislation allowing local governments to send accounts to Financial Management Service for participation in the Federal Offset Program?

Yes. The local government must mail a tax bill and at least two delinquency notices and attempts, at least, one phone call to the delinquent taxpayer. Under the proposed legislation, the local government must send to the delinquent taxpayer a certified mail notice that the taxpayer's delinquent account will be submitted to the Financial Management Services for involvement in the Federal Offset Program. Following this certified mail notice, a taxpayer has sixty days to successfully dispute or pay the tax bill.

How will the state taxing authority know that the local government complied with the certified mailing requirement of the statute?

The local government must certify in writing to the state taxing authority that it has complied with the statute requirements prior to sending an account to the taxing authority for involvement in the Federal Offset Program. A sample certification is attached hereto.

What happens if a citizen's federal refund is offset and the money is not owed by the citizen to the local government?

The Financial Management Service will reimburse the citizen. The state taxing authority will reimburse Financial Management Service. Either, the local government will refund the money to the state taxing authority (including applicable fees) or the state will withhold the amount due to the locality in future payments. However, Financial Management Services and the State Taxing Authority will keep the administrative fees paid to them by the local government. The states may have to pay interest on the citizen's reimbursement, but Financial Management Services will not have to pay interest on a reimbursement. The states may pass the interest payment on to the locality.

Are the administrative fees paid to Financial Management Service and the state taxing authority refundable to the local government?

No, the fees are not refundable under any circumstances.

Will the Department of Treasury's reputation be affected by allowing the local governments to participate in the Federal Offset Program?

By allowing the local governments to participate in the Federal Offset Program, the Department of Treasury is making good tax policy. Good citizens, who pay their taxes and vote, will appreciate that the federal government is assisting localities to collect from the scofflaws. Each citizen should share in paying his fair share of taxes. "Taxes are the lifeblood of government, and their prompt and certain availability an imperious need." U.S. Supreme Court Justice Roberts in Bull v. United States, 295 U.S. 247 (1935).

Is it fair to the citizens to allow local governments to participate in the Federal Offset Program?

Yes. It is particularly fair to the overwhelming majority of citizens, who pay their taxes on time, because it helps to collect from the citizens who are not paying their share of the tax burden. It is also fair to the delinquent taxpayer or non taxpayer, because due process applies at all stages. Prior to any account being sent to the offset program, the local government mails a bill and, at least, two delinquency notices and attempts a phone call. When the local government sends the account to the Federal Offset Program, the local government must send a notice out via certified mail. At this point, the delinquent taxpayer or non taxpayer has been contacted at least five times, over more than ninety days, and has had ample opportunity to pay or dispute the tax bill.

What is the fiscal impact of the Commonwealth of Virginia participation in the Federal Tax Offset program?

For Virginia localities, it is estimated that it will bring in between **65-70 million dollars** in revenue. Furthermore, the Commonwealth would receive some of these funds. Each locality would be required to pay the Commonwealth of Virginia Department of Taxation a fee for passing the tax debt information onto Financial Management Service.

Certification of Compliance
with the
Federal Offset Program for Local Taxes

To The Commonwealth of Virginia Department of Taxation:

I, _____, the duly elected or appointed treasurer or finance officer of _____ do attest as follows:

1) The data file being submitted reflects only local taxes, all of which were assessed within the last ten years.

2) No debtor is associated with a total tax liability of less than $50.00.

3) Each taxpayer listed was mailed certified notice no later than _____ and should not be submitted to the Federal Offset Program prior to _____, the difference between these two dates being greater than sixty (60) days.

4) Each taxpayer listed has been mailed: a tax assessment, two delinquency notices, and, at least, one telephone call has been attempted.

5) In the event of erroneous collection, all associated fees charged by the federal and/or state government(s) shall be paid by my jurisdiction.

6) All information concerning taxpayers shall be regarded as strictly confidential.

I recognize that adherence to all of the above strictures is subject to audit by the Commonwealth of Virginia and/or the Department of Treasury and that any violation, thereof, may result in my locality being terminated from the program.

Signed under my hand this ____ day of _____, _____.

_____ _____
(Signature) (Title)

Federal Offset Program

List of Participating States

Alabama	Missouri
Arizona*	Montana
Arkansas*	Nebraska
California*	New Jersey*
Colorado	New Mexico
Delaware	New York
Georgia	North Carolina*
Hawaii	Ohio
Idaho	Oklahoma
Illinois	Oregon
Indiana*	Pennsylvania
Iowa**	Rhode Island**
Kansas*	South Carolina*
Kentucky	Utah
Louisiana	Vermont
Maine*	Virginia*
Maryland*	Washington, DC*
Massachusetts*	West Virginia*
Minnesota	Wisconsin*

*Indicates states that also participate in State offset programs.

**Participates in a State offset program, but not for local taxes.

States that do not participate in the Federal Offset Program, but use a State offset program include: Connecticut, Mississippi, and South Dakota.

The following states do not have a personal income tax: Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming.

DEBT MANAGEMENT
DMAS
ACCOUNTING SYSTEM

Comparison of State Agencies' and the District of Columbia's Net Collections from Treasury Offset Program for Calendar Years 2005 and 2006

Department	DECEMBER 2006	DECEMBER 2005	2005-2006	Percentage Change %	DECEMBER 2006	DECEMBER 2005	2005-2006	Percentage Change %
			Monthly Differences		YTD	YTD	YTD Differences	
ALABAMA	$10,049	$12,200	-$2,151	-17.63%	$4,671,183	$3,219,748	$1,451,435	45.08%
ARKANSAS	$3,066	$2,801	$265	9.46%	$121,650	$308,340	-$186,690	-60.55%
ARIZONA	$12,685	$10,808	$1,877	17.37%	$3,604,259	$1,556,917	$2,047,342	131.50%
CALIFORNIA	$19,897	$28,546	-$8,650	-30.30%	$1,150,112	$1,519,949	-$369,838	-24.33%
COLORADO	$732	-$246	$979	-397.10%	$43,268	$27,184	$16,084	59.17%
WASHINGTON DC	$35,362	$26,145	$9,217	35.26%	$3,733,303	$3,805,254	-$71,951	-1.89%
DELAWARE	$6,504	$25,700	-$19,196	-74.69%	$1,550,716	$1,850,958	-$300,242	-16.22%
GEORGIA	$216,334	$246,718	-$30,383	-12.32%	$20,397,710	$22,269,663	-$1,871,952	-8.41%
HAWAII	$11,853	$15,670	-$3,817	-24.36%	$687,805	$506,005	$181,800	35.93%
IOWA	$9,162	$11,944	-$2,782	-23.29%	$1,501,390	$2,143,190	-$641,800	-29.95%
IDAHO	$14,522	$5,314	$9,208	173.27%	$509,342	$567,752	-$58,410	-10.29%
ILLINOIS	$133,416	$68,400	$65,017	95.05%	$11,400,923	$10,695,783	$705,140	6.59%
INDIANA	$40,024	$6,445	$33,579	521.04%	$3,792,298	$5,218,963	-$1,426,664	-27.34%
KANSAS	$80,409	$30,116	$50,293	167.00%	$3,059,135	$2,586,418	$472,717	18.28%
KENTUCKY	$64,559	$131,702	-$67,143	-50.98%	$5,663,470	$6,820,315	-$1,156,846	-16.96%
LOUISIANA	$150,265	$152,810	-$2,545	-1.67%	$9,892,371	$33,665,891	-$23,773,520	-70.62%
MASSACHUSETTS	$66,633	$64,782	$1,850	2.86%	$3,465,778	$3,524,420	-$58,642	-1.66%
MARYLAND	$228,911	$219,852	$9,058	4.12%	$22,136,148	$22,751,066	-$614,919	-2.70%
MAINE	$55,123	$8,355	$46,768	559.76%	$1,560,782	$4,924,827	-$3,364,046	-68.31%
MINNESOTA	$57,739	$39,264	$18,475	47.05%	$3,631,932	$4,523,988	-$892,055	-19.72%
MISSOURI	$104,688	$59,461	$45,227	76.06%	$8,694,833	$8,530,172	$164,662	1.93%
MONTANA	$2,416	$0	$2,416	0.00%	$310,694	$41,289	$269,405	652.48%
NORTH CAROLINA	$91,755	$90,427	$1,328	1.47%	$8,953,827	$7,282,404	$1,671,422	22.95%
NEBRASKA	$4,397	$3,060	$1,337	43.68%	$741,601	$831,039	-$89,439	-10.76%
NEW JERSEY	$78,645	$67,588	$11,057	16.36%	$6,479,627	$4,436,858	$2,042,769	46.04%
NEW MEXICO	$14,510	$11,706	$2,804	23.95%	$1,578,012	$851,538	$726,475	85.31%
NEW YORK	$401,663	$242,068	$159,595	65.93%	$31,353,664	$31,375,603	-$21,939	-0.07%
OHIO	$105,022	$98,743	$6,279	6.36%	$11,297,015	$10,757,554	$539,461	5.01%
OKLAHOMA	$93,918	$126,587	-$32,669	-25.81%	$5,667,830	$6,267,154	-$599,324	-9.56%
OREGON	$63,191	$91,541	-$28,350	-30.97%	$6,902,905	$6,058,131	$844,774	13.94%
PENNSYLVANIA	$66,872	$42,548	$24,324	57.17%	$5,574,530	$6,355,195	-$780,665	-12.28%
RHODE ISLAND	$1,925	$7,786	-$5,861	0.00%	$912,275	$981,991	-$69,716	-7.10%
SOUTH CAROLINA	$25,762	$36,893	-$11,132	-30.17%	$3,101,728	$1,462,027	$1,639,700	112.15%
UTAH	$34,508	$27,967	$6,541	23.39%	$2,367,260	$1,939,695	$427,565	22.04%
VIRGINIA	$400,270	$168,093	$232,176	138.12%	$16,216,833	$9,775,076	$6,441,757	65.90%
VERMONT	$8,978	$4,330	$4,648	107.33%	$568,636	$504,215	$64,421	12.78%
WISCONSIN	$50,657	$12,691	$37,965	299.14%	$2,449,874	$4,275,048	-$1,825,175	-42.69%
WEST VIRGINIA	$9,632	$27,436	-$17,804	-64.89%	$2,506,480	$3,104,199	-$597,719	-19.26%
Total	$2,776,053	$2,226,251	$549,802	24.70%	$218,251,199	$237,315,821	-$19,064,621	-8.03%

Mr. TOWNS. Thank you very much, too, for your testimony.

Ms. WETH. Thank you.

Mr. TOWNS. Let me begin with you, Mr. Mayor.

Why do you suggest a pilot program rather than just doing it?

Mr. CORNETT. Well, I think we would just as soon just do it. I think that the pilot program, to a certain extent, isn't our idea. We are just willing to proceed with it and make it as large as possible.

Mr. TOWNS. And you think that would sort of bring people on board that might not be on board?

Mr. CORNETT. Well, I don't know necessarily if it would do that, but I think the larger you could make it the better it would be for local government, the more of these delinquent taxes that we would be able to recoup. I know there is some reluctance to try to do this all across the country all at once, just because there might be some people on the other end of this that are leery that it will work as smoothly as we project, but we would like to see it.

You have to understand that local governments work so differently throughout the country that I think it would be a good idea to try every different taxing situation you could find. The relationship between municipal government and county government and State government work distinctly different in almost all 50 States.

Mr. TOWNS. Right.

Mr. CORNETT. It is going to work better in some places than it will in others.

Mr. TOWNS. Right. I guess what we need to do is probably get a good definition of local taxes. I mean, what do you consider local taxes? I mean, I think we need to get a good definition, because when you look at parking tickets, library fines, sewer fees, and sometimes even trash collection——

Mr. CORNETT. I would consider local sales taxes and local property taxes as local taxes.

Mr. TOWNS. Ms. Coates.

Ms. WETH. Mr. Chairman, that was a concern of a lot of folks, that we would throw in library fines and parking tickets and different fees of that nature, but this is limited specifically to local government tax debt, so it would only be for a tax that a local government charges, so parking tickets and library fines would not be allowed to be submitted to Treasury.

Mr. TOWNS. Right. Thank you, that is good to know.

Ms. WETH. Mr. Chairman, also, as the mayor stated, sometimes things are called different things in different communities, so I believe the bill allows it up to Treasury to work on what would be considered a local tax. So there is a lot of flexibility in here, and I personally think that one of the best things about the pilot program is that it gives us an opportunity to work with Treasury and work out those details so that it makes common sense.

Mr. TOWNS. Right. And I must admit that I sort of like the pilot program, too, sort of like test it before we really implement it fully.

Ms. FORD-COATES. Right. And, of course, with States like Florida we have no income tax, and we are not sure exactly how those of us who have no income tax will fit into this in the future, but it is an area that we want to support or neighboring States and our colleagues in local government so that they can start that, and

maybe there is a place for us down the road after all the details are worked out.

Mr. TOWNS. Right. In your testimony you used the word flexibility twice. What do you really mean by flexibility? You said greater flexibility.

Ms. FORD-COATES. We would like to see the Department of Treasury have the opportunity to decide on the number of pilot programs. If there are a certain number of States, as in the current bill, if there is a State that is suddenly ready sooner, we would like Treasury to have that opportunity to make some of those decisions as the process is worked through.

Mr. TOWNS. Yes. Let me ask all three of you this question: what do you see that is not in there that should be in there, if we are looking for an ideal situation here?

Ms. WETH. Mr. Chairman, I don't see anything missing in the legislation. I do agree it would be a wonderful thing to open it up to all the States and let all local governments participate, but I think we do need to make it a pilot program to allow the Treasury some time to evaluate the program and work out the kinks before it is allowed for each State and each local government. But I am afraid nothing comes to mind that I see specifically missing in the legislation as it is written now.

Mr. TOWNS. All right.

Ms. FORD-COATES. Mr. Chairman, we would like, again, an area that we believe that the Treasury could work out is the question on how certified mail is specified within the bill, because there are certain products that the Postal Service offers that change on a regular basis. Technology changes. We would prefer something along the lines of adequate notice, whatever. We want to make sure that the taxpayer knows what is going on. There is no question about that. But I think that is one of those things that Treasury could work out with your staff as the bill proceeds.

Mr. CORNETT. I have no suggestions.

Mr. TOWNS. That means it is a good bill.

Mr. CORNETT. Nice work.

Ms. FORD-COATES. We think so.

Mr. TOWNS. Thank you very much.

I yield to the ranking member.

Mr. BILBRAY. Thank you very much.

I guess after being 18 years in local government and having worked with the Federal Government, I think even the mayor on second thought will look at this. Twenty-four months is a flash in the pan for the Federal Government. I think, Mr. Chairman, one of the biggest problems that those of us in local government have with the Federal Government isn't that they try new things or that they make mistakes, but they usually don't want to go back and correct the mistakes once they have made it.

I think that one great advantage with a pilot program is that it does give political cover. I remember when I was 27 years old when I was elected mayor, and I developed a policy of pilot programs because you could say let's try this, and then if it doesn't work out, instead of taking the political heat that it didn't work out you say, see, I was right to have it as a pilot program.

I think that we are going to find things that need to work out, but I have to sort of agree with the mayor and, I know these numbers, but the four to eight is a workable number. I would only say, Mr. Chairman, we at least consider that aspect of it as the possible expansion, and as being one of the co-sponsors on this I think that we ought to at least discuss that testimony and look into it.

All I have to say is, to the gentlelady from Florida, my uncle was a tax assessor in Las Vegas for 30 years, a dyed-in-the-wool Democrat, but he survived in that environment for 30 years. So how tough you think it is, you can imagine being out there in the desert with all those slot machines.

Ms. FORD-COATES. I sympathize.

Mr. BILBRAY. My question would be: how successful do you think the process is right now that we are building on here?

Mr. CORNETT. I guess the question I would have is what percentage of tax refunds now are coming in. Do most people get a refund? Do most people not get a refund? Even if this legislation were 100 percent effective it is still not going to solve 100 percent of our problem. But we are talking about millions of dollars, and at local government's level a lot can be done with those millions of dollars.

Mr. BILBRAY. I am out of order because I haven't done a tax return in probably 20 years, but my family has owned a business from the year I was born. I guess my mother decided to get out of having children and go into something more productive after she looked at me. But the one thing that is obvious for those of us that were tax consultants is the overwhelming majority of the rank and file that file returns are getting money back. That is the biggest incentive for people to file returns. There is a whole other problem with those that have outstanding debts with the Federal Government, but for those that are filing, there really is an incentive out there.

I think on the negative side you might be able to say that some may not file now, knowing their withholdings won't be returned to them, but I think that is a very small number in reality. I think by the time they get hit with this it will be too late for them to know about not filing. So I think we need to build on this and hopefully we will be able to work out all the details.

The challenges that we have with who we choose is going to be a tough one, but I hope that we all work together on this.

I ask, because we are all sort of local government people here, that the separation of powers is so often talked about between the three branches of Federal Government, and I wish our government teachers would teach more often that the real separation of power is between the local, special district, city, county, and State. That is where the real power is, than those of us in the Federal Government.

Mr. Chairman, I support this program and I support it for a big reason. I think those who always talk about that the Federal Government isn't sending enough resources down to what we call the first responders should look at this as a way, instead of us taking Federal money and controlling it and conditioning it and sending it down and making the local government say thank you, sir, for letting me have this little bit, ought to be empowering in working with the local government to get their own money from their own

constituents so they can do it with no conditions and then the first providers won't be needing to come to us hat in hand, or a lot less hat in hand, because they will have those resources that are being denied them now, not by the Federal Government but by those deadbeat taxpayers out there, both women and men.

I appreciate the chance for you to be here to day, and I yield back, Mr. Chairman.

Mr. TOWNS. Thank you very much.

I want to thank all of you for coming and testifying. I was wondering if there was any kind of collection tools that need to go into this. I mean, do you really feel that part is covered? Do we need any collection new rules that need to be changed from the Federal level in order to make it possible for you to be able to collect?

Ms. WETH. Well, Mr. Chairman, I can speak about Virginia. In Virginia the local government treasurers look to the Code of Virginia for our power for our collection tools, and in Virginia we have an amazing amount of collection tools. We are able to lien bank accounts. We are able to seize vehicles. We are able to go into businesses and seize the property and the business. We do employment liens. So we have an amazing amount of collection tools, but I don't believe many of the counties and cities in the United States do not have the same powers that the treasurers in Virginia have.

Mr. BILBRAY. Would the gentleman yield a second?

Mr. TOWNS. I would be delighted to yield.

Mr. BILBRAY. You hit on a point that I think all of us need to talk about. You are talking about, like, the bank accounts. I don't know about your neighborhood, but there was a big issue about what constitutes a proper documentation to open bank accounts, and there was this issue of foreign governments giving documents that aren't secure, and there is such potential for people to be opening bank accounts under false identities and hiding their resources. This is specifically why we have a Federal law that says you are supposed to be proving who you are when you open a bank account.

I think, Mr. Chairman, we need to be very much on top of that in talking to the Finances Committee because just something like this, that somebody starts opening bank accounts under a different Social Security number or under a taxpayers ID number rather than one that we can track, they will use these for hiding.

I want to say it because we don't think it bothers us until we get to exactly like you said and you know the people that are doing this will learn how to leverage the system and go over. So please, when we talk about the proper identification, things like implementation of a real ID is going to be essential to programs like this.

I yield back, Mr. Chairman.

Mr. TOWNS. Yes, thank you.

Ms. WETH. I couldn't agree with you more, Representative Bilbray. I think that is an excellent point. I wasn't even aware that people were doing that these days, but in this area of identity theft and all the craziness that is out there, I think that is an excellent requirement.

Mr. TOWNS. The reason I was late coming back here is that I am a sponsor of the spyware bill, and it was being marked up. That is what I was doing.

Ms. FORD-COATES. I think everything has been said.

Mr. TOWNS. Mr. Mayor.

Mr. CORNETT. No additional comments.

Mr. TOWNS. All right. Thank you so much, all of you, for your testimony. We look forward to working very closely with you in the days and months ahead.

I yield.

Mr. BILBRAY. I apologize, but I would ask unanimous consent to introduce into the record the opening statement by Ranking Member Davis.

Mr. TOWNS. Without objection.

Mr. BILBRAY. Thank you.

[The prepared statement of Hon. Tom Davis follows:]

TOM

Opening Statement of Ranking Member Davis
Committee on Oversight and Government Reform
Subcommittee on Government Management, Organization, and Procurement
Legislative Hearing on Tax Collection
April 19, 2007

Today, this Subcommittee will consider two pieces of legislation – both relating to the ability of the government at all levels to collect taxes owed. Neither piece of legislation increases the overall tax burden on our fellow citizens. Indeed, in theory, both bills are intended to shift the burden currently shouldered by honest taxpayers back to those individuals who have been cheating the system.

On Tuesday, I introduced H.R. 1865, *the Tax Offset for Owed Local Taxes*. This proposal builds on the Federal Offset Program, which authorized the collection of support payments from so-called "dead-beat dads" from their federal tax returns.

H.R. 1865 calls for a pilot program which allows localities in certain states, selected by the Secretary of the Treasury, to participate in a similar Tax Offset program. The bill is narrowly drafted and only permits localities to use this tool to collect tax debts, but does not extend to the collection of fees owed as a result of traffic tickets, overdue library books or other such assessments. Furthermore, localities would still be required to take all the steps they now take to collect taxes before they turn it over to their state. States will act as the clearinghouses for their local governments and turn over the account number, name of the taxpayer and amount owed to the local government to the Financial Management Service at the Department of Treasury for action.

I introduced this legislation, along with Representatives Towns, Bilbray, Turner, and Moran because it is simply not fair to those of us who pay all our taxes that tax cheats get away with not paying their fair share. In Congress, we pass many bills which cost local governments money without providing federal funding. This is a small thing we can do to help local governments at least collect the money due to them. This legislation does not cost honest taxpayers a dime and I am pleased to see that it is being considered by this Subcommittee.

With respect to H.R.1870, *the Contractor Tax Enforcement Act*, I appreciate and share Chairman Towns' intent – to prevent tax cheats from participating in federal contracting. But however well-intentioned, the bill goes too far and unreasonably reduces the competitive market the government can tap for the goods and services it needs to serve our citizens.

I am concerned about the bill's potentially negative impact on small business, as well as the potential to cause unnecessary disruption and delay in the already-overburdened acquisition process. H.R. 1870 circumvents a well-established debarment and suspension process established in regulation decades ago by automatically disqualifying contractors for not paying taxes – no matter what the reason or possible mitigating circumstances.

Many, if not most, of the federal contractors who run afoul on their taxes are small and relatively unsophisticated firms.

However, if we must legislate on this issue, language similar to a recent proposal to revise the Federal Acquisition Regulation (FAR) might be a more reasonable way to hold federal contractors accountable for unpaid taxes while, at the same time, preserving the fairness and transparency necessary to encourage our best commercial firms to participate in the federal market. This proposal would require competitors for federal contracts to certify, among other things, they have not been notified of liability for delinquent taxes and to include the failure to pay taxes as a specific cause for debarment from participation in federal contracting. Legislation crafted along those lines would accomplish the same goals as those of the Chairman, while avoiding many of my concerns.

Today, I am here to listen to the witnesses, and I look forward to working with Chairman Towns and Ranking Member Bilbray on this legislation.

Mr. TOWNS. Thank you so much for your testimony.
Mr. CORNETT. Thank you.
Ms. FORD-COATES. Thank you.
Ms. WETH. Thank you.
Mr. TOWNS. The committee is now adjourned.
[Whereupon, at 3:40 p.m., the subcommittee was adjourned.]
[Additional information submitted for the hearing record follows:]

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

TOM DAVIS, VIRGINIA
RANKING MINORITY MEMBER

ONE HUNDRED TENTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
2157 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6143

Majority (202) 225-5051
Minority (202) 225-5074

April 25, 2007

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

Dear Mr. Kutz:

Thank you for your testimony and participation at the Subcommittee on Government Management, Organization, and Procurement's April 19, 2007 hearing on "The Contractor Tax Enforcement Act and Amendments to Title 31 of the United States Code." Please answer the following questions for the official hearing record.

1. You indicate in your statement you believe there should be a law requiring contractors to pay their taxes before participating in the federal procurement system. You also state any law seeking this objective should have "due process and other safeguards built into the system." Do you think that H.R. 1870, as introduced, meets these criteria? If so, could you describe the features which accomplish these objectives?

2. H.R. 1870 would treat the eligibility to compete for a federal contract like eligibility to receive a federal loan or a loan insurance guarantee. Do you believe there is no significant difference between a federal contract for goods and services and federal assistance in the form of a loan? Under what rationale should they be treated the same way for the purposes of eligibility?

3. In your statement, you mention the proposed FAR rule which would require prospective contractors to provide tax-related certifications and would include the failure to pay taxes as a specific cause for debarment from participation in federal contracting? Would this proposal, which incorporates the current regulatory

   debarment procedures, meet your due process concerns? Would this proposal be adequate in your view to address the tax delinquency issue concerning federal contractors? If not, why not?

4. As I understand it, federal law allows the government to levy contractor payments for outstanding tax debts. Does this law have a significant impact on the collection of taxes from federal contractors?

5. H.R. 1870 would automatically eliminate any firm that does not meet its tax liability. As I read the bill, it does not appear to include any threshold amount either in terms of the size of the potential contract or on the amount of the tax debt. Considering the hundreds of thousands of federal contract actions each year, could this be implemented in a cost effective manner?

6. Your statement contains an extensive analysis of the amounts in back taxes owed by federal contractors, and you conclude the acquisition system ought to include some methodology to remedy this problem. Have you done an analysis of the potential impact on the acquisition system in terms of potential cost and delay which would be inherent in such a remedy, particularly one that would require a contracting officer to review tax liability information on all prospective contractors? Have you studied the potential impact on small business or on the competitive market available to meet the government's acquisition needs of a provision requiring a prospective contractor to authorize the disclosure of information concerning outstanding tax debts? Have you made an attempt to estimate the percentage of total contract actions which involve firms having unpaid tax liabilities?

7. While no one disagrees all citizens, including federal contractors, should meet their tax obligations, some have argued the government's acquisition system – which is already burdened with numerous provisions concerning social issues and other matters not directly related to buying the best value goods and services – is not the proper vehicle for the enforcement of our tax laws. What is your view on this?

8. In your statement, you note under current law contracting officers do not have to take into account a contractor's tax liability when determining a prospective contractor's responsibility. You also point out none of the 122 firms in a prior study had been debarred. Has GAO tried to determine on a government-wide basis how many firms owing taxes have been denied the award of a federal contract because the firm had been determined either to be non-responsible or debarred or suspended?

If you have any questions regarding this letter, please contact John Brosnan of my staff at (202) 225-5074.

Sincerely,

Tom Davis
Ranking Member

United States Government Accountability Office
Washington, DC 20548

May 17, 2007

The Honorable Tom Davis
Ranking Member
Committee on Oversight
and Government Reform
United States House of Representatives

Dear Mr. Davis:

This letter responds to your request for additional information related to the Subcommittee on Government Management, Organization and Procurement's April 19, 2007 hearing entitled *The Contractor Tax Enforcement Act and Amendments to Title 31 of the United States Code*. Enclosed are our responses to the supplemental questions you submitted for the record. Our responses are based largely on information contained in our published reports and testimonies related to Department of Defense, civilian agency, and GSA contractors with unpaid taxes and reflect our views based on that information. I understand that since my testimony, the Subcommittee has passed H.R. 1870 after adopting substitute language for the bill language originally introduced on April 17, 2007. The answers provided herein refer to H.R. 1870 as originally introduced since that was the bill language discussed at the hearing.

If you have any further questions or would like to discuss these responses, please contact me on (202) 512-9505.

Sincerely yours,

Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Enclosure-1

Responses to Supplemental Questions for the Record
Submitted by
The Honorable Tom Davis
Subcommittee on Government Management, Organization and Procurement's
Hearing on
The Contractor Tax Enforcement Act and
Amendments to Title 31of the United States Code
April 19, 2007

1. You indicate in your statement you believe there should be a law requiring contractors to pay their taxes before participating in the federal procurement system. You also state any law seeking this objective should have "due process and other safeguards built into the system." Do you think that H.R. 1870, as introduced, meets these criteria? If so, could you describe the features which accomplish these objectives?

Answer:

Currently, section 3720B of title 31 of the United States Code makes federal debtors, other than tax debtors, ineligible to receive federal loans or loan insurance as specified by standards prescribed by the Secretary of the Treasury. Those standards as set forth in section 285.13 of title 31 of the code of federal regulations implement the Debt Collection Improvement Act of 1996 and recognize and incorporate provisions protecting non-tax debtors seeking federal loans or loan insurance while they are challenging their debt in ongoing administrative appeals or contested judicial proceedings. As introduced, H.R. 1870 would add the following categories of ineligibility: those with delinquent federal tax debt would be ineligible to receive government contracts; those with delinquent federal non-tax debt would be ineligible to receive government contracts; and those with delinquent tax debt would be ineligible to receive federal loans or loan insurance. These three new categories of ineligibility would not be covered automatically by current provisions of the code of federal regulations implementing the Debt Collection Improvement Act of 1996. Since H.R. 1870 itself does not call for any due process rights, once passed, presumably the Secretary of the Treasury would have to prescribe due process standards in conformance with existing tax code provisions.

2. H.R. 1870 would treat the eligibility to compete for a federal contract like eligibility to receive a federal loan or a loan insurance guarantee. Do you believe there is no significant difference between a federal contract for goods and services and federal assistance in the form of a loan? Under what rationale should they be treated the same way for the purpose of eligibility?

Answer:

There are differences between a federal contract for goods and services and federal assistance in the form of a loan. These distinctions generally may take two forms. In one instance when the federal government contracts for goods and services, it enters the commercial market place and to some extent is no longer a sovereign entity but rather another commercial entity. The other difference between a contract and a loan is that when the government contracts, it receives goods or services as opposed to providing a benefit in the form of a loan.

In a contract the Federal government is subject to rules imposed upon commercial entities seeking to do business with the federal government, most notably the Federal Acquisition Regulation. When the federal government provides a loan, to some extent it provides these loans in its capacity as a sovereign entity distinct from its status as a commercial entity. When the federal government provides loans, it does so not to receive goods and services, but to advance policy objectives.

While the status and rationale of the federal government when it enters into contracts for goods and services is different from its status and rationale for providing loans, both approaches use federal revenue to achieve their purposes. In other words, the federal government uses tax dollars to pay for goods and services and tax dollars to provide loans. As stewards of tax dollars belonging to the citizens of the United States, the federal government has an obligation to ensure that those tax dollars spent on contracts and loans are use appropriately.

3. In your statement, you mention the proposed FAR rule which would require prospective contractors to provide tax-related certifications and would include the failure to pay taxes as a specific cause for debarment from participation in federal contracting. Would this proposal, which incorporates the current regulatory debarment

procedures, meet your due process concerns? Would this proposal be adequate in your view to address the tax delinquency issue concerning federal contractors? If not, why not?

Answer:
The proposed FAR rule meets our concerns with respect to the due process it offers contractors that are proposed for debarment or suspension. The FAR provision is a positive step and if implemented will provide the federal procurement system with a powerful tool for holding those doing business with the federal government accountable for their obligations. I think it is worth exploring whether there is a mechanism that will make the process effective without unduly burdening an already overburdened acquisition workforce and without sacrificing due process.

4. As I understand it, federal law allows the government to levy contractor payments for outstanding tax debts. Does this law have a significant impact on the collection of taxes from federal contractors?

Answer:
Federal law does allow the government to levy contractor payments for outstanding tax debts in two ways. In our previous reports and testimonies, we reported that thousands of federal contractors owed billions in federal taxes and focused on the additional revenues that could be collected through a continuous levy that is administered jointly by Treasury's Financial Management Service and the Internal Revenue Service via the federal payment levy program (FPLP). Before any payment to a contractor is levied for unpaid taxes, the contractor is provided a series of notices, giving the contractor the ability to dispute the tax debt in question. In fiscal year 2006, the federal government collected over $50 million from the federal contractors using the FPLP.

The second method of levying a payment to a contractor is through paper levies. In paper levies, IRS seizes property either held by the taxpayer or owned by the taxpayer and held by a third party. This authority includes the seizure of payments federal agencies had scheduled to make to federal contractors. Unlike levies from the continuous levy program, each paper levy is typically a one-time seizure of property (i.e., the receivable that a contractor created

as a result of providing the government goods or services) and is done on a case-by-case basis based on the particular circumstances of the case. We have not performed a review on the use of paper levies to collect taxes owed by federal contractors and, thus, do not have collection statistics on IRS's utilization of paper levies.

5. H.R. 1870 would automatically eliminate any firm that does not meet its tax liability. As I read the bill, it does not appear to include any threshold amount in terms of the size of the potential contract or on the amount of the tax debt. Considering the hundreds of thousands of federal contract actions each year, could this be implemented in a cost effective manner?

Answer:

We have not conducted any specific analysis to determine the costs and feasibility of implementing the exclusion provision of H.R. 1870. We agree that it is important to consider whether the implementation of this provision would add undue costs and inefficiencies to either the federal procurement system or the tax system. We understand that there are current efforts by Treasury to link its systems with the Central Contractor Registry. We have not determined how far along this effort may be or if it can be adapted for this purpose (e.g.., it would need to ensure protection against unauthorized access to taxpayer information). Should those prove successful, it may be possible for IRS to build on this system and include a link that would allow contracting officers to access a list of contractors deemed ineligible due to tax delinquency. The requirement in H.R. 1870 that each prospective contractor authorize disclosure by Treasury of whether they have an outstanding debt in delinquent status would facilitate these modifications.

6. Your statement contains an extensive analysis of the amounts in back taxes owed by federal contractors and you conclude the acquisition system ought to include some methodology to remedy this problem. Have you done an analysis of the potential impact on the acquisition system in terms of potential cost and delay which would be inherent in such a remedy, particularly one that would require contracting officers to review tax liability information on all prospective contractors? Have you studied the potential impact on small business or on the competitive market available to meet the government's acquisition needs of a provision requiring a prospective contractor to

authorize the disclosure of information concerning outstanding tax debts? Have you made an attempt to estimate the percentage of total contract actions which involve firms having unpaid tax liabilities?

Answer:

We have not performed a review to determine (1) the potential impact on the acquisition system in terms of potential cost and delay that would require contracting officers to review tax liability information on all prospective contractors, (2) the potential impact on small business or on the competitive market of the provision requiring a prospective contractor to authorize the disclosure of information concerning outstanding tax debts, or (3) the percentage of total contract actions which involve firms having unpaid tax liabilities. As previously mentioned, we understand there are current efforts by Treasury to link its systems with the Central Contractor Registry. It may be possible to utilize such a linkage to share tax debtor information with contracting officers. We have not determined how far along this effort may be or if it can be adapted for this purpose (e.g., it would need to ensure protection against unauthorized access to taxpayer information). ~~In order to avoid potential unintended negative impacts on the federal procurement system, there may be some merit to deferring the effective date of H.R. 1870 until the Treasury/IRS has had time to establish and test a data base (whether assessed through the Central Contractor Registration or otherwise) that identifies tax debtors and makes that information available to contracting officers.~~

7. While no one disagrees all citizens, including federal contractors, should meet their tax obligations, some have argued the government's acquisition system – which is already burdened with numerous provisions concerning social issues and other matters not directly related to buying the value goods and services – is not the proper vehicle for the enforcement of our tax laws. What is your view on this?

Answer:

While the federal acquisition system should not be the primary place to enforce the tax system, the extent to which the acquisition system can incorporate steps into the contract award process that would support the tax enforcement policies of the federal government would benefit the taxpayer. It is important, however, that those steps do not impose undue

burdens on the acquisitions system's primary mission of buying the goods and supplies that the government needs.

8. In your statement, you note under current law contracting officers do not have to take into account a contractor's tax liability when determining a prospective contractor's responsibility. You also point out none of the 122 firms in a prior study had been debarred. Has GAO tried to determine on a government-wide basis how many firms owing taxes have been denied the award of a contract because the firm had been determined either to be non-responsible or debarred or suspended?

Answer:

We have not conducted any studies to determine on a government-wide basis the number of firms owing taxes that have been denied the award of a federal contract because the firm had been determined to be either non-responsible or debarred or suspended.