Federal Guidelines Do Not Prohibit the Awarding of Contracts to Contractors With Delinquent Tax Liabilities

September 28, 2010

Reference Number: 2010-30-120

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:
1 = Tax Return/return Information

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HIGHLIGHTS

FEDERAL GUIDELINES DO NOT PROHIBIT THE AWARDING OF CONTRACTS TO CONTRACTORS WITH DELINQUENT TAX LIABILITIES

Highlights

Final Report issued on September 28, 2010

Highlights of Reference Number: 2010-30-120 to the Internal Revenue Service Deputy Commissioner for Operations Support.

IMPACT ON TAXPAYERS

President Obama and Congress view increased enforcement on tax evasion as a way to reduce the tax gap. However, all taxpayers must be treated equitably. Because Federal guidelines allow the Internal Revenue Service (IRS) to conduct business with contractors that do not comply with the Nation's tax laws, it conveys to the American taxpayers an adverse message regarding the fairness of the system and the IRS' ability to administer tax laws fairly.

WHY TIGTA DID THE AUDIT

This audit was initiated because Federal Government contractors receive, on an annual basis, an estimated $377.5 billion in Federal payments. Our overall objective was to determine whether businesses contracting to provide services to the IRS are compliant with Federal tax laws, including filing and paying Federal income taxes and withholding and paying employment and withholding taxes.

WHAT TIGTA FOUND

IRS employees awarded contracts without completing tax checks and financial capability surveys. From a review of 135 contractors with an award equal to at least $250,000, TIGTA identified 20 (15 percent) with delinquent tax liabilities totaling $5.2 million. Tax checks were not completed for seven of the 20 contractors.

TIGTA believes IRS contractors should be held accountable to the same tax compliance requirements as IRS employees. If IRS employees fail to file accurate and timely income taxes, it can result in disciplinary action, and even loss of employment.

Guidelines do not require IRS employees to complete tax checks or financial capability surveys at the time a contract is up for renewal. Our analyses showed the IRS renewed the contracts for 17 contractors, of which 6 had delinquent tax liabilities that totaled over $943,000 at the time of the original award. As of March 2009, the delinquent tax liabilities increased by more than 500 percent to approximately $4.9 million.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) convene its senior executives to discuss its response to the Administration's January 20, 2010, request to evaluate IRS contract award processes and make process improvement recommendations to ensure that contractors with serious tax delinquencies do not receive additional work from Federal agencies; 2) ensure all required tax checks and financial capability surveys are performed before contracts are awarded; and 3) establish procedures requiring the Office of Procurement Policy to complete an annual tax check for all IRS contractors and to notify the Director, Collection Policy, when subsequent tax delinquencies occur after the initial contract is awarded.

IRS management agreed with the recommendations to evaluate the contract award process and to ensure tax checks and financial capability surveys are done before contracts are awarded. In addition, the IRS plans to include tax check responsibilities in future employee training workshops.

IRS management disagreed with the recommendation to establish procedures to conduct annual tax checks on all contractors to identify subsequent tax delinquencies. TIGTA continues to believe that this recommendation would help the IRS identify contractors that have a serious tax liability and possibly prevent them from receiving new contracts from the IRS.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 28, 2010

MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Federal Guidelines Do Not Prohibit the Awarding of Contracts to Contractors With Delinquent Tax Liabilities (Audit # 200830051)

This report presents the results of our review to determine whether businesses contracting to provide services to the Internal Revenue Service are compliant with Federal tax laws, including filing and paying Federal income taxes and withholding and paying employment and withholding taxes. This audit was conducted as part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

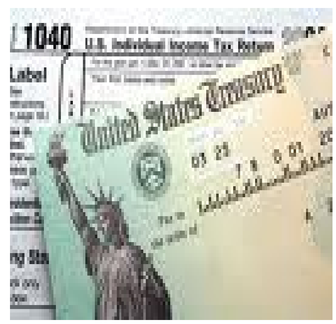
Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

Table of Contents

Background

Each year, Federal Government contractors receive an estimated $377.5 billion in Federal payments. In February 2004, the Government Accountability Office reported that approximately 27,000 Department of Defense contractors owed nearly $3 billion in Federal taxes.[1] In June 2005, an audit of 33,000 civilian agency contractors identified $3.3 billion in delinquent Federal taxes. Finally, in March 2006, the Government Accountability Office found that 3,800 General Services Administration contractors owed about $1.4 billion in Federal taxes.[2]



On January 15, 2009, legislation[3] was proposed by Representative Brad Ellsworth (D-IN) that "prohibits any person who has a seriously delinquent tax debt[4] from obtaining a Federal Government contract or grant." This bill requires Federal agency heads to require prospective recipients of a contract or grant in excess of an amount equal to the simplified acquisition threshold[5] to: (1) certify that they do not have such a tax debt and (2) authorize the Secretary of the Department of the Treasury to disclose information describing whether they have such a tax debt. Additionally, in the Fiscal Year 2010 budget, the Department of the Treasury proposed 2 changes to debt collection procedures that will increase the amount of delinquent taxes collected from Federal contractors by an estimated $2 billion over 10 years. Specifically, the changes propose to:

1) Modify administrative requirements so the Department of the Treasury can levy a payment much sooner in the debt collection process.

2) Increase the amount of tax debt the Department of the Treasury can collect from a payment made to Federal contractors.

On January 20, 2010, President Obama issued a Presidential Memorandum for the Heads of Executive Departments and Agencies directing the Commissioner of the Internal Revenue Service (IRS) to conduct a review of the annual self-certifications of taxes owed for those

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[1] *Some Department of Defense Contractors Abuse the Federal Tax System With Little Consequence* (GAO-04-414T, dated February 2004).
[2] *Thousand of GSA Contractors Abuse the Federal Tax System* (GAO-06-492T, dated March 2006).
[3] Contracting and Tax Accountability Act of 2009, H.R. 572, 111th Congress (2009).
[4] The legislation defines "seriously delinquent tax debt" as an outstanding tax debt for which a Notice of Federal Tax Lien has been filed in public records.
[5] See Appendix IV for a glossary of terms.

contractors bidding for Federal contracts.[6] The Commissioner was to provide a report by April 20, 2010,[7] on the overall accuracy of the contractors' certifications. Also, the President directed the Department of the Treasury and the Office of Management and Budget to evaluate agencies' contract award processes and make recommendations to ensure that contractors with serious tax delinquencies do not receive new work from Federal agencies. President Obama called the steps "basic common sense," but said they alone will not eliminate all instances of contractor abuse. He stated "it is simply wrong for companies to take taxpayer dollars and not be taxpayers themselves." He further stated "we need to insist on the same sense of responsibility in Washington that so many of you strive to uphold in your own lives, in your own families, and in your own businesses."

This review was performed in the Agency-Wide Shared Services Office of Procurement in Oxon Hill, Maryland, during the period January 2009 through July 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[6] The self-certifications are maintained on the Online Representations and Certifications Application System.
[7] As of August 4, 2010, we have not received a copy of the requested report.

Results of Review

Additional Oversight and Internal Controls Need to Be Strengthened at the Time Contracts Are Awarded to Contractors With Delinquent Tax Liabilities

Our review of IRS Procurement Request Transaction System records of 135 active contractors (that received at least 1 contract award greater than or equal to $250,000 from October 2006 through December 2008) identified 20 (15 percent) with delinquent tax liabilities and penalties totaling approximately $5.2 million.[8] Six of these contractors had delinquent tax liabilities totaling approximately $943,000 when they were awarded the contracts. In January 2008, Agency-Wide Shared Services Policy and Procedures Memorandum[9] established standard procedures for IRS contracting officers to apply when determining the financial health of prospective contractors who owe delinquent taxes. Specifically:

- Contracting officers are required to request the Director, Office of Revenue Reporting, to complete a tax check to determine the existence of tax indebtedness. The information is returned to the contracting officer within 2 business days and forwarded to the Director, Office of Procurement Policy.
- The Director, Office of Procurement Policy, conducts a financial capability survey, which includes reviewing Dun and Bradstreet financial reports.

Contracts were awarded without the completion of tax checks and financial capability surveys

For 7 (39 percent) of the 20 contractors,[10] IRS contracting officers did not request the required tax checks before awarding the contracts. As a result of our discussions with IRS personnel, we determined that:

- Five contractors were awarded contracts, but contract files did not include any documentation that tax checks were completed before the contracts were awarded. The

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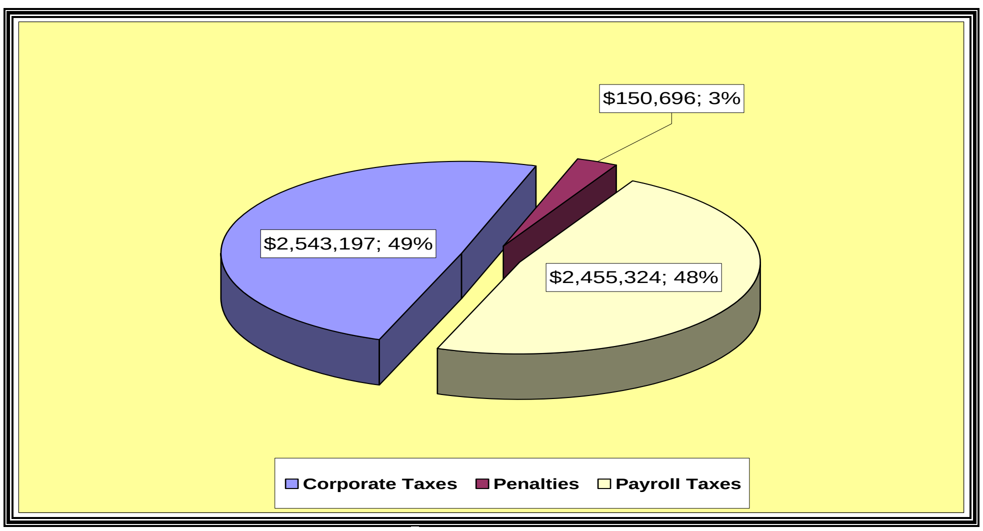
[8] We analyzed the tax accounts for the 20 contractors from February 25 through March 11, 2009, to identify the $5.2 million in current tax liabilities and penalties.
[9] Agency-Wide Shared Services Policy and Procedures Memorandum No. 9.1 (dated January 1, 2008) provides that IRS employees will complete a tax check on prospective contractors for all IRS solicitations over $250,000.
[10] The percentage calculation is based on 18 because 2 contractors were Federal agencies. Tax checks are not required when the IRS enters into a contract with another Federal agency.

IRS could not provide an explanation as to why these checks were not completed, but took immediate actions to complete the checks after we discussed our results.

- One contractor, for which a financial capability survey was performed, was awarded the contract without documentation of a tax check in the contract file.
- One contractor's contract file had documentation stating that the IRS was waiving the required tax check because it was relying on a prior determination made by the General Services Administration.

Our review of the data included in the tax checks showed only limited information was provided to help IRS employees evaluate the significance of the delinquent tax liabilities. For example, the tax checks did not indicate the types of taxes outstanding (i.e., corporate or payroll), the ages of the tax debts, or if the contractors had taken steps to establish installment agreements to repay the taxes. We performed further research of the contractors' tax accounts to determine the specific types of taxes that were outstanding. Figure 1 shows a breakdown of the types and percentages of taxes and penalties owed for the 20 contractors that had delinquent tax liabilities at the time of our review.

Figure 1: Delinquent Tax Liabilities Owed by 20 Contractors



Source: Our analysis of contractors' delinquent tax liabilities based on IRS data.

Federal laws, statutes, and the Federal Acquisition Regulation govern the roles and responsibilities of IRS procurement officials. Their responsibility in awarding contracts is the same as that of any other Federal agency procurement office. We were advised by Office of Procurement Policy officials that they are required to complete the tax checks. However, although tax indebtedness may indicate serious issues that could jeopardize contract performance, Federal guidelines prevent the IRS from using this information to preclude a contractor from obtaining a contract. The financial capability survey provides additional information about a contractor's overall financial position and the ability to carry out the terms of the contract even with the contractor's delinquent tax liability. However, our results showed that Office of Procurement Policy employees did not complete the financial capability survey for 5 (25 percent) of the 20 contractors. All five of these contractors had delinquent tax liabilities at the time the contracts were awarded.

Contractors received $541 million in revenue from the IRS, but had not established installment agreements to repay outstanding delinquent tax liabilities.

When a contract is awarded to a contractor that has a delinquent tax liability, the Director, Collection Policy, is notified that a contract was issued to a contractor with a Federal tax debt. The Director, Collection Policy, determines whether the information should be referred to a Revenue Officer to conduct a courtesy investigation. The purpose of the investigation is to resolve the outstanding delinquencies (i.e., establish an installment agreement to repay the outstanding taxes) and identify sources of income available for the IRS to levy. Our results showed that none of the 20 contractors had established installment agreements. Furthermore, as of March 2009, the 7 contractors that did not have completed tax checks received payments from the IRS that totaled approximately $541 million.

The completion of these investigations is critical because on April 14, 2008, the House of Representatives passed the Contracting and Tax Accountability Act of 2008.[11] The Act was not signed into law, but would have prevented firms with "seriously delinquent tax debts" from contracting with the Federal Government. The legislation defines "seriously delinquent" as any tax debt for which a Notice of Federal Tax Lien has been filed and does not apply to contracts below the simplified acquisition threshold of $100,000. Our review found that none of the contractors had a lien filed on their tax accounts. However, when the IRS does not complete the required tax checks and financial capability surveys, it is not clear how the IRS can ensure it is effectively evaluating the risk that contractors may not be able to fulfill their contractual obligations.

In addition, contractors are taxpayers themselves, and they should be held accountable to the same tax compliance requirements as IRS employees and new requirements for paid preparers. Specifically:

- Congress implemented Section 1203(b)(8) of the IRS Restructuring and Reform Act of 1998[12] to ensure that IRS employees are held to a high standard with respect to the tax legislation and regulations they are required to administer and enforce. Supplemental internal IRS documents state that IRS employees must also pay Federal, State, and local

[11] Bill H.R. 4881 (2008).
[12] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

income taxes accurately and do so on time. Failure to meet these tax obligations can result in disciplinary action, and even loss of employment.

- On January 4, 2010, the IRS initiated its Paid Preparer Strategy, which requires all preparers to register with the IRS. As part of this registration process, preparers will have to disclose whether they are compliant with their Federal taxes. By Calendar Year 2013, the IRS will conduct automated tax checks. If the IRS determines that certain preparers are untruthful, they will be unable to lawfully prepare Federal tax returns for a fee.

Although IRS contractors are not considered employees, they are conducting business and doing work on behalf of the agency whose mission is to ensure taxpayers meet their tax responsibilities. As a result, we believe IRS contractors should be held to the same ethical standards as IRS employees and paid preparers concerning their compliance with the Nation's tax laws. Lack of tax compliance by IRS employees has an adverse impact on voluntary compliance and also the perception that the IRS is a fair and ethical Government agency.

President Obama and Congress view increased enforcement on tax evasion as a way to reduce the tax gap. The Department of the Treasury's Office of Tax Policy issued *A Comprehensive Strategy for Reducing the Tax Gap*,[13] stating its commitment to reduce the tax gap through enforcement activities. In its Fiscal Year 2008 Annual Report, the IRS' Oversight Board reported that the tax gap was a serious systemic weakness that must be addressed and is a real cost to taxpayers. The Annual Report stated that the tax gap, which is unacceptably high, deprives the Nation and its people of $290 billion in tax revenue each year that should be collected. It further cited, "…. if the tax gap was zero, the Federal Government would have an additional $290 billion each year that it could either spend on programs or refund to taxpayers."

Recommendations

Recommendation 1: The Deputy Commissioner for Operations Support should convene senior IRS executives to discuss the IRS' response to the Administration's January 20, 2010, request to evaluate its contract award processes and make process improvement recommendations to ensure that contractors with serious tax delinquencies do not receive additional work from Federal agencies.

> ***Management's Response:*** IRS management agreed with this recommendation. They will initiate an internal review and will work with the Office of Federal Procurement Policy within the Office of Management and Budget to gain a better understanding of the role contracting officers can and should play in conducting tax checks on contractors doing business with the Federal Government under the Federal Acquisition Regulations. The IRS will engage the Office of Federal Procurement Policy to determine what authorities the Federal Acquisition Regulations may grant or what

[13] Office of Tax Policy HP-111(September 26, 2006).

limitations it may impose and how those authorities and limitations may affect the awarding of contracts to contractors with seriously delinquent tax liabilities.

Recommendation 2: The Chief, Agency-Wide Shared Services, should ensure all required tax checks and financial capability surveys are performed before contracts are awarded.

Management's Response: IRS management agreed with this recommendation. Policy and Procedure 9.1, "Tax Checks on Prospective Contractors" establishes procedures for Contracting Officers to obtain and use information concerning the Federal tax indebtedness of prospective contractors and subcontractors in a responsibility determination, in accordance with Federal Acquisition Regulation 9.103, in all IRS solicitations over $250,000. One tool that helps to ensure that the required documentation is included in all contract files is the mandatory use of the applicable contract file checklists, in accordance with Policy and Procedure 4.1, :File Content Checklists." "Completion of Tax Check" is Item No 19.d of Section III of the Pre-Award Documents checklist. The tax check record is just one item considered when the Contracting Officer makes a responsibility determination prior to contract award, in accordance with Federal Acquisition Regulations subpart 9.1. The Office of Procurement Policy has conducted "Lessons Learned" training throughout Procurement this year based on quality assurance review findings and internal contract file auditing efforts, which included an emphasis on the use of the required contract file checklists. Two separate lessons learned training sessions were also conducted for managers who review contract files to emphasize key areas to review for compliance. Future contract file review workshops will include tax check responsibilities.

Additional Actions Are Needed to Ensure Contractors Are Compliant at the Time Contracts Are Renewed

Guidelines do not require IRS employees to complete tax checks or financial capability surveys at the time a contract is being considered for renewal. Therefore, an annual tax check is not performed because it can only be used in relation to a responsibility determination. As a result, contractors who may have become delinquent or noncompliant since the initial award date can continue to receive Federal payments without being subject to additional tax checks. Our analyses of procurement records showed the IRS renewed contracts for 17 contractors, of which 6 had delinquent tax liabilities totaling over $943,000 at the time of the original award. As of March 2009, these same contractors' delinquent tax liabilities have increased by more than 500 percent to approximately $4.9 million. The remaining 11 contractors did not have

Six contractors' delinquent tax liabilities have increased 500 percent to $4.9 million since the time of the original award.

delinquent tax liabilities at the time of the awards, but their delinquent tax liabilities subsequently increased to $286,877. Figure 2 shows the number and the range of dollar increase in delinquent tax liabilities for the 17 contractors whose contracts were renewed by the IRS.

Figure 2: Increase in Delinquent Tax Liabilities Owed by 17 Contractors[14]

Number of Contractors	Dollar Increase in Delinquent Tax Liabilities
7	$1 to $2,000
3	$2,001 to $20,000
3	$20,001 to $100,000
**1 **	**1**
1	**1**

Source: Our analyses of delinquent tax liabilities of contractors offered contract renewals.

It is the Federal Government's policy to award contracts only to responsible prospective contractors.[15] In order to determine the responsibility of a prospective contractor, the IRS contracting officer must examine the contractor's financial capability, production capabilities, performance record, integrity, experience, organization, accounting practices, operational controls, and technical skills. However, neither the Federal Acquisition Regulation nor the IRS has established guidelines that require the completion of a tax check at the time the decision is made to exercise an option to renew a contract. Furthermore, annual tax checks are not required for contractors that are awarded multiyear contracts.

If a tax compliance check was required prior to renewing a contract, it would provide contracting officers with updated information to evaluate the contractor's financial position and the ability to carry out the terms of the contract. In addition, the sharing of this information with the Director, Collection Policy, will provide a source of income the IRS has available to levy. We are currently conducting a separate review to evaluate if the IRS is effectively using the Federal Payment Levy Program[16] to collect payments from contractors with delinquent tax liabilities. If the IRS continues to conduct business with contractors that do not comply with the Nation's tax laws, an adverse message will be sent to the American taxpayers as to the fairness of the tax administration system.

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[14] Eleven of these contractors either did not have tax liabilities at the time the contracts were awarded or their tax liabilities could not be determined because tax checks were not completed. The number of contractors in the table does not equal 17 because we ****1*************************.

[15] Federal Acquisition Regulation, 48 C.F.R. ch. 1 (2009). See Subpart 9.103.

[16] IRS Contractors Whose Accounts Are Blocked From the Federal Payment Levy Program (Audit Number 201030029). The Federal Payment Levy Program is an automated program that levies up to 15 percent of payments disbursed to taxpayers with delinquent Federal taxes.

Recommendation

Recommendation 3: The Chief, Agency-Wide Shared Services, should establish procedures requiring the Office of Procurement Policy to complete an annual tax check for all IRS contractors. In addition, the Director, Collection Policy, should be notified when subsequent tax delinquencies occur after the initial contract is awarded.

> ***Management's Response:*** IRS management disagreed with this recommendation. Agency policies implement Federal laws and regulations. As there is no Federal law or regulation that authorizes a Contracting officer to complete an annual responsibility determination, there is no justification to obtain an annual tax check. The tax check record is only used by the Contracting Officer to assist in making a determination regarding contractors' responsibility issues prior to the initial contract award, in accordance with Federal Acquisition Regulations subpart 9.1. A tax check is cursory, unverified tax account information that is not actionable as the contractor has had no due process in regard to the tax check information and tax liability has not been finally determined.
>
> ***Office of Audit Comment:*** We continue to believe the IRS should establish procedures requiring a completed annual tax check for all contractors and the Director, Collection Policy, should be notified when subsequent delinquencies occur after the initial award. Our review showed that several contractors with multiple-year contracts continued to increase their outstanding tax liabilities and obligations to the IRS. A change in procedures requiring annual tax checks would enable the IRS to determine if a contractor has become seriously delinquent in their tax liabilities. Contractors that have become seriously delinquent would be at risk of not having the ability to carry out the terms of their contract.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine whether businesses contracting to provide services to the IRS are compliant with Federal tax laws, including filing and paying Federal income taxes and withholding and paying employment and withholding taxes. To accomplish our objective, we:

I. Determined whether contractors with delinquent tax liabilities are prohibited by law from receiving contracts from the Federal Government.

   A. Identified regulations governing the awarding of IRS contracts by reviewing the following documentation:

      1. IRS directives.
      2. Internal Revenue Manuals.
      3. Federal Acquisition Regulation.[17]
      4. Department of the Treasury Acquisition Regulations.

II. Interviewed personnel within the Office of Procurement Policy to determine which IRS management information system contained contractor data and other relevant information regarding current active contracts.

III. Researched the IRS Procurement Request Transaction System to identify contractors with active contracts and awards greater than $250,000.

   A. Selected a judgmental sample of 20 contractors from a population of 135 contractors[18] with contracts greater than or equal to $250,000 from October 2006 to December 2008. We only selected contractors with delinquent tax liabilities and used judgmental sampling because we did not plan to project our results.

   B. Determined if the required tax checks and financial capability surveys were completed.

   C. Identified contracts with a renewal options.

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[17] See Appendix IV for a glossary of terms.
[18] Our analyses identified the Treasury Inspector General for Tax Administration as part of the population of 135 contractors that have contracts with the IRS. The contract was related to our agency providing Defense Contract Audit Agency Services.

IV. Used the Integrated Data Retrieval System to research the tax accounts of sampled contractors.

   A. Identified contractors with delinquent tax liabilities and tax liens.

   B. Determined if contractors established installment agreements to repay unpaid taxes.

V. Discussed the results of our test with IRS personnel to determine why the conditions identified existed.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the IRS' policies and procedures for awarding contracts to contractors who have tax indebtedness. We evaluated these controls by researching and evaluating policies and procedures, analyzing procurement folders, and reviewing the tax accounts for 20 IRS contractors.

Appendix II

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Frank W. Jones, Director
Marybeth Schumann, Director
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Appendix III

Report Distribution List

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- Chief, Agency-Wide Shared Services OS:A
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Appendix IV

Glossary of Terms

Corporate Taxes – Corporate tax refers to a tax imposed on entities that are taxed at the entity level in a particular jurisdiction. Such taxes may include income or other taxes. The tax generally is imposed on net taxable income.

Federal Acquisition Regulation – A regulation established to codify uniform policies for acquisition of supplies and services by executive agencies.

Financial Capability Surveys – The Federal Acquisition Regulation 9.104-1(a) describes that a contracting officer will evaluate a prospective contractor to determine that it has adequate financial resources to perform the contract, or the ability to obtain them.

Integrated Data Retrieval System – The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

Levy – A levy generically refers to seizure of property to collect a debt. For tax debts, it is the legal process by which the IRS orders a third party to turn over property in its possession (e.g., the Federal Government payment) that belongs to the tax debtor.

Notice of Federal Tax Lien – A lien is a legal claim to the property of the taxpayer as security for a tax debt. The Federal tax lien arises when the liability is assessed, Notice and Demand for Payment has been sent, and the taxpayer neglects or refuses to fully pay the debt after 10 days from the issuance of the Notice and Demand. After that time, the IRS may file a Notice of Federal Tax Lien in the public records. The purpose of filing the Notice of Federal Tax Lien is to protect the Government's right of priority against certain third-party creditors. It puts the public on notice that a Federal tax lien exists and that the taxpayer owes the IRS money. Generally, the Federal tax lien will continue until the liability is satisfied or becomes unenforceable by lapse of time (collection statute expires) or until a bond is accepted in the amount of the liability.

Payroll Taxes – Amounts employers withhold from employee's wages for Federal income taxes, Social Security, and Medicare, as well as the employer's mandatory matching contributions for Social Security and Medicare taxes.

Responsibility Determination – Signifies that the Government has judged the contractor to have the means and ability to complete the contract in question.

Revenue Officer – IRS employees who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS.

Simplified Acquisition Threshold – Thresholds are used to identify contracts where procurement officials do not have to apply certain requirements required by the Federal Acquisition Regulation. For example, this threshold is established at $100,000.

Tax Check – Procedures for contracting officers to obtain and use information concerning the Federal tax indebtedness of prospective contractors and subcontractors in a responsibility determination.

Tax Gap – The difference between the annual Federal tax obligation and the amount of tax the taxpayer pays voluntarily and timely. The tax gap consists of those who do not file their returns, those who do not make their payments on time, and those who file returns but underreport their income or over report their expenses.

Appendix V

Management's Response to the Draft Report

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

CHIEF
AGENCY-WIDE
SHARED SERVICES

October 29, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: David A. Grant
Chief, Agency-Wide Shared Services

SUBJECT: Federal Guidelines Do Not Prohibit the Awarding of Contracts to Contractors with Delinquent Tax Liabilities (Audit #200830051)

We are in receipt of the Treasury Inspector General for Tax Administration's (TIGTA) recent audit concerning the awarding of contracts to contractors with delinquent tax liabilities. We have received TIGTA's final report, *Federal Guidelines Do Not Prohibit the Awarding of Contracts to Contractors with Delinquent Tax Liabilities* (Audit #200830051), which includes the IRS' response in Appendix V and TIGTA's Office of Audit Comments.

TIGTA initiated this audit to determine whether businesses providing contracting services to the IRS are compliant with Federal tax laws, including filing and paying Federal income taxes, withholding and paying employment and withholding taxes. In the report, TIGTA made three recommendations: 1) convene its senior executives to discuss its response to the Administration's January 20, 2010 request to evaluate IRS contract award processes and make process improvement recommendations to ensure that contractors with serious tax delinquencies do not receive additional work from federal agencies; 2) ensure all required tax checks and financial capability surveys are performed before contracts are awarded – we agreed with this recommendation; 3) establish procedures requiring the Office of Procurement Policy to complete an annual tax check for all IRS contractors and to notify the Director, Collection Policy, when subsequent tax delinquencies occur after the initial contract is awarded – we disagreed with this recommendation.

With regard to Recommendation #1, we are initiating an internal review and will work with the Office of Federal Procurement Policy (OFPP) within the Office of Management and Budget to gain a better understanding of the role Contracting Officers can and should play in conducting tax checks on contractors doing business with the Federal Government under the Federal Acquisition Regulations (FAR). We will engage OFPP to determine what authorities the FAR may grant or what limitations it may impose, and

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how those authorities and limitations may affect the awarding of contracts to contractors with seriously delinquent tax liabilities.

If you have any questions, please contact me at (202) 622-7500 or Fred W. Martin, Director, Procurement, at (202) 283-1200.

cc: Mark A. Ernst, IRS Deputy Commissioner for Operations Support

RECOMMENDATION #1: The Deputy Commissioner for Operations Support should convene senior IRS executives to discuss the IRS' response to the Administration's January 20, 2010 request to evaluate its contract award processes and make process improvement recommendations to ensure that contractors, with serious tax delinquencies, do not receive additional work from Federal agencies.

CORRECTIVE ACTION TO RECOMMENDATION #1: We agree to initiate an internal review and will work with the Office of Federal Procurement Policy (OFPP) within the Office of Management and Budget (OMB) to gain a better understanding of the role Contracting Officers can and should play in conducting tax checks on contractors doing business with the Federal Government under the Federal Acquisition Regulations (FAR). We will engage OFPP to determine what authorities the FAR may grant or what limitations it may impose, and how those authorities and limitations may affect the awarding of contracts to contractors with seriously delinquent tax liabilities.

IMPLEMENTATION DATE: February 16, 2012

RESPONSIBLE OFFICIAL: Chief, Agency-Wide Shared Services

CORRECTIVE ACTION MONITORING PLAN: Corrective Actions will be tracked in the JAMES system until completion.

RECOMMENDATION #2: The Chief, Agency-Wide Shared Services, should ensure all required tax checks and financial capability surveys are performed before contracts are awarded.

CORRECTIVE ACTION TO RECOMMENDATION #2: We agree with this recommendation. Policy and Procedure (P&P) 9.1, "Tax Checks on Prospective Contractors," establishes procedures for Contracting Officers to obtain and use information concerning the Federal tax indebtedness of prospective contractors and subcontractors in a responsibility determination, in accordance with FAR 9.103, in all IRS solicitations over $250,000. One tool that helps to ensure that the required documentation is included in all contract files is the mandatory use of the applicable contract file checklists, in accordance with P&P 4.1, "File Content Checklists." "Completion of Tax Check" is Item No. 19.d of Section III of the Pre-Award Documents checklist. The tax check record is just one item considered when the Contracting Officer makes a responsibility determination prior to contract award, in accordance with FAR subpart 9.1.

The Office of Procurement Policy has conducted "Lessons Learned" training throughout Procurement this year based on quality assurance review findings and internal contract file auditing efforts, which included an emphasis on the use of the required contract file checklists. Two separate lessons learned training sessions were also conducted for managers who review contract files to emphasize key areas to review for compliance. Future contract file review workshops will include tax check responsibilities.

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IMPLEMENTATION DATE: Completed

RESPONSIBLE OFFICIAL: Director, Procurement

CORRECTIVE ACTION MONITORING PLAN: N/A

RECOMMENDATION #3: The Chief, Agency-Wide Shared Services, should establish procedures requiring the Office of Procurement Policy to complete an annual tax check for all IRS contractors. In addition, the Director, Collection Policy, should be notified when subsequent tax delinquencies occur after the initial contract is awarded.

CORRECTIVE ACTION TO RECOMMENDATION #3: We disagree with this recommendation. Agency policies implement Federal laws and regulations. As there is no Federal law or regulation that authorizes a Contracting Officer to complete an annual responsibility determination, there is no justification to obtain an annual tax check. The tax check record is only used by the Contracting Officer to assist in making a determination regarding contractors' responsibility issues prior to the initial contract award, in accordance with FAR subpart 9.1.

A tax check is cursory, unverified tax account information that is not actionable as the contractor has had no due process in regard to the tax check information and tax liability has not been finally determined.

IMPLEMENTATION DATE: NA

RESPONSIBLE OFFICIAL: NA

CORRECTIVE ACTION MONITORING PLAN: NA