



*Contractor Employees Have
Millions of Dollars of Federal Tax Debts*

August 30, 2013

Reference Number: 2013-10-082

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.

Phone Number / 202-622-6500

E-mail Address / TIGTACommunications@tigta.treas.gov

Website / <http://www.treasury.gov/tigta>



HIGHLIGHTS

CONTRACTOR EMPLOYEES HAVE MILLIONS OF DOLLARS OF FEDERAL TAX DEBTS

Highlights

Final Report issued on August 30, 2013

Highlights of Reference Number: 2013-10-082 to the Internal Revenue Service Deputy Commissioner for Operations Support.

IMPACT ON TAXPAYERS

The IRS requires that its own employees file their Federal tax returns on time and pay any Federal tax debt. However, TIGTA identified hundreds of employees working for IRS contractors (contractor employees) who were not held to that same standard. The IRS should address tax noncompliance for these contractor employees to ensure that all individuals employed by the IRS, whether as Federal employees or contractor employees, are tax compliant.

WHY TIGTA DID THE AUDIT

The overall objective of this audit was to determine the effectiveness of the IRS's background investigation process to identify contractor employees who do not file required Federal tax returns or who owe Federal taxes but are not currently on a payment plan.

WHAT TIGTA FOUND

As of June 14, 2012, 691 (5 percent) of the 13,591 IRS contractor employees reviewed by TIGTA had \$5.4 million in Federal tax debt. These Federal tax debts were either agreed to by the taxpayers or affirmed by the court. Of the 691 contractor employees, 352 were not currently on a payment plan to resolve their tax debt. Most of the contractor employees appeared to have been compliant when their initial staff-like access was granted. However, at least 319 contractor employees had tax debt assessed after they were granted staff-like access, and these employees were not currently on a payment plan. Under IRS policy, these 319 contractor employees were not eligible for staff-like access and should not have had

access to IRS facilities, systems, and data.

TIGTA identified five IRS contractor employees who either did not file required tax returns or filed them late but were still granted staff-like access. TIGTA also identified 13 IRS contractor employees who were tax compliant at the time staff-like access was granted but who subsequently failed to file a required Federal tax return while assigned to an active IRS contract.

TIGTA identified weaknesses in the IRS's existing practices that allowed contractor employees with Federal tax debts and instances of nonfiling to go undetected after staff-like access was initially granted because the IRS does not continuously monitor contractor employee tax compliance in the same way it monitors IRS employee tax compliance. Instead, the IRS reviews contractor tax compliance only every five years or if the contractor employee has longer than a two-year break in service.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS continuously monitor contractor employee tax compliance similar to the way IRS employee Federal tax compliance is monitored. In addition, TIGTA recommended that when revalidating contractor employee staff-like access after a break in service longer than two years, the IRS should complete a tax compliance check. Finally, TIGTA recommended that the IRS further evaluate the contractor employees TIGTA identified as potentially noncompliant and promptly bring those individuals into compliance or remove them from IRS contracts.

In their response, IRS management agreed with our recommendations and plans to establish and implement policies to ensure that contractor employee tax compliance is continuously monitored and background clearance revalidations include a tax compliance component. In addition, the IRS plans to further research and carefully evaluate the contractor employees identified in this report as potentially noncompliant and refer them for additional action as appropriate. Finally, the IRS plans to convene a team to fully explore all viable options to address any future tax noncompliance.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 30, 2013

MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Contractor Employees Have Millions of Dollars
of Federal Tax Debts (Audit # 201210029)

This report presents the results of our review of the background clearance process for contractor employees. The overall objective of our audit was to determine the effectiveness of the Internal Revenue Service (IRS) background investigation process to identify contractor employees who do not file required Federal tax returns or who owe Federal taxes but are not on a payment plan. This review is included in the Treasury Inspector General for Tax Administration's Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Security for Taxpayer Data and Employees.

Management's complete response to the draft report is included as Appendix IV. Copies of this report are also being sent to the IRS managers affected by the report recommendations.

If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).



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Background

Federal agencies of the U.S. Government contract with independent contractor companies to accomplish Government business. Because Federal contractors and their employees are frequently paid in whole or in part from funds appropriated by Congress, it is imperative that these entities and their employees remain in full compliance with all Federal tax laws. The Internal Revenue Service (IRS) collected about \$2.4 trillion in Federal taxes in Fiscal Year¹ 2011 and employed approximately 93,000 Federal employees. In addition to Federal employees, the IRS also maintains a contractor employee workforce, many of whom work side by side with IRS employees. As of June 2012, there were approximately 14,500 IRS contractor employees assigned to active contracts who had “staff-like” access (unescorted access) to IRS facilities and/or access to sensitive but unclassified data in IRS information systems.

Contractor employees who require escorted or unescorted (staff-like) access to IRS facilities, or work on contracts that involve the design, operation, repair, or maintenance of information systems and/or require access to sensitive but unclassified information or security items or products, must meet the following three eligibility criteria before a full background investigation will be initiated:

- Must be compliant with Federal taxes. Must have filed all required Federal tax returns and paid all taxes due or be current on a payment plan for taxes due.²
- Must be a U.S. citizen or have lawful permanent residency, depending on the contractor employee’s risk level.
- For all males born after 1959, must be registered with Selective Service or have an exception.

Contractor employees are required to undergo background investigations if their duration of employment exceeds 180 days. If the duration of employment is less than 180 days or access is

¹ A 12-consecutive-month period, ending on the last day of any month. The Federal Government’s fiscal year begins on October 1 and ends on September 30.

² The IRS considers a contractor to be tax compliant if the individual has filed all required Federal tax returns for the last three years, and if any tax debt balances are due, the individual must be current on a payment plan or part of an active bankruptcy proceeding. For information on bankruptcy proceedings, see Internal Revenue Code Section 5.9.4.18, *Installment Agreements and Bankruptcy, Protection of the Taxpayer’s Rights* (Jan. 2011). The IRS protects taxpayer’s rights while the debtor is under the protection of the bankruptcy court. Therefore, an installment agreement should be regarded as suspended – not terminated – during the pendency of a bankruptcy proceeding. In a follow-up audit, we plan to review the adequacy of the IRS’s controls over the background clearance process, including those controls that would prevent granting staff-like access to individuals with significant financial problems.



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infrequent (*i.e.*, two to three days per month), and the contractor requires unescorted access, the contractor employee must meet the previously mentioned eligibility requirements and must undergo Federal tax compliance and fingerprint check screenings (but does not have to undergo a complete background investigation). A contractor employee who has been approved for interim or final staff-like access requires no escort while in an IRS owned or controlled facility. Approved contractor employees may be granted access to information systems, data, or sensitive but unclassified information, no matter where the work will be located.

Once staff-like access is granted to an IRS contractor, the background investigation, including the tax compliance component, is reinvestigated only every five years. In addition, if a contractor employee takes less than a two-year break in service while under the initial five-year investigation period, the contractor employee's access can be "revalidated." According to current IRS policy, a revalidation does not require another tax compliance review. However, if a contractor employee is assigned to a different contract prior to the expiration of the five-year period and the new duties are at a higher risk level, the contractor employee is required to undergo a new investigation at the higher risk level. A new tax check is conducted with the new investigation.

The IRS reported that retired and active Federal employees owed more than \$3.5 billion in unpaid Tax Year³ 2011 Federal income taxes. The delinquency rate for Federal workers and retirees was 3.2 percent in 2011, while the delinquency rate for the Department of the Treasury, which includes the IRS, was 1.1 percent. The U.S. population as a whole has a delinquency rate of 8.2 percent. Currently, only IRS employees can be terminated for nonpayment of Federal income taxes. All IRS employees are required to file and pay Federal taxes accurately and on time. In order to ensure that IRS employees meet their tax obligations, the IRS matches its employee database with information available from the Integrated Data Retrieval System⁴ three times a year to identify potential employee noncompliance. The IRS Restructuring and Reform Act of 1998⁵ made mandatory the removal of IRS employees who are found to have intentionally committed certain acts of misconduct, including willful failure to timely file a Federal tax return and willful understatement of their Federal tax liability. For IRS employees, failure to timely pay one's full Federal tax liability does not require mandatory removal; however, it is still considered misconduct and may result in discipline up to and including removal.

Recent legislation has been introduced that would require the termination of current tax delinquent Federal employees and would also prohibit the hiring for Federal employment

³ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁴ The Integrated Data Retrieval System is an IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

⁵ 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.).



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individuals with documented serious delinquent tax debts.⁶ While the IRS does require contractor employees to be tax compliant at the time an interim staff-like access determination is made and when a reinvestigation is required on a five-year cycle, there are currently no requirements for contractor employees to be monitored for tax compliance during this five-year period.

The IRS maintains a file of all “unpaid assessments.” These unpaid assessments are legally enforceable claims against taxpayers and consist of taxes, penalties, and interest that have not been paid or abated. For the purposes of this report, we refer to these unpaid assessments as Federal tax debts. These Federal tax debts are generally created when a taxpayer files a return without full payment, an IRS audit identifies additional amounts owed, and the IRS makes adjustments to correct inaccuracies on a return. In addition, a Federal tax debt can be identified as a part of IRS enforcement programs. These enforcement programs generally identify taxpayers who fail to file or timely file required Federal returns, accurately report their taxes, or voluntarily pay the amount of taxes due. The IRS classifies its total Federal tax debt inventory into the following four categories:

- Taxes receivable: Assessments that are self-assessed by the taxpayer, an agreed examination, a court ruling in favor of the IRS, *etc.*
- Compliance: Assessments not agreed to by the taxpayer.
- Write-Offs: Assessments that the IRS still has the statutory authority to collect, but for which there is no collection potential.
- Memo: Assessments that are not receivables according to Federal financial standards, including duplicate assessments, assessments due to a fraudulent return filed by a taxpayer, assessments involving many tax periods with related and/or intermingled issues, and instances in which an examination/appeal will not be resolved for more than one year.

Under Federal accounting standards, Federal tax debts require taxpayer or court agreement to be considered Federal tax receivables. Because of this distinction, when we refer to Federal tax debts in this report, we are referring to those debts that require taxpayer or court agreement that are classified by the IRS as taxes receivable and write-offs. Compliance and memo assessments are not considered Federal taxes receivable because they have not been agreed to by the taxpayers or the courts.

We held discussions with personnel and/or analyzed data obtained from the Agency-Wide Shared Services Office of Procurement in Oxon Hill, Maryland; the Agency-Wide Shared Services Physical Security and Emergency Preparedness Office in Washington, D.C., and

⁶ H.R. 249, *Federal Employee Tax Accountability Act of 2013* (Jan. 15, 2013). The bill defines seriously delinquent tax debt as an outstanding tax debt for which a notice of lien has been filed in public records.



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Florence, Kentucky; and the Human Capital Office in Washington, D.C., during the period June 2012 through March 2013. We assessed the effectiveness of the controls over the background investigation process for determining contractor tax compliance, specifically looking at certain types of Federal tax debt and failure to file required tax returns. 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.



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Results of Review

Contractor Employees Owe Almost \$5.4 Million in Federal Tax Debt

Although the IRS has controls to prevent contractor employees who have Federal tax debts or who have not filed required Federal tax returns from obtaining staff-like access, we found weaknesses in the IRS's existing practices that allowed contractor employees with Federal tax debts and instances of nonfiling to go undetected after staff-like access was initially granted. We determined that 691 (5 percent) of the 13,591 contractor employees⁷ assigned to active IRS contracts had almost \$5.4 million in Federal tax debts. However, the IRS considers a potential contractor employee to be tax compliant and, therefore, eligible to work on an IRS contract, if the individual's tax debt is part of a current payment plan. We identified 352 contractor employees, with Federal tax debts totaling \$2.7 million dollars as of June 14, 2012,⁸ who were not on a payment plan to resolve their tax debt. In addition, we identified 13 contractor employees who were tax compliant at the time staff-like access was granted but who subsequently failed to file a required Federal tax return. The IRS must immediately address noncompliance for these contractor employees to ensure that individuals employed by the IRS, whether as Federal employees or contractor employees, are tax compliant.

These almost \$5.4 million in Federal tax debts were almost exclusively associated with individual income tax returns.⁹ The majority of the contractor employees (65 percent) had Federal tax debts from only one calendar year; however, 30 contractor employees had Federal tax debts from five or more tax years. Figure 1 shows information related to the number of tax years of Federal tax debt by contractor employee.

⁷ We obtained a list of active contractor employees as of October 22, 2012, who received staff-like access on or before June 30, 2012. There were 910 additional contractor employees listed in this database for which we could not identify a complete Social Security Number, which was required to perform our data analysis. The IRS began requiring a complete Social Security Number in April 2011. Due to the incomplete data, we removed these individuals from our analysis.

⁸ Information on these Federal tax debts is as of June 14, 2012, because this is the most recent date that data were available at the time our analysis was performed. All figures in this report related to the number of contractor employees, the amount of tax balances due, and the status of contractor employee installment agreements are based on our analysis of IRS data as of June 14, 2012.

⁹ Approximately \$500 of the \$5.4 million in Federal tax debts was related to Individual Retirement Accounts or other savings plans.



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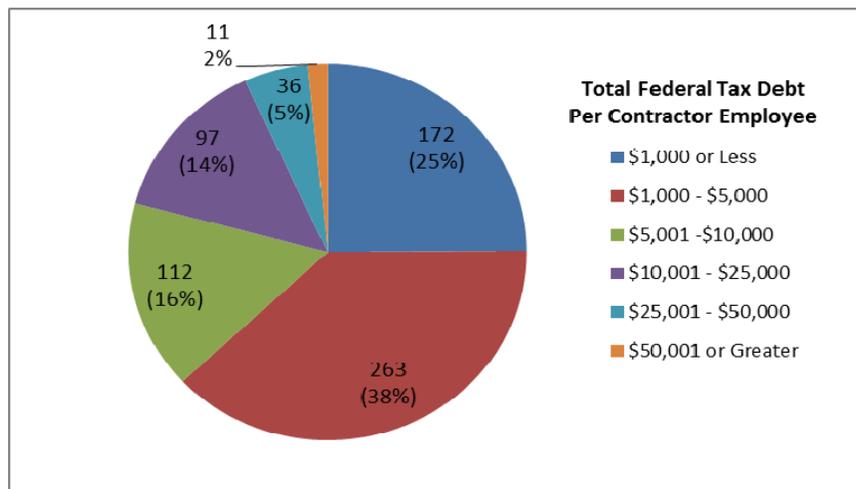
**Figure 1: Number of Tax Years That
Contractor Employees Incurred Federal Tax Debts**

Number of Tax Years	Number of Contractor Employees	Total Federal Tax Debt
1 tax year	452	\$1,960,226
2 tax years	123	\$968,520
3 tax years	60	\$758,770
4 tax years	26	\$1,012,066
5 or more tax years	30	\$688,936
Total	691	\$5,388,518

Source: Analysis of the IRS unpaid assessment file. Federal tax debt amounts shown in this table include only those that are agreed to by the taxpayer or affirmed by the court. All information is current as of June 14, 2012.

Almost 80 percent of the 691 contractor employees with Federal tax debts owed \$10,000 or less. However, 11 contractor employees owed more than \$50,000 each. These 11 employees had Federal tax debts that ranged from around \$64,000 to a high of around \$184,000, for a total of \$1.1 million in Federal tax debt. Figure 2 shows the distribution of total Federal tax debt by the size of the various debts.

Figure 2: Size of Federal Tax Debt for Contractor Employees



Source: Analysis of the IRS unpaid assessment file. Federal tax debt amounts shown in this table include only those that are agreed to by the taxpayer or affirmed by the court. All information is current as of June 14, 2012.



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We determined that of the 691 contractor employees who had a Federal tax debt, 339 were on a payment plan. These 339 had Federal tax debts totaling \$2.7 million. The IRS considers a potential contractor employee to be tax compliant and, therefore, eligible to work on an IRS contract, if the individual's tax debt is part of a payment plan. However, 352 of the 691 contractor employees, with Federal tax debt totaling an additional \$2.7 million, were not on a payment plan to resolve their tax debt. Figure 3 shows the number of contractor employees and whether they were part of a payment plan.

Figure 3: Contractor Employee Federal Tax Debt

Type of Assessment	Number of Contractor Employees	Total Federal Tax Debt
Federal tax debt, on a payment plan	339	\$2.7 million
Federal tax debt, not on a payment plan ¹⁰	352	\$2.7 million
All Federal tax debts	691	\$5.4 million

Source: Analysis of the IRS unpaid assessment file. Federal tax debt amounts shown in this table include only those that are agreed to by the taxpayer or affirmed by the court. All information is current as of June 14, 2012.

A contractor employee could have Federal tax debts that originated before he or she was granted staff-like access, after staff-like access was granted, or both. Of the 691 contractor employees we identified as having Federal tax debts, at least 556 contractor employees had at least one Federal tax debt that originated after the contractor employee obtained staff-like access.¹¹ Of these 556 contractor employees with Federal tax debts that originated after staff-like access was granted, 319 were not on a payment plan to resolve their tax debt.

¹⁰ We found that our data analysis could not systematically identify individuals who were engaged in bankruptcy proceedings. Individuals who are part of bankruptcy proceedings are considered tax compliant by the IRS; therefore, these figures could overstate the number of contractor employees with tax debt that are not tax compliant. In a future audit, the Treasury Inspector General for Tax Administration plans to look at the broader issue of IRS policies related to hiring contractor employees with known financial problems.

¹¹ The IRS maintains two separate systems to track the contractor background investigation process – the Personal Identity Verification Background Investigation Process database maintained by the Physical Security and Emergency Preparedness Office, and the Automated Background Investigation System maintained by the Human Capital Office. For approximately one-third of the contractor employees, the earliest access date on record in the Automated Background Investigation System was before the earliest access date on record for the Personal Identity Verification Background Investigation Process database. We used the Personal Identity Verification Background Investigation Process database to perform our analysis, which is a more conservative approach. Therefore, it is possible that more than 556 contractor employees with Federal tax debts had debts that originated after they obtained staff-like access.



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We selected for further review the 50 contractor employees with the largest Federal tax debts from the 691 contractor employees we identified as having Federal tax debts. As of June 14, 2012, these 50 contractor employees had Federal tax debts that ranged from approximately \$24,000 to \$184,000, for a total of \$2.4 million in Federal tax debts. The Federal tax debts for these 50 contractor employees can be categorized as follows:

- 28 contractor employees (56 percent) had Federal tax debts that originated before staff-like access was granted. We confirmed that all 28 contractor employees were on a payment plan or engaged in bankruptcy proceedings and, therefore, were considered tax compliant at the time staff-like access was granted.¹² However, as of June 14, 2012, IRS records show that 15 of the 28 contractor employees were no longer tax compliant because they were not on a payment plan while assigned to an active IRS contract. In addition, 17 of the 28 contractor employees incurred another instance of Federal tax debt that originated after access was granted.
- 22 contractor employees (44 percent) had Federal tax debts that originated after staff-like access was granted. IRS records show that, of these 22, seven IRS contractor employees were not on a payment plan as of June 14, 2012.

In addition, we determined that of these 50 contractor employees:

- 16 contractor employees (32 percent) had an outstanding Federal tax debt for which a notice of lien had been filed in public records.
- 12 contractor employees (24 percent) had an outstanding State tax debt for which a notice of lien had been filed in public records.
- 10 contractor employees (20 percent) had both an outstanding Federal and State tax debt for which a notice of lien had been filed in public records.

In addition to the 50 contractor employees previously discussed, we reviewed tax information for 29 contractor employees who had agreed-to Federal tax debts that originated prior to their staff-like access and who were not on a payment plan as of June 14, 2012.¹³ Of these 29, we confirmed that all 29 contractor employees were on a payment plan or engaged in a bankruptcy proceeding and therefore were considered tax compliant at the time that staff-like access was granted. We found that six (21 percent) of the 29 were on a payment plan at the time their staff-like access was granted but subsequently defaulted on their payment plan.

¹² As mentioned previously, we plan to conduct a follow-up audit that will examine contractor employee bankruptcy and other financial and integrity issues.

¹³ In total, we identified 50 contractor employees who had Federal tax debts that originated prior to their earliest access date recorded who were not on a payment plan as of June 14, 2012. Eleven of the 50 were also in the top 50 contractor employees by total unpaid taxes and, therefore, were previously researched. Of the remaining 39 contractor employees, we selected 29 to research further. We eliminated 10 contractor employees from further review because their total Federal tax debt was less than \$500 as of June 14, 2012.



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In total, 21 (27 percent) of the 79 contractor employees who we selected for further review were on a payment plan or engaged in a bankruptcy proceeding at the time staff-like access was granted but defaulted on a payment agreement after staff-like access was granted. On average, these contractor employees defaulted on their payment plans 192 calendar days (less than seven months) after obtaining staff-like access. Some of these contractor employees were responsible for physical and information technology security activities, such as monitoring security cameras, checking badges, physical patrol, and security analysis and strategic planning and tactical support to integrate IRS cybersecurity activities.

Existing practices allowed the Federal tax debts of contractor employees to go undetected after interim access was granted

There were at least 319 contractor employees assigned to active IRS contracts with agreed-to tax debts that originated after staff-like access was granted who were not on a payment plan as of June 14, 2012.¹⁴ These 319 individuals had almost \$2 million in Federal tax debts. Unlike IRS employees, contractor employees are not monitored for tax compliance after the initial staff-like access is granted. According to IRS policies, the tax compliance of contractor employees is reinvestigated only every five years. In addition, if a contractor employee takes less than a two-year break in service (was not assigned to an active IRS contract during this period) while under the initial five-year investigation period, the employee's staff-like access can be revalidated. According to current IRS policies, a revalidation does not require another tax check.

Due to limitations in the databases that store information on IRS contractor employees, we could not confirm that all 319 employees were actively employed on any specific date as IRS contractor employees as of June 14, 2012. However, these contractor employees were assigned to active contracts and were, therefore, eligible to work on IRS contracts. The IRS told us that due to the nature of many of its contracts, contractor employees can frequently change their status from active to inactive; however, the IRS tracking system cannot tell which contractor employees are working on any given day.

IRS data show that in the past 10 years more than 400 IRS employees were removed from employment, retired, or resigned after being investigated for having one or more tax compliance issues. We asked the IRS for information on how many contractor employees had either been denied staff-like access or removed from a contract due to tax compliance issues, and we were told that the systems that track contractor employee background investigations do not capture

¹⁴ As previously mentioned, the IRS maintains two separate systems to track the contractor background investigation process: the Personal Identity Verification Background Investigation Process and the Automated Background Investigation Process System. For approximately one-third of the contractor employees, the earliest access date on record in the Automated Background Investigation Process System was before the earliest access date on record for the Personal Identity Verification Background Investigation Process. We used the Personal Identity Verification Background Investigation Process database to perform our analysis, which is a more conservative approach. Therefore, it is possible that more than 319 contractor employees with Federal tax debts were not in a payment plan as of June 14, 2012, and had debt that originated after they obtained a clearance.



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information in a way that would allow the IRS to systematically identify how many contractor employees were denied access or had access revoked due to tax issues.

We determined that some of the 319 contractor employees with Federal tax debts that originated after staff-like access was granted and who were not on payment plans had access to sensitive IRS systems such as those:

- Used to research tax cases, track money-laundering and other currency flow activities, and investigate leads.
- Used for tracking the status of assets seized during criminal investigations.
- Related to the IRS's Computer Security Incident Response Center.

Ensuring that all individuals employed by the IRS, whether as Federal employees or as contractor employees, are tax compliant is essential to the tax administration mission of the IRS.

Existing practices allowed contractor employee nonfiling to go undetected

We identified five contractor employees who had either missing or delinquent (late) Federal tax returns at the time they were granted staff-like access and 13 contractor employees who were tax compliant at the time staff-like access was granted but who subsequently failed to file a required Federal tax return. We also identified 79 contractor employees who appeared to have missing or late returns at the time they were granted staff-like access. We asked the IRS to research 40 of these 79 cases. Of these 40 contractor employees, 35 were tax compliant at the time interim access was granted. However, the IRS confirmed that the remaining five contractor employees either did not file required tax returns and thus were improperly granted staff-like access due to human error during the tax compliance screening process or submitted documentation to support that a return was filed but never actually filed that return. In addition, 13 contractor employees were tax compliant at the time staff-like access was granted but failed to file a required return subsequent to receiving their staff-like access. In four of the 13 cases, the contractor employees went through the revalidation process, but this process does not require a follow-up tax check.

IRS officials explained that when a contractor moves from one contract to another within five years of the date on which they were granted staff-like access, and less than a two-year break in service has occurred, a revalidation is completed instead of a complete background investigation. During this revalidation process, a tax compliance check is not performed. It is not until five years have elapsed that the IRS specifically determines whether contractor employees remain tax compliant.



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Recommendations

The IRS Chief Human Capital Officer should:

Recommendation 1: Establish and implement policies and procedures to ensure that contractor employee tax compliance is continuously monitored, similar to the way IRS Federal employee tax compliance is monitored. The IRS Human Capital Officer should work with the Chief, Agency-Wide Shared Services, to implement any necessary contractual provisions to inform contractors of the established policies.

Management's Response: The IRS agreed with this recommendation and stated that it will establish and implement policies to ensure that contractor employee tax compliance is continuously monitored. The IRS indicated, however, that currently there is no systemic means of continuously monitoring contractor employees' tax compliance. The IRS stated that it can conduct manual tax checks annually and establish a cross-functional team comprised of members from the Human Capital Office, Information Technology, and Agency-Wide Shared Services to create a systemic process that would allow for the matching and monitoring of systems related to the contractor background investigations process and the Integrated Data Retrieval System. Further, the IRS stated that once a systemic process is developed, it can conduct tax checks more frequently, similar to IRS employees.

Recommendation 2: Establish and implement policies and procedures to require that contractor employee background investigation revalidations, which occur when a contractor employee has had a longer than a two-year break in service, include a tax compliance component.

Management's Response: The IRS agreed with this recommendation and will incorporate tax compliance checks during the revalidation process.

Recommendation 3: Ensure that any contractor employees we identified in this report as potentially noncompliant are further evaluated and that any contractor employees who are not tax compliant are promptly brought into compliance or removed from IRS contracts (including removal of access to IRS facilities, information systems, and taxpayer data).

Management's Response: The IRS agreed with this recommendation. The IRS secured additional information on the contractor employees identified in this report as potentially noncompliant and has begun reviewing the 691 records to determine if they are still active contractor employees and whether they are still potentially noncompliant. The IRS plans to carefully evaluate each of these cases and refer them for additional action as appropriate. Additionally, the IRS will convene a team to fully explore all viable options to address any future noncompliance.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of our audit was to determine the effectiveness of the IRS background investigation process to identify contractor employees who do not file required Federal tax returns or who owe Federal taxes but are not on a payment plan. To accomplish this objective, we:

- I. Assessed the adequacy of the internal control environment and agency compliance with established Federal regulations and agency policies for the IRS contractor employee background investigation program as it relates to tax compliance.
 - A. Obtained and reviewed current Department of the Treasury, IRS, and other policies and procedures for requesting, processing, monitoring, and adjudicating background investigations on contractor employees.
 - B. Interviewed key IRS personnel from the Office of Procurement; the Contractor Security Management Branch, Incident and Contract Management Division, Physical Security and Emergency Preparedness Office; and the Personnel Security Office, Employment, Talent and Security, Human Capital Office, to identify and document their roles and responsibilities in the contractor employee background investigation program, and the procedures and practices utilized in executing those responsibilities.
- II. Determined whether background investigations of contractor employees are adequately performed to identify any tax compliance issues before contractor employees are granted interim access to work on IRS contracts.
 - A. Obtained an extract of the Personal Identity Verification Background Investigation Process database showing contractor employees assigned to work on active IRS contracts who have background investigations that were successfully completed or were in progress as of June 30, 2012.¹ To determine the reliability of the data, we verified whether all records contained a complete Social Security Number, and we compared the Social Security Numbers and last names of the contractor employees to the Social Security Numbers and name controls on the National Account Profile² to identify Social Security Numbers that are incorrect in Personal Identity Verification Background Investigation Process data. There were 910 additional contractor

¹ Upon receiving an interim staff-like access, contractor employees are eligible for unescorted access to IRS facilities and information systems.

² The National Account Profile contains IRS and Social Security Administration information for name control, date of birth, and date of death for each Taxpayer Identification Number.



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employees listed in this database for which we could not identify a complete Social Security Number, which was required to perform our data analysis. The IRS began requiring a complete Social Security Number in April 2011. Due to the incomplete data, we removed these individuals from our analysis. In addition, we identified 95 incorrect contractor Social Security Numbers and corrected these numbers before using the data. Finally, we compared the earliest access date on record in the Personal Identity Verification Background Investigation Process database with the earliest staff-like access date on record in the Automated Background Investigation Process. For approximately one-third of the contractor employees, the earliest staff-like access date on record in the Automated Background Investigation Process System was before the earliest access date on record for the Personal Identity Verification Background Investigation Process database. We used the Personal Identity Verification Background Investigation Process database to perform our analysis, which was a more conservative approach. We determined that the data were sufficiently reliable for our purposes but made the adjustments previously mentioned for the limitations we identified.

- B. Evaluated the tax compliance of the contractor employees identified from Step II.A.
1. Matched the contractor employees who had been granted at least interim staff-like access with the IRS unpaid assessments file to identify all contractor employees with Federal tax debts as of June 14, 2012.³
 2. Determined whether any tax compliance issues identified were present at the time the contractor employee was granted interim access for the IRS contract.
 3. Determined the number of contractor employees and the dollar value of any uncollected tax assessments occurring before and after staff-like access approval.
 4. For the 50 contractor employees with the largest total dollar value of Federal tax debts, further research was conducted using the Integrated Data Retrieval System⁴ and the Consolidated Lead Evaluation and Reporting public records database.

³ The IRS classifies its total Federal tax debt inventory into the following four categories: 1) taxes receivable: assessments that are self-assessed by the taxpayer, an agreed examination, a court ruling in favor of the IRS, *etc.*; 2) compliance: assessments not agreed to by the taxpayer; 3) write-offs: assessments that the IRS still has the statutory authority to collect, but for which there is no collection potential; and 4) memo: assessments that are not receivables according to Federal financial standards, including duplicate assessments, assessments due to a fraudulent return filed by a taxpayer, assessments for which many tax periods are involved with related and/or intermingled issues, and instances in which an examination/appeal will not be resolved for more than one year. We analyzed those Federal tax debts that were either agreed to by the taxpayers or affirmed by the court, represented by categories one and three.

⁴ The Integrated Data Retrieval System is an IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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- C. Evaluated the tax filing history of the contractor employees identified from Step II.A.
 - 1. Matched the contractor employees with the Individual Master File⁵ to identify contractor employees who had not filed Individual Tax Returns during the three prior tax years⁶ (2009, 2010, and 2011).⁷
 - 2. Determined whether any tax compliance issues identified were present at the time the contractor employee was granted interim access for the IRS contract.
- D. Determined how the IRS monitors contractor employee tax compliance after granting interim access and completion of the full background investigation in order to identify tax compliance issues.

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: IRS Human Capital Office and Physical Security and Emergency Preparedness Office procedures for background investigations for contractor employees. We evaluated these controls by interviewing management, reviewing documentation, and reviewing a judgmental sample of cases.

⁵ The Individual Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁶ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁷ These tax years are the only tax years available at Treasury Inspector General for Tax Administration's data warehouse. Thus, we limited our analysis to these tax years.



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Appendix II

Major Contributors to This Report

Gregory Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Alicia Mrozowski, Director
Heather Hill, Audit Manager
Darryl Roth, Audit Manager
Dana Karaffa, Acting Audit Manager
Gary Pressley, Lead Auditor
Melvin Lindsey, Senior Auditor
Trisa Brewer, Auditor
Evan Close, Auditor
Allison Meyer, Auditor



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Appendix III

Report Distribution List

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Appendix IV

Management's Response to the Draft Report



HUMAN CAPITAL OFFICE

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

July 30, 2013

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: David A. Krieg *David A. Krieg*
IRS Human Capital Officer

SUBJECT: Draft Audit Report – Contractor Employees Have
Millions of Dollars of Federal Tax Debt (Audit # 201210029)

Thank you for the opportunity to provide comments on the draft audit report *Contractor Employees Have Millions of Dollars of Federal Tax Debt* issued July 2, 2013. I understand the seriousness of this issue as it relates to both our mission and responsibility to enforce tax law with integrity and fairness to all and therefore agree with all three recommendations. Employee tax compliance is a key foundation of the public's trust in the IRS.

The IRS remains committed to working with all contractor employees to help resolve their tax liabilities. We agree we can strengthen our existing practices by implementing all of the recommendations. The attachment contains our planned corrective actions to address each finding.

We value your continued support to strengthen IRS's processes. If you have any questions, please contact me or a member of your staff may contact Becky Barber, Director, Employment, Talent and Security at 202-622-7011.

Attachment



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Attachment

The IRS Human Capital Officer should:

RECOMMENDATION 1: Establish and implement policies and procedures to ensure that contractor employee tax compliance is continuously monitored, similar to the way IRS Federal employee tax compliance is monitored. The IRS Human Capital Officer should work with the Chief, Agency-Wide Shared Services to implement any necessary contractual provisions to inform contractors of the established policies.

CORRECTIVE ACTION 1: We agree to establish and implement policies to ensure contractor employee tax compliance is continuously monitored. However, currently, there is no systemic means of continuously monitoring contractor employees' tax compliance. We can conduct manual tax checks annually and establish a cross-functional team comprised of members from the Human Capital Office, Information Technology, and Agency Wide Shared Services to create a systemic process that would allow for the matching and monitoring of systems related to the contractor background investigation process and the Integrated Data Retrieval System (IDRS). Once a systemic process is developed, we can conduct tax checks more frequently, similar to IRS employees.

IMPLEMENTATION DATES:

- Establish and implement policy and procedures to ensure contractor employees are monitored annually - December 31, 2013
- Begin conducting annual tax compliance checks manually - January 31, 2014
- Implement any necessary contractual provisions with respect to new contract actions to inform contractors of the established policies - March 31, 2014
- Automate the tax compliance check process and increase frequency to twice a year - January 31, 2015

RESPONSIBLE OFFICIAL:

IRS Human Capital Officer

CORRECTIVE ACTION MONITORING PLAN:

We will enter accepted Corrective Actions into the Joint Audit Management Enterprise System (JAMES) and monitor them on a monthly basis until completion.



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RECOMMENDATION 2: Establish and implement policies and procedures to require that contractor employee clearance revalidations, which occur when a contractor employee has had less than a 2-year break in service, require a tax compliance component.

CORRECTIVE ACTION 2: We agree with this recommendation. We currently conduct a tax check during the pre-screening phase and as part of the reinvestigation process conducted every 5 years. We will incorporate tax compliance checks during the revalidation process.

IMPLEMENTATION DATES:

- Establish and implement policies and procedures that incorporate a tax compliance component into the contractor employees revalidation process - December 31, 2013
- Begin incorporating tax compliance checks into the revalidation process - January 31, 2014

RESPONSIBLE OFFICIAL:

IRS Human Capital Officer

CORRECTIVE ACTION MONITORING PLAN:

We will enter accepted Corrective Actions into the Joint Audit Management Enterprise System (JAMES) and monitor them on a monthly basis until completion.

RECOMMENDATION 3: Ensure that any contractor employees we identified in this report as potentially noncompliant are further evaluated and any contractor employees that are not tax compliant are promptly brought into compliance or removed from IRS contracts (including removal of access to IRS facilities, information systems and taxpayer data).

CORRECTIVE ACTION 3: We agree with this recommendation. We secured additional information on the contractor employees identified in this report as potentially noncompliant and have already begun reviewing the 691 records to determine if they are still active contractor employees and whether they are still potentially noncompliant. We plan to carefully evaluate each of these cases and refer them for additional action as appropriate. Additionally, we will convene a team to fully explore all viable options to address any future noncompliance.



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IMPLEMENTATION DATES:

- Conduct further analysis on the 691 contractor employees identified in the report as potentially noncompliant - August 15, 2013
- Address noncompliant of contractor employees and update any policies and procedures accordingly - March 31, 2014

RESPONSIBLE OFFICIAL:

IRS Human Capital Officer

CORRECTIVE ACTION MONITORING PLAN:

We will enter accepted Corrective Actions into the Joint Audit Management Enterprise System (JAMES) and monitor them on a monthly basis until completion.