

**GAO**

Testimony

Before the Subcommittee on Oversight,  
Committee on Ways and Means,  
House of Representatives

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**TAX DEBT**

**Some Combined Federal  
Campaign Charities Owe  
Payroll and Other Federal  
Taxes**

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





Highlights of [GAO-06-755T](#), a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

### Why GAO Did This Study

The Office of Personnel Management (OPM) administers the annual Combined Federal Campaign (CFC), which gave more than 22,000 charities access to the federal workplace, helping those in need by collecting more than \$250 million in donations during the 2005 campaign. The success of the campaign is predicated on each donor's confidence in a system that ensures donations reach charitable organizations that have met the CFC's specific eligibility requirements and are legitimate charities. For example, to be eligible, each charity must have formally received from the Internal Revenue Service (IRS) tax-exemption designation under 501(c)(3) of the Internal Revenue Code.

The Subcommittee on Oversight is reviewing tax-exempt status entities and asked GAO to determine whether charitable organizations participating in the CFC were remitting their payroll and other taxes to the IRS as required by law. Specifically, GAO was asked to investigate and determine whether and to what extent (1) charities listed in the 2005 CFC have unpaid payroll and other taxes; (2) selected charities, their directors or senior officers are abusing the federal tax system; and (3) OPM screens charities for federal tax problems before allowing them to be listed with the CFC.

[www.gao.gov/cgi-bin/getrpt?GAO-06-755T](http://www.gao.gov/cgi-bin/getrpt?GAO-06-755T).

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

## TAX DEBT

# Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes

### What GAO Found

More than 1,280 CFC charities, or about 6 percent of charities in the OPM-administered 2005 campaign, had tax debts totaling approximately \$36 million as of September 30, 2005. The majority of delinquent charities owed less than \$10,000. Approximately \$28 million of this debt represented payroll taxes, penalties, and interest dating back as far as 1988. The remaining \$8 million represented annual reporting penalties, excise taxes, exempt organization business income, unemployment taxes, and other types of taxes and penalties during this same period. Further, at least 170 of the charities with tax debt received about \$1.6 billion in federal grants in 2005.

GAO investigated 15 CFC charities, selected primarily for the amount and age of their outstanding tax debt. All 15 charities engaged in abusive and potentially criminal activity related to the federal tax system. Although exempt from certain taxes (e.g., federal income tax), these charities had not forwarded payroll taxes withheld from their employees along with other taxes to the IRS. Willful failure to remit payroll taxes is a felony under U.S. law. However, rather than fulfill their role as trustees of this money and forward it to the IRS, the directors and senior officers diverted the money for charity-related expenses, including their own salaries, some of which were in excess of \$100,000. We referred all 15 of these charities to the IRS for consideration of additional collection or criminal investigation.

#### Examples of Abusive and Potentially Criminal Activity by CFC Charities

Type of charity	Tax debt	Charity activity
Museum	Over \$100,000	Repeatedly underpaid payroll taxes. Federal and local liens were filed against the charity. The IRS assessed a penalty against personal assets of the director who admitted to underpaying payroll taxes to fund operations.
Health service provider	Over \$400,000	Repeatedly remitted payroll taxes late while accruing interest and penalties. Executives were paid through a contractor that received \$3 million from the charity. Received more than \$2 million in federal grants from the Department of Health and Human Services.
Mental health clinic	Over \$1.5 million	Repeatedly failed to remit or to remit timely payroll taxes for the last 15 years. Director diverted payroll tax to pay his and employee salaries.

Source: GAO's analysis of IRS, public and other records.

OPM does not screen CFC charities for federal tax problems or independently validate with the IRS whether the charity is truly a tax-exempt organization. Federal law prevents OPM from accessing taxpayer information required to screen for tax delinquency, although information on exempt status is available to the public. Consequently, OPM was unaware of the charities that owed federal tax debt and cannot provide assurance that the more than 22,000 participating charities are tax-exempt organizations. To demonstrate the vulnerability of this process, GAO created a fictitious charity and successfully applied to three large local campaigns.

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Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to assist the subcommittee as it reviews tax-exempt organizations. This testimony builds on our experience investigating entities that have abused the federal tax system<sup>1</sup> while benefiting from doing business with the federal government.<sup>2</sup> Today, our testimony addresses whether organizations exempt from federal income taxes were delinquent in remitting payroll and other federal taxes to the Internal Revenue Service (IRS) while participating in the 2005 Combined Federal Campaign (CFC).

The CFC, which is administered and promoted by the Office of Personnel Management (OPM) and about 300 local campaigns, gave more than 22,000 charities access to the federal workplace, where they collected more than \$250 million in donations during the 2005 campaign. The success of CFC has made a notable difference in the benefits provided to those in need. The CFC represents that it brings three unique qualities to those it serves—the three C’s of CFC—by offering donors a “choice” to select from thousands of charities to support, allowing the “convenience” of making payroll deductions, and ensuring donors’ “confidence” that charities listed with the campaign meet CFC’s specific eligibility requirements. In the spirit of ensuring that donors can trust their contributions are going to organizations that have met CFC’s specific eligibility requirements, and are legitimate charities, you asked us to investigate charities listed with the CFC.

Specifically, you asked us to investigate and determine whether and to what extent (1) charities listed in the 2005 CFC have unpaid payroll and other federal taxes; (2) selected charities, their directors or senior officers

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<sup>1</sup> We considered activity to be abusive when a 501(c)(3) organization’s actions (e.g., diversion of payroll tax funds) or inactions (e.g., failure to remit the annual Form 990 return, which is the basis for review of whether an organization continues to meet requirements for exempt status) 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.

<sup>2</sup> See GAO, *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, [GAO-06-492T](#) (Washington, D.C.: Mar. 14, 2006), *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-05-637](#) (Washington, D.C.: June 16, 2005), and *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-04-95](#) (Washington, D.C.: Feb. 12, 2004).

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are abusing the federal tax system; and (3) OPM screens charities for federal tax problems before allowing them to be listed with the CFC.

As you know, to qualify as exempt from federal income taxes, an organization must meet the requirements set forth in the Internal Revenue Code<sup>3</sup> and formally receive tax-exemption designation under 501(c)(3) to participate in the CFC. Regardless of tax-exempt status, all employers are required to withhold from their employees' wages payroll taxes for Social Security and Medicare and other taxes. Willful failure to remit payroll taxes is a felony under U.S. law.<sup>4</sup>

To determine whether and to what extent CFC 501(c)(3) charities had unpaid payroll and other federal taxes, we obtained and analyzed IRS unpaid tax debt data as of September 30, 2005. We matched organizations with unpaid tax debts to the CFC's list of charities that participated in the 2005 campaign.<sup>5</sup> To further analyze abuse of the federal tax system by selected charities, their directors, or senior officers, we applied certain criteria—the amount of outstanding tax debt, the number and age of reporting periods for which taxes were due, and the type of outstanding tax—to select 15 organizations for detailed audit and investigation. For these 15 organizations, we reviewed tax records and performed additional searches of criminal, financial, and other public records.

To determine whether OPM screens organizations for federal tax problems before allowing them to be listed with the CFC, we identified the legal criteria for doing so and gained an understanding of the screening process through meetings with OPM's Office of CFC Operations and others responsible for processing applications. To test OPM's process of screening for legitimate charities, we created a fictitious charity and applied to three large campaigns in various parts of the country. We also matched the CFC's list of charities that participated in the 2005 campaign against the list of all tax-exempt organizations identified by the IRS to

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<sup>3</sup> 26 U.S.C. § 501(c)(3).

<sup>4</sup> 26 U.S.C. § 7202.

<sup>5</sup> The campaign cycle for CFC consists of a 2-year reporting period, which marks the beginning of a campaign and the end of a campaign. Most campaigns will begin operation on or about March 15 of the first year of the campaign and end around March 14 2 years later, depending on the final disbursement for the campaign. For example, March 15, 2005, begins the fall 2005 campaign and March 14, 2007, marks the end of the fall 2005 campaign. Typically, the annual campaign runs for a 6-week period from September 1 through December 15. Actual dates may vary from one campaign to another.

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determine whether non-tax-exempt organizations participated in the 2005 campaign. For further details on our scope and methodology, see appendix I.

We conducted our audit work from January 2006 through May 2006 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.

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## Summary

More than 1,280 CFC charities had tax debts totaling at least \$35.6 million as of September 30, 2005. This represented nearly 6 percent of the charities that participated in the OPM-administered 2005 campaign. Of this debt, \$27.7 million represented payroll taxes, penalties, and interest dating back as far as 1988. The remaining \$7.9 million includes annual reporting penalties, excise taxes, exempt organization business income taxes, unemployment taxes, and other types of taxes and penalties. The majority of the 1,280 delinquent charities, 78.6 percent, owed less than \$10,000 in delinquent taxes. The \$35.6 million in delinquent taxes is likely understated because we took a conservative approach to identifying the amount of tax debt owed to the IRS by CFC charities. The delinquent tax totals do not include amounts for charities that do not file required tax returns and related taxes or charities that underreport unrelated business income or payroll taxes.

In addition to CFC donations, we found that more than 170 of these tax-delinquent charities received about \$1.6 billion in federal grants during fiscal year 2005. Five of 15 case study charities we reviewed in detail were among the more than 170 charities that received federal grants. These 5 charities received grants from the Departments of Health and Human Services (excluding Medicaid) and Education that totaled more than \$6.5 million.

Our detailed audit and investigation of the 15 CFC charities with tax debt and their directors or senior officers identified abusive and potentially criminal activity. Although charities are exempt from certain taxes (e.g., federal income tax), the executives of the 15 charities we investigated were required by law but failed in their roles as "trustees" to forward payroll taxes to the IRS, which include amounts withheld from their employees' wages for Social Security, Medicare, and the employer's matching portion of these taxes and individual income taxes.

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During interviews, three of the 15 selected charities' executives denied owing payroll and other taxes when IRS records showed otherwise. Executives from 5 other charities explained that they knowingly withheld payroll taxes in order to have enough funds available to pay for charity activities and the salaries of charity employees. As a result of remitting tax payments late, the charities accumulated tens of thousands of dollars in penalties and interest. Our investigations also showed that several of the executives who potentially could be assessed trust fund recovery penalties for the debts of their charities had salaries in excess of \$100,000 and owned significant personal assets. In addition, according to independent audit reports, some of the charities appeared to have significant cash flow problems. Willful failure to remit payroll taxes is a felony under U.S. law.<sup>6</sup> We referred all 15 cases detailed in our report to the IRS so that it can determine whether additional collection action or criminal investigation is warranted.

Neither OPM nor the approximately 300 local campaigns dispersed throughout the United States screen charities for federal tax problems before allowing the charities to be listed with the CFC. OPM policies do not require such screening. Additionally, federal law generally prohibits the disclosure of taxpayer data and, consequently, even if OPM had specific policies to check for unpaid taxes, it has no access to a specific charity's tax data. The administration of CFC does not have the internal controls necessary to assure donors that charities listed with and backed by the CFC are meeting federal laws.

We also found that OPM, its local campaigns, and federations do not validate with the IRS each CFC applicant's tax-exempt status. To be eligible for the CFC, a charity must submit as part of its application a copy of a standard IRS letter showing that it has received tax-exemption status from the IRS under 501(c)(3) of the Internal Revenue Code.<sup>7</sup> To demonstrate the vulnerability of OPM's lack of validation of tax-exempt status, we applied as a fictitious charity to three local campaigns using fake documents and an erroneous IRS taxpayer identification number. In

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<sup>6</sup> 26 U.S.C. § 7202. Under section 7202, it must be shown that a defendant voluntarily and intentionally acted in violation of a known legal duty. *Cheek v. United States*, 498 U.S. 192 (1991).

<sup>7</sup> Exempt from this requirement are organizations seeking local eligibility in Puerto Rico or the U.S. Virgin Islands. However, these organizations must include in their applications, the appropriate local forms demonstrating their status as charitable organizations. 5 C.F.R. Pt. 950.204(b)(2)(iii).

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all three cases, our fictitious charity was accepted into the local CFC. Furthermore, our match of CFC charities from the 2005 campaign against IRS's database of tax-exempt organizations identified charities whose 501(c)(3) status could not be confirmed. Therefore, we referred these charities to OPM and IRS for further review and confirmation of their tax-exempt status.

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## More Than 1,280 CFC Charities Had Tax Debts Totaling \$35.6 Million

Based on our analysis, more than 1,280 CFC charities had federal tax debts totaling \$35.6 million as of September 30, 2005. This represented nearly 6 percent of the charities that participated in the OPM-administered 2005 campaign. \$27.7 million of this debt represented payroll taxes, penalties, and interest dating as far back as 1988. The remaining \$7.9 million includes annual reporting penalties, excise taxes, exempt organization business income, unemployment taxes, and other types of taxes and penalties. In performing our analysis, we took a conservative approach to identifying the amount of tax debt owed by the CFC's charities, and therefore the number of delinquent charities and amount due to the IRS are likely understated. We also found that at least 170 charities with unpaid taxes also benefited by receiving about \$1.6 billion in federal grants.

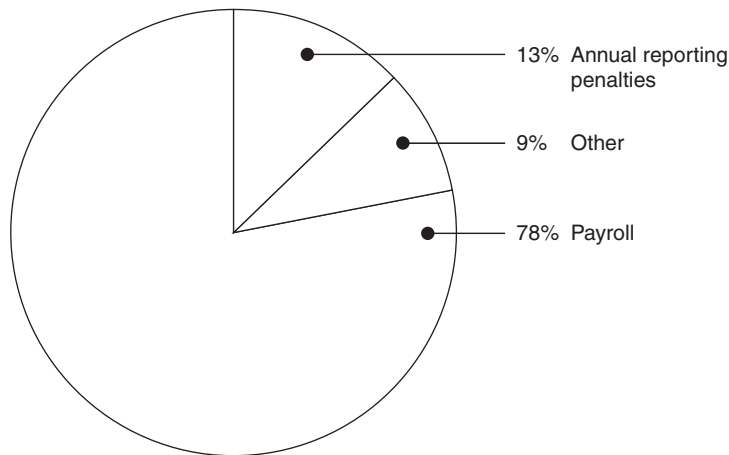
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## Unpaid Payroll Taxes Comprised Almost 80 Percent of Charities' Federal Tax Debt

As indicated in figure 1, payroll taxes comprised \$27.7 million, or almost 80 percent, of the \$35.6 million in unpaid federal taxes owed by CFC charities. Unpaid payroll taxes included amounts that were withheld from employees' wages for federal income taxes, Social Security, and Medicare but not remitted to the IRS, as well as the matching employer contributions for Social Security and Medicare. Employers who fail to remit payroll taxes to the federal government may be subject to civil and criminal penalties. Figure 1 shows the types of federal taxes owed by CFC charities as of September 30, 2005.

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**Figure 1: Types of Federal Tax Debt Owed by CFC Charities**



Source: GAO analysis of IRS data as of September 30, 2005 and 2005 CFC data.

The next largest component, annual reporting penalties, was \$4.5 million or almost 13 percent of the unpaid taxes. Generally, the IRS requires 501(c)(3) charities with more than \$25,000 of income to file an annual return (i.e., Form 990). This annual return serves as the basis for review in determining whether an organization continues to meet requirements for exempt status. Failure to file an annual return at all or in a timely manner, as well as filing an incomplete return, results in various types of penalties. Excise taxes related to employee benefit plans, exempt organization business income taxes, unemployment, and other types of taxes and penalties comprised the remaining \$3.4 million.

The majority of the approximately 1,280 delinquent charities, 78 percent, owed less than \$10,000 in delinquent taxes. Fifteen percent owed from \$10,000 to \$50,000, and 7 percent owed more than \$50,000 in delinquent taxes. Also, 91 percent of 1,280 charities were delinquent for up to 4 tax periods, 7 percent of charities for 5 to 9 tax periods, and 2 percent for 10 or more tax periods.<sup>8</sup>

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<sup>8</sup> A tax period varies by tax type. For example, the tax period for payroll and excise taxes is generally one quarter of a year. The taxpayer is required to file quarterly returns with IRS for these types of taxes, although payment of the taxes occurs throughout the quarter. In contrast, for income, corporate, and unemployment taxes, a tax period is 1 year.



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## Amount of Unpaid Federal Taxes Is Understated for CFC Charities

The amount of unpaid federal taxes we identified among CFC charities—\$35.6 million—is understated. To avoid overestimating the amount owed by CFC charities, we intentionally limited our scope to tax debts that were affirmed by either the charity or a tax court for tax periods prior to 2005.<sup>9</sup> We did not include the most current tax year because recently assessed tax debts that appear as unpaid taxes may involve matters that are routinely resolved between the taxpayer and the IRS, with the taxes paid, abated,<sup>10</sup> or both within a short period. We eliminated these types of debt by focusing on unpaid federal taxes for tax periods prior to calendar year 2005 and eliminating tax debt of \$100 or less.

Also limiting our estimate of CFC charities' unpaid federal taxes is the fact that the IRS tax database reflects only the amount of unpaid taxes either reported by the charity on a tax return or assessed by the IRS through various enforcement programs. The IRS database upon which we relied exclusively does not reflect amounts owed by charities that have not filed tax returns or that have underreported the owed taxes in their return and for which the IRS has not assessed tax amounts due. According to the IRS, underreporting of payroll taxes accounts for about \$60 to \$70 billion of the estimated \$345 billion annual gross tax gap. Consequently, the true extent of unpaid taxes for these charities is unknown.

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## Some CFC Charities with Delinquent Tax Debt Also Received Substantial Federal Grants

In performing our analysis, we identified at least 170 of the CFC charities with delinquent tax debt that also received federal grants totaling about \$1.6 billion from the Departments of Health and Human Services (excluding Medicaid), Education, and others in 2005. These charities are benefiting from the federal government through their tax-exempt status and receipt of substantial amounts of federal grants, while not meeting their responsibility to pay required federal taxes. Included in the \$1.6 billion are grants to 5 of the 15 charities we selected, totaling more than \$6.5 million.

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<sup>9</sup> We eliminated from our analysis all tax debt coded by IRS as not having been agreed to by the taxpayer (for example, by filing a balance due return) or a tax court. For financial reporting, those cases are referred to as compliance assessments.

<sup>10</sup> Abatements are reductions in the amount of taxes owed and can occur for a variety of reasons, such as to correct errors made by IRS or taxpayers or to provide relief from interest and penalties. 26 U.S.C. § 6404.

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## Certain CFC Charity Executives We Investigated Abused the Federal Tax System

Executives responsible for the tax debts of the 15 charities we investigated abused the federal tax system and may have violated the law by diverting payroll or other taxes due to the IRS. Willful failure to remit payroll taxes is a felony under U.S. law,<sup>11</sup> and the IRS can assess a trust fund recovery penalty (TFRP) equal to the total amount of taxes not collected or not accounted for and paid against all individuals who are determined by the IRS to be “willful and responsible” for the nonpayment of withheld payroll taxes.<sup>12</sup> In this regard, one executive from these 15 case study CFC charities was assessed a TFRP for what IRS determined to be his abusive behavior.

Table 1 highlights 5 of the 15 case study CFC charities that we investigated with payroll tax issues.

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<sup>11</sup> 26 U.S.C. § 7202.

<sup>12</sup> 26 U.S.C. § 6672. The amount of a TFRP does not include employers' matching amounts.

**Table 1: CFC Charities with Unpaid Federal Taxes**

Charity	Nature of the charity	Tax debt <sup>a</sup>	Comments
1	Museum	Over \$100,000	<ul style="list-style-type: none"> <li>Payroll tax debt covers more than 12 tax periods dating back to the mid 1990s.</li> <li>The IRS assessed a TFRP against the charity's director.</li> <li>Federal and local tax liens have been filed against the charity.</li> <li>The charity filed for bankruptcy protection in the past but the court denied the petition.</li> <li>The executive director admitted to underpaying payroll taxes to fund the charity's operations.</li> </ul>
2	Hospital	Nearly \$1 million	<ul style="list-style-type: none"> <li>Payroll tax debt covers more than 5 periods dating back several years.</li> <li>The charity paid two of its executives a salary of more than \$200,000 each.</li> <li>The charity received about \$1.5 million in federal grants from the Department of Health and Human Services (non-Medicaid) and the Department of Education.</li> </ul>
3	Mental health clinic	Over \$1.5 million	<ul style="list-style-type: none"> <li>Payroll tax debt covers more than 12 tax periods dating back to the early 1990s.</li> <li>The charity recently signed an installment agreement.</li> <li>Federal, state, and local tax liens have been filed against the charity.</li> <li>The executive director received a salary of more than \$100,000.</li> <li>The executive director admitted to underpaying payroll taxes to fund the charity's operations, which includes the director's salary.</li> </ul>
4	Homeless shelter	Over \$300,000	<ul style="list-style-type: none"> <li>Charity failed to submit payroll tax payments for more than 5 tax periods over several years.</li> <li>The executive director received a salary of more than \$100,000 per year.</li> </ul>
5	General health clinic	Over \$700,000	<ul style="list-style-type: none"> <li>Payroll tax debt covers 7 tax periods dating back over 5 years.</li> <li>The charity submitted an offer in compromise, which is pending.</li> <li>The chief executive officer received a salary of more than \$100,000 per year.</li> </ul>

Source: GAO's analysis of IRS, OPM, public, and other records.

<sup>a</sup>Tax debt amount includes principal, interest, and penalties as of September 30, 2005.

For the five charities in table 1, tax debt ranged from about \$100,000 to more than \$1.5 million, and the unpaid taxes spanned a period ranging from 5 to more than 12 payroll tax periods. In addition to the federal tax debt, two of the five CFC charities had unpaid state and/or local taxes, where state and/or local taxing authorities filed multiple tax liens against them.

During the time frames for which these charities were not paying their taxes, funds were available to cover other charity expenses, including officer salaries. Executives at two charities explained that they knowingly withheld payroll taxes in order to have enough funds available to pay their own salaries and the salaries of charity employees, in addition to charity expenses. One executive we investigated denied owing payroll or other

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taxes when IRS records showed otherwise. In at least one case, the charity's executives remitted payroll taxes later than the IRS required to pay their salaries, while the charity accumulated tens of thousands of dollars in penalties and interest for remitting late.

We also identified directors and senior executives who potentially could be assessed TFRPs by the IRS for the debts of their charities. Some of these directors and executives had salaries in excess of \$100,000 and owned significant personal assets. One of these executives has already been assessed a TFRP.

See appendix III for the details on the other 10 CFC charities reviewed in detail. We referred all 15 cases discussed in our report to the IRS so that it can determine whether additional collection action or criminal investigation is warranted.

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## OPM Does Not Screen Charities for Delinquent Tax Debt

OPM does not screen charities for federal tax debt prior to granting CFC eligibility, thereby making charities with unpaid federal taxes eligible to receive donations from federal civilian employees and military personnel. OPM policies do not specifically require CFC charities to be screened for these problems. Additionally, federal law generally prohibits the disclosure of taxpayer data and, consequently, even if OPM had specific policies to check for unpaid taxes, it has no access to a specific charity's tax data. OPM determines the completeness of a charity applicants' paperwork, but it does not perform third-party verification of documents as part of that process. For example, OPM does not verify with the IRS the tax-exempt status of CFC applicants and relies solely on each applicant's submission of IRS documentation that it is a bona fide charity. To demonstrate the vulnerability of OPM's lack of validation of tax-exempt status, we applied to three of CFC's largest local 2006 campaigns using a fictitious charity with entirely false documents and an erroneous IRS taxpayer identification number. We were accepted into all three campaigns.

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## Tax Debts Are Not Considered When Granting Charities Eligibility to Participate in the CFC

OPM does not screen charities for tax debts prior to granting CFC eligibility and, ultimately, charities with unpaid federal taxes are eligible to receive donations from federal civilian employees and military personnel. Federal law implemented in the Code of Federal Regulations does not require OPM to screen charities for federal tax delinquency nor does it explicitly authorize CFC to reject charity applicants that have delinquent tax debt from participation in the CFC. Consequently, CFC's processes for

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determining eligibility are based on and limited to what is required of the CFC in Part 950 of Title 5, C.F.R.

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### Restrictions on Tax Data Hamper Identification of Charities with Delinquent Taxes

Federal law does not permit the IRS to disclose taxpayer information, including tax debts.<sup>13</sup> Thus, unless the taxpayer provides consent, certain tax debt information can only be discovered from public records when the IRS files a federal tax lien against the property of a tax debtor.<sup>14</sup> However, public record information is limited because the IRS does not file tax liens on all tax debtors, and, while the IRS has a central repository of tax liens, OPM officials do not have access to that information. Further, the listing of a federal tax lien in the credit reports of an entity or its key officials may not be a reliable indicator of a charity's tax indebtedness because of deficiencies in the IRS's internal controls that have resulted in the IRS not always releasing tax liens from property when the tax debt has been satisfied.<sup>15</sup>

### OPM Does Not Verify Charity Applicant's Exempt Organization Status

Part 950 of Title 5 of the Code of Federal Regulations requires that applicants to the CFC include in their application packages a copy of their most recent IRS determination letter<sup>16</sup> showing the charity's 501(c)(3) status. OPM does not perform any independent verification of charity applicants' tax-exempt status. The IRS does have publicly available data wherein OPM could verify an applicant's tax exempt status, but this is not an OPM-required procedure in the CFC eligibility determination process. Other documents OPM requires applicants to include in the CFC application package are a copy of the charity's most recent form 990, their most recent annual audit report, and an application with various self-certifications. According to an official from one of the CFC's largest local campaigns, the single most frequent reason for rejecting an applicant from the CFC is the applicant's failure to submit its IRS determination letter.

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<sup>13</sup> 26 U.S.C. § 6103.

<sup>14</sup> 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.

<sup>15</sup> GAO, *IRS Lien Management Report: Opportunities to Improve Timeliness of IRS Lien Releases*, [GAO-05-26R](#) (Washington, D.C.: Jan. 10, 2005).

<sup>16</sup> A determination letter to an organization is the IRS's notification that it has reviewed the organization's application package and qualified it as exempt from federal income taxes.

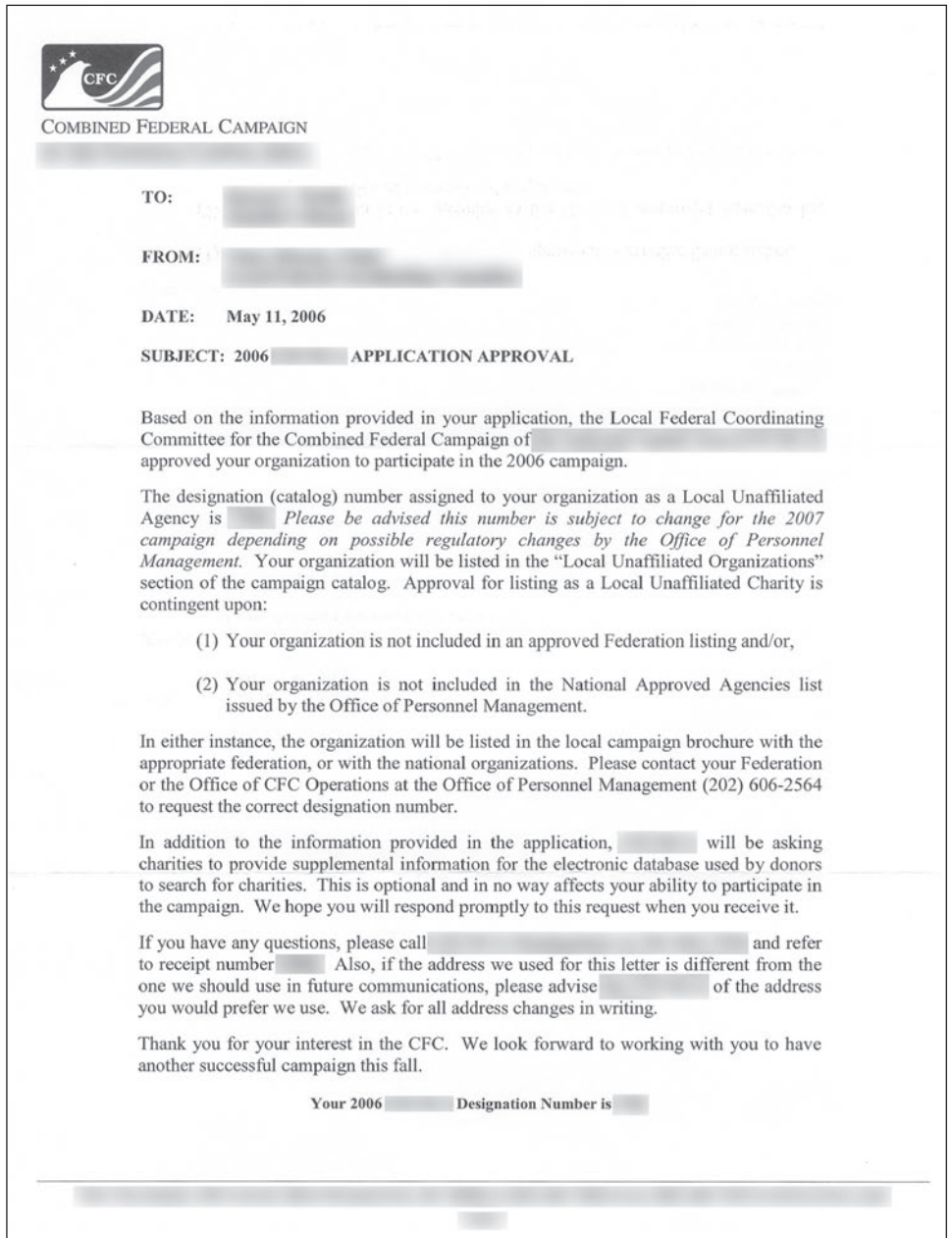
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**Control Weaknesses  
Allowed GAO to Enroll  
Fictitious Charities in the  
CFC**

To determine whether and to what extent CFC's eligibility determination processes are vulnerable, we applied to three local campaigns with a fictitious charity using fake documents and an erroneous IRS taxpayer identification number. In all three campaigns, our application for participation in the 2006 CFC was accepted. Figure 2 shows one example of the three letters we received regarding our acceptance into the 2006 CFC. Immediately after our applications were accepted, we notified CFC officials and withdrew our charity from the campaigns in order to prevent donations to our fictitious charity.

In addition to our direct testing of OPM's screening process, our match of CFC charities from the 2005 campaign against IRS's database of tax-exempt organizations identified charities whose 501(c)(3) status could not be confirmed. Therefore, we referred these charities to OPM and IRS for further review and confirmation of their tax-exempt status.

**Figure 2: Copy of an Acceptance Letter from One of the Three Local CFC Campaigns for Our Fictitious Charity**



Source: GAO.

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## Concluding Observations

The success of the OPM's CFC is predicated on each donor's confidence in a system that ensures that their donations reach charitable organizations that have met the CFC's specific eligibility requirements and are legitimate charities. The bona fide charities participating in the annual campaign have the most to lose when such confidence is shaken because of the abuse of a minority of participating charities. Until OPM takes steps to independently validate whether applicants are legitimate 501(c)(3) organizations, the campaign is vulnerable to entities that fraudulently purport to be charities. Further, tax-abusing charities will continue to benefit by being eligible to participate and receive donations unless OPM is provided access to their tax debt information and determines whether sanctions such as expulsion from the CFC are warranted. OPM and each local CFC cannot provide the assurance needed to sustain such confidence. This could have devastating consequences for the vast majority of eligible and tax-compliant charities that are dependent on donor contributions to support their critical missions.

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Mr. Chairman and Members of the Subcommittee, this concludes my statement. I would be pleased to answer any questions that you or other members of the committee may have at this time.

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## Contacts and Acknowledgments

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-7455 or [kutzg@gao.gov](mailto:kutzg@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony.



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# Appendix I: Objectives, Scope, and Methodology

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Our objectives were to investigate and determine whether and to what extent (1) charities listed in the 2005 Combined Federal Campaign (CFC) have unpaid payroll and other federal taxes; (2) selected charities, their directors, or senior officers are abusing the federal tax system; and (3) the Office of Personnel Management (OPM) screens charities for federal tax problems before allowing them to be listed with the CFC.

To determine whether any of the charities listed in the 2005 CFC have unpaid payroll and other federal taxes, we first identified charities that participated in the 2005 campaign. To identify CFC charities we requested data from CFC headquarters. To obtain these data, CFC headquarters requested data from the 299 local campaigns throughout the United States. We received data from 291 of the 299<sup>1</sup> local campaigns.

To identify CFC charities with unpaid federal taxes, we obtained and analyzed the Internal Revenue Service's (IRS) September 30, 2005, Unpaid Assessments file. We matched the CFC charity data to the IRS unpaid assessment data using the taxpayer identification number (TIN) field. To avoid overstating the amount owed by charities with unpaid federal tax debts and to capture only significant tax debt, we excluded tax debts meeting specific criteria. The criteria we used to exclude tax debts are as follows:

- tax debts the IRS classified as compliance assessments or memo accounts for financial reporting,<sup>2</sup>
- tax debts from calendar year 2005 tax periods, and
- charities with total unpaid taxes of \$100 or less.

The criteria above were used to exclude tax debts that might be under dispute or generally duplicative or invalid and tax debts that are recently incurred. Specifically, compliance assessments or memo accounts were excluded because these taxes have neither been agreed to by the taxpayers nor affirmed by the court, or these taxes could be invalid or duplicative of other taxes already reported. We excluded tax debts from calendar year 2005 tax periods to eliminate tax debt that may involve

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<sup>1</sup> Data from the remaining 8 local campaigns were either not received or not sufficient for analysis.

<sup>2</sup> Under federal accounting standards, unpaid assessments require taxpayer or court agreement to be considered federal taxes receivables. Compliance assessments and memo accounts are not considered federal taxes receivable because they are not agreed to by the taxpayers or the courts.

matters that are routinely resolved between the taxpayers and the IRS, with the taxes paid or abated within a short period. We also excluded tax debts of \$100 or less because they are insignificant for the purpose of determining the extent of taxes owed by CFC charities.

The 2005 pledged donation (pledges) information was unavailable at the time we selected our charity cases for investigations. We requested pledge information from the CFC and were in the process of receiving these data, piecemeal, from the CFC's 299 campaigns as of the end of our fieldwork. The pledge information we received through the end of fieldwork lacked the detail necessary to efficiently determine the amount of pledges for tax-delinquent charities. Consequently, we were unable to determine the amount of pledges received for tax-delinquent charities we identified.

To determine whether selected charities, their directors, or senior officers are abusing the federal tax system, we selected 15 charities for a detailed audit and investigation. We selected the 15 charities using a nonrepresentative selection approach based on our judgment, data mining, and a number of other criteria, including the amount of unpaid taxes, number of unpaid tax periods, amount of payments reported by the IRS, and indications that key officials might be involved in multiple charities with tax debts.

We obtained copies of automated tax transcripts and other tax records (for example, revenue officers' notes) from the IRS as of September 30, 2005, and reviewed these records to exclude charities that had recently paid off their unpaid tax balances and considered other factors before reducing the selection of charities to 15 case studies. For the selected 15 cases, we reviewed the charity CFC application files and performed additional searches of criminal, financial, and public records. Our investigators also contacted several of the charities and conducted interviews.

To determine whether and to what extent OPM screens charities for federal tax problems before allowing them to be listed with the CFC, we reviewed OPM's policies and procedures, performed process walkthroughs, and interviewed key CFC officials at CFC Headquarters and three local campaigns. We reviewed laws and regulations governing OPM's administration of the CFC. We identified processes and procedures performed by the CFC during the annual application period. To confirm our understanding of the requirements placed on charity applicants and to test whether OPM's processes would identify fraudulent charities, we attempted to gain acceptance into the 2006 CFC by posing as a charity. We

prepared and submitted application packages for each of three local campaigns using fake documentation for a fictitious charity. To test the effectiveness of OPM's processes and procedures to identify charity applicants that are not valid tax-exempt organizations, a primary requirement for participation in the CFC, we matched the list of CFC charities that participated in the 2005 campaign with the IRS's database of tax-exempt organizations.

We conducted our audit work from January 2006 through May 2006 in accordance with U.S. generally accepted government auditing standards, and we performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

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## Data Reliability Assessment

For the IRS unpaid assessments data, we relied on the work we performed during our annual audits of the IRS's financial statements. While our financial statement audits have identified some data reliability problems associated with the coding of some of the fields in the IRS's tax records, including errors and delays in recording taxpayer information and payments, we determined that the data were sufficiently reliable to address this testimony's objectives. Our financial audit procedures, including the reconciliation of the value of unpaid taxes recorded in IRS's master file to IRS's general ledger, identified no material differences.

To help ensure reliability of CFC-provided data, we performed electronic testing of specific data elements in the databases that we used to perform our work and performed other procedures to ensure the accuracy of the charity data provided by the CFC.

Based on our discussions with agency officials, our review of agency documents, and our own testing, we concluded that the data elements used for this testimony were sufficiently reliable for our purposes.

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# Appendix II: Background

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The Combined Federal Campaign (CFC) is the only authorized solicitation of employees in the federal workplace on behalf of charitable organizations. The CFC's mission is to promote and support philanthropy through a program that provides all federal employees the opportunity to improve the quality of life for others through donations to eligible nonprofit organizations. In 1971, the CFC began operation as a combined campaign with donations solicited once a year. Also during this period, charitable contributions in the form of payroll deduction were made possible. Contributions grew dramatically from \$12.9 million in 1964 to \$82.8 million in 1979. Growth in the number of participating charities was slow through the 1970s, increasing from 23 charities in 1969 to only 33 charities in 1979. Significant changes in CFC regulations occurred in the late 1970s and early 1980s<sup>1</sup> which in April 1984 opened the CFC to organizations that received tax-exempt status under 501(c)(3) of the Internal Revenue Code. The CFC has grown to a campaign consisting of approximately 1,700 (2005 campaign) national and international charitable organizations and more than 21,000 local charities. Contributions have also increased from about \$95 million in 1981 to more than \$255 million in 2004.

Each campaign is conducted during a 6-week period, varying by local campaign from September 1 through December 15, at every federal agency in the campaign community. During this period, current federal civilian and active duty military employees, throughout the country and internationally, donate tens of millions of dollars to these nonprofit organizations that provide health and human service benefits throughout the world.

The Director of the Office of Personnel Management (OPM) exercises general supervision over all operations of the CFC and takes steps to ensure the campaign objectives are achieved. The CFC is decentralized; therefore, each of the approximately 300 campaigns manages its local campaign and then reports statistics in aggregate to OPM. The Local Federal Coordinating Committee (LFCC) is the leadership element of the local CFC and is comprised of members from the federal community—federal civilian, military, and postal. The LFCC solicits annually a principle combined fund organization (PCFO), conducts local agency eligibility,

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<sup>1</sup> Including a court order that prohibited OPM from excluding legal defense and advocacy groups from the CFC because of their "indirect" support of health and welfare or their lobbying/advocacy activities.

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approves campaign material, conducts compliance audits, is the liaison to federal agency heads, and is generally engaged in a host of the scheduled campaign activities. The PCFO manages all aspects of the campaign. The PCFO develops campaign materials; serves as fiscal agent; collects, processes, and distributes pledges; and trains loaned executives and campaign personnel. The PCFO and the LFCC are responsible for reporting to the OPM summary data about their campaign results.

# Appendix III: CFC Charities with Unpaid Taxes

Table 1 in the main portion of this testimony provides data on 5 detailed case studies. Table 2 shows the remaining case studies that we audited and investigated. As with the 5 cases discussed in the body of this testimony, for all 10 of these case studies we found abuse or potentially criminal activity related to the federal tax system. All 10 charities in table 2 had unpaid payroll taxes.

**Table 2: CFC Charities with Unpaid Federal Taxes**

Charity	Nature of charity	Tax debt <sup>a</sup>	Comments
6	Rehabilitation services	Over \$100,000	<ul style="list-style-type: none"> <li>The charity failed to pay its payroll taxes in full or on time, resulting in delinquent payroll taxes and subsequent interest and penalties.</li> <li>A federal tax lien has been filed against the charity.</li> <li>Although these taxes remain outstanding, one of the executives of this charity recently placed property into a family trust.</li> </ul>
7	Psychiatric center	Over \$1 million	<ul style="list-style-type: none"> <li>This entity owes more than \$600,000 in penalties and interest.</li> <li>A state tax lien of \$200,000 has been filed against the charity.</li> <li>The charity repeatedly underpaid payroll taxes in 1 year recently.</li> <li>Executive director received a salary of more than \$100,000.</li> <li>A recent independent auditor's report states there is substantial doubt regarding the entity's ability to continue operating (i.e., a going concern).</li> <li>An officer of the charity told us that rather than remitting the payroll taxes to the IRS, the officer used them to pay operating expenses, which included the officer's own salary.</li> </ul>
8	Healthcare provider of hospital and nursing home services	Over \$400,000	<ul style="list-style-type: none"> <li>Federal tax lien has been filed against the charity.</li> <li>The charity filed for Chapter 11 bankruptcy protection.</li> <li>The top executives of the charity and several part-time management personnel were employed through a contracting firm and were paid wages that totaled more than \$3 million.</li> <li>The charity received over \$2 million in grants from the Department of Health and Human Services.</li> </ul>
9	Drug and alcohol rehabilitation center	Over \$70,000	<ul style="list-style-type: none"> <li>The charity has substantial equity in a multi-acre parcel of real estate located in a major metropolitan area.</li> <li>The charity owns a boat that is primarily used by the executive director.</li> </ul>
10	Charity provides social welfare programs	Nearly \$300,000	<ul style="list-style-type: none"> <li>A recent independent auditor's report states there is substantial doubt regarding the entity's ability to continue operating (i.e., a going concern).</li> <li>The charity received federal grants of more than \$2.5 million from the Department of Health and Human Services.</li> </ul>
11	Social services for the blind	Nearly \$100,000	<ul style="list-style-type: none"> <li>The charity has more than 13 periods of payroll tax debt dating back several years.</li> <li>The charity entered into an installment agreement that the IRS terminated after the charity did not make the required payments.</li> </ul>

**Appendix III: CFC Charities with Unpaid Taxes**

<b>Charity</b>	<b>Nature of charity</b>	<b>Tax debt<sup>a</sup></b>	<b>Comments</b>
12	Prevent and treat child abuse	Over \$120,000	<ul style="list-style-type: none"> <li>• Charity owes over \$120,000 in payroll taxes, penalties and interest from the late 1990s.</li> <li>• Charity requested an offer in compromise on the tax debt.</li> <li>• State and local tax liens have been filed against the charity's real estate.</li> <li>• After the charity was delinquent in paying its payroll taxes, it obtained more than \$600,000 to construct a new building.</li> <li>• An officer of the charity told us that rather than remitting the payroll taxes to the IRS, the officer used them to pay the charity's workers, which included the officer's own salary.</li> <li>• The charity received federal grants of \$40,000.</li> </ul>
13	Counseling service for adults, adolescents, and children	Over \$500,000	<ul style="list-style-type: none"> <li>• The charity's tax debt covers more than six tax periods.</li> <li>• Charity paid consultant more than \$100,000 for professional services.</li> </ul>
14	Adult and senior services	Nearly \$200,000	<ul style="list-style-type: none"> <li>• Federal tax lien has been filed against the charity.</li> <li>• The charity received federal grants of \$140,000.</li> </ul>
15	Family social services	Over \$500,000	<ul style="list-style-type: none"> <li>• The charity's tax debt covers more than 20 tax periods of payroll taxes.</li> <li>• Federal tax lien has been filed against the charity.</li> <li>• An officer of the charity told us that rather than remitting the payroll taxes to the IRS, the officer used them to pay operating expenses, which included the officer's own salary.</li> </ul>

Source: GAO's analysis of IRS, OPM, public, and other records.

<sup>a</sup>Tax debt amount includes principal, interest, and penalties as of September 30, 2005.

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