

GAO

Report to Subcommittee on Oversight,
Committee on Ways and Means, House of
Representatives

July 2006

TAX DEBT

Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes





Highlights of [GAO-06-887](#), a report to the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

The continued success of the Combined Federal Campaign (CFC), which is administered by the Office of Personnel Management (OPM), is predicated on donor confidence that each donation reaches a legitimate charitable organization.

The Ways and Means Committee's review of tax-exempt entities has led to concerns that charities listed in CFC are failing to remit payroll and other taxes to IRS as required by law. Specifically, GAO was asked to 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 CFC.

What GAO Recommends

To ensure donor confidence and improve control over participation in CFC, GAO recommends that OPM take the following two actions:

- create and maintain a comprehensive database of all local, national, and international charities that participate in CFC; and
- verify with IRS the tax-exempt status of all charities applying to be included in the CFC.

OPM concurred with both of our recommendations and stated it had taken or will take actions to address these recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-06-887.

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.

TAX DEBT

Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes

What GAO Found

More than 1,280 CFC charities, nearly 6 percent of charities in the OPM-administered 2005 campaign, had tax debts totaling almost \$36 million as of September 30, 2005. While the majority of this debt represented payroll taxes, penalties, and interest dating back as far as 1988, the debt also included amounts from annual reporting penalties, excise taxes, exempt organization business income taxes, unemployment taxes, and other types of taxes and penalties. Most of the 1,280 tax delinquent charities (79 percent) owed less than \$10,000. Further, at least 170 of the charities with tax debt received about \$1.6 billion in federal grants in 2005.

All 15 of the charities that we selected for detailed audit and investigation had abusive and potentially criminal activity related to the federal tax system. Specifically, 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. Although exempt from federal income tax, charities as employers are required to forward payroll taxes withheld from their employees' wages to the IRS. Willful failure to remit payroll taxes is a felony under U.S. law. 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. 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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United States Government Accountability Office
Washington, D.C. 20548

July 28, 2006

The Honorable Jim Ramstad
Chairman
Subcommittee on Oversight
Committee on Ways and Means
The House of Representatives

Dear Mr. Chairman:

On May 25, 2006, we testified before the Subcommittee on Oversight of the House of Representatives' Committee on Ways and Means on the results of our audit and investigations of 2005 Combined Federal Campaign (CFC) charities with unpaid federal taxes.¹ CFC, which is administered and promoted by the Office of Personnel Management (OPM) and about 300 local campaigns, is the only authorized solicitation of employees in the federal workplace on behalf of charitable organizations. In order to participate in CFC, an organization must be recognized as tax-exempt by the Internal Revenue Service (IRS). Notwithstanding this status, all employers are required to withhold from their employees' wages payroll taxes for Social Security, Medicare, and other taxes. Willful failure to remit payroll taxes is a felony under U.S. law.² Our work focused on determining whether and to what extent (1) charities listed in the 2005 CFC had unpaid payroll and other federal 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 CFC.

This report summarizes our testimony, which is reprinted in appendix I, and makes specific recommendations for corrective actions. 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.

¹ GAO, *Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes*, [GAO-06-755T](#) (Washington, D.C.: May 25, 2006).

² 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 US 192 (1991).

Overview of Testimony

In our testimony, we stated that more than 1,280 CFC charities, nearly 6 percent of the charities that participated in the OPM-administered 2005 campaign, had federal tax debts totaling \$35.6 million as of September 30, 2005. While the majority of this debt represented payroll taxes, penalties, and interest dating back as far as 1988, the unpaid debt also included amounts from annual reporting penalties, excise taxes, exempt organization business income taxes, unemployment taxes, and other types of taxes and penalties. Most of the 1,280 delinquent charities, 79 percent, owed less than \$10,000 in delinquent taxes. Further, in identifying charities with unpaid tax debt we took a conservative approach, so the \$35.6 million in delinquent taxes is likely understated. For example, the delinquent tax totals do not include amounts for charities that do not file required tax returns or taxes for charities that underreport unrelated business income or payroll taxes.

In addition to receiving exclusive access to the federal workplace, we also found that more than 170 of these tax-delinquent CFC charities received about \$1.6 billion in federal grants during fiscal year 2005. Five of the 15 charities we investigated were among the more than 170 charities that received federal grants. These 5 charities received grants from the Departments of Health and Human Services (not including Medicaid) and Education that totaled more than \$6.5 million.

Our detailed audit and investigation of 15 CFC charities with tax debt and their directors or senior officers identified abusive and potentially criminal activity.³ Specifically, we found that the executives of the 15 charities we investigated failed in their role as “trustees” to forward payroll taxes to IRS. Although the charities themselves are exempt from federal income taxes, the charities as employers are still required by law to withhold amounts from their employees’ wages for Social Security, Medicare, and individual income taxes. Willful failure to remit payroll taxes is a felony.

³ We characterized as “potentially criminal” any activity related to federal tax liability that may be a crime under a specific provision of the Internal Revenue Code. Depending on the potential penalty provided by statute, the activity could be a felony (punishable by imprisonment of more than 1 year) or a misdemeanor (punishable by imprisonment of 1 year or less). Some potential crimes under the Internal Revenue Code constitute fraud because of the presence of intent to defraud, intentional misrepresentation or deception, or other required legal elements.

Executives from 3 of the 15 selected charities denied owing payroll and other taxes when IRS records showed otherwise. Another 5 charities' executives explained that they knowingly withheld payroll taxes in order to have enough funds available to pay for their salaries and the salaries of charity employees, in addition to charity expenses. Our work 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, the independent audit reports for some of the charities indicated significant cash flow problems. We referred all 15 cases detailed in our report to IRS so that it can determine whether additional collection action or criminal investigation is warranted.

Neither OPM nor the approximately 300 local campaigns screen charities for federal tax problems before allowing charities to be listed with CFC. Neither federal regulations nor OPM policies require federal tax debt to be considered when determining CFC eligibility. 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. Nevertheless, CFC does not have the internal control necessary to assure donors that charities listed with and backed by CFC are meeting federal laws.

We also found that OPM and its local campaigns do not validate with IRS each CFC applicant's tax-exempt status. To be eligible for CFC, a charity must submit as part of its application a copy of a standard IRS letter showing that it has received tax-exempt status from IRS under 501(c)(3) of the Internal Revenue Code.⁴ 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 all three cases, our fictitious charity was accepted into the local CFC. Further, from our referral of more than 1,300 CFC charities whose 501(c)(3) status we could not confirm using publicly available IRS data, IRS identified a number of charities that are not valid 501(c)(3) entities.

⁴Exempt 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 CFR § 950.204(b)(2)(iii).

Conclusion

Federal employees have made a notable difference in the lives of those in need through CFC. The continued success of CFC is predicated on each donor's confidence in a system that ensures their donations reach legitimate charitable organizations. Bona fide charities of CFC have the most to lose when such confidence is shaken because of the abuse of a small number of charities. Until a governmentwide policy is developed that addresses availability of federally sponsored benefits to entities that fail to pay their federal tax obligations, tax delinquent CFC charities may continue to benefit by participating in CFC and potentially receiving donations. Further, unless OPM centralizes charity information and validates whether applicants are legitimate 501(c)(3) organizations, the campaign will also be vulnerable to entities that fraudulently purport to be charities. These weaknesses 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.

Recommendations for Executive Action

To help ensure continuing donor confidence and improve control over participation in CFC, we recommend that the Director of the Office of Personnel Management direct the Director of CFC Operations to take the following actions:

- create and maintain a comprehensive database of all local, national, and international charities that participate in CFC; and
- verify with IRS the tax-exempt status of all charities applying to be included in CFC.

Agency Comments and Our Evaluation

Both OPM and IRS provided written comments on a draft of this report, which are reprinted in appendix II and appendix III, respectively. OPM concurred with both of our recommendations and explained the actions it has already taken or plans to take to implement them. For example, OPM has initiated and expects to complete by the fall of 2007 the creation of a "National Charity Registry" that would provide OPM with the ability to independently verify data on participating charities. In addition, OPM has begun implementing a series of steps for verifying with IRS the tax-exempt status of all charities applying to CFC. OPM expects to finish this screening for the 2006 Campaign by September 30, 2006. Although we did not make any specific recommendations directly to IRS, it provided and has agreed to continue providing OPM assistance in verifying the tax-exempt status of

CFC charities. Also, IRS stated it is reviewing the 15 cases we referred to IRS for collection and criminal investigation and will take further action if warranted.

As agreed with your offices, we will send copies to interest congressional committees, the Director of the Office of Personnel Management, and the Commissioner of the Internal Revenue Service. We will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-7455 or kutzg@gao.gov if you or your staff have any questions concerning this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors are acknowledged in appendix IV.

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is written in a cursive style with a large initial "G".

Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Testimony on CFC Charities with Unpaid Federal Tax Debt

GAO

United States Government Accountability Office

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

For Release on Delivery
Expected at 11:00 a.m. EDT
Thursday, May 25, 2006

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



GAO-06-755T

**Appendix I
 Testimony on CFC Charities with Unpaid
 Federal Tax Debt**

May 25, 2006



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

TAX DEBT

Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes

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.

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.

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.

United States Government Accountability Office

**Appendix I
Testimony on CFC Charities with Unpaid
Federal Tax Debt**

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 system¹ while benefiting from doing business with the federal government.² 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

¹ 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.

² 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 Code³ 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.⁴

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.⁵ 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

³ 26 U.S.C. § 501(c)(3).

⁴ 26 U.S.C. § 7202.

⁵ 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.

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.⁶ 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.⁷ 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

⁶ 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).

⁷ 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.

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

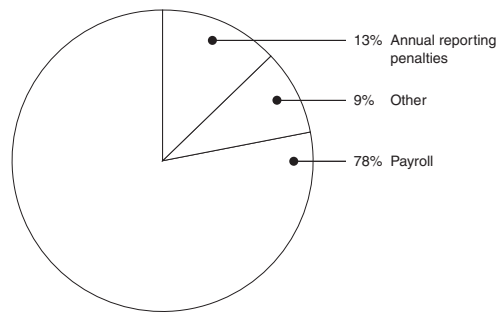
Based on our analysis, more than 1,280 CFC charities had federal tax debts totaling \$35.6 million as of September 30, 2005. This represented nearly 6 percent of the charities that participated in the OPM-administered 2005 campaign. \$27.7 million of this debt represented payroll taxes, penalties, and 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.

**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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Federal Tax Debt**

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.⁸

⁸ 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.

**Appendix I
Testimony on CFC Charities with Unpaid
Federal Tax Debt**

**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 2005.⁹ 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,¹⁰ 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.

**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.

⁹ 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.

¹⁰ 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.

**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,¹¹ 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.¹² 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.

¹¹ 26 U.S.C. § 7202.

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

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 Testimony on CFC Charities with Unpaid
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Table 1: CFC Charities with Unpaid Federal Taxes

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

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

*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.

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.

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.

**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.¹³ 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.¹⁴ 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.¹⁵

**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 letter¹⁶ 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.

¹³ 26 U.S.C. § 6103.

¹⁴ 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.

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

¹⁶ 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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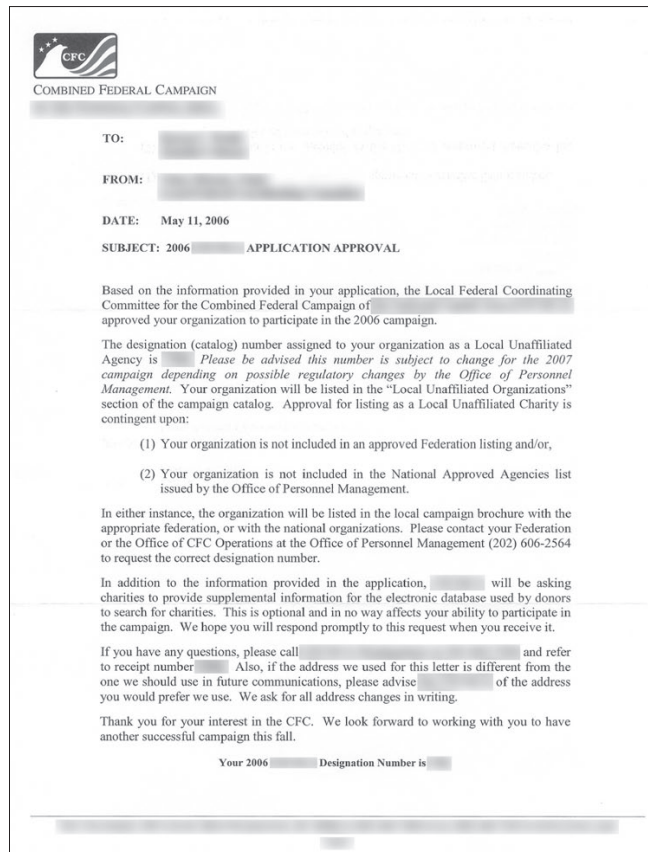
**Control Weaknesses
Allowed GAO to Enroll
Fictitious Charities in the
CFC**

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.

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



Source: GAO.

Appendix I: Objectives, Scope, and Methodology

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 299¹ 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,²
- 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

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

² 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.

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**Appendix I: Objectives, Scope, and
Methodology**

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

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**Appendix I: Objectives, Scope, and
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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.

**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.

Appendix II: Background

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 1980s¹ 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,

¹ 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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Appendix II: Background

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

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**Appendix III: CFC Charities with Unpaid
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Charity	Nature of charity	Tax debt*	Comments
12	Prevent and treat child abuse	Over \$120,000	<ul style="list-style-type: none"> Charity owes over \$120,000 in payroll taxes, penalties and interest from the late 1990s. Charity requested an offer in compromise on the tax debt. State and local tax liens have been filed against the charity's real estate. After the charity was delinquent in paying its payroll taxes, it obtained more than \$600,000 to construct a new building. 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. The charity received federal grants of \$40,000.
13	Counseling service for adults, adolescents, and children	Over \$500,000	<ul style="list-style-type: none"> The charity's tax debt covers more than six tax periods. Charity paid consultant more than \$100,000 for professional services.
14	Adult and senior services	Nearly \$200,000	<ul style="list-style-type: none"> Federal tax lien has been filed against the charity. The charity received federal grants of \$140,000.
15	Family social services	Over \$500,000	<ul style="list-style-type: none"> The charity's tax debt covers more than 20 tax periods of payroll taxes. Federal tax lien has been filed against the charity. 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.

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

*Tax debt amount includes principal, interest, and penalties as of September 30, 2005.

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Comments from the Office of Personnel Management



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

JUL 14 2006

Mr. Gregory D. Kutz
Managing Director
Government Accountability Office
Forensic Audits and Special Investigations
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Kutz:

Thank you for the opportunity to respond to the Government Accountability Office's (GAO) report "Tax Debt – Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes (GAO-06-887)." We appreciate the audit and investigative work performed by GAO and welcome its findings. The Office of Personnel Management (OPM) is working to address the recommendations set forth in the report and has provided a summary of the actions taken to date as well as our plans for the future. In the last section of our response we discuss specific observations concerning limiting factors that may add to the complexity of meeting the GAO recommendations.

I. Management and Structure of the CFC

OPM's mission is to ensure the Federal Government has an effective civilian workforce. As part of its mission, OPM is responsible for the overall management of the Combined Federal Campaign (CFC). However, OPM does not directly manage the Federal employee contribution process. The CFC structure relies on the dedication and commitment of the Federal employees who make up the Local Federal Coordinating Committees (LFCC) which administer local campaigns. LFCCs are responsible for reviewing and approving applications for participation by local charities in each of the 299 local CFCs. OPM's Office of CFC Operations (OCFCO) serves a similar role in reviewing and approving the applications of national and international charities, which participate in all of the local CFCs. Thus, Federal employees in the geographic areas of the 299 local CFC's have a wide choice of donating to charities that provide local services, to charities that provide national and international service, or to a combination of both.

OPM provides oversight and guidance to each of the local campaigns to ensure that each campaign is conducted in accordance with OPM regulations, congressional mandates, and operating policy. This oversight is primarily conducted through the review of required accountability and status reports provided by each local campaign throughout the year.

II. Screening Charities for Participation in the CFC

All CFC participating charities must apply each year for that year's campaign, with an application made either to OPM or the appropriate LFCC, depending on whether the applicant is applying as a national/international or local charity. These applications set forth the information and background submissions required by OPM's regulatory eligibility criteria and public accountability standards. Each applicant charity must demonstrate that it meets those standards in order to participate in the CFC. These criteria were designed to ensure Federal donors that only legitimate, accountable, and responsible charities are admitted to the CFC. The criterion for both local and national/international applicants includes, but is not limited to, a demonstration by the applicant that it:

- Has status as an Internal Revenue Service (IRS) determined tax-exempt charity under section 501(c)(3) of the Internal Revenue Code;
- Accounts for funds in accordance with generally accepted accounting principles and has an audit of financial activities performed by an independent certified public accountant performed in accordance with generally accepted auditing standards;
- Completed and provided to the IRS a Form 990, the annual tax return for non-profit organizations;
- Provides real health and human services, benefits, assistance or program activities; and,
- Has an active and responsible Board of Directors, in which a majority of such Board members serve without compensation and without conflict of interest.

Determinations of eligibility are based in part on a series of self certifications by the applicant charity, affirming that the information provided in the application is correct and that the charity agrees to comply with the eligibility criteria. In some cases, the charity is required to provide specific documentation to support the certification. For example, OPM requires that all applicants submit either to OPM or the local LFCC, depending on application status, a copy of its IRS 501(c)(3) determination letter to substantiate that it is recognized by the IRS as a tax-exempt charity as described above. During the screening process, OPM and the LFCCs compare the IRS determination letter and the applicant's IRS Form 990, to detect inconsistencies and possible fraud.

For example, OPM requires verification that the applicant's name and Employer Identification Number (EIN) on the applicant's IRS exemption letter match the name and EIN on the IRS Form 990, also provided with the application. If an advanced ruling period is provided by the IRS, its expiration date must fall within the upcoming CFC campaign period. If the advanced ruling period has expired, the applicant must either provide OPM with evidence that it has applied for or that it has otherwise received its permanent tax-exempt status ruling under 501(c)(3) of the Internal Revenue Code. Since a charity does not lose its tax-exempt status even when the temporary ruling expires, OPM cannot solely rely on the expiration date of the ruling.

In the event that the names on the various documents do not match, the applicant charity must provide a State-issued certification approving the use of a fictitious name. Also, use of DBAs is a fairly common practice by nonprofits in order to better associate the charity's name with a

cause for marketing purposes. It is also our experience that, while the IRS requires that charities register their name changes; many fail to do so, thus complicating the verification process.

As noted in GAO's report, the current eligibility criteria do not require the applicant charity to disclose the status of its payment of payroll or any other taxes. A requirement for this type of information was not included in the Executive Orders applicable to the CFC or in the existing congressional eligibility mandates. In addition, current law prevents OPM from making the existing eligibility criteria more restrictive than it was in 1984. To further complicate consideration of adding such a public accountability standard, the IRS is prevented, by law, from sharing such tax data with OPM.

As such, OPM currently cannot screen charities for compliance with tax payments to the IRS and has never denied a charity the opportunity to participate in the CFC because of non-compliance in this area.

III. Accountability within the CFC

In addition to the eligibility determination process for national/international applicants, OPM conducts a number of monitoring activities over local campaigns to minimize the risk of non-compliance with CFC regulations and prevent abuse in the CFC. In particular, OPM's OCFCO receives copies of audit reports for each local campaign as required by CFC regulations. OPM also receives audit reports from OPM's Office of the Inspector General, which audits a number of local CFCs each year. The OCFCO reviews all audit findings and works with the local CFC's to resolve each finding. The OCFCO also selects a sample of local CFC brochures each year to review for compliance with CFC regulations and OPM guidance. In addition, the OCFCO requires each local campaign to report campaign results, including amounts raised, campaign costs, and Federal employee participation rates, after the solicitation period. This information helps OPM identify campaign performance and potential at-risk campaigns that might need assistance, consider requiring a merging with another, more efficient campaign, or require dissolution. OPM recognizes the importance of the PCFO, as the local campaign administrator, and works with each PCFO to correct any non-compliance with CFC regulations. However, if OPM determines a pattern of non-compliance by the campaign, OPM has the authority to impose sanctions and penalties on the local PCFO, including removal from the position of local administrator, suspension of local campaign operations, merger of the local campaign with an adjacent campaign, and removal of the PCFO as a CFC participating charity or federation. Finally, OPM regularly communicates with the local campaigns to ensure that each campaign is fully operational and has an active LFCC.

IV. OPM Response to GAO Recommendations

Recommendation 1. Create and maintain a comprehensive database of all local, national, and international charities that participate in the CFC.

OPM recognizes the benefit in having a single database or "National Charity Registry (NCR)" for the estimated 20,000 CFC local, national, and international charities. Such a database would provide OPM with the ability to independently verify data on participating charities. As the

GAO report suggested, had such a system existed, the GAO process of data gathering and verification would have been greatly expedited.

In 2005, OPM began the design of just such a database, which is now a central part of our efforts to modernize the CFC. The NCR will provide OPM with information to allow verification of the IRS tax-exempt status of all charities applying to be included in the CFC. Eventually it will lead to the development of an online workplace giving system designed to promote giving electronically among Federal donors, provide donors with central access to all CFC participating charities, and eliminate current geographic restrictions to giving.

This project is proceeding in two phases. First, OPM must design a system to assign a new code to all participating charities and register all relevant information regarding CFC participation. The recoding is necessary because under the current decentralized local campaign system, charities in different campaigns may have identical codes. In addition, with the growth in the number of charities participating in the CFC, the existing four-digit code structure that serves the Federal donor as the primary identifier of charities is no longer adequate. This recoding process and compilation of data for the NCR is projected for completion in the fall of 2007.

The next phase involves the development and deployment of a system that would achieve the goal of converting the CFC into a fully electronic online giving system. OPM is currently exploring various financing options for the development of a system that would be financed through a portion of donations; much like the CFC works today. In May 2006, OPM released a "Request for Information" to begin the process of assessing what type of vendors might be qualified to undertake this project and what level of resources it would involve. A decision on the feasibility of the various financing options will be made later this year.

Whatever options are chosen, OPM intends to ensure that the system has the necessary functional capabilities to facilitate the IRS tax-exempt verification process.

Recommendation 2. Verify with the IRS the tax-exempt status of all charities applying to be included in the CFC.

As GAO noted, neither OPM nor the local campaigns and federations currently validate each CFC applicant's tax-exempt status with the IRS.

Local campaigns do not possess the staff resources and database management capabilities to perform such verifications. To perform verifications of all participating charities in the upcoming 2006 CFC at the national and local level, OPM will assume responsibility for centralizing the verification process and is taking the following steps to achieve this:

- OPM has requested that all local campaigns send OCFCO information about participating charities new to the CFC for 2006 to OPM for verification (see Attachment).
- Local campaigns also have been instructed to periodically (at least quarterly) review the IRS listing of charities determined to no longer qualify as entities to which contributions are tax-deductible.

- OPM's Center for Information Services is developing the programming to upload charity data to perform EIN verifications as the initial source of validation.
- Information on all 2006 participating charities is being compiled into a single database at OPM.
- Verifications are being made against IRS master files and exceptions are being classified according to findings (i.e. tax-exempt, but other than 501(c)(3); EINs with no IRS matching record; mismatch between EIN and charity name; IRS tax-exemption terminated or merged; failure to establish IRS tax-exemption, etc).
- A protocol has been developed to further research all exceptions with priority given to charities that "fail to establish" or whose tax-exemption was terminated or merged.
- Once review and analysis is completed, OPM will corroborate findings with IRS for all charities that fail to establish their tax-exemption.
- As appropriate, OPM will implement steps to suspend participation and refer charities to the OPM Office of the Inspector General or other entities as necessary.

Given the timing of this report and the anticipated amount of time it will take to complete the verification process, OPM anticipates that these activities will be completed no later than September 30, 2006, in time for the fall 2006 CFC.

V. The GAO-Created CFC Applicant and Local Charity Eligibility Screening Controls

GAO created a fictitious charity and applied to three local campaigns utilizing realistic documents and a fabricated IRS electronic identification number (EIN). The fictitious charity was admitted to all three campaigns. OPM recognizes that this is a matter of great concern and importance.

OPM is developing additional guidance to be provided to each local campaign on possible fraud indicators to assist in the identification of a fictitious charity as well as procedures for more definitively determining the legitimacy of such charities. In conjunction with the upcoming implementation of the NCR and improved training, OPM is confident that we have implemented sufficient controls to dramatically improve our ability to protect against fraudulent applications as brought to light by the GAO activities.

VI. Issues and Limitations of the IRS Database Verification Process

As described previously, OPM is developing and implementing procedures for comparing charities deemed eligible for participation in the CFC against an IRS master file of tax-exempt charities. OPM is coordinating this effort with the IRS, but has found this comparison to be a more difficult task than anticipated. We understand that GAO encountered similar difficulties in comparing IRS data with CFC applicants and could not validate approximately 1,300 CFC participants against IRS data. GAO referred these charities to the IRS for its determination of the tax-exempt status. The information available on the IRS web based master file has only limited information that OPM can use to try and determine tax-exempt status. The IRS has provided and agreed to continue to provide us with more detailed extracts, on a periodic basis, of publicly available information from IRS master files to better assist OPM with our comparisons.

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However, the actual process of performing this comparison of CFC participants against the IRS master file has required significant OPM resources. OCFCO staff obtained assistance from OPM's Center for Information Services to develop a program to upload CFC charity data and the IRS master file data into a database and develop a program to run the comparison and identify charities that may not be currently recognized by the IRS as tax-exempt. This comparison and identification of charities not on the IRS master file still does not allow OPM to make a definite conclusion on the charities' tax-exempt status. The IRS has notified us that there are circumstances where a charity may have been removed from its master file, but still maintains its tax-exempt status for a variety of reasons. In these cases, the IRS cannot provide us with any confirmation or additional information because of the limitations of current law regarding what is considered public information and what IRS can share with OPM.

We will continue to perform our comparison of CFC charities against the IRS master file of tax-exempt charities to the best of OPM's ability under current law. We agree it will provide additional assurances to donors that only legitimate charities are participating in the CFC. Because of the difficulties in corroborating tax-exemption for all charities OPM will continue to rely on the IRS for assistance in this area.

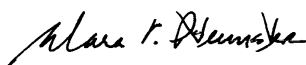
VII. Conclusion

OPM has taken steps to ensure that all 2006 CFC participating charities are validated against IRS master files and is implementing additional controls in the charity eligibility screening process based on the lessons learned from the GAO review.

In addition, we will continue to modernize the CFC with the objective of bringing the greatest accountability possible at an affordable cost to donors and charities alike. The implementation of the NCR with the capacity to perform periodic verifications which is to be implemented in 2007 represents a significant step in this direction.

Again, thank you for the opportunity to respond to GAO's report.

Sincerely,



Mara T. Paternoster, Director
Office of CFC Operations

Attachment

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CFC MEMORANDUM 2006-16

June 20, 2006

TO: LOCAL FEDERAL COORDINATING COMMITTEES (LFCCs)
AND PRINCIPAL COMBINED FUND ORGANIZATIONS (PCFOs)

FROM: MARA T. PATERMASTER
DIRECTOR
OFFICE OF CFC OPERATIONS

SUBJECT: Verification of New 2006 CFC Applicant Organizations Tax Exempt
Status

In follow-up to the recently concluded Government Accountability Office (GAO) review of CFC participating charities, the Office of CFC Operations will be performing an independent verification of the tax-exempt status for all new applicants to the 2006 CFC against IRS publicly available data. Your timely cooperation is required to ensure that we can obtain a complete and properly formatted database in order to perform this verification as soon as possible.

Local campaigns are required to submit an Excel list of **new 2006 applicants only** to the Office of CFC Operations (OCFCO) no later than 5:00 pm EST, June 30, 2006. By “new applicants” we refer to only those charities that applied to participate in the 2006 CFC and which either had not applied for, or were denied, participation in the 2005 CFC. Please include only new 2006 applicants, regardless of whether or not they have been admitted for the 2006 Campaign.

The list must be formatted as shown in the attached example and include the following information:

- Employer Identification Number (EIN)
- Legal Name (as it appears on the IRS Letter of Determination)
- Doing Business As (DBA) Name or Brochure Listing Name—required only if different from the Legal Name
- Campaign Name
- Campaign Code (ID)
- 2006 LFCC Decision (admitted/denied)

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Please create a record for each organization by following the "Local CFC Charity Upload File Layout Description" with special attention to the EIN. (Most errors in data entry for these records tend to be linked with the EIN.) An attached Excel spreadsheet is included with a sample entry. This spreadsheet may be used for your local charity information, saved, and returned to OPM with the required information.

Please e-mail your **Excel** list to the OCFCO no later than 5:00 pm EST, June 30, 2006 to cfc@opm.gov. Please include your four-digit campaign number and campaign name in the subject line. For example, "0001 East Alabama CFC 2006 Charities".

Your full cooperation and timely response is appreciated. If you have any questions regarding this matter, please contact Pamela Rodgers at 202/606-2564 or by e-mail at cfc@opm.gov.

Enclosures:

Charity Upload File Description
Excel Spreadsheet Example

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Local CFC Charity Upload File Layout Description

for

Verification of New 2006 CFC Applicants' Tax Exempt Status

Each charity record contains the following fields in the order shown:

<u>Field Name</u>	<u>Format</u>	<u>Description</u>
<u>EIN</u>	9 digits in text format E.g. 234574366	The 9-digit employer identification number (EIN) issued by IRS. All EINs must be nine digits without a hyphen in your excel list. Family Support and Youth Activities (FSYA), also known as Military Welfare and Recreation (MWR) organizations, may or may not have an EIN. They must still be included. Use nine zeros without a hyphen mark in the EIN field for these organizations.
<u>LEGAL NAME</u>	Less than 100 characters	A text field for the organizations' legal name as found on the IRS Determination Letter.
<u>DBA NAME</u>	Less than 100 characters	A text field for the organizations' name listing in CFC materials if different from the Legal Name.
<u>2006 LFCC DECISION</u>	Less than 10 characters	A text field documenting the LFCC's decision on the organization for the 2006 CFC. Enter either "Admitted" or "Denied".
<u>CAMPAIGN ID</u>	4 digit number in text format E.g. 0090	The 4 digit campaign (code)ID
<u>CAMPAIGN NAME</u>	Less than 200 characters	The name of the campaign.

Text Fields: All of the fields in this request are text fields. Do not use punctuation in text fields.

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Examples:

EIN: 234560900 **Campaign ID:** 0700

Legal Name: The “Historical Society, Inc.” should be submitted as Historical Society Inc

“P.A.T.T” should be submitted as P A T T

“International Children’s Services” should be submitted as International Childrens Services

DBA: The “Historical Society of Hawaii, Inc.” should be submitted as Historical Society Hawaii Inc

Comments from the Internal Revenue Service



COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

JUL 19 2006

Mr. Gregory Kutz
Managing Director
Forensic Audits and Special Investigations
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Kutz:

Charities participating in the Combined Federal Campaign (CFC) are required to be tax-exempt under Internal Revenue Code section 501(c)(3). As part of GAO's investigation into whether charities participating in the CFC have unpaid taxes (GAO-06-887), GAO performed a computer match of CFC charities against the IRS' database of organizations recognized as tax-exempt. This database is known as the Exempt Organizations Business Master File (EOBMF) and is available to the public pursuant to Internal Revenue Code section 6104. While EOBMF contains information on all tax-exempt organizations, the match was limited to organizations described in section 501(c)(3). This match resulted in a list of approximately 1300 participating organizations that were potentially not tax-exempt under section 501(c)(3) and thus unqualified to participate in the CFC. You provided us with this list, which includes names and employer identification numbers (EINs) of the 1300 organizations, for the purpose of assisting the Office of Personnel Management (OPM) in verifying the section 501(c)(3) status of these organizations. The purpose of this letter is to inform you of the results of our inquiry into these matters, as well as provide information and comments on your draft report of investigation.

The draft report indicates "from our referral of more than 1,300 CFC charities whose 501(c)(3) status we could not confirm using publicly available IRS data, the IRS identified a number of charities that are not valid 501(c)(3) entities." This is correct. Ultimately, however, we believe that further research will confirm that the number of entities that are not qualified 501(c)(3) organizations will be quite small.¹ We believe it would be helpful to explain our findings in this regard.

We performed a match of the EINs you provided against our Returns Inventory and Classification System (RICS) database. This database provided us with information about each organization and its current status. Based on the results of the match and some

¹ Some of the names on the list appeared to be state and local government entities, or instrumentalities of state and local government entities, which are not tax-exempt under section 501(c)(3), but may receive tax deductible contributions. The disclosure provisions of the Internal Revenue Code do not permit the IRS to confirm or deny the tax-exempt status of these entities.

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amount of manual research, we believe that the vast majority of the mismatches occurred because of data input errors. For example, in numerous cases in which the charity was obviously legitimate, the EIN had two or more transposed digits. As we discussed with Aaron Hollings of your office, because the data was initially input by the local CFC campaigns, we have recommended to OPM that the data for these organizations be reviewed and verified prior to any subsequent match against the EOBF.

The match with our RICS database did indicate that some of the EINs belonged to organizations that had terminated or terminated following a merger, or were otherwise not recognized as exempt under section 501(c)(3). We provided the names and EINs of these organizations to OPM, which is all that we are permitted to disclose under section 6104 of the Internal Revenue Code, which governs the publicity of information relating to exempt organizations. In a number of cases, however, this did not necessarily mean that the organization named was not tax-exempt under section 501(c)(3). In some cases we found that a new organization, or the organization resulting from a merger, was in fact tax-exempt but had provided the terminated organization's EIN.

We found that some of the organizations were in a status "unable to locate." This status does not necessarily mean that the organization is no longer tax-exempt--only that the organization has failed to respond to IRS correspondence. We are, however, considering our own follow up.

In addition, we are providing assistance to OPM in implementing a program to verify the tax-exempt status of CFC charities. We met with OPM and explained what data elements were available from the EOBF. We agreed to provide a quarterly EOBF extract of section 501(c)(3) organizations so that OPM could electronically match up the list of CFC charities with the recognized 501(c)(3)s. We have also provided a cumulative list of names and EINs of organizations whose names have appeared in the bulletins because we no longer recognize them as tax-exempt.

Your report notes that the fifteen charities discussed in your testimony have been referred to the IRS. Collection and Criminal Investigation are reviewing those cases and will take further action if warranted.

If you have any questions, please contact Lois G. Lerner, Director of Exempt Organizations, Tax Exempt and Government Entities Division at (202) 283-2300.

Sincerely,



Steven T. Miller

GAO Contact and Staff Acknowledgments

GAO Contact

Michael C Zola (202) 512-3867, zolam@gao.gov

Acknowledgments

Key contributors to this report include Beverly Burke, Ray Bush, Joonho Choi, William Cordrey, Paul Desaulniers, Steve Donahue, Dennis Fauber, Jessica Gray, Mary Ann Hardy, Ken Hill, Aaron Holling, Jason Kelly, John Kelly, Rick Kusman, Jenny Li, Renee McElveen, John Mingus, John Ryan, Matt Valenta, Ting-Ting Wu, and Michael Zola.

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