



EXECUTIVE SUMMARY
Department of Revenue & Taxation
Business Privilege Tax on Military Construction Contracts
OPA Report No. 23-03, March 2023

Our performance audit of the Department of Revenue and Taxation (DRT) - Business Privilege Tax (BPT) on military construction contracts covering Fiscal Years (FY) 2016-2020 disclosed several deficiencies relative to the registration and licensing requirements, gross receipts reporting and BPT payments, questionable exemptions without sufficient documentation, and lapses in internal controls. These deficiencies resulted in question costs (over \$500K), unrealized revenues (over \$10M), and other financial impact/foregone revenues (over \$5M) for a total financial impact of over \$22M. DRT management and oversight body/commission need to address and resolve these deficiencies to enhance revenue collections relative to Guam's military construction contracts/projects. Specifically, we found the following:

PART 1: REGISTRATION AND LICENSING

Out of the 28 sampled foreign and local contractors from a total of 135 contractors taken from USASpending, we found the following with registration and licensing deficiencies:

Federal Contractors without DRT Records and Tagged by DRT as Non-Filers

Based on USASpending data, we found four contractors awarded military construction contracts from FY 2016-2020 with a combined total award of over \$85M. In DRT's response, these contractors were not registered with DRT, without required licensing documents such as a Certificate of Authority (COA) and Business License (BL), did not file Gross Receipts (GR), and thus were tagged by DRT as Non-Filers. Per DRT, these contractors are now part of the 2021 Tax Enforcement Division (TED) Compliance Initiative Program (CIP)-Federal Contractors, which started on June 17, 2021 (16 days after the start of this audit on June 1, 2021).

Federal Contractors Tagged by DRT as Filers Without DRT Business License

Nine contractors, mostly joint ventures (JVs) or limited liability companies (LLCs), were tagged as "Filers" per DRT's record. These contractors had either no BLs or expired BLs and were not on the CLB list of Authorized Contractors as of June 30, 2021. Per USASpending, these contractors had a combined construction contracts for FY 2016-2020 totaling over \$70M and reported combined Gross Receipts of over \$200M during the same period.

Non-coordination between DRT and CLB on Federal Contractor Licenses

DRT did not provide information regarding the contractors' CLB licenses for some of our sampled contractors, specifically those that did not have DRT BLs. Instead, DRT referred us to the CLB or Professional Engineers, Architects, and Land Surveyors (PEALS) for contractors' licenses. We verified these contractors with the CLB listing of Authorized Contractors as of June 30, 2021, and found that some were not within the listing. Without a CLB license, the contractors could have worked exclusively on military installations (on base) in Guam, thus requiring a DRT BL.

Lapses in Monitoring of Federal Contractors' Registration and Reporting Compliance

Lapses were noted in DRT's monitoring of contractor compliance on registration and gross receipts reporting requirements. DRT did not periodically monitor if:

- Contractors awarded with military contracts on Guam applied for and filed appropriate licenses and were registered;
- Contractors who filed GRs had COA, DRT BL, or CLB/PEALS licenses;
- Contractors who had COA or BL had consistently filed monthly GRs and paid BPTs promptly; and
- Appropriate registration, documentation, and GRT filing process of a JV, LLC, or other companies with similar features were done.

PART 2: CONTRACTING GROSS RECEIPTS, BUSINESS PRIVILEGE TAX, AND BPT EXEMPTIONS

In our review of the data provided by DRT on GR filings and paid BPTs, on 86 out of 103 sampled contractors, we found the following:

Contracting Gross Receipts (GRs) and Business Privilege Tax (BPT)

Potential Causes of Variances of Contractor Reported Gross Receipts versus Awarded Contract Amounts

We noted some limitations in the reportable data required to be filled-in by the contractors based on GRT Form 1. The GRs were reported on each line item categorized per taxpayers' business activities and license type and inputted as it is in the DRT Power 7 system. Due to these limitations in the GRT Form-1, the Power 7 system cannot automatically distinguish and generate the following:

- Gross receipts for military construction contracts versus local construction contracts;
- BPTs due and paid/collected for military construction contracts versus local construction contracts; and
- Exemptions availed for military construction projects or local construction projects.

Additionally, without any information regarding the actual contract payments and list of contractors/sub-contractors with qualified/allowable exemptions, neither DRT nor OPA can accurately determine the reportable gross receipts and BPTs due from military construction contracts. Therefore, we cannot accurately ascertain the impact of potentially uncollected revenues on military construction contracts on Government of Guam (GovGuam) revenues.

Federal Contractors Reported as "Non-Filers" without GRs and BPT Records with DRT

Six contractors, who were mostly joint ventures (JV) or limited liability companies (LLC), were tagged by DRT as "Non-Filers" for FY 2016-2020 based on its responses to our data request. Additionally, these contractors did not have a business license with DRT. Per USASpending, these contractors were awarded construction contracts of over \$90M with a performance period from 10/27/2015 to 6/30/2024. Without information on actual contract payments as reportable gross receipts, potential unpaid revenues would be over \$4M. Based on DRT's response in November 2022, these contractors are included in DRT's on-going FedCon CIP, which started in FY 2021.

Contractors Tagged as “Filers” Reported “Zero” GRs, and BPT for Five Years

For FY 2016-2020, contractor TT was awarded construction contracts for the military buildup in Guam totaling over \$10M for a period of performance from 10/23/2017 through 9/30/2024. The contractor did not have a COA nor a BL and was tagged by DRT as a “Filer.” However, in its first response for FY 2016-2020, DRT reported “zero” gross receipts and “zero” BPTs for this contractor.

In November 2022, DRT provided a second set of data updated as of October 2022 (beyond our audit scope). These reflected GRs of over \$5M for Services and under \$500K for Contracting U.S. Without any information regarding the actual construction contract payments, potential estimated BPTs to be collected for construction contracts would be over \$500K.

Contractor Tagged by DRT as “Filer” Reported “Zero” GRs in a Certain Fiscal Year

Contractor F reported by DRT as a “Filer,” filed “Zero” GRs for FY 2019 per DRT's response in the 2021 audit data request. The contractor was awarded federal construction contracts totaling over \$50M relative to the military build-up in Guam based on the USASpending report from FY 2016 to FY 2020. For the performance period 5/19/2016 to 7/31/2024, the reportable amount for 2019 would be over \$15M with a potential unpaid BPT of over \$500K.

In November 2022, DRT provided a second set of data updated as of October 2022 (beyond our audit scope). This reflected GRs of over \$80M filed for tax years 2016-2022 for Service and Profession and none for Contracting-local or Contracting-U.S. Accordingly, some of these GRT returns were processed after FY 2020 due to a shortage of manpower.

Variations between Reported GRs Compared with Awarded Contract Amounts

Gross Receipts filed by eleven contractors, per DRT provided data from FY 2016-2020, had variances or were deficient versus the awarded contract amounts per USASpending. Deficiencies ranged from over \$3M to over \$315M.

In November 2022, DRT provided another updated GRs filed covering Tax Years 2016 to 2022 (beyond the audit scope). Using the DRT updated data to compare the awarded contract amounts versus updated gross receipts filed, it was determined that three contractors remained deficient in the amount of gross receipts filed, ranging from over \$2M to over \$160M. The potential unpaid BPT is over \$5M at 4%. We also noted excesses in gross receipts filings for eight contractors versus the DRT-reported contract amount per USASpending data.

Challenges in the Review of Contractor GR Reporting and BPT Payment Compliance

DRT representatives identified several factors and variables, with undeterminable amounts for applicable contractors as of the audit termination date, that could potentially affect the contractors' gross receipts filing. Monetary values related to the factors could only be determined if an audit is performed. Specifically:

- USASpending data keeps on evolving as these include contract modifications such as additions, reductions, change orders, or cancellations;
- Multi-year awarded contracts or varying periods of performance;
- Contractors filing through their parent company or under a changed company name;
- On-island contractors hiring a third party or a company outside of Guam may or may not be subject to GRT reporting and BPT payment.

- Gross Receipts Form I filed by contractors encompasses all their business activities, which does not classify the sources of revenue specifically for local projects and for federal or military projects, as this is not specified in the GRT Form.

Business Privilege Tax Exemptions

Calculated BPT Rates are way below the Mandated 4% or 5% rate Due to Potential Exemptions Claimed

Gross Receipts and BPT data provided by DRT from FY 2016-2020 for the 16 contractors disclosed calculated BPT rates on contractors' reported GRs ranging from 0.19% to 4.31% only, which were way below the mandatory 4% rate (effective October 1, 2005) and 5% rate (effective April 1, 2018). According to DRT representatives, the deficiencies *could be due to exemptions, tax credits, or credit adjustments* (which are allowed by law) deducted from taxable gross receipts in contractors' GRT Form filings. For these 16 selected contractors, potential forgone revenues would be over \$5M. Rate deficiencies, which ranged from 0.48% to 4.27%, are the variances between the BPT rate that should be collected versus the actual rate of BPTs paid.

Exemptions Claimed for Exemption Code E42 (P. L. 32-230) cannot be identified if Filer is a Prime or Sub-Contractor due to lack of documentation

We reviewed 25 federal contractors' GR filings. Six federal contractors had claimed exemptions in Schedule GRT-E under E-42 (PL 30-230). However, we could not find any documentation to show that the "Filers" are *prime contractors (who are not eligible for exemptions) or sub-contractors (who are eligible for exemptions)*. We were unable to identify from the documents provided (such as Schedule GRT-E and payment documents) if the "Filer" is the Prime Contractor or a Sub-Contractor and the contracting business names claimed as exemptions are Prime-Contractors.

Additionally, no documentation was provided to verify if the tax Filer or the exemptions claimed by certain contractors, numbering from one to 15 contractors, are eligible and valid according to the law. The claimed exemptions significantly reduced contractors' taxable gross receipts, reducing their tax liabilities. For the six contractors alone, questionable exemptions totaled over \$10M or equivalent to over \$500K (at 4%) potentially foregone BPTs.

During our discussion with DRT representatives, "Filers" who claimed Exemption Code E-42 (P.L. 30-230) were presumed to be sub-contractors as they are eligible to claim such exemptions under the law. However, DRT did not validate this presumption, as the GRT filings were not subjected to post reviews. In addition, per the DRT website, any exemptions or deductions must be sufficiently supported with documentation. Therefore, DRT needs to know the specific supporting documents necessary for claimed exemptions.

Deficiencies in 1% BPT Exemptions per P.L. No. 34-116 and P. L. No. 34-87

We noted deficiencies in our review of the 1% exemptions claimed by some contractors. Total exemptions/credit adjustments claimed for the three contractors alone amounted to over \$1M. The deficiencies refer to contract name and date details, base for the 1% exemptions and lack of documents to support credit adjustments.

PART 3: OTHER FINDINGS

System Cannot Automatically Generate Taxpayers with BPT Receivables

In the audit final report, a finding states that an accounts receivable account is not set up for specific contractors' unpaid BPT. This finding was provided to DRT since June 20, 2022. In their response, DRT states, "there is an A/R account set up for every taxpayer who has unpaid BPT. Also, DRT's system can generate a specific contractor's unpaid BPT if it has already been assessed."

When the OPA requested a list of total outstanding BPT receivables booked as of September 30, 2022, they responded, "it would take some time to work on." However, DRT provided OPA with a system-generated Annual Activity Report, which only contains totals for BPT Receivables for FY 2021 and other related activities.

Internal Controls

Unprocessed BPT Returns and Unavailable Documents

For the ten (10) contractors we have tested, we found that certain contractors' BPT payment document files were not available for examination. Per DRT procedure, the payment documents are filed and processed for recording at a later time when manpower is available. Additionally, per DRT's response as of May 19, 2022, to the OPA data request, some FY 2020 GRT returns were still not processed. Historically, DRT has had delays in processing/encoding GR-BPT filings.

Inadequate Process and Review of GRT-BPT Filings and Exemptions Claimed

DRT does not have a defined process or written standard procedures to review supporting documentation to validate claimed exemptions and credit adjustments' eligibility, authenticity, and accuracy. Additionally, DRT's day-to-day review process of GRT filings is only to ensure that information is completely documented in Schedule GRT-E form and properly encoded so that the system approves the encoded information. Therefore, there is no further verification of the eligibility of exemptions claimed.

Procedures in Pursuing Unpaid/Delinquent Taxes Not Clearly Defined

DRT Examination Branch does not follow specific procedures for determining, following up, and pursuing the collection of unpaid/delinquent taxes. Aside from having insufficient manpower, DRT does not have the framework to determine a timeframe for sending notices for unfiled returns and unpaid taxes or implementing the necessary action to enforce collections. This process appeared to be done and applicable only to taxpayers selected for a full compliance investigation under the CIP.

Conclusion and Recommendations

The lapses in monitoring contractor registrations, limitations in the GR-BPT form, and other factors and variables (of undeterminable values) affect the reportable GRs. Additionally, the lack of information on actual contract payments, insufficient exemption documentation, lack of exemptions post reviews, and periodic audits are some of the vital factors that pose challenges in determining a fair estimate of a contractor's potential unreported/underreported taxable GRs. Cumulatively, we found total financial impact totaling over \$22M.

Until these factors are resolved, determining contractors' reportable GRs and BPTs due would remain challenging. Neither DRT nor OPA can measure the significance of the impact of revenue leakages from military construction contracts on GovGuam revenues. But certainly, the impact of

foregone revenues/revenue leakage on GovGuam revenues would be highly significant if unaudited.

According to DRT, it initiated its Tax Enforcement Division Compliance Initiative Program-Federal Contractors on June 17, 2021 (16 days after the start of this audit on June 1, 2021) and found 78% filing compliance. Phase I is ongoing, and Phase II, for an in-depth review of potential understatement, is expected to be performed in the second quarter of FY 2023.

DRT needs to collaborate with DFAS to obtain information on actual contract payments for contractors' awarded contracts and perform periodic audits. Therefore, we encourage DRT and an oversight government body to address and resolve the surmountable issues to enhance revenue collections relative to Guam's military construction contracts/projects. In this audit, we made eight recommendations and three suggestions.



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