



InsightMagazine A Taxing Dilemma By John Berlau berlau@insightmag.com

Unlike Bush Cabinet officials, a Bill Clinton holdover who is IRS commissioner refuses to divest large holdings in the company he used to run which does big business with the IRS.

When it was revealed that Dick Cheney would be running for vice president on the GOP ticket with George W. Bush, Cheney was pummeled with questions about potential conflicts of interest that might result from his holdings in Halliburton Corp., the oil-services company Cheney headed before he was tapped as Bush's running mate. Cheney sold the stock and turned over his unvested options to an independent administrator to give the proceeds to charity. When Treasury Secretary Paul O'Neill announced he was going to keep his \$100 million in stock and options in Alcoa Corp., where he had been chairman and chief executive officer, he was subjected to intense scrutiny in the media, including Insight (see "The \$100 Million Misunderstanding," April 2-9). O'Neill did an about-face and announced on ABC's This Week that he would divest. In sharp contrast, hardly a peep has been uttered, even from Republicans, about a Clinton-administration holdover who owns millions of dollars of stock in a company that has millions of dollars of contracts with the very agency he heads. Charles O. Rossotti was appointed by Bill Clinton to head the IRS in 1997. His background in technology and business won praise at the time from both Republicans and Democrats. Rossotti had been chairman of American Management Systems (AMS), a Fairfax, Va.-based information-technology consulting firm that he cofounded after a stint as one of Robert McNamara's famed "Whiz Kids" at the Defense Department's Office of Systems Analysis. With the IRS computer systems in disarray and gross abuses of taxpayer rights unearthed during congressional hearings, members of Congress were eager to have a "manager" at the helm of IRS rather than another political tax attorney. So eager, apparently, that the Senate Finance Committee agreed to let Rossotti keep his stock in AMS, even though the company was providing computer software and data-processing services to the IRS. At his confirmation hearing Rossotti promised Sen. William Roth of Delaware, then-chairman of the Senate Finance Committee, that he would divest "if AMS decides to bid for more work from the IRS beyond existing GSA contracts, or successor contracts of similar scope." He also said he would do his best to avoid even the appearance of a conflict of interest. "No one has, I do not think, a greater interest than I do in ensuring that no one believes, at this stage in my life, that I have taken on this job in order to further any particular interest of my own," Rossotti said. Yet in a press release dated Nov. 7, 1997 - just four days after he was confirmed as IRS commissioner on a Senate vote of 92-0, but in a convenient interlude before he was sworn - Rossotti praised the achievements of AMS in a company press release announcing his IRS confirmation and AMS resignation. "This is an exciting time for AMS," Rossotti said, sounding like the major shareholder he is, in this release distributed to the business press by the PR Newswire service. "Within the next year, AMS is expected to reach \$1 billion in revenues. The company will have nearly 9,000 employees working with leading organizations around the world, including the largest banks, telecommunications firms, government organizations, health-care providers and utilities. The outlook for the business is excellent, and I am confident that

AMS' management team will continue the company's successful track record." This statement, and other questionable actions such as putting state tax chiefs whose agencies contracted with AMS in top IRS positions, has raised questions among critics about how independent Rossotti really is of his former company. "I think that in this case the line between public interest and his private interests is, at a minimum, blurred," says Mark Levin, president of Landmark Legal Foundation, a conservative public-interest legal group. "All the more reason to follow the lead of Mr. O'Neill and Mr. Cheney and so many other officials" who have divested themselves of large holdings in companies where they were executives. According to his most recent financial-disclosure forms (filed in May 2000), at the end of 1999 Rossotti and his wife, Barbara, owned between \$16 million and \$80 million in AMS stock. In 1998, the New York Times reported that he was the largest individual shareholder in AMS, a company that last year had revenues of \$1.28 billion. At press time Rossotti had not responded to Insight's request for an interview. But Rossotti's spokesman, Frank Keith, tells Insight that his boss has no plans to divest: "He's done an incredible job of running the Internal Revenue Service, which is as large as most corporations. And he's done it successfully within the ethical constraints of his executed recusal statements." Levin says there must not be a double standard in ethics for Bush appointees and Clinton holdovers such as Rossotti. "What Treasury Secretary O'Neill did stands in stark contrast to what Rossotti hasn't done and still refuses to do, which is divest himself of interest in a business that raises at least the appearance of a conflict," Levin says. "I think this is a snapshot of the difference between the Clinton and Bush administrations." Former senator Roth tells Insight Rossotti's decision not to divest is still fine with him. "In today's world, it's almost impossible to avoid any perception of conflict of interest and you've got to get people that are qualified," Roth says. "I think we also have to have a little more confidence that a typical person is going to do what's right. . We're extraordinarily fortunate to have a man of his caliber." Sen. Charles Grassley, R-Iowa, who replaced Roth as chairman of the Senate Finance Committee after the Delaware Republican was defeated last November, has praised Rossotti for improving customer service by putting more IRS personnel on the taxpayer hot lines. He gave Rossotti an "A" for managing the agency in a recent Wall Street Journal article. But Grassley is a stickler for ethics, and a Senate Finance Committee staffer tells Insight the chairman is likely to review the issue, particularly if AMS is bidding for more IRS business than was under contract when Rossotti was confirmed. "Grassley's good government," the staffer says. "I think you could certainly say that it's something that the Finance Committee is going to want to understand better." And the scrupulous Grassley may have a lot to investigate. The IRS' Keith says that the agency signed three new contracts with AMS in 2000 that will pay the company more than \$17 million this year. Keith stressed that the new contracts were "add-ons" to an existing contract with the IRS to provide financial-management systems. This means Grassley may be asking Rossotti whether the add-ons violate his pledge to the Senate Finance Committee in 1997 to divest if his old company did additional business with the agency. Keith claims Rossotti recused himself "on matters relative to that financial-management system and the financial reports we must issue each year." But a Senate aide also tells Insight that there has been tension between the IRS and its parent agency, the Treasury Department, concerning whether Rossotti should recuse himself from dealings with these financial-management contracts. "The IRS is arguing that the conflict should be waived," the aide says. "Treasury is having problems with that. I believe it's still an ongoing issue between the two staffs." Critics say that even if Rossotti were recusing himself he still would not be able to perform his duties without ethical question as long as he owned all that stock. And if he were to recuse himself from every issue that may affect AMS, he would be taking himself out of important agency decisions that he was appointed to manage. "The problem

is that, particularly with an agency like the Internal Revenue Service or the Federal Bureau of Investigation or the Drug Enforcement Administration, you're talking about serious, powerful enforcement agencies," says Levin. "There must be absolute certainty in the public's mind that there is no conflict of interest and no appearance of a conflict of interest. The problem here is that it's hard to say with a straight face that there wasn't at least an appearance problem." AMS contracts with the IRS are not Rossotti's only problem with conflicts, say critics. In the early 1990s, AMS began modernizing and integrating tax systems for state revenue departments. State tax collectors always have had an important relationship with the IRS. They frequently share data and cooperate on investigations. In addition, the IRS Restructuring and Reform Act, passed by Congress in 1998, gave state officials and certain private-sector specialists an incentive to come to work for the IRS. Previously, top-paying IRS posts other than the commissioner had to be filled by career IRS employees. But the new law gave the commissioner the authority to hire executives for 40 positions from outside the agency and pay all the way up to the vice president's then salary level of \$175,000 - still less than what many private-sector firms pay professionals, but a substantial pay raise for state officials. In 1998, soon after the law was passed, Rossotti hired two state tax chiefs. He named Kansas Secretary of Revenue John LaFaver as the IRS deputy commissioner for modernization. Val Oveson, chairman of the Utah State Tax Commission, was made national taxpayer advocate. Both officials since have left the IRS: LaFaver now is director of the Treasury Department's Tax Advisory Program; Oveson is a senior director in the Salt Lake City office of Pricewaterhouse Coopers. Neither returned phone calls from Insight. The rub is that, coincidentally or not, both officials oversaw agencies that had hired AMS to overhaul the tax computer systems of their respective states. The contracts together totaled almost \$100 million, according to a 1999 Wichita Eagle article that noted the connections of these men to Rossotti's old firm. An IRS spokesman told Investor's Business Daily (IBD) that Oveson was found by an executive search firm and that both men passed ethical checks within the Treasury Department. But the arrangement still seems odd to Mississippi Commissioner of Revenue Ed Buelow, who successfully sued AMS for breach of a contract to overhaul Mississippi's tax system. "It may not be technically wrong, but to me it's not proper," Buelow tells Insight. "To me the impropriety of it would be somewhat apparent. It's just too much of a coincidence: Out of 50 commissioners, why did those two get picked. Why wasn't it one of the other 47 that didn't have a contract. . If I had been in the position that Mr. Rossotti's in, I would have been somewhat reluctant to consider someone to whom I had a contract in the private sector for a top job with the IRS." Another state official who found the hirings suspicious was Kansas Senate Minority Leader Anthony Hensley. A staunch Democrat, Hensley often criticized the governor and his appointees such as LaFaver. But in 1999 he also launched a volley against Rossotti, an appointee of his own party's president. "It looks almost like a pipeline," Hensley told IBD in 1999. "You cooperate with AMS, and you can move on to the IRS." LaFaver responded by saying that Hensley's charge was "absolutely preposterous" because there was no way LaFaver could have known when he signed the contract with AMS that Rossotti would be IRS commissioner more than two years later. The question, say critics, is whether Rossotti was rewarding key state officials whose states gave AMS huge contracts. And AMS did use LaFaver's status in its marketing. In a sales brochure, as well as on its Website, AMS featured this quote: "The real results of this partnership will be the creation of the best tax incentives for any firm to locate and prosper in Kansas." The author of that commercial endorsement then was identified as "former Kansas Secretary of Revenue and current Deputy Commissioner of Modernization, U.S. Internal Revenue Service." Tom Morgan, a professor of law who teaches legal ethics at George Washington University, sees nothing wrong per se with Rossotti hiring

officials who happened to have steered big contracts to AMS. At the same time, he criticizes AMS' use of LaFaver's IRS status as a sales tool. "An implication of saying that you're going to withdraw from involvement is also a kind of representation that your company, from which you're currently benefiting, should not trade on the fact that you are IRS commissioner or that your deputy is a customer of the company," says Morgan. "That implies something that you've warranted is not true - namely, that there's some connection between the commissioner and the company." AMS did not return Insight's repeated phone calls requesting comment. Questions again surfaced last November when LaFaver's successor as Kansas secretary of revenue, Karla Pierce, announced she was leaving Kansas to go to work on the IRS computer-systems modernization project as an employee of Computer Sciences Corp., the lead contractor. In speaking to Insight, Hensley alleged, "There's a quid pro quo here." Pierce, a longtime employee of the Kansas Department of Revenue, had been project manager when the AMS overhaul began. She and LaFaver would meet with Rossotti when he came to Kansas as AMS chairman for quarterly status reports, according to IBD. Pierce defended AMS when the company's work was under attack by Kansas lawmakers of both parties after a rash of late refunds. Mississippi officials also say she tried to thwart their efforts to get information about the AMS problems in Kansas. "I don't question that there's a connection and that he helped her get that job," says Armin Moeller, a partner at the Jackson, Miss., office of Phelps Dunbar, LLP, who represented Mississippi in the lawsuit. "Karla Pierce was a key player in defending AMS to the hilt. Karla Pierce was a key player in not cooperating with us." Mississippi Commissioner Buelow agrees. "In my dealings with Miss Pierce, she conducted herself more as an employee of AMS than she did as a commissioner of revenue of a sister state," he says. "She was totally uncooperative as far as trying to help us, quite contrary to other states. [Other states and Mississippi] always shared information and tried to help each other find out how your project's doing. She wouldn't cooperate, she wouldn't return telephone calls. When I filed suit, she called me and told me if that would require her to do any testifying she wasn't going to do it, and she wasn't going to do anything at all to help us." A Computer Sciences Corp. public-affairs officer did not return Insight's telephone calls and an e-mail inquiring about these matters. The IRS' Keith said he had "no information" concerning whether Rossotti had any input or influence over the company in the hiring of Pierce. Insight tried to reach Pierce directly at the company's Federal Sector Division at Falls Church, Va. An operator said no one with the name Karla Pierce was in the employee database. Although Mississippi had contracted with AMS in 1993 to modernize and integrate the state's entire system of various taxes, by "April 1999 not a single tax-collection software program was operational," the lawsuit said. Buelow charged that AMS had misrepresented its work and diverted resources to other states. A jury found AMS guilty of breach of contract and, because the state had included lost revenue in its damages, ordered AMS to pay the state \$475 million - one of the largest jury verdicts in the country last year. The state and AMS eventually settled for \$185 million, \$32 million of which - plus nearly \$4 million in litigation costs - had to be charged against quarterly earnings. AMS currently is suing one of its insurers for not paying a settlement to the state before trial. Some in Kansas think that Pierce may have saved AMS from a similar fate there and claim to see a connection to her new job. The Kansas tax system that AMS modernized seems to be running well now and received an award from the Federation of Tax Administrators. But, in 1999, refunds took nearly twice as long, on average, to be processed as the year before, according to a state legislative audit. Delinquent notices were sent out erroneously and lawmakers were flooded with calls from angry taxpayers. Pierce defended AMS at the time, blaming the problem on legislative changes and the difficulty of finding temporary employees. But many lawmakers put much of the blame on

AMS, saying that a multimillion-dollar system should have been able to handle the changes in tax law. Some wanted to follow Mississippi's lead and sue. "When there was a lawsuit in Mississippi, that was the same time we were having lots of problems and many of us were suggesting that maybe we ought to be doing the same thing," recalls Kansas state Rep. Tony Powell, R-Wichita, a member of the House Tax Committee. "Even though things have improved at the department now, I'm not convinced it's because of this new tax system. . I still have questions as to whether this contract was a good deal." But AMS touted Kansas in promotional materials as an example of its success with favorable quotes from LaFaver and Pierce. "Our vision will be achieved when we put the customer first every time," Pierce was quoted as saying in a brochure next to her picture. In news stories about the Mississippi case, AMS officials also cited the Kansas project as proof of their competence. Another connection Rossotti still has to AMS is through his wife, Barbara. Barbara Rossotti, a partner at the Washington law firm of Shaw Pittman, which represented AMS, attended the trial in Mississippi and participated in the mediation and settlement conferences between the state and AMS, according to Buelow and Moeller. The latter recalls Barbara Rossotti giving very specific instructions about terms of the settlement. "She was acting almost as inside and outside counsel," Moeller says. "It was clear to me that when you speak to her, you're speaking to a real player. It seemed to be a bit different than your typical lawyer-client relationship." Moeller says he was surprised to see her playing such an active role in the case, given that her husband was supposed to be distancing himself from the company. "It seemed clear to us she was there as his [IRS Commissioner Rossotti's] proxy," Moeller says. "As a partner at Shaw Pittman, she could work on all kinds of things. The bottom line was she was working on this." Barbara Rossotti did not return Insight's repeated phone calls. The IRS' Keith insists her representation of AMS posed no problems. "Why, if the commissioner has executed a viable and rigorous recusal process to separate himself from any dealings with AMS in his capacity as the commissioner of the Internal Revenue Service, would his wife's employment have an impact?" Keith asks. Moeller concludes, "All indications are that Charles Rossotti is a major influence, if not the primary influence, on AMS." These are serious matters. The 1998 IRS Restructuring and Reform Act gave Rossotti a five-year term that will not end until November 2001, but it also provides that "the commissioner may be removed at the will of the president." Tom Fitton, president of the conservative ethics watchdog group Judicial Watch, thinks Rossotti's ties to AMS, as well as the allegedly politicized audits of many conservative groups critical of the Clinton administration that continued during his tenure (see sidebar, p. 12), justify his removal. The IRS commissioner's actions "raise the appearance that Rossotti and his family are working for AMS rather than the American people," Fitton says. "The taxpayer should have full faith and confidence that the IRS is not acting on behalf of any special interest, whether it be politicians like Bill Clinton or big businesses like AMS."

Political Audits Revisited

During the mid-nineties, a long list of conservative groups and Clinton critics were subjected to audits by the IRS. It seemed to many that every time someone on the right - from the Western Journalism Center to Paula Jones - criticized the president, they would be visited by the IRS and put through the turmoil and fear of a government audit. Many traced these allegedly politicized audits to IRS Commissioner Margaret Milner Richardson, who President Clinton appointed in 1993. Richardson was an accomplished Democratic fund-raiser and a close friend of Hillary Rodham Clinton. She was a determined partisan who served on the president's transition team and, while boss of the IRS, even attended the 1996 Democratic National Convention. So it was

hoped that when Charles Rossotti, an information-technology executive with good managerial skills and no apparent ties to the Clinton administration, came aboard in 1997 the rash of audits would stop. But as long as Clinton was in power the suspicious audits continued. In May 2000, less than two months after a report from the Joint Committee on Taxation found "no credible evidence" of politically motivated audits during Clinton's tenure, the nursing home owned by Juanita Broadrick - who alleged that Clinton raped her while he was Arkansas attorney general - was subjected to an audit from the IRS. Then, in August, Katherine Prudhomme, a woman who grilled Al Gore in New Hampshire about the Broadrick case, found out from the IRS that she owed \$1,500 in back taxes just hours before she spoke at a rally in front of Hillary Rodham Clinton's New York campaign headquarters. (The IRS has resolved Prudhomme's case in her favor, but Broadrick's case continues, according to Larry Klayman of Judicial Watch, the public-interest law firm now representing both women.) The National Center for Public Policy Research, a group critical of the Clinton administration's environmental policies, received a new audit in 2000 after getting a clean bill of health from an earlier audit in 1996. Bill O'Reilly, who ripped into Clinton every weeknight on Fox News, was audited three years in a row after he began hosting The O'Reilly Factor. And the Heritage Foundation and Citizens Against Government Waste, two nonprofit organizations audited in 1996 for sending out fund-raising letters signed by presidential candidate Bob Dole that the IRS deemed too political, did not get closure on their cases until after the November 2000 elections. But according to Rossotti, a former Robert McNamara "Whiz Kid," politicized audits never were a problem during the Clinton years. Upon release of the Joint Committee report, Rossotti issued the following statement: "With this report, I think we can safely lay to rest concerns that the resources of the IRS have been diverted for political purposes." His spokesman, Frank Keith, tells Insight that Rossotti stands by that statement today. At least one member of the congressionally created National Commission on Restructuring the IRS finds Rossotti's comments very disturbing. "It suggests he's part of a cover-up rather than getting to the bottom of this," says Grover Norquist, president of Americans for Tax Reform and an informal adviser to the Bush administration. "Those obviously targeted political audits are a scandal, and if Rossotti doesn't get them stopped and uncovered - if Rossotti's not capable of doing that, if he continues to cover up - he should resign or be asked to leave."

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