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*The Internal Revenue Service's Private Tax Debt Collection Initiative: Current Status, Legislative Proposals, and Issues for Congress*

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September 23, 2008

**Abstract.** Since the IRS began to implement the PDC initiative, congressional opponents have made repeated efforts to eliminate it. In the 110th Congress, five bills that would repeal the IRS's authority to enter into contracts with PCAs have been introduced: H.R. 695, S. 335, H.R. 3056, H.R. 3996, and H.R. 5719. While the House has passed three of them (H.R. 3056, H.R. 3996, and H.R. 5719), the Senate has not acted on two of them (H.R. 3056 and H.R. 5719), and the enacted version of H.R. 3996 lacked a provision terminating the PDC initiative. In addition, each of the bills providing funding for the IRS in FY2009 approved by the House (no number yet assigned) and Senate (S. 3260) Appropriations Committees contains a provision barring the IRS from using any appropriated funds to operate or manage the initiative.



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# CRS Report for Congress

## The Internal Revenue Service's Private Tax Debt Collection Initiative: Current Status, Legislative Proposals, and Issues for Congress

Updated September 23, 2008

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Prepared for Members and  
Committees of Congress

# The Internal Revenue Service's Private Tax Debt Collection Initiative: Current Status, Legislative Proposals, and Issues for Congress

## Summary

A provision of the American Jobs Creation Act of 2004 gave the Internal Revenue Service (IRS) the authority to use private debt collection agencies (PCAs) to assist in the collection of overdue individual taxes. The IRS has since launched a private tax debt collection (PDC) initiative which could collect between \$1.5 billion and \$2.2 billion in gross revenue from 2007 through 2016.

This report examines the design of the initiative and the policy issues it raises. More specifically, the report describes the scope of the IRS's authority to use PCAs under the AJCA, reviews the steps the IRS has taken to implement a private collection initiative derived from this authority, outlines the arguments that have been made for and against such an initiative, and concludes with a discussion of legislation in the 110<sup>th</sup> Congress to modify the initiative. The report will be updated to reflect significant new developments, legislative or otherwise.

Under Section 6306 of the Internal Revenue Code (IRC), the IRS may enter into contracts with PCAs to assist in the collection of a prescribed portion of individual tax debt under a set of rules intended to protect the rights of taxpayers and the confidentiality of taxpayer information and to prevent abusive collection practices. The IRS may use PCAs only to locate and contact taxpayers with an overdue tax liability who are not contesting it, and to arrange for the payment of those taxes.

The PDC initiative has been a source of controversy from the outset. Proponents say it is needed to help shrink a large and growing inventory of delinquent individual tax debt that is eroding public trust in the fairness of the tax system, and to free the IRS to devote its collection resources to problems with larger potential payoffs. Although critics of the initiative agree that the current backlog of individual tax debt should be reduced, they argue that the task of retiring the debt should be handled by properly trained IRS agents, not PCA employees. In their view, the use of PCAs is a flawed approach for three reasons: (1) the collection of taxes is an inherently governmental function, (2) it would be more cost-effective to hire and train additional IRS agents to collect the overdue taxes, and (3) PCAs cannot be trusted to protect taxpayer rights and eschew abusive collection practices.

Since the IRS began to implement the PDC initiative, congressional opponents have made repeated efforts to eliminate it. In the 110<sup>th</sup> Congress, five bills that would repeal the IRS's authority to enter into contracts with PCAs have been introduced: H.R. 695, S. 335, H.R. 3056, H.R. 3996, and H.R. 5719. While the House has passed three of them (H.R. 3056, H.R. 3996, and H.R. 5719), the Senate has not acted on two of them (H.R. 3056 and H.R. 5719), and the enacted version of H.R. 3996 lacked a provision terminating the PDC initiative. In addition, each of the bills providing funding for the IRS in FY2009 approved by the House (no number yet assigned) and Senate (S. 3260) Appropriations Committees contains a provision barring the IRS from using any appropriated funds to operate or manage the initiative.

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# The Internal Revenue Service's Private Tax Debt Collection Initiative: Current Status, Legislative Proposals, and Issues for Congress

For many Americans, the collection of taxes is an inherent function of government.<sup>1</sup> According to this view, collecting federal taxes owed by individuals and private firms should be the exclusive responsibility of a federal agency like the Internal Revenue Service (IRS).

This view appears rooted in federal law. Section 6301 of the Internal Revenue Code (IRC) states that the "Secretary [of the Treasury] shall collect the taxes imposed by the internal revenue laws." Under the Debt Collection Improvement Act of 1996 (DCIA, P.L. 104-34), federal agencies may enter into contracts with private firms to collect all debts owed to the federal government, except tax debts. And the Federal Activities Inventory Reform Act of 1998 (FAIR, P.L. 105-270) prohibits federal agencies from contracting out functions deemed inherently governmental. The act defines an inherently governmental activity as one that "is so intimately related to the public interest as to require performance by Federal Government employees," and that requires the "exercise of discretion" in the use of authority or the "making of value judgments relating to monetary transactions and entitlements."<sup>2</sup>

Nonetheless, at the urging of the Bush Administration, Congress granted the IRS the authority to hire private debt collection agencies (PCAs) to assist in the collection of individual tax debt through a provision of the American Jobs Creation Act of 2004 (AJCA, P.L. 108-357).<sup>3</sup> This grant of authority marked both the second time the

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<sup>1</sup> According to the results of a national poll conducted by the Global Strategy Group in October 2003, 66% of respondents opposed a plan unveiled earlier that year by the Bush Administration to use private debt collection companies to assist the IRS in the collection of some delinquent individual tax debt; the margin of error was plus or minus four percentage points. See Amy Hamilton, "The Fight Over the IRS Hiring Private Debt Collectors," *Tax Notes*, Oct. 20, 2003, p. 321.

<sup>2</sup> See 31 U.S.C. 501.

<sup>3</sup> The first documented case of the federal government outsourcing the collection of taxes occurred in 1872, when Congress granted the IRS's predecessor, the Bureau of Internal Revenue, the authority to hire no more than three individuals to assist in "discovering and collecting any money belonging to the United States." The effort lasted until 1874, when it was terminated in response to the findings of an investigation conducted by the House Ways and Means Committee. The Committee concluded that private tax collection contracts served no useful purpose and undermined the existing apparatus of federal tax (continued...)

agency was permitted to hire PCAs and the culmination of a contentious debate in Congress over the best way to reduce a large and growing inventory of potentially collectible individual tax debt. Fueling the debate was a proposal by the Bush Administration in its budget requests for FY2004 and FY2005 to allow the IRS to use PCAs to collect certain overdue individual taxes. Although the proposal attracted enough support in the 108<sup>th</sup> Congress to be adopted, it continues to serve as a lightning rod for criticism. Congressional opponents have not ceased their efforts to curtail or repeal the IRS's authority to hire PCAs.

The IRS's initial experience with PCAs came in the form of a pilot project — known as the Contracting Out Collection Activities Project — authorized by the Treasury, Postal Service, and General Government Appropriations Act, 1996 (P.L. 104-52). The project was supposed to last two years, but the IRS ended it after one year in response to mounting opposition from some Members of Congress and senior officials in the Clinton Administration.

This report examines IRS's current program for using PCAs to collect delinquent individual taxes and the policy issues it raises. More specifically, it describes the scope of IRS's statutory authority to use PCAs under the AJCA, summarizes the steps the IRS has taken so far to implement this authority, reviews the main arguments that have been raised for and against the IRS's private tax debt collection initiative, and discusses legislation in the 110<sup>th</sup> Congress that would modify the initiative. The report concludes with a brief discussion of possible policy issues for Congress, as it exercises its power to oversee the private debt collection initiative. It will be updated to reflect new legislative activity and other significant developments.

## **IRS's Statutory Authority to Use Private Debt Collection Agencies**

### **Current Law**

Among other things, the AJCA added section 6306 to the Internal Revenue Code (IRC). As a result, the IRS is permitted to hire PCAs for the purpose of assisting with the collection of delinquent individual tax debt in a manner that protects basic taxpayer rights, avoids the use of abusive collection practices, and takes into account federal laws governing the outsourcing of activities deemed inherently governmental. Current federal tax law considers an individual taxpayer delinquent if he or she fails to pay his or her taxes by the due date, despite receiving a notice from the IRS about the amount owed.

IRC section 6306 also lays down a set of detailed guidelines for the use of PCAs by the IRS. First and foremost, the IRS may use PCAs for two narrowly specified

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<sup>3</sup> (...continued)

administration. For more details on this effort, see Joseph J. Thorndike, "The Unhappy History of Private Tax Collection," *Tax Notes*, Sept. 20, 2004, pp. 1346-1349.

purposes only: (1) to locate and contact taxpayers with overdue tax liabilities who have no unresolved disputes with the IRS over the amount of taxes owed, and (2) to arrange for payment of those taxes. Most of these taxpayers fit into one of two categories: (1) those who have filed a return indicating an amount due but have failed to pay the balance in full, and (2) those who have been assessed an additional tax by the IRS in its review of their returns and made several payments but have failed to pay the entire amount owed. No cases whose resolution requires the “exercise of discretion” by the IRS — mainly disputes over the interpretation of the tax code or the amount of tax assessed by the IRS — are to be handled by PCAs. The exercise of such judgment is considered an inherent function of government under federal law; so any activity involving the exercise of discretion may not be outsourced.

Second, PCAs awarded tax collection contracts must follow a carefully prescribed procedure when contacting a delinquent taxpayer. Their initial contact has to be in the form of a letter reminding the individual of an overdue tax liability. If his or her last known address is incorrect, the PCA is authorized to track down the correct address. If the letter does not lead to a prompt payment of the tax debt, a PCA then may try to reach the taxpayer by telephone and request that he or she pay the balance immediately. If a taxpayer says that he or she cannot do so, the PCA can offer the taxpayer the option of paying off the tax debt through installment payments made over a period of up to five years. If the taxpayer does not agree to such a payment plan, the PCA then may obtain certain financial information about the taxpayer and turn it over to the IRS for further action. Once a PCA gathers this information, it may have no further contact with the taxpayer.

Third, employees of PCAs are obliged to adhere to the same statutory code of ethics for collection that applies to IRS employees. But if a taxpayer contacted by a PCA accuses it of acting unlawfully or abusively and sues for civil damages, the IRS cannot be held legally liable for the actions of the PCA. And if the IRS determines that the actions of a PCA violate section 1203 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98), which specifies the circumstances under which an IRS employee can be fired for misconduct, the agency may impose several penalties, including revoking the firm’s tax collection contract and barring it from bidding on future contracts.

Fourth, PCAs awarded tax collection contracts must also adhere to existing statutory protections of the rights of individual taxpayers with tax debts. Specifically, the employees of PCAs assigned to work on the contracts must understand and abide by the provisions of the Fair Debt Collection Practices Act of 1996 (FDCPA), which prohibits the use of collection practices deemed unreasonably intrusive or abusive to debtors.<sup>4</sup> Those same employees are also obligated to uphold the legal protections of taxpayer rights and privacy in the same manner as IRS employees. This requirement means that PCA employees are as subject to civil and criminal penalties for the unlawful disclosure of taxpayer information under IRC section 6103 as IRS employees are. It also means that PCAs must inform the taxpayers they contact of

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<sup>4</sup> For example, PCAs would not be allowed to communicate with taxpayers at unusual or inconvenient times or places and would be barred from harassing or threatening taxpayers.

their right to seek assistance from the IRS National Taxpayer Advocate, whose rulings under IRC section 7811 apply with equal force to PCA and IRS employees.

Fifth, a PCA may not hire subcontractors to contact taxpayers, provide quality assurance services, or write debt collection notices. If a PCA wishes to hire a subcontractor for another purpose connected to its obligations under a tax debt collection contract, it must first obtain the approval of the IRS.

Sixth, all revenue collected through the efforts of PCAs has to go into a revolving fund. PCAs are not allowed to receive or process any of this money; only the IRS can do so. The IRS may use up to 25% of the money in the fund to compensate PCAs for their services — though IRC section 6306 offers no guidance on the factors the IRS should consider in compensating a PCA for its services. In addition, the IRS may transfer up to 25% of the revenue in the revolving fund to its budget for tax law enforcement.

IRS's current authority to use PCAs comes with at least one notable string attached: periodic congressional review of the results of the private tax debt collection initiative. Under the AJCA, the IRS must submit a report every other year, beginning in 2005, to the House Ways and Means and Senate Finance Committees assessing various aspects of the initiative, including its overall costs and benefits, its impact on IRS enforcement staffing levels, its impact on the inventory of overdue tax assessments, the amount of revenue collected, the performance of contractors, and the effectiveness of the collection techniques used by PCAs.<sup>5</sup>

## Previous Law

Before the enactment of the AJCA, the IRS lacked the authority to hire private companies to assist in the collection of overdue taxes, with one notable but short-lived exception (see below).

Since 1954, the federal tax code has made it clear that only the IRS is authorized to collect taxes: under IRC Section 6301, only officers, employees, and agencies of the Treasury Department may collect “taxes imposed by the internal revenue laws.” This restriction on tax collection authority was included in the Debt Collection Improvement Act of 1996 (DCIA, P.L. 104-134), which permitted all federal agencies, except the IRS, to enter into contracts with PCAs to collect overdue debts owed to the federal government. Reinforcing the prohibition on the outsourcing of federal tax collection were several provisions of the Federal Activities Inventory Reform Act of 1998 (FAIR Act). The act barred federal agencies from hiring the private sector to conduct activities regarded as inherently governmental. According to Section 5 of the act, an activity is considered inherently governmental if “it is so intimately related to the public interest as to require performance by Federal Government employees,” and if it entails the “exercise of discretion” in applying

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<sup>5</sup> According to an e-mail message received from June McHenry of IRS on Nov. 21, 2007, the initial report is likely to be submitted to the committees by December 31, 2007.



governmental authority or the “making of value judgments relating to monetary transactions and entitlements.”<sup>6</sup>

The short-lived exception occurred in 1996 and 1997, when Congress gave the IRS the authority to establish and manage a pilot project involving the use of PCAs. In the appropriations bills for the Treasury Department enacted for both FY1996 and FY1997, Congress authorized the IRS to spend up to \$13 million each year to experiment with the use of PCAs in the collection of delinquent individual taxes. In response to the mandate, the IRS set up a program under which the PCAs it hired assisted IRS collection staff by locating and contacting individual taxpayers to remind them of their overdue tax liabilities and inform them of payment options. Taxpayers who agreed to a payment plan were referred to someone in IRS’s collection division to arrange a payment schedule. Only IRS employees could collect funds to settle delinquent accounts. PCAs received a fixed fee for their services, regardless of the amount of overdue taxes collected.

Dissatisfaction with the results of the program among some in Congress and within the Clinton Administration led the IRS to cancel it in 1997. These results and the main factors behind them were examined in a report issued by the General Accounting Office (GAO) in July 1997.<sup>7</sup> According to the GAO, through the end of January 1997, PCAs had contacted 14,000 out of 153,000 targeted taxpayers and collected \$3.1 million in overdue taxes. But the total cost of the program exceeded the total amount collected: through January 1997, expenditures for the design, start-up, and administration of the program came to \$3.1 million; about \$1.0 million had been paid to PCAs for their services; and the estimated opportunity cost of using IRS collection staff to assist with the pilot program instead of using them to collect taxes was \$17 million. GAO blamed the failure of the program to live up to initial expectations on the limitations imposed on the work PCAs were allowed to undertake; the number and types of cases referred to PCAs; and repeated problems in using IRS’s computer system to identify, select, and transmit collection cases to PCAs.

## Legislative History of IRS’s Current Authority

IRS’s current authority to outsource tax debt collection has its origins in the Bush Administration’s budget requests for the IRS in both FY2004 and FY2005. Each request included a proposal to allow the IRS to hire PCAs to help reduce a swelling inventory of overdue but potentially collectible individual taxes.<sup>8</sup>

Under the proposal, the use of PCAs was to be limited to locating individual taxpayers with overdue tax liabilities who were not contesting their tax assessments,

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<sup>6</sup> 31 U.S.C. 501.

<sup>7</sup> U.S. General Accounting Office, *Issues Affecting IRS’ Collection Pilot*, GGD-97-129R (Washington: July 18, 1997).

<sup>8</sup> For a summary of the Administration’s proposal, see Amy Hamilton, “Bush Proposes Private Agencies Collect Known Tax Delinquencies,” *Tax Notes*, Feb. 10, 2003, pp. 885-887.

contacting them to request full and immediate payment of these debts, offering the option of paying in installments over three years if full payment could not be made immediately, and obtaining needed financial information about the taxpayer and transmitting it to the IRS if no such agreement could be reached. PCAs were to be assigned cases that were likely to be resolved with one or two phone calls and required no “exercise of discretion” by the IRS. Most of these cases were to focus on taxpayers who had filed tax returns showing that taxes were owed but had not been paid, or who made three or more payments against an added tax assessment by the IRS but had stopped the payments without paying the full amount. All revenue collected through the activities of PCAs was to be funneled into a revolving fund, from which they were to be compensated for their services. Compensation was to be based mainly on the quality of service provided, taxpayer satisfaction, and case resolution. Employees of PCAs were to be subject to the same rules protecting basic taxpayer rights and the confidentiality of taxpayer information that applied to IRS employees. Taxpayers who believed their rights had been violated by the actions of a PCA could sue the company for civil damages. But the IRS could not be held liable for any illegal act committed by a PCA employee..

In asking Congress to give the IRS the authority to use PCAs for tax debt collection, the Bush Administration was addressing at least two key policy issues. One was the rising amount of delinquent individual income tax debt and the concern that it would erode public confidence in the basic fairness of the federal income tax system and the ability of the IRS to ensure that each taxpayer pays the tax he or she owes in a timely manner. In testimony at a hearing held by the House Ways and Means Subcommittee on Oversight on May 13, 2003, IRS Commissioner Mark W. Everson stated that the amount of individual income tax debt deemed uncollectible by the IRS because of shifting enforcement priorities increased from about \$7 billion in early 2000 to over \$13 billion in early 2003. These uncollected taxes represent a small part of the estimated gross federal tax gap, which is the difference between taxes owed and taxes paid voluntarily in a timely manner, before enforcement activity by the IRS.<sup>9</sup>

A second policy issue was the declining capacity of the IRS to address the growing inventory of delinquent individual tax debt. From FY1996 through FY2003, the number of IRS revenue officers responsible for handling delinquent accounts fell from about 5,500 to about 3,500, a decrease of 36%. IRS officials attributed the decline to an increase in the workload in other essential operations (e.g., processing returns, issuing refunds, and responding to mail from taxpayers); a dramatic shift in the strategic focus of the IRS away from enforcement and toward taxpayer service and support; increases in operating costs (e.g., rent, mail, and wages) not covered by appropriated funds; and congressional opposition to the Bush Administration’s repeated requests for larger budgets for tax collection.<sup>10</sup> The decline in collection

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<sup>9</sup> The most recent IRS estimate of the gross tax gap is \$345 billion in FY2001. IRS enforcement actions and late tax payments recovered about \$55 billion of that amount, leaving a net tax gap of \$290 billion. For more information on the federal tax gap, see CRS Report RL33882, *Tax Gap and Tax Enforcement*, by James M. Bickley.

<sup>10</sup> U.S. General Accounting Office, *Tax Debt Collection: IRS Is Addressing Critical Success* (continued...)

staff widened the gap between the number of cases assigned for collection and the number of cases closed each year so that by May 2003, the IRS was deferring action on one of every three collection cases.<sup>11</sup>

In a bid to address both issues at once, the Bush Administration proposed that more resources be channeled into tax law enforcement. But Congress did not provide the requested funding. For instance, the Administration asked Congress to appropriate \$3.881 billion for tax compliance services in FY2003 so that the IRS could expand its full-time compliance workforce to 45,959 persons. Congress ended up approving a budget for tax compliance services of \$3.623 billion, which meant that the IRS was able to hire 1,569 fewer compliance services agents than it had requested.

Faced with the prospect of continued growth in the inventory of potentially collectible tax debt, senior IRS officials, led by IRS Commissioner Mark Everson, elected to gain congressional assent for a plan to outsource some of the collection work to the private sector.

Several legislative initiatives in the 108<sup>th</sup> Congress sought to implement the main elements of the Administration's proposal. Specifically, H.R. 1169, H.R. 2896, S. 2, and S. 1637 contained provisions that would have given the IRS the authority to hire PCAs to assist with the collection of individual tax debt under the guidelines laid down in the proposal. The AJCA emerged from the conference report (H.Rept. 108-755) on H.R. 4520 approved by the House and Senate. On the issue of whether the IRS should be allowed to enter into tax collection contracts with private firms, the report combined elements from the House-passed version of the bill (which included the provision on PCAs from H.R. 2896), and the Senate-passed version (which included the provision on PCAs from S. 1637).

## **Steps Taken by the IRS to Implement a Private Tax Debt Collection Initiative**

### **2004 and Earlier**

The IRS began to lay the foundation for its current private tax debt collection initiative late in 2001, about three years before it gained the authority to undertake such an initiative. A central objective of the planning effort was to agree on an approach that would collect a substantial amount of overdue individual taxes without repeating the main mistakes that led to the demise of the 1996 pilot project.

A PCA project team was formed within the IRS in October 2001. One of its first activities was to meet with representatives from the revenue agencies of five

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<sup>10</sup> (...continued)

*Factors for Contracting Out but Will Need to Study the Best Use of Resources*, GAO-04-492 (Washington: May 2004), p. 5.

<sup>11</sup> *Ibid.*, p. 5.

state governments and two federal agencies with extensive experience in administering private debt collection programs.<sup>12</sup> Among the issues explored by the team were the structure and management of contracts for the private collection of public debts, data security, compensation arrangements, and the protection of taxpayer rights. The team also met with representatives from three PCAs five times between May and October 2002 to discuss a variety of issues related to collection case management, including case screening criteria, electronic data sharing capabilities, data security requirements, and potential compensation schemes.

In a clear signal the IRS was ready to move forward with a plan for a tax debt collection involving the use of PCAs, the agency issued in February 2003 a Request for Quotation (RFQ) for its emerging plan to hire PCAs.<sup>13</sup> The RFQ's primary purpose was to promote awareness among prospective contractors of the IRS's intention to enter into contracts with PCAs for tax debt collection, and to solicit feedback from PCAs on the requirements that should be included in those contracts.

In May 2004, the GAO issued a report assessing the IRS's readiness to implement a plan for using PCAs like the one proposed by the Bush Administration. GAO made the assessment largely on the basis of what it called the "five broad factors that are critical to the success of a proposed program for contracting with PCAs to collect tax debt."<sup>14</sup> One factor concerned the goals for the program; a second addressed the resources needed by the IRS to achieve those goals; a third focused on the nature of the work to be assigned to PCAs; a fourth dealt with the protection of taxpayer rights and privacy; and the fifth stressed the importance of monitoring the performance of PCAs and periodically comparing the results and costs of the program with its main goals. The report concluded that, though the IRS had taken some steps to address each of the factors, more work needed to be done before the agency could be deemed prepared to begin assigning collection cases to PCAs.

## 2005

With the passage of the AJCA in late 2004, the IRS shifted its focus from devising a plan to outsource the collection of certain individual tax debt to implementing the guidelines for such a plan set forth in the act.

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<sup>12</sup> Department of the Treasury, Treasury Inspector General for Tax Administration, *Efforts to Develop a Successful Collection Contract Support Program Could Be Enhanced*, Audit Report 2003-30-075 (Washington: March 2003), p. 2.

<sup>13</sup> Generally, a Request for Quotation (RFQ) is a method used by federal agencies to describe to prospective contractors the products and services that may be purchased and the terms and conditions that would apply. RFQs serve the useful purpose of informing the private sector about the procurement needs of federal agencies and informing federal agencies about the depth of interest in the private sector in bidding on specific contracts. A response by a prospective contractor to a RFQ is not considered an offer and thus cannot be accepted by a federal agency as a binding contract. Each RFQ has a unique identifying number; the RFQ issued by the IRS in February 2003 was TIRNO-03-H-0001.

<sup>14</sup> U.S. General Accounting Office, report GAO-04-492, p. 9.

**Initial Request for Quotes (RFQ).** On April 27, 2005, the agency issued an RFQ (TIRNO-05-Q-00050) to solicit bids for contracts to assist with the collection of specified delinquent tax debt. In the document, the IRS announced it would implement such an undertaking in two stages: “a limited implementation in FY2005, (followed by) a full implementation in FY2007.” In the first stage, the IRS would enter into contracts with “approximately three” PCAs. To be eligible to bid on a contract, a firm had to be registered as a debt collection agency with the General Services Administration (GSA) and a current supplier of debt collection services to a federal agency “under GSA Schedule 520-4.” Only 23 of the 87 PCAs authorized by the GSA to perform debt collection for federal agencies as of early 2005 met these criteria. In addition, all employees of contractors and subcontractors had to be U.S. citizens or permanent resident aliens. Each of the contracts would last 12 months and could be extended up to six months, as many as three times. Firms interested in bidding for the three initial contracts had to provide the IRS with details on their past performance, pricing, licenses, and bonding. Applications were due by 12:30 p.m. on June 1, 2005.

In late May 2005, IRS changed the application deadline to June 7, 2005, and said it would award the three contracts by the end of July 2005 and start the initial phase of the collection work in January 2006.

The RFQ covered many issues, including the rules governing the collection work to be done by PCAs and the compensation of contractors. Basically, PCAs with contracts would be assigned collection cases involving individual taxpayers who filed tax forms 1040, 1040A, or 1040EZ, owed \$25,000 or less in assessed taxes, and were not contesting their tax liabilities. Only tax debt that was overdue a minimum of 30 days but no more than four years before the expiration of the 10-year statute of limitations on the collection of federal tax debt could be assigned to a PCA. According to the RFQ, as of December 2004, the IRS had classified \$7.7 billion in delinquent tax debt as “potentially available for the limited implementation of private debt collection.” Nearly \$5.5 billion of this amount was considered “low-priority work load that would likely be eligible for placement with PCAs.” The IRS anticipated assigning about 100,000 delinquent accounts to PCAs in the first year of the initiative.

All collection work would be performed in the United States, and none of the taxpayer information could be transmitted outside the United States through the contractors’ computer systems.

PCAs were required to comply with all laws protecting basic taxpayer rights and the confidentiality of taxpayer information. For each collection case assigned to it, a PCA would be given the following information: the taxpayer’s name, telephone number, home address, the tax year in question, and the amount due. PCA employees working on assigned cases had to be U.S. citizens or permanent resident aliens and to pass a background investigation conducted by the IRS. In addition, these employees would have to undergo training on IRS security, collection, and privacy policies and the penalties under IRC Sections 7213, 7213A, and 7431 for the unauthorized disclosure or use of tax return information, and they would have to certify in writing that they received such instruction.

The IRS would take several steps to ensure that PCAs were complying with the terms of their collection contracts. All letters sent by contractors to delinquent taxpayers had to be approved in advance by the IRS, and the IRS reserved the right to monitor telephone conversations between contractors and taxpayers. In addition, PCAs were required to grant the IRS “full, free, and uninhibited access” to all facilities owned by the contractors so the agency could verify that contractors were taking all necessary and appropriate measures to protect the rights of taxpayers and the confidentiality of taxpayer information.

PCAs would be paid a share of the delinquent tax debt they collect. Compensation would range from 24% of collections totaling less than \$1,500 to 21% for collections exceeding \$10,000. In addition, the compensation would cover only payments received from delinquent taxpayers 11 or more days after an account is transferred to a PCA and no later than 10 days after the account is returned to the IRS. Contractors that were the target of repeated complaints from taxpayers could lose some or all of the compensation they are owed.

**Legal Challenge to Initial RFQ.** The solicitation of bids under the April RFQ came to an abrupt halt on June 6, 2005, when a PCA based in Houston, Texas — Universal Fidelity LP — filed a lawsuit in the U.S. Court of Federal Claims challenging the legality and fairness of the procedure used by the IRS to award the three contracts for the initial phase of the private tax debt collection initiative.<sup>15</sup> Universal Fidelity was one of the 87 contractors approved by the GSA for debt collection under Schedule 520-4, but it was not allowed to bid for a contract with the IRS because the company was not performing debt collection for a federal agency under a current work order. The lawsuit (*Universal Fidelity LP v. United States*, Fed. Cl., No. 05-602C) charged that the IRS’s solicitation of bids violated the Competition in Contracting Act of 1984 in two ways: (1) by setting conditions that were “arbitrary, capricious, and unduly restrictive,” and (2) by unfairly excluding firms that could meet the agency’s minimum requirements. It asked the court to issue temporary and permanent injunctions preventing the IRS from awarding contracts under the RFQ.

In its response to the lawsuit, the IRS argued that hiring only contractors with active federal work orders had several key advantages. Such an approach would shorten the time required to begin the first phase of the debt collection initiative. It would also avoid many of the problems that could arise from unfamiliarity with the laws and regulations governing the use of PCAs in the public sector and a lack of compatibility between information systems used by the contractors and the systems used by the IRS. Finally, limiting the field of potential contractors to those with active work orders would increase the IRS’s chances of achieving its short-term objective of collecting a minimum of \$4 million in revenue in FY2006 through the use of PCAs — 25% of which would be transferred to the IRS’s budget for enforcement activities.

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<sup>15</sup> Alison Bennett, “Universal Fidelity Sues IRS Over Debt Collection Initiative,” *Daily Report for Executives*, Bureau of National Affairs, July 18, 2005, p. G-10.

The judge presiding over the case issued a temporary ruling on July 25, 2005, barring the IRS from proceeding with its original bid solicitation and requiring the agency to open the bidding to all 87 contractors approved by the GSA for debt collection work.<sup>16</sup> In his ruling, the judge noted that excluding contractors without current work orders, “irrespective of their experience or ability, is arbitrary and capricious in the circumstances presented.” He also noted that the IRS could achieve its aims “more fairly and efficiently by other means, including other mandatory minimum requirements.” The ruling was not final, as the judge wanted to give the IRS “an opportunity to make alternative plans and to take appropriate actions in a prompt and efficient manner.” On July 29, the IRS announced that it would abide by the judge’s ruling in a report it filed with the court, and on August 4, it cancelled the contested RFQ.

In mid-August 2005, the IRS asked the judge to dismiss Universal Fidelity’s lawsuit on the grounds that the agency’s decision to change its bid solicitation to bring it into compliance with the judge’s ruling rendered the suit invalid. The judge concurred with the IRS, in a ruling issued on September 28, and dismissed the case. In his view, the underlying controversy had been resolved.<sup>17</sup> At the same time, he allowed Universal Fidelity to file a motion to re-open the case if it were to find that the IRS’s revised bid solicitation raised the same concerns as the earlier one.

**Revised RFQ.** Following up on its agreement to abide by the judge’s ruling in the Universal Fidelity lawsuit, the IRS issued a new RFQ for the first phase of its tax debt collection initiative on October 14, 2005.

The document reiterated the agency’s intention to hire three PCAs to assist in the collection of certain delinquent individual tax debt starting in early 2006. It also stated that the IRS would award the contracts in February 2006 and launch the first phase of the collection program the following June — assuming no significant problems arose. All firms approved by the GSA to undertake debt collection work for federal agencies under Federal Supply Schedule 520-4 were eligible to submit bids — which meant that a firm’s eligibility would no longer depend on whether it had a current work order with a federal agency for debt collection. The contracts were to cover one year, with an option to extend them another year. An important consideration in awarding the contracts would be a bidder’s “relevant” experience in performing debt collection work. To quote from the RFQ: “vendors’ experience should demonstrate a wide variety of collection experience, on a nationwide basis, and should also demonstrate a level of accomplishment in a competitive environment.”<sup>18</sup> Most of the remaining terms of the RFQ were identical to the terms of the one issued in April 2005, including the compensation of contractors. If there

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<sup>16</sup> Diane Freda, “Federal Judge Says He Will Stop Debt Collection Initiative as Planned,” *Daily Report for Executives*, Bureau of National Affairs, July 28, 2005, p. G-11.

<sup>17</sup> Diane Freda, “Judge Dismisses Universal Fidelity Lawsuit Challenging IRS Debt Collection Procurement,” *Daily Report for Executives*, Bureau of National Affairs, Oct. 7, 2005, p. G-6.

<sup>18</sup> Diane Freda, “IRS Issues New Request for Quotes In Private Debt Collection Initiative,” *Daily Report for Executives*, Bureau of National Affairs, Oct. 7, 2005, p. G-16.

were no major problems in the first phase, the initiative could be expanded to as many as 12 contractors in January 2008.

## 2006

**First Round of Contract Awards.** On March 9, 2006, the IRS awarded the first three collection contracts to the CBE Group, Linebarger Goggan Blair & Sampson, and Pioneer Credit Recovery. They were chosen from a field of 33 firms that submitted bids. Each was an established collection agency with extensive experience working with government agencies. CBE and Pioneer both had received “satisfactory” ratings from the Better Business Bureau and then had current contracts with the U.S. Department of Education to collect delinquent student loan debt.<sup>19</sup> Linebarger Goggan had a GSA contract to offer collection services to federal agencies. Under the terms of their contracts, the three firms could be assigned collection cases totaling \$750 million in delinquent individual tax debt during the first year of the contract.

**Legal Challenge to Initial Contract Awards.** In mid-March, two of the unsuccessful bidders (Diversified Collection Services and GC Services) filed separate formal protests with the GAO over the method used by the IRS to evaluate the bids. According to news reports, the two firms accused the agency of evaluating the 33 bids it received on the basis of criteria that were inconsistent with the RFQ issued in October 2005.<sup>20</sup> By law, the GAO had up to 100 days — or until June 26 — to issue a ruling in the case. In deciding whether to deny or uphold protests involving bids on federal procurement contracts, the agency normally considers the relevant parts of the Competition in Contracting Act and federal regulations on procurement. Under federal law, the IRS had to suspend implementation of the contracts while the protests were being adjudicated. The CBE Group became a party to one of the protests in late March, giving it access to all documents filed in the case.

In assessing the merits of the protests, the GAO decided to combine the two cases into one. On June 14, it denied the protest filed by GC Services because it found no evidence to support the charge that the IRS evaluated the bids unfairly. In the view of some analysts, the agency’s ruling re-affirmed the belief that a protester’s disagreement with an agency’s judgment or evaluation does not mean that such a judgment or evaluation is unreasonable or unfair.<sup>21</sup> As a result of the ruling, the IRS was free to resume implementation of the first phase of the tax debt collection initiative.

**Release of First Round of Collection Cases.** The IRS turned over 12,000 delinquent taxpayer accounts on September 7, 2006 to the three PCAs awarded contracts, despite considerable opposition to the initiative in Congress. At

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<sup>19</sup> Dustin Stamper, “IRS Awards First Three Private Debt Collection Contracts,” *Tax Notes*, Mar. 13, 2006, p. 1133.

<sup>20</sup> Dustin Stamper, “Bid Protest Put IRS Private Debt Collection Program on Hold,” *Tax Notes*, Mar. 27, 2006, p. 1376.

<sup>21</sup> Diane Freda, “GAO Says GC Services Not Contender in IRS Private Debt Collection Project,” *Daily Report for Executives*, BNA, June 23, 2006, p. G-11.



the time, the IRS anticipated assigning as many as 40,000 such accounts to the contractors by the end of 2006, followed by the assignment of an additional 158,000 accounts in 2007. The dollar value of those 158,000 accounts was expected to total between \$616 million and \$1 billion. During the first phase of the initiative, which is to extend from September 2006 through December 2007, the IRS estimated that the three contractors could collect from \$56 million and \$92 million in delinquent tax revenue, at a cost of \$61 million (including the salaries of IRS staff and the cost of new information systems).<sup>22</sup>

To mark the start of the first phase of the private tax debt collection initiative, the IRS issued two publications offering detailed information on how the initiative was supposed to operate in its first year and the steps being taken by the IRS to safeguard taxpayer rights and the confidentiality of taxpayer information. One publication was a brochure intended to answer basic questions about the initiative for taxpayers contacted by a PCA.<sup>23</sup>

The second publication (Announcement 2006-63) appeared in Internal Revenue Bulletin 2006-37, which was released on September 11, 2006.<sup>24</sup> Basically, it summarized the functions served by PCAs, the limits on their activities, and the steps the IRS was taking to monitor their compliance with the terms of their tax debt collection contracts. More specifically, the publication offered the following information about the initiative:

- IRC section 6303 limits the role of PCAs to locating and contacting taxpayers identified by the IRS about tax debts “specified by the IRS”; requesting payment of the overdue taxes, either in a lump sum or in installments over a period of not more than five years; and obtaining financial information “specified by the IRS.”
- PCAs must get the approval of the IRS for any installment agreement covering a total payment of over \$25,000 and a period of more than 36 months.
- In trying to obtain financial information about a taxpayer, PCAs may access non-IRS computer databases or websites, but PCA employees may not call or write to a third party, such as the taxpayer’s employer, bank, or neighbors, to inquire about the taxpayer’s finances.

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<sup>22</sup> U.S. Government Accountability Office, *Tax Debt Collection: IRS Needs to Complete Steps to Help Ensure Contracting Out Achieves Desired Results and Best Use of Federal Resources*, GAO report GAO-06-1065 (Washington: Sept. 2006), p. 49.

<sup>23</sup> It is entitled *What You Can Expect When the IRS Assigns Your Account to a Private Collection Agency* (Publication 4518) and can be accessed through the IRS website at [<http://www.irs.gov/pub/irs-pdf/p4518.pdf>].

<sup>24</sup> Questions about the announcement should be directed to Joyce Peneau, who may be reached at (202) 283-0715, or by e-mail at [PDC@irs.gov](mailto:PDC@irs.gov).

- The IRS is to give PCA employees the following tax return information for the delinquent taxpayer accounts they are assigned: the taxpayer's name and social security number or taxpayer identification number; the name and social security number of the taxpayer's spouse, if the tax liability is jointly held; the taxpayer's last known address; the amount of the assigned tax debt, the tax year(s) to which it applies and the date when the statute of limitations for the collection of the tax debt expires; and the name, address, and telephone number of anyone with the power of attorney for the taxpayer.
- PCAs may retain any tax records provided by the IRS "only for the limited time period specified in (their) contract with the IRS."
- PCAs and their employees may not use "any information obtained about a taxpayer in the course of working on the contract with the IRS for any purpose other than working on the contract."
- PCAs and their employees must adhere to all protections of taxpayer rights in the collection of taxes "to the same extent" that IRS employees do.
- PCAs may be sued by the taxpayer under IRC Section 7433A if they fail to observe any of these protections.
- PCAs must comply with the provisions of the FDCPA, and they have no special immunity from prosecution for violations of these provisions while working for the IRS.
- PCAs are as subject to taxpayer assistance orders issued by the National Taxpayer Advocate as the IRS.
- PCA employees may not contact a taxpayer at "any unusual time or place without a taxpayer's prior consent"; no contacts can be made earlier than 8:00 a.m. or later than 9:00 p.m. at the taxpayer's location.
- PCAs may not undertake enforcement action (e.g., filing a lien, issuing a levy, seizing property, or commencing legal action) against a taxpayer.
- The IRS has created a special unit to monitor and oversee all PCA operations related to contracts with the IRS.
- It also has trained key personnel in each PCA about taxpayer rights and IRS procedures and provided each PCA with "videos, instructional materials, and operational handbooks."
- PCAs must keep records of all incoming and outgoing calls with taxpayers and make them available to the IRS, which "will randomly

monitor PCA calls to assure that taxpayers are treated fairly and professionally.”

- Taxpayers may contact a PCA or the IRS to complain about the conduct of any PCA employee.
- If the IRS receives such a complaint, it “will direct the PCA to suspend collection activity on the account” until the PCA and IRS have evaluated the complaint.

## 2007

The IRS announced on February 16 that it would extend the collection contracts awarded Pioneer Credit Recovery and the CBE Group for another year, through March 2008, but that it would not renew the contract of Linebarger Goggan Blair & Sampson LLP. All three firms received one-year collection contracts on March 9, 2006. For the next phase of the program, which may begin sometime in 2008, the IRS hopes to rebid all contracts and add as many as 12 contractors.<sup>25</sup>

In late March, the Treasury Department’s Inspector General for Tax Administration (TIGTA) issued a report evaluating the IRS’s implementation of the private tax debt collection initiative. It concluded that the IRS “effectively developed and implemented several aspects of the Program, thus providing better assurance that taxpayer rights are protected and Federal tax information is secure.”<sup>26</sup> At the same time, the report criticized the agency’s handling of certain computer security issues and its failure to update procedure guides and the “application used to calculate projected revenue.”

About one month later, the IRS briefed the IRS Oversight Board about the steps the agency had taken to implement the initiative. In a document distributed at the briefing, the IRS noted that the return on investment (ROI) for the initiative in FY2007 was likely to fall somewhere between \$3.2 and \$3.6 for each dollar collected; the estimate was derived from a comparison of projected gross revenue with the operating costs for the initiative.<sup>27</sup> By contrast, “ROI resulting from IRS enforcement programs ranges from \$3 to \$14 for every additional \$1 invested.”

TIGTA released another report on the private tax debt collection initiative in late December. This one focused on the fees paid to contractors from April 2006 through

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<sup>25</sup> Dustin Stamper, “IRS Extends Contracts of Two Private Collection Agencies,” *Tax Notes*, Feb. 26, 2007, p. 823.

<sup>26</sup> Treasury Inspector General for Tax Administration, *The Private Debt Collection Program Was Effectively Developed and Implemented, But Some Follow-up Actions Are Still Necessary*, reference no. 2007-30-066 (Washington: March 27, 2007), p. 1.

<sup>27</sup> Internal Revenue Service, *IRS Private Debt Collection Program Details* (Washington: Apr. 30, 2007), p. 16.

November 2007. It found that the “approximately \$2.7 million in fees charged on the 18 invoices audited [by TIGTA] were accurate, supported, and allowable.”<sup>28</sup>

Shortly after TIGTA released its report, the National Taxpayer Advocate, Nina Olson, issued her annual report to Congress.<sup>29</sup> In it, she identified the IRS private tax debt collection program as one of the “most serious problems encountered by taxpayers.” In Olson’s view, the program “is failing in most respects.” Specifically, according to Olson, it is “not meeting revenue projections; it is not more successful than IRS employees in finding delinquent taxpayers; and it is less successful than IRS employees in resolving delinquent accounts.” Perhaps the biggest concern cited by Olson was that the IRS has “placed the interests of the PCAs above the interests of taxpayers and tax administration by failing to require the PCAs to disclose training materials, scripts, letters, and operational plans relating to taxpayer contact.” She charged that such a lack of transparency “is a formula for compromising taxpayers’ rights.” These concerns about the program prompted Olson to again call for its repeal.<sup>30</sup>

## 2008

In its budget documents for FY2008, the IRS noted that it expected to spend \$7.65 million to administer the private tax debt collection initiative that year. It also predicted that the initiative would lead to the collection of \$23 million in gross revenue in the same year, and that net revenue could total \$11 million, after allowing for commissions paid to PCAs and the direct costs of operating the program.

On March 3, the IRS renewed the contracts for another year of the two contractors that have been involved in the collection effort since the beginning: Pioneer Credit Recovery, Inc. and CBE Group, Inc. It is unclear if the IRS will expand the program later in 2008, as it said it would at the outset of the program.

From the start of the collection effort through August 23, 2008, 156,730 delinquent taxpayer accounts had been placed with the three original contractors.<sup>31</sup> These accounts involved 278,314 separate collection cases. Total payments on these accounts since the start of the initiative amounted to \$49.9 million, as of August 14, 2008. From these funds, the IRS had paid \$10.9 million in compensation to the three contractors, leaving net revenue of \$39 million.

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<sup>28</sup> Treasury Inspector General for Tax Administration, *Invoice Audit of Fees Paid Under the Private Debt Collection Initiative*, reference number 2008-10-054 (Washington: Dec. 26, 2007), p. 1.

<sup>29</sup> National Taxpayer Advocate, *2007 Annual Report to Congress*, vol. 1 (Washington: 2007). Available at [[http://www.irs.gov/pub/irs-utl/arc\\_2007\\_vol\\_1\\_cover\\_msps.pdf](http://www.irs.gov/pub/irs-utl/arc_2007_vol_1_cover_msps.pdf)].

<sup>30</sup> *Ibid.*, p. 422.

<sup>31</sup> Based on information obtained in an e-mail from Brad Bouton of the IRS on Sept. 22, 2008.

## Main Arguments For and Against the Initiative

Although the IRS now has the authority to hire PCAs to assist in the collection of selected delinquent taxes and says it is midway through the first phase of implementing its private tax debt collection initiative, recent developments affecting the initiative indicate that the debate over the use of PCAs to collect federal tax debt continues unabated. Congressional opponents of the initiative seem as determined as ever to shut it down.

Proponents and opponents of the IRS's private tax debt collection initiative agree that the expanding inventory of potentially collectible taxes is a serious policy problem that needs to be remedied. As of September 2005, \$13.5 billion in individual income tax debt (including accrued interest and penalties) was considered uncollectible because the IRS lacked sufficient resources to work on the delinquent accounts; five years earlier, that debt totaled about \$9.0 billion.<sup>32</sup> A key factor behind this growth was a significant rise in the workload of the average IRS enforcement agent: from 1996 to 2003, the number of IRS agents engaged in enforcement activities decreased by 26%, while the volume of individual tax returns increased by 12%. Both sides in the debate worry that unchecked expansion of this inventory will erode taxpayer compliance, leading to increases in the federal tax gap.

Where the two sides have differed is on the question of how best to solve this problem. Proponents have favored outsourcing the collection of a significant portion of that inventory, whereas opponents have insisted on hiring more full-time IRS collection agents to do the job.

Four issues have come to dominate the debate over whether the IRS should be allowed to continue with its initiative to outsource the collection of certain delinquent individual income taxes: (1) the legality of IRS's private tax debt collection initiative; (2) the protection of taxpayer rights and the confidentiality of taxpayer information; (3) the prevention of abusive treatment of taxpayers by PCAs; and (4) the cost-effectiveness of hiring PCAs to collect the overdue taxes relative to the alternative of hiring more IRS collection agents do so. Not surprisingly, proponents and opponents hold differing views on each of them.

### Legality of Outsourcing Federal Tax Collection

One key issue in the debate over whether to allow the IRS to continue outsourcing some of the collection of overdue taxes has been the legality of such a step. Of particular concern has been the question of whether the collection of taxes is an activity that should be considered "inherently governmental." As noted earlier, the FAIR Act bars federal agencies from outsourcing activities deemed inherently governmental. Under the act, an inherently governmental activity is defined as one that "is so intimately related to the public interest as to require performance by Federal Government employees." The act established two tests for determining if an activity meets this standard. One involved the "exercise of discretion" in using

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<sup>32</sup> Based on data obtained in an e-mail message from Floyd Williams of the IRS on Dec. 14, 2005.

governmental power, and the other the “making of value judgments relating to monetary transactions and entitlements.”

Opponents of the IRS’s private tax debt collection initiative — led by the National Treasury Employees Union, the National Taxpayer Advocate, the Tax Executives Institute, and some consumer advocacy groups — contend that the collection of taxes is an inherent function of government and thus should not be delegated to the private sector under any circumstances. In their view, such a stance is both reasonable and defensible because it rests on a solid foundation of legal precedent. Of particular relevance, say opponents, are IRC Section 6301 and certain of the provisions of DCIA and FAIR, all of which limit the exercise of the power to collect taxes to the IRS. They maintain that it is hard to conceive of an activity that is more intimately related to the public interest than the collection of taxes. To underscore that point, some opponents claim that because “no taxpayer views his or her tax collection case as easy,” IRS employees, not PCA employees, should be the “ones to interact with the taxpayer.”<sup>33</sup>

Proponents of the initiative seem to take a more nuanced view of the issue. They claim that the initiative has been crafted to avoid running afoul of any of the federal statutes prohibiting the collection of taxes on the grounds that it is an inherently governmental activity. Under current tax collection contracts, PCAs are assigned only those cases where the taxpayer is not contesting the tax liability. In the view of proponents, such cases involve no exercise of discretion over the enforcement of tax law and therefore do not violate any statutory ban on the outsourcing of inherently governmental activities. By contrast, say proponents, cases involving disputes between taxpayers and the IRS over the interpretation of the tax code or the amount of tax owed do require the exercise of discretion and thus should be handled only by qualified IRS employees. Under the initiative, such cases are handled by the IRS.

## Protection of Taxpayer Rights

A second key issue in the debate over the desirability of the IRS initiative has been the protection of taxpayer rights, including the confidentiality of taxpayer information. Under current federal law, taxpayers have many statutory rights, including the right to be adequately informed of their obligations, options, and rights; the right to enlist the services of the Taxpayer Advocate in resolving disputes with the IRS; the right to be treated fairly and courteously by IRS employees; the right to appeal IRS judgments; and the right to privacy and confidentiality in all dealings with the IRS. IRS employees who interact with taxpayers undergo special training to ensure they understand these rights and uphold them in their dealings with taxpayers. Employees who violate any taxpayer rights are subject to a variety of punishments, including loss of job.

Opponents of the IRS’s initiative say that the statutory rights of taxpayers and the confidentiality of taxpayer information are at risk of being violated egregiously

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<sup>33</sup> See prepared statement of Nina E. Olson, the National Taxpayer Advocate, for a hearing by the Ways and Means Committee on May 22, 2007.

under the initiative. For them, this is a risk not worth taking. Some of this concern springs from an expectation that PCA employees involved in contacting taxpayers will not receive the same training in taxpayer rights as IRS employees.

Opponents also think the IRS cannot be counted on to provide the degree of oversight needed to ensure that PCAs are taking all required steps under their collection contracts to safeguard these rights. Such skepticism is warranted, in their view, because of certain well-documented episodes of lax IRS oversight of contractors in recent years. Specifically, opponents cite numerous alleged violations of the FDCPA by some of the PCAs participating in the pilot tax debt collection initiative launched by the IRS in 1996 and terminated in 1997, and the failure of the IRS to cancel the contracts of the firms found in violation of the act, even though it had the authority to do so.<sup>34</sup> They also point to one of the main findings of a 2004 report on IRS's oversight of its contractors by the Treasury Inspector General for Tax Administration (TIGTA). TIGTA found there was an elevated risk of unauthorized disclosure of taxpayer information and the spread of computer viruses in the IRS's information systems in 2003 because the agency allowed four contractors to have unsupervised access to its computer systems.<sup>35</sup>

In addition, opponents argue the initiative carries an unacceptably high risk of the wrongful disclosure of taxpayer information. The statute granting the IRS the authority to hire PCAs (IRC Section 6306) places no restrictions on the taxpayer information that may be released to PCAs. If proper restrictions and a strict enforcement mechanism are not put in place, opponents worry that PCA employees assigned to collect tax debt for the IRS could share confidential taxpayer information with individuals who could use it for criminal purposes, such as identity theft.

Proponents agree that protection of taxpayer rights should be a central concern of any effort to use PCAs to collect overdue individual taxes. But they maintain the safeguards built into the collection contracts signed by PCAs and the steps being taken by the IRS to monitor their adherence to these safeguards should be sufficient to prevent serious violations of these rights and the confidentiality of taxpayer information. For example, all PCA employees assigned to work on an IRS collection contract must pass a background investigation and undergo training on taxpayer rights conducted by the IRS before they receive confidential taxpayer information. Contractors must also provide secure facilities and equipment that can be used by authorized IRS and PCS employees only. And contractors are allowed to receive

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<sup>34</sup> According to Colleen M. Kelley of the NTEU, "contractors (for the 1996 pilot project in using PCAs managed by the IRS) violated the FDCPA and did not protect the security of sensitive taxpayer information." She also has said that "an IRS internal audit report found that contractors made hundreds of calls to taxpayers outside of the time restrictions of the FDCPA, and calls were placed as early as 4:19 a.m." See House Ways and Means Subcommittee on Oversight, *Use of Private Collection Agencies To Improve IRS Debt Collection*, p. 30.

<sup>35</sup> Allen Kenney, "IRS Needs Tighter Control of Contractors, TIGTA Finds," *Tax Notes*, June 28, 2004, p. 1579.

only limited information about the delinquent accounts they handle; they are not given copies of actual tax returns.<sup>36</sup>

In addition, proponents note that the IRS is devoting considerable resources to enforcing compliance with the collection contracts. Among the steps the agency is taking to oversee the collection actions of PCAs are live monitoring of telephone conversations between PCA employees and the taxpayers they contact, review of recorded conversations, surveys of taxpayers contacted by PCA employees, audits of the financial records of contractors, and periodic reviews of their performance.<sup>37</sup>

## Prevention of Abusive and Illegal Collection Practices

Another prominent issue in the debate over whether the IRS's authority to outsource tax collection under the terms of IRC Section 6306 should be revoked is the prevention of abusive and illegal collection practices by PCAs. These practices are a concern largely because many Americans with debts have had unpleasant experiences with third-party debt collectors. In 2006, the Federal Trade Commission (FTC) received 69,204 complaints from consumers alleging that PCAs were engaging in activities forbidden by the FDCPA, or 19.9% of all complaints related to the act; in 2005, PCAs were the target of 19.1% of all consumer complaints received by the FTC.<sup>38</sup> In general, the FDCPA prohibits deceptive, unfair, and abusive practices by third-party debt collectors. The leading complaints about such collectors in 2006 were that they demanded a larger payment than was permitted by law (40.3% of complaints filed with the FTC against debt collectors), harassed the debtor or others (21.2% of complaints), threatened dire consequences for failing to pay the outstanding debt (8.4% of complaints), and made impermissible calls to a consumer's place of employment (5.8% of complaints).<sup>39</sup>

Opponents of the IRS's initiative argue that it paves the way for illegal and abusive collection practices by PCAs. In their view, a major cause for concern is the method for compensating PCAs. Paying PCAs with collection contracts by giving them 21% to 24% of the revenues collected through their contacts with delinquent taxpayers, say opponents, is likely to encourage them to resort to harassment and other unreasonable or unlawful collection practices in a bid to maximize their earnings from the contracts. They also contend that the PCA compensation plan is blatantly inconsistent with Section 1204 of the RRA98, which effectively bars IRS management from basing the compensation paid to enforcement agents, in whole or

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<sup>36</sup> Jeffrey B. Tate, "Debt and Taxes: A Look at the IRS Private Debt Collection Program," *Tax Notes*, Aug. 13, 2007, p. 590.

<sup>37</sup> See the testimony of Kevin M. Brown, a former IRS Acting Commissioner, before the Ways and Means Committee on May 23, 2007.

<sup>38</sup> Diane Freda, "Private Debt Collectors Lead In Consumer Complaints, FTC Says," *Daily Report for Executives*, BNA, March 28, 2007, p. G-5.

<sup>39</sup> Federal Trade Commission, *Annual Report 2007: Fair Debt Collection Practices Act* (Washington: 2007), pp. 4-5.



in part, on the amount of unpaid taxes they collect from delinquent taxpayers.<sup>40</sup> This provision of the act is intended to ensure the “fair and equitable treatment of taxpayers.” Opponents maintain that the method of compensating PCAs increases the chances they will treat taxpayers unfairly, if not abusively.

Proponents counter that these concerns are exaggerated and without merit. They contend the initiative contains adequate safeguards against abusive and illegal collection practices. Of particular importance, in their view, is the provision in each collection contract stipulating that PCA employees are as subject to the provisions of the FDCPA as are IRS employees. As a result, the contracts specify that PCA employees may not contact a taxpayer at an unusual time or place, or at a time and place that would be inconvenient for the taxpayer; may not contact a taxpayer at work, unless he or she explicitly authorizes such an action in advance; may not contact a taxpayer if the IRS or the taxpayer has told the PCA that the taxpayer has an authorized representative; may not engage in conduct that is “harassing, oppressive, or abusive”; and may not visit a taxpayer.<sup>41</sup> Furthermore, say proponents, the IRS is devoting considerable resources to ensuring that contractors do not violate any of these restrictions of their interaction with taxpayers. In FY2007, 45 full-time-equivalent IRS employees were involved in overseeing the performance of the three PCAs with contracts, including their adherence to the terms of their contracts. Proponents claim this level of oversight should be sufficient to prevent contractors from engaging in abusive and illegal collection practices.

## **Cost-Effectiveness of the Private Tax Debt Collection Initiative**

Another key issue in the ongoing debate over the desirability of the IRS’s initiative is its cost-effectiveness. The focus of concern here is the comparative costs and benefits of the initiative and the principal alternative favored by opponents: hiring additional IRS enforcement agents to collect the targeted individual tax debt.

Spending on tax collection is akin to an investment in that it generates a return in the form of added revenue. So one could say that the most cost-effective approach to collecting overdue taxes would be the one that produces the greatest return on investment, as measured by the revenue collected per dollar of spending on collection. Few would deny that it is in the interest of the federal government and U.S. taxpayers for the IRS to take the most cost-effective approach. Yet it can be difficult to determine which approach is most cost-effective because of the complex considerations that enter into estimating the costs and benefits of all possible approaches. A case in point is the revenue collected by PCAs under existing collection contracts. Up to 25% of the revenue can be used to pay PCAs for their services, and another 25% goes to the IRS to bolster its spending on tax law

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<sup>40</sup> Section 1204(a) of RRA98 states that “the Internal Revenue Service shall not use records of tax enforcement results (1) to evaluate employees; or (2) to impose or suggest production quotas or goals with respect to such employees.”

<sup>41</sup> See testimony of Kevin M. Brown before the Ways and Means Committee on May 23, 2007.

enforcement. Should that 50% or so of the revenue be considered a cost or a benefit from the initiative — or both?

Opponents contend the initiative should be jettisoned because it is not as cost-effective as the alternative of giving the IRS the needed resources to collect the same delinquent individual tax debt. They cite several studies to substantiate their claim. In testimony given at a hearing held by the House Ways and Means Subcommittee on Oversight in May 2003, Colleen Kelley, the National President of the NTEU, noted that hiring PCAs to collect this debt within the guidelines of the Bush Administration's proposal could be expected to collect \$3 in revenue for each \$1 paid to PCAs for their services, but that hiring additional IRS enforcement agents for the same purpose would eventually collect as much as \$31 in revenue for each \$1 spent on wages and benefits for the new staff.<sup>42</sup> A more recent analysis of the cost-effectiveness of both options by analysts at the Taxpayer Advocate Service estimated that the IRS could have collected \$1.4 billion in delinquent individual tax debt — instead of the \$19.5 million in gross revenue collected through the initiative as of April 28, 2007 — if the agency had spent the \$71 million it expected to incur in startup and operating costs for the initiative in FY2007 on the agency's Automated Collection System.<sup>43</sup> Opponents also point out that the IRS has admitted it would be more cost-effective to scrap the initiative and instead hire additional agents to collect the overdue taxes. Replying to a question from Representative Steven Rothman during a congressional hearing in March 2006, then-IRS Commissioner Mark Everson affirmed that it would cost more to use PCAs to collect delinquent individual tax debt than to hire additional IRS employees for the same purpose.<sup>44</sup>

Proponents, while conceding the initiative may be less cost-effective than using IRS employees, argue that it should be continued for several reasons related to its expected costs and benefits. First, they note that Congress has been unwilling to give the IRS the funds it would need to hire and train additional employees to collect the tax debt targeted by the initiative. So if the initiative were terminated today, say proponents, the tax debt would probably go uncollected, because the funds the IRS is investing in the initiative would be transferred to IRS employees pursuing collection cases with higher priorities.

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<sup>42</sup> U.S. Congress, House Ways and Means Committee, Subcommittee on Oversight, *Use of Private Collection Agencies to Improve IRS Debt Collection*, 108<sup>th</sup> Congress, 1<sup>st</sup> sess., May 13, 2003 (Washington: GPO, 2004), p. 29. Her calculations were based on estimates contained in a 2002 proposal by then-IRS Commissioner Charles Rossotti and the Administration's FY2004 budget request. Under the most optimistic scenario, the Administration's plan to use PCAs was expected to collect \$13 billion in delinquent individual tax debt at a cost of \$3.25 billion, assuming PCAs hired for this purpose receive 25% of the total amount collected as compensation for their services. By contrast, Rossotti estimated that the IRS would eventually collect \$9.47 billion in collectible tax debt at a cost of \$296.4 million by adding 5,450 full-time employees to its enforcement staff.

<sup>43</sup> See testimony of Nina E. Olson before a hearing held by the Ways and Means Committee on May 23, 2007.

<sup>44</sup> Dustin Stamper, "Everson Admits Private Collectors Cost More Than IRS Employees," *Tax Notes*, April 3, 2006, p. 11.

Second, proponents claim there is a critical need to act now to reduce the federal tax gap, mainly to prevent further erosion in public trust in the fairness of the federal income tax system. In their view, hiring additional IRS employees and training them to collect the delinquent tax debt targeted by the initiative would only serve to delay a process that should be completed as soon as possible.

Third, proponents point out that once the initiative is operating at its intended scale, it should come close to matching the overall return on investment (ROI) of spending on IRS operations. In testimony given at a hearing held by the Ways and Means Committee on May 23, 2007, then-acting IRS Commissioner Kevin M. Brown stated that the overall ROI for the IRS is about \$4 in revenue collected for each \$1 of total spending on operations. In contrast, according to Brown, the initiative was expected to generate an ROI of between \$4 to \$1 and \$4.3 to \$1 once it reached a “steady state” in FY2008.<sup>45</sup>

Finally, proponents say the initiative ends up boosting the IRS’s ROI for enforcement activities by enabling the agency to concentrate its collection and enforcement resources on relatively difficult cases with higher payoffs.

## **Legislative Initiatives in the 109<sup>th</sup> and 110<sup>th</sup> Congresses to Modify the IRS’s Authority to Hire PCAs**

Congressional opponents of the IRS’s private tax debt collection initiative continue to look for ways to delay or defeat it, even as the IRS says it is midway through the first phase of implementing the initiative. This section describes the proposals to modify the IRS’s authority to use PCAs to collect overdue taxes that have been considered by the House or Senate since the IRS gained the authority with the enactment of the AJCA.

### **109<sup>th</sup> Congress**

In April 2005, two bills to repeal the IRS’s authority to enter into contracts with PCAs were introduced in the House: H.R. 1583 (sponsored by Representative Chris Van Hollen) and H.R. 1621 (sponsored by Representative Rob Simmons). The latter attracted 81 cosponsors from both parties. Lacking support from the Republican leadership, neither measure was incorporated into broader legislation considered by the House. Similar bills did not emerge in the Senate.

In addition, during the floor debate in the House on H.R. 3058, a measure to provide appropriations in FY2006 for the Treasury Department and certain other federal agencies, Representatives Simmons and Van Hollen introduced an amendment (H.Amdt. 418) to bar the IRS from using any appropriated funds to enter

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<sup>45</sup> The estimate assumed that in FY2008, contractors would collect gross revenue of \$86 to \$127 million, operating costs for the initiative would total \$5.8 million, and compensation of contractors would average 18.5% of revenue collected.

into, implement, or manage contracts with PCAs in FY2006. They withdrew the amendment when it became known that a point of order would be raised against it if a vote were held on the amendment. A similar amendment did not surface during the Senate's consideration of its version of H.R. 3058.

A provision in a tax reconciliation bill (S. 2020) passed by the Senate on November 18, 2005, would have reserved at least 10% of the tax debt collection contracts awarded by the IRS after April 1, 2006 for firms that employ disabled persons. The provision began as an amendment (S.Amdt. 2625) introduced by Senator E. Benjamin Nelson on November 17; the Senate agreed to it by unanimous consent. Eligible firms not only had to meet the general eligibility requirements for bidding on the contracts, but their domestic workforces had to satisfy one of three disability requirements (e.g., the firm's domestic workforce included at least 50 persons who were considered severely disabled when the contracts were awarded). The provision defined a severely disabled person as a war veteran with a disability of "50% or greater," or someone considered a disabled beneficiary under section 1148(k)(2) of the Social Security Act. A similar provision was not included in the version of the tax reconciliation bill (H.R. 4297) passed by the House on December 8. The final version of H.R. 4297 (H.Rept. 109-455) approved by the House and Senate in May 2006 did not include the provision.

In April 2006, Representative John Dingell introduced a measure (H.R. 5084) to repeal the IRS's authority to hire PCAs to collect delinquent tax debt, but no action was taken on it.

In June 2006, the House passed a FY2007 appropriations bill (H.R. 5576) for Treasury and certain other agencies that included a provision barring the IRS from using any appropriated funds to implement the private tax debt collection initiative. The provision was not enacted, however, as the version of the bill passed by the Senate Appropriations Committee lacked a similar provision, and the full Senate never voted on the version of H.R. 5576 marked up by the committee.

In September 2006, Senators Byron Dorgan and Patty Murray introduced a bill (S. 3887) that would have required the IRS to suspend indefinitely its private tax debt collection initiative and would have barred the use of appropriated funds to implement it. The measure attracted 18 cosponsors and the endorsement of eight interest groups, including the National Treasury Employees Union and the Consumer Federation of America.<sup>46</sup> No action was taken on it.

## 110<sup>th</sup> Congress

In January 2007, two bills that would end the IRS's private tax debt collection initiative were introduced: S. 335 and H.R. 695. No action has been taken on either measure.

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<sup>46</sup> Diane Freda, "Groups Join NTEU in Effort to Move Congress Against Private Debt Collection," *Daily Report for Executives*, BNA, Sept. 21, 2006, p. G-3.

The Senate Appropriations Committee passed its version of a bill (H.R. 2829) in July to appropriate funds for the Treasury Department and certain other executive agencies for FY2008. It includes a provision that would limit the funds available to the IRS to administer the initiative to \$1 million, or \$254 million less than the amount requested by the Bush Administration. If such a limit were enacted, the IRS would have little choice but to suspend the initiative. Under the provision, the IRS could use funds collected through the initiative to cover the initiative's operating costs in FY2008, but the agency would be required to spend an equal amount on retraining employees in its processing centers. In addition, the IRS would have to retrain as many employees as the PCAs use in the collection of delinquent tax debt.<sup>47</sup> The version of H.R. 2829 passed by the House lacks a similar provision.

In October 2007, the House passed a bill (H.R. 3056) that would repeal the IRS's authority to outsource the collection of delinquent taxes, as of July 18, 2007. The Joint Tax Committee has estimated that such a provision would lead to a revenue loss of \$1.05 billion from FY2008 through FY2017. H.R. 3056 would also delay by one year, until December 31, 2011, a requirement that federal, state, and local governments withhold 3% from all payments they receive for goods and services, with some exceptions. To offset the estimated revenue cost of these and one other provision, as required by current budget rules, the bill would tax the mark-to-market gains on property held by individuals who renounce their U.S. citizenship, raise the penalties on failures to submit tax form 1099, and repeal the suspension of interest and penalties on certain unpaid tax liabilities in cases where the IRS fails to notify a taxpayer of an unpaid liability within 36 months of filing a tax return. It is unclear whether opponents of the initiative in the Senate have enough support to pass a similar bill.

The House passed a bill (H.R. 3996) on November 9 that, among other things, would repeal the authority of the IRS to outsource tax collection. The provision stripping the IRS of this authority borrows the language from the same provision in H.R. 3056. As passed by the House, H.R. 3996 has two main purposes: (1) to provide relief from the individual alternative minimum tax for millions of middle-income taxpayers in 2007, and (2) to extend for one year a variety of tax preferences that are due to expire at the end of 2007; it also included a variety of revenue-raisers intended to offset the revenue cost of those tax cuts. Opposition among Republicans in the Senate to those revenue-raisers led it to pass a version of H.R. 3996 that provided AMT relief for 2007 only, with no offsetting revenue-raisers or additional tax cuts. On December 19, the House approved the Senate version of the measure, and President Bush signed it (P.L. 110-166) on December 26.

The omnibus appropriations bill for FY2008 (H.R. 2764, P.L. 110-161) passed by the House and Senate and signed by the President imposed no restrictions on funding for the IRS's private tax debt collection initiative, even though the House and Senate Appropriations Committees expressed support for placing stringent limits on such funding during their consideration of a bill (H.R. 2829) to provide

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<sup>47</sup> Dustin Stamper, "House Taxwriters Vote to End IRS Private Debt Collection," *Tax Notes*, July 23, 2007, p. 220.

appropriations in FY2008 for the Treasury Department and certain other agencies involved in financial services.

In the second session of the 110<sup>th</sup> Congress, the House passed H.R. 5719 — a measure mainly intended to modify tax return preparer penalties, assist low-income taxpayers, and delay the implementation of withholding taxes on federal contractors — on April 15, 2008. The bill contained a provision that would repeal the authority of the IRS to enter into private debt collection contracts, as of March 1, 2008. No action on H.R. 5719 has been taken (or is scheduled to be taken) in the Senate.

In addition, each of the bills providing funding for the IRS in FY2009 approved by the House (no number yet assigned) and Senate (S. 3260) Appropriation Committees included a provision that would bar the agency from using any appropriated funds to “enter into, renew, extend, administer, implement, enforce, or provide oversight of any qualified tax collection contract.” The Bush Administration has expressed opposition to such a restriction.

## Possible Policy Issues for Congress

Two and a half years after PDCs began to collect delinquent individual federal tax debt under contracts issued by the IRS, the agency’s private tax debt collection initiative continues to raise a variety of policy concerns. The limits placed on the collection activities of contractors, while serving several important policy aims, may keep the initiative from demonstrating its potential usefulness as a policy tool for reducing the federal tax gap. There is some evidence that the initiative is generating a lower return on investment than the alternative of giving the IRS the funds needed to hire additional employees to collect the delinquent tax debt. The formula for compensating the contractors gives rise to two concerns: namely, that it may encourage them to engage in abusive collection practices, and that contractors are being paid too much for handling what are relatively simple tax collection cases. Additionally, critics doubt the contractors will respect the privacy and other rights of taxpayers they contact.

In using its oversight powers to ascertain whether the IRS’s initiative is operating as intended, Congress may address the following questions:

- Is the private tax debt collection initiative generating greater returns at a lower total cost than the alternative of giving the IRS the resources it says it would need to collect the same tax debt?
- What is the cost to the IRS of processing cases that the PCAs cannot handle because of the restrictions placed on their collection activities?
- Are taxpayers being adequately informed of their rights and protections under the initiative?
- Do the collection contracts contain enough sanctions against the use of unlawful or abusive collection practices by PCAs?

- Are PCAs and their employees adequately informed of their rights and responsibilities under the contracts and the penalties they face for failing to uphold them?
- Does the IRS have adequate resources to monitor the performance of PCAs?
- Does the compensation package offered to PCAs promote the lawful and fair treatment of taxpayers, while providing a reasonable incentive to pursue the collection cases assigned to them?
- Are the PCAs engaging in activities deemed inherently governmental?
- What factors should the IRS consider in compensating PCAs and evaluating the results of the private debt collection initiative?
- Under what circumstances should the initiative be terminated?