



THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

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May 13, 2014

The Honorable Ron Wyden  
Chairman  
Committee on Finance  
United States Senate  
Washington, D.C. 20510

The Honorable Orrin G. Hatch  
Ranking Member  
Committee on Finance  
United States Senate  
Washington, D.C. 20510

The Honorable Dave Camp  
Chairman  
Committee on Ways and Means  
House of Representatives  
Washington, D.C. 20515

The Honorable Sander Levin  
Ranking Member  
Committee on Ways and Means  
House of Representatives  
Washington, D.C. 20515

The Honorable Charles W. Boustany, Jr.  
Chairman  
Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives  
Washington, D.C. 20515

The Honorable John Lewis  
Ranking Member  
Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives  
Washington, D.C. 20515

Dear Chairmen and Ranking Members:

I was recently asked by several Senators to provide my views regarding the use of private collection agencies (PCAs) to collect delinquent federal tax debts.<sup>1</sup> Specifically, the Senators requested my perspective on the private debt collection (PDC) program administered by the IRS from 2006-2009 and on a revamped PDC provision contained in S. 2260, the Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014, as approved by the Senate Committee on Finance.<sup>2</sup> Because the statute governing the position of the National Taxpayer Advocate generally contemplates my reporting to the tax-writing committees and because I have significant concerns about the PDC proposal, I want to share my perspective with you as well. The text below is substantially identical to the response I sent to the requesting Senators last week.

The Office of the Taxpayer Advocate and I personally were intimately involved in the development of the 2006-2009 PDC program.<sup>3</sup> We also handled more than 3,700 cases involving taxpayers against whom PCAs sought to collect. Based on what I saw, I concluded the program undermined effective tax administration, jeopardized taxpayer rights protections, and did not accomplish its intended objective of raising revenue. Indeed, despite projections by the Treasury Department and the Joint Committee on Taxation that the program would raise more than \$1 billion in revenue, the program ended up losing money. We have no reason to believe the result would be any different this time.

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<sup>1</sup> The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget.

<sup>2</sup> The relevant provisions are contained in Sections 304 and 305 of S. 2260, 113<sup>th</sup> Cong. (2014). They are explained in the accompanying committee report, S. 113-154 (2014).

<sup>3</sup> At the time the program was developed, senior officials at the Treasury Department asked me to participate in its development, despite my conceptual concerns, to help protect taxpayer rights to the maximum extent possible.

## **BACKGROUND**

The IRS Collection organization is responsible for collecting delinquent tax debts after the amount of the taxpayer's liability has been established via an assessment. Tax liabilities may be self-assessed when a taxpayer files a tax return reporting a liability, or the IRS may adjust the taxpayer's liability through audit or other procedures.<sup>4</sup> Once the tax is assessed and the IRS issues a notice and demand for payment, the IRS sends out a series of notices.<sup>5</sup> If the taxpayer does not respond, the Collection organization receives the case.

There are two main units within the IRS Collection organization: (1) the Collection Field function, which consists of Revenue Officers who operate locally, often knocking on doors and otherwise making personal visits to taxpayers, and (2) the Automated Collection System, which consists of employees in centralized locations that send letters and handle taxpayers' telephone calls.

The IRS has significant volumes of collection cases in its inventory. Near the end of April, there were just over five million taxpayers with delinquent accounts.<sup>6</sup> Collection personnel often speak of three categories of delinquent taxpayers – “willing to pay,” “can't pay,” and “won't pay.” The “won't pays” are taxpayers who can afford to pay their tax liabilities but refuse to do so. The “willing to pay” are taxpayers who want to pay their tax liabilities but because of various circumstances need some time and flexibility. The “can't pays” are financially struggling taxpayers who cannot pay their tax liabilities without enduring economic hardship.

The IRS is the most powerful creditor in the country, and most taxpayers do not want to get crosswise with it. In particular, the IRS may, without judicial approval, serve a levy against a taxpayer's bank account, serve a levy against a taxpayer's Social Security benefits, garnish a taxpayer's wages, or file a notice of federal tax lien against a taxpayer's property. In rare cases, it may even seize a taxpayer's property, including a car, a boat, a residence, or business assets.

However, the IRS also aims to avoid collecting tax when such action would cause a financial hardship for a taxpayer. As of March 31, 2014, nearly 1.8 million taxpayer delinquent accounts were designated as “Currently Not Collectable (CNC) – Hardship.”<sup>7</sup> Indeed, Congress has recognized that

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<sup>4</sup> A taxpayer can challenge the liability prior to assessment in the United States Tax Court in response to a statutory notice of deficiency. After assessment, a taxpayer has various avenues to challenge an assessed liability – through the refund claim process (including a refund suit in a federal district court or the U.S. Court of Federal Claims), via a Collection Due Process Hearing (with recourse to the Tax Court), or as part of a bankruptcy proceeding.

<sup>5</sup> Internal Revenue Code (IRC) § 6303 requires that at least one notice be sent to the taxpayer. The IRS sends multiple notices.

<sup>6</sup> IRS, *Collection Activity Report 5000-2* (Apr. 28, 2014).

<sup>7</sup> IRS, *Collection Activity Report 5000-149* (Apr. 1, 2014).

taxpayers may need additional time to pay a tax debt by enacting provisions such as guaranteed installment agreements<sup>8</sup> and offers in compromise,<sup>9</sup> and by requiring the IRS to develop guidelines for allowable living expenses to be taken into account when determining the taxpayer's ability to pay.<sup>10</sup> Where IRS levy activity would create an "economic hardship" for an individual taxpayer, the Internal Revenue Code requires the IRS to release the levy if it determines the levy "is creating an economic hardship due to the financial condition of the taxpayer."<sup>11</sup> The IRS may even return levy proceeds it has already acquired.<sup>12</sup>

As the National Taxpayer Advocate, I believe this flexible approach to taxpayers' differing circumstances and intent is critical to maintaining a fair and balanced tax system. Where a delinquent taxpayer can afford to pay, the government has a responsibility to collect the debt – both to help fund the government and to ensure that compliant taxpayers are not effectively required to subsidize noncompliant taxpayers. Where financially struggling taxpayers cannot afford to pay (either immediately or at all), I share the IRS and congressional view that the government should not inflict financial hardship on its citizens. Unlike private debt collectors, the IRS can use its levy, lien and seizure powers to address the "won't pay," it can accept extended and partial-payment installment agreements and offers in compromise to resolve the tax debts of the "willing to pay," and it can place the "can't pay" into "currently not collectible" status or even accept a low-dollar offer in compromise.<sup>13</sup>

Twice over the last 18 years, the IRS has attempted to outsource the collection of tax debts to private collection agencies (PCAs). Twice the experiment has ended in failure. For fiscal year (FY) 1996, Congress enacted appropriations language that directed the IRS to "initiate a program to utilize private counsel law firms and

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<sup>8</sup> IRC § 6159(c).

<sup>9</sup> IRC § 7122.

<sup>10</sup> IRC § 7122(d).

<sup>11</sup> IRC § 6343(a)(1)(D). Economic hardship is established "if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses." Treas. Reg. § 301.6343-1(b)(4).

<sup>12</sup> IRC § 6343(d).

<sup>13</sup> The IRS retains these powers because the collection of federal taxes is an inherently governmental function. That is, the determination whether to issue a levy, the determination whether to file a lien, or the analysis of a complex financial statement requires the exercise of judgment and discretion that cannot be delegated to third parties. Thus, PCAs can only enter into simple installment agreements that meet very limited terms (e.g., divide the amount due by 36 for the monthly payment amount). Cases involving any other treatment must be referred back to the IRS for handling. See Office of Federal Procurement Policy, Policy Letter 11-01, *Performance of Inherently Governmental and Critical Functions*, 76 FR 56,227 (Sept. 12, 2011). According to the OFPP Policy Letter, an inherently governmental function is "a function that is so intimately related to the public interest as to require performance by federal government employees." Appendix A provides examples of inherently governmental functions. Example 20 expressly states that tax collection is an inherently governmental function.

debt collection agencies in [its] collection activities.”<sup>14</sup> The IRS awarded contracts to five PCAs in June 1996, and they performed work from August 1996 through June 1997. The statute did not authorize the PCAs to collect tax debts, so the IRS used them to assist in its own collection activities (e.g., by locating taxpayers, reminding them of their tax liabilities, and securing commitments to pay). The IRS terminated the program after concluding it lost money when opportunity costs were taken into account.

In 2003, the Treasury Department requested statutory authority to utilize PCAs more broadly to assist in the collection of tax debts.<sup>15</sup> Treasury estimated the PDC program would increase revenue by more than \$1 billion over a ten-year period.<sup>16</sup> The Joint Committee on Taxation gave the final provision a higher revenue estimate, projecting it would raise \$1.356 billion over ten years, including \$621 million between 2005 and 2009.<sup>17</sup> Congress granted the requested authority in 2004.<sup>18</sup> Again, the IRS terminated the program and again concluded it had lost revenue.

Section 304 of the EXPIRE Act would require the Secretary to operate the program and would require that all “inactive tax receivables” be assigned to PCAs, subject to limited exceptions. In general, the bill would mandate a vast expansion of the PDC program compared with the 2006-2009 version.

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<sup>14</sup> Treasury, Postal Service, and General Government Appropriations Act, 1996, Pub. L. No. 104-52, 109 Stat. 468 (1995); see also H.R. Rep. 104-183, at 27 (1995) (explaining the original House proposal).

<sup>15</sup> Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* 98-100 (Feb. 2003).

<sup>16</sup> *Id.* at 100.

<sup>17</sup> Joint Committee on Taxation, JCX-69-2004, *Estimated Budget Effects of the Conference Agreement for H.R. 4520, The "American Jobs Creation Act of 2004,"* at 9 (2004).

<sup>18</sup> American Jobs Creation Act, Pub. L. No. 108-357, § 881 (2004) (codified at IRC § 6306).

## **CONCERNS REGARDING PDC**

The following is a summary of my concerns:

- 1. The PDC initiative is premised on the mistaken belief that the IRS does not collect taxes on cases that are inactive or awaiting assignment.**

The PDC program rests largely on the assumption that a significant number of accounts are sitting inactive, with no collection activity occurring. It is certainly true that the IRS maintains a relatively large dollar amount in its "queue" of cases for assignment to revenue officers, and it is also true that the IRS "shelves" cases it does not have the resources to work or where it is unable to locate the taxpayer.

But this does not mean the IRS ignores the debts. First, the IRS is required by law to send a collection notice to every taxpayer with a delinquent account at least once annually.<sup>19</sup> Second, the IRS collects significant revenue each year via "refund offsets." About 80 percent of individual taxpayers are entitled to tax refunds each year, and the Treasury Department automatically withholds refunds to satisfy delinquent tax liabilities. In FY 2013, the IRS collected \$3.9 billion via refund offsets.<sup>20</sup> Of that total, \$517 million was collected with respect to cases in the queue (*i.e.*, cases that arguably may be considered "inactive"). In addition, the IRS collected \$195 million via refund offsets on cases classified as Currently Not Collectible (including "hardship" and "unable to locate" cases).<sup>21</sup> In reality, there is no such thing as a truly "inactive" collection case.

- 2. The PDC program will require the IRS to incur significant start-up costs, jeopardizing taxpayer service and other IRS operations that are already reeling from budget cuts.**

As I detailed in the National Taxpayer Advocate's 2013 Annual Report to Congress, the volume of IRS work has been increasing while IRS funding was reduced by eight percent from FY 2010 through FY 2013.<sup>22</sup> As a consequence, the IRS's ability to meet the needs of the taxpaying public has declined. In FY 2013, the IRS was only able to answer 61 percent of the telephone calls it received from taxpayers seeking to speak with a customer service representative. Those fortunate enough to get through had to wait an average of

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<sup>19</sup> IRC § 7524.

<sup>20</sup> IRS, *Collection Activity Report 5000-2* (Dec. 30, 2013).

<sup>21</sup> These one-year refund offset totals compare with \$98.2 million in gross PCA collections during the entire 2006-2009 PDC initiative.

<sup>22</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 20-37 (Most Serious Problem: *IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

nearly 18 minutes on hold. At the same time, the IRS substantially restricted the scope of tax-law questions it would answer. Taxpayers are experiencing significant delays waiting for their correspondence to be processed, and the scope of services available to taxpayers in the IRS's walk-in sites has been reduced.

Other IRS functions have also faced significant challenges. IRS enforcement actions are down, and critical Information Technology projects have been placed on hold while the IRS prioritizes implementation of the Foreign Account Tax Compliance Act (FATCA) and the Patient Protection and Affordable Care Act (ACA).

To prepare for the 2006-2009 PDC program, the IRS incurred \$55.4 million in business and information technology start-up costs, plus additional start-up costs in other areas. The proposed PDC program is larger in scale than the 2006-2009 version and almost surely would require more funding.

Significantly, the IRS will not receive any dedicated funding to implement this program. Requiring the IRS to spend significant funds to implement a PDC program at this time will further reduce its resources to meet taxpayer needs.

**3. The government's objective of maximizing long-term compliance without causing financial hardship for taxpayers is fundamentally different from the profit-maximizing objective of a private collection agency.**

The goals of the IRS collection function and PCAs are different in at least two respects. First, and as explained above, it is a longstanding principle in tax administration that when the IRS collects a tax debt, it seeks to avoid placing individuals into financial hardship. This is the right thing for the government to do, and it also may be cost effective because aggressive collection actions would force some marginal taxpayers into public assistance programs that may ultimately cost the government more than the amount of tax collected.

Second, the IRS's overriding goal is to maximize long-term compliance. If a taxpayer is out of compliance, he may feel he risks nothing more by continuing to be delinquent in the future. Often, the IRS may decide to compromise a past debt in exchange for a commitment from the taxpayer to remain compliant for the succeeding five-year period (or else the original debt may be reinstated in full, plus penalties and interest).<sup>23</sup> This approach maximizes revenue collection over the long term. By contrast, PCAs get paid by extracting the maximum amount from taxpayers with respect to a fixed liability – regardless of whether collection

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<sup>23</sup> See IRC § 7122 (authorizing the IRS to settle delinquent debts for less than the amount due); see also Internal Revenue Manual (IRM) 5.19.7.3.19.4 (*Failure to Adhere to Compliance Terms*): IRS Form 656-B, *Offer in Compromise Booklet* (containing the contractual terms of an offer, including Section 8(g)).

reduces the likelihood the taxpayer will be compliant in the future or creates a financial hardship that may cause the taxpayer to qualify for government assistance programs. Simply put, the IRS may tailor its collection approach based on a taxpayer's individual circumstances in ways that PCAs cannot.

**4. Section 304 as drafted appears to place a bulls-eye on the backs of low income taxpayers.**

In analyzing this proposal, the IRS prepared a preliminary estimate of the percentage of individual taxpayers who fall into the pool of "inactive tax receivables" and are low income. Although the bill defines the term "inactive tax receivable," it does so by reference to the terms "potentially collectible inventory" and "active inventory" and it does not define those latter terms. Therefore, the IRS attempted to make this computation based on current administrative practice. Congress and the IRS have both used 250 percent of the federal poverty level as a proxy for low income, so it applied that percentage here.<sup>24</sup> After analyzing Collection data for FY 2013, the IRS found that 79 percent of the cases that fall into the "inactive tax receivables" category involve taxpayers with incomes below this low income threshold. Thus, nearly four-fifths of these taxpayers are almost surely in the "can't pay" category and either cannot make payments when contacted by a PCA or, as discussed in more detail below, will feel pressured into making commitments they cannot afford and may not follow through on.

As the National Taxpayer Advocate, I believe it would be unconscionable for Congress to create a government-sponsored debt collection program that, even if inadvertently, targets such a high percentage of low income taxpayers. If this proposal remains in the EXPIRE Act, I strongly recommend it be amended to carve out low income taxpayers.

**5. The Internal Revenue Code contains strict confidentiality rules to ensure that taxpayer data is shielded from disclosure. Providing taxpayer identifying information to private companies creates risks that this data will be misused.**

The Federal Trade Commission receives more complaints each year about the debt collection industry than any other industry. In 2013, the number exceeded 204,000.<sup>25</sup> This is hardly surprising. PCAs are profit-making businesses, and

<sup>24</sup> Congress has set 250% of the Federal poverty level (FPL) as the maximum income for qualifying for assistance from a Low Income Taxpayer Clinic. See IRC § 7526(b)(1)(B)(i). The IRS has developed a low income tax filter that excludes individual taxpayers who otherwise would be subject to the Federal Payment Levy Program (FPLP) if their estimated total income falls below 250% of the FPL. IRM 5.11.7.2.2.3. Under the FPLP, the IRS can levy 15% percent of certain federal payments, including Social Security retirement and disability payments. IRC § 6331(h).

<sup>25</sup> Federal Trade Commission, *Consumer Sentinel Network Data Book for January-December 2013* at App. B2 (Feb. 2014).

their success is primarily dependent on how much revenue they collect. Incentives inevitably arise to take shortcuts or employ aggressive practices if they are profitable.

The IRS will be providing PCAs with contact information for taxpayers. If the PCAs are also collecting against those individuals on behalf of businesses, they may be tempted to use the IRS information for the collection of other debts. In addition, the information the IRS provides may include full names, Social Security numbers, and dates of birth – precisely the data that can be used to commit identity theft. These problems did not materialize during the prior PDC program,<sup>26</sup> but because of the incentives, the risks will continue to exist. The IRS will always need to devote resources to ensuring adequate safeguards are in place and to monitoring that they are being followed. The longer the PDC program is operated, the greater the risk these incentives will at some point lead to a security breach.

**6. Congress has imposed strict penalties on IRS collection employees who are abusive to taxpayers, but these penalties do not apply to PCA employees who are abusive to taxpayers.**

As part of the IRS Restructuring and Reform Act of 1998, Congress created significant new protections for taxpayers.<sup>27</sup> Most notably, Section 1203 of the Act specified ten acts or omissions (known as the “10 Deadly Sins”) for which an IRS employee is to be fired. As the Government Accountability Office (GAO) has noted: “Most, but not all, of the acts or omissions involve mistreatment of taxpayers.”<sup>28</sup> Section 6306(b)(2) of the tax code prohibits PCA employees from “committing any act or omission which employees of the Internal Revenue Service are prohibited from committing in the performance of similar services.” This provision was intended to implement the Treasury Department’s original proposal, which included a sentence explaining that “[t]he PCAs would be governed by all of the same rules by which the IRS is governed, thus ensuring that taxpayer rights would be safeguarded.”<sup>29</sup> Despite the intent of the drafters, a prohibition is only meaningful to the extent there are consequences for violations (*i.e.*, taxpayer protections must be enforceable). While IRS employees who mistreat taxpayers generally must be fired, there is no requirement that PCAs fire employees who are found to have mistreated taxpayers. Under the governing

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<sup>26</sup> To reduce the risk of data breaches, the IRS established procedures requiring PCAs to separate their IT systems, their business processes, and even their trash associated with federal tax accounts from their other debt collection accounts, and the IRS devoted resources to monitoring PCA compliance with these requirements.

<sup>27</sup> Pub. L. No. 105-206 (1998).

<sup>28</sup> GAO, GAO-04-1039R, *IRS’ Efforts to Evaluate the Section 1203 Process for Employee Misconduct and Measure Its Impacts on Tax Administration 1* (2004).

<sup>29</sup> Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2004 Revenue Proposals 98* (Feb. 2003).

procedures utilized during the 2006-2009 program, such employees could simply be moved from IRS work to other debt collection accounts handled by the PCA.

- 7. IRS employees are instructed to be straightforward in dealing with taxpayers and the IRS publishes its instructions to staff in the Internal Revenue Manual. By contrast, the PCAs instructed their employees to use “psychological” techniques to pressure taxpayers to agree to payments and attempted to shield those instructions from disclosure.**

During the 2006-2009 program, the IRS awarded contracts to three PCAs. All of them instructed their employees to use a “psychological pause” to put pressure on taxpayers.

A calling script included in one of the PCA’s operational plans required representatives to advise taxpayers: “*Your balance of \$\_\_\_\_\_ is due in full today.*” followed by the question “*How can we help you resolve this?*” The script then required the collection representative to employ a “*Psychological pause – let the Taxpayer speak first,*” (emphasis in original), in which the representative says nothing and waits for the taxpayer to commit to a payment amount.<sup>30</sup>

The training materials for a second PCA contained the following:<sup>31</sup>

Training Plan:

“Use the psychological pause (pregnant pause):

Once you ask for payment in full, pause for the taxpayer’s response. *Silence will work in your favor.*” (Emphasis added.)

Sample Phone Script:

Collection Representative: “What are your intentions regarding payment on your account?”

Psychological Pause:

*The next person to speak loses.* (Emphasis added.)

<sup>30</sup> Calling script for Pioneer Credit Recovery, Inc. (labeled “The Initial Demand”).

<sup>31</sup> Training Materials for Linebarger Goggan Blair & Sampson LLP.

The training materials for the third PCA contained this passage:<sup>32</sup>

Collector's Resource Guide to Success: Step 4: Psychological Pause and Listen

This pause is the most powerful part of your call. *This silence shifts the burden of the conversation to the taxpayer, and they [sic], in turn, will tell you everything you need to know to "close the sale."* When you use the psychological pause, make sure you have left a question or statement to be answered. (Emphasis added.)

Some have suggested that collection tactics like this are acceptable, and even standard, in the debt collection industry. If true, that may explain the high complaint rate. But more fundamentally, Congress has repeatedly enacted laws to protect taxpayers from aggressive collection practices. In my view, instructions to create a "psychological pause" and assertions that "[t]he next person to speak loses" are inconsistent with the values built into IRS customer service initiatives since the IRS Restructuring and Reform Act of 1998. Were a taxpayer to complain to me about such a script being used by IRS employees, I would immediately demand that the script be changed and that remedial training be offered to all collection employees, and I would feel bound to refer the specific case to the Treasury Inspector General for Tax Administration (TIGTA) for investigation of potential intimidation.

It is also noteworthy that the PCAs largely sought to shield their operational plans, including their calling scripts, from disclosure. They argued they were proprietary. By contrast, the IRS publishes all instructions to its staff in the Internal Revenue Manual. Despite the Treasury Department's stated intent that "[t]he PCAs would be governed by all of the same rules by which the IRS is governed, thus ensuring that taxpayer rights would be safeguarded,"<sup>33</sup> its reluctance to require the PCAs to disclose their operational plans and calling scripts demonstrates that taxpayer protections built into the conceptual design of the program were not always enforced.

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<sup>32</sup> Training Materials for CBE Group, Inc.

<sup>33</sup> Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* 98 (Feb. 2003).

**8. One significant consequence of using “psychological” tactics is that financially struggling taxpayers who cannot afford to pay their debts feel pressured into making commitments they ultimately cannot keep.**

My concerns about tactics like the “psychological pause” arise in part from my experience before I joined the IRS as the founder and executive director of a Low Income Taxpayer Clinic (LITC) in Richmond, Virginia, as well as from reports I continue to receive from LITCs. I represented low income taxpayers for many years in states that retained private debt collectors for the bulk of their tax collection activity. I routinely saw taxpayers agree to installment agreements with monthly payment amounts greatly in excess of what they could afford and often at harm to their welfare and their ability to be compliant in the future.<sup>34</sup> Low income taxpayers often lack financial savvy and are terrified of what a debt collector might do to their lives. Often, I saw they had offered up any amount in order to be free of the collection agency and did not ask about lower amounts. Needless to say, taxpayers frequently defaulted on these agreements and ended up in my clinic’s office for assistance.

Agreeing to an unreasonable installment agreement that will result in a default is not neutral to the IRS or the taxpayer. From the IRS perspective, this taxpayer has demonstrated additional noncompliance and will require additional (costly) contacts and efforts, including levies. The taxpayer no longer qualifies for a guaranteed installment agreement<sup>35</sup> and will have to submit additional financial information (and pay an additional user fee) to reinstate the installment agreement or enter into a new one.<sup>36</sup> Additionally, the default may prevent a taxpayer from later securing another installment agreement that is not guaranteed.<sup>37</sup> From the taxpayer’s perspective, he now may be even more uneasy or afraid about communicating with the IRS in addition to having fewer options, potentially reducing the taxpayer’s future compliance. All of this could be avoided were taxes collected the right way – *i.e.*, with an eye to future compliance and the particular circumstances of the taxpayer. The “psychological

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<sup>34</sup> In a TAS study of the Federal Payment Levy Program, TAS found that more than one-quarter of FPLP taxpayers who paid their tax liability, entered into an installment agreement with the IRS, or were subject to an ongoing FPLP levy had incomes at or below the poverty level. See National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, at 46-73 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*). The risk taxpayers will agree to make payments they cannot afford increases with the PCAs that employ techniques like the “psychological pause” and that think in terms of “win/lose.”

<sup>35</sup> IRC § 6159(c)(2)(C).

<sup>36</sup> IRM 5.19.1.5.4.22(6).

<sup>37</sup> The fact that a taxpayer has defaulted on a prior installment agreement can be the basis for determining that a subsequent installment agreement request has been made solely to delay collection. IRM 5.14.3.2(2).

pause” instructions and attendant consequences demonstrate an important difference between the compliance-oriented IRS and the profit-oriented PCAs.

**9. Under the proposal, the IRS would be required to send taxpayer cases to PCAs where the sole or primary reason for the liability is the Patient Protection and Affordable Care Act (ACA).**

Under the ACA, an individual may owe tax if s/he (i) does not purchase health care coverage and is therefore liable for an Individual Shared Responsibility payment<sup>38</sup> or (ii) receives an excess Premium Tax Credit subsidy to purchase health insurance and must pay back the excess.<sup>39</sup> Where the IRS is charged with administering social benefit programs, I believe the agency should proceed with particular sensitivity in collecting delinquencies attributable to those programs (except in cases involving fraud). If debt collectors come to be seen as the public face of the ACA, I am concerned that could make the IRS’s job more difficult as it tries to balance its twin missions of revenue collection and benefits administration.

**10. As noted above, the PDC program raises significant taxpayer rights concerns, yet it will raise comparatively little revenue at best and is more likely to be another revenue loser.**

The Joint Committee on Taxation has estimated that the pending proposal would raise \$2.4 billion over ten years.<sup>40</sup> That is an average of \$240 million per year. For context, if that revenue were to materialize, here is how the annualized PDC revenue would stack up to the IRS’s most recent annual estimate of the gross tax gap:<sup>41</sup>

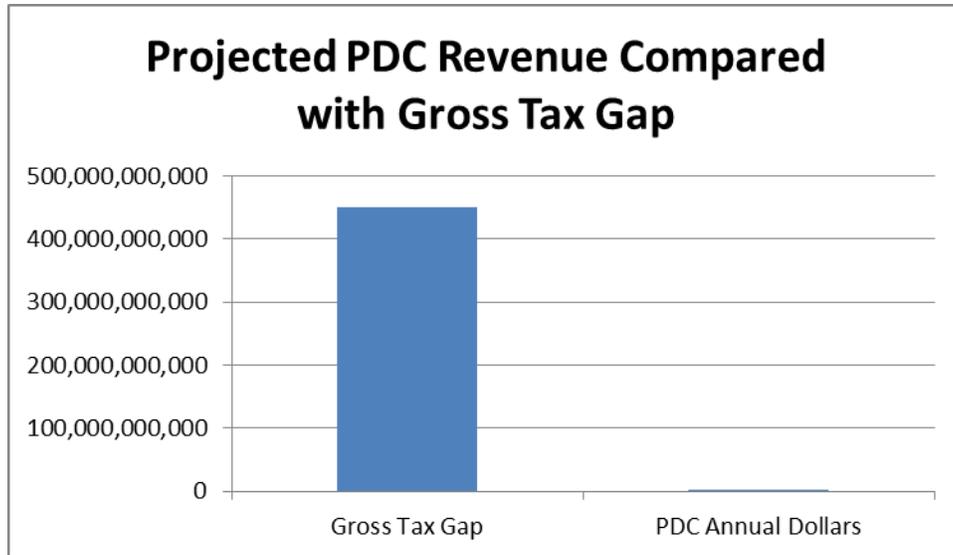
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<sup>38</sup> IRC § 5000A.

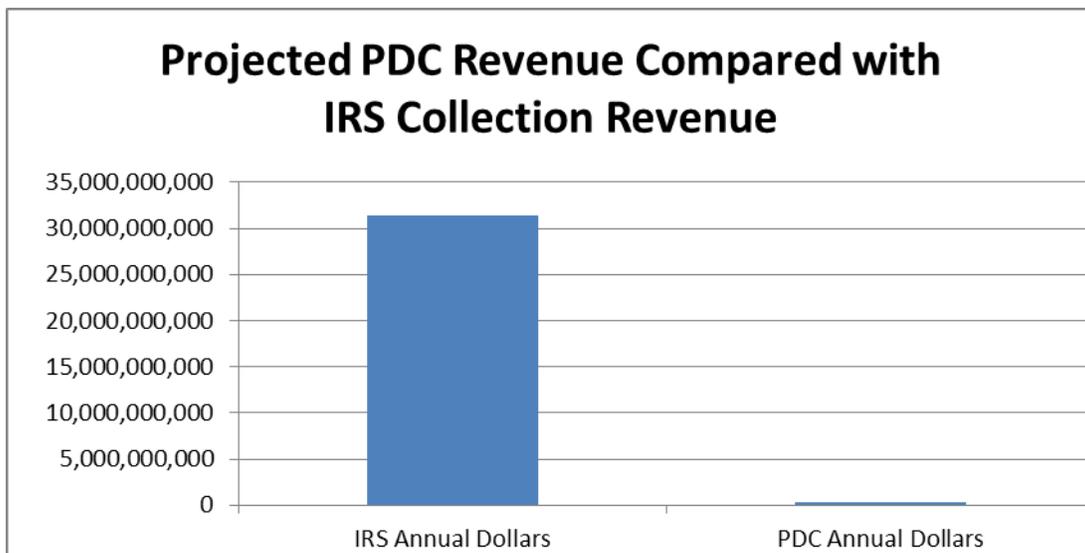
<sup>39</sup> IRC § 36B.

<sup>40</sup> S. Rep. No. 113-154, at 131 (2014).

<sup>41</sup> The gross tax gap represents the difference between the amount of tax due and the amount of tax timely and voluntarily paid. The most recent IRS estimate of the gross tax gap was \$450 billion and was made for tax year 2006.



Viewed differently, the IRS Collection function brought in \$31.4 billion in FY 2013.<sup>42</sup> Here is how the projected PDC revenue would stack up to the revenue actually collected last year by the IRS:



As noted above, even these scenarios are probably too optimistic. The PDC program lost revenue last time – a small amount if one ignores opportunity costs and likely more than \$1 billion if one considers those costs. Ignoring opportunity costs, IRS data shows the PCAs collected gross revenue of \$98.2 million over the life of the program and paid \$16.5 million in commissions, producing net

<sup>42</sup> IRS, *Fiscal Year 2013 Enforcement and Service Results*, at <http://www.irs.gov/uac/Newsroom/FY-2013-Enforcement-and-Service-Results>.

revenue of \$81.7 million. The expenses incurred to administer the program, excluding commissions paid to the PCAs, were \$86.2 million. Therefore, the program lost \$4.5 million.

During the pendency of the program, we computed that the return on investment (ROI) achieved by an IRS employee in the Automated Collection System (ACS) was about 20:1.<sup>43</sup> If the IRS had been given the \$86.2 million spent on the PDC program without restriction, it could have collected about \$1.72 billion in gross revenue, or \$1.63 billion after subtracting the \$86.2 million in costs, compared with the PDC program's net loss of \$4.5 million.

No one has credibly argued the PCAs can collect taxes more efficiently than the IRS,<sup>44</sup> nor has anyone credibly argued that PCAs are better at respecting taxpayer rights than the IRS. Rather, the main argument for PDC has been that Congress is not appropriating sufficient funds to allow the IRS to work enough collection cases. Therefore, the intent was to create a separate self-funded program that would operate independently of the appropriations process. Under the existing PDC provision, the IRS may pay the PCAs up to 25 percent of the revenue they collect, and the IRS itself may retain up to 25 percent of the revenue the PCAs collect (the "25 percent holdback"). The intent was that the 25 percent holdback would cover the full costs of administering the program. If that were to happen, the program should raise revenue.

But that did not happen for several reasons. First, the assumption that the 25 percent holdback would cover its costs has proven false. During the 2006-2009 program, the IRS had to dip into appropriated funds to administer PDC, so it essentially was required to apply funds it had been using to pursue higher priority cases to support the PCAs' lower priority work. This is a significant opportunity cost that caused significant revenue loss to the government.<sup>45</sup>

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<sup>43</sup> For FY 2008, we computed the fully loaded annual cost of an average ACS employee was about \$75,000, and the average annual revenue collected by an ACS employee was about \$1.49 million.

<sup>44</sup> In 2013, the TAS Research function analyzed the dollars collected by PCAs during the 2006-2009 and the dollars collected by IRS employees who worked cases the PCAs were unable to resolve. PCA employees collected 5.4 percent of the dollars available for collection, while IRS employees collected 9.2 percent of the dollars available for collection – nearly double. In fact, the comparison understates the extent to which IRS employees are more effective in working cases, because the IRS only worked cases on which PCAs failed to collect. Thus, the PCAs had an opportunity to close the easy cases, and by the time the IRS received the cases, the debts were older. See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, at 97-107 (Research Study: *The IRS Private Debt Collection Program: A Comparison of Private Sector and IRS Collections While Working the Private Collection Agency Inventory*).

<sup>45</sup> According to IRS data, the costs the IRS incurred in running the program were \$67.8 million more than the amount of PCA collections the IRS retained. These costs required the IRS to use appropriated funds. If those funds had been applied to the ACS program and achieved an ROI of 20:1, the collected amount would have been \$1.356 billion. Some of the IRS's costs were one-time start-up costs, but even leaving those aside, IRS data indicates that the costs of the program exceeded the amount it retained by \$12.4 million. Even if just the appropriated funds of \$12.4

Second, the IRS adopted a policy to support the PDC program during 2006-2009 of working the cases that came back from the PCAs unresolved. In fact, the majority of the 357,449 tax modules assigned to the PCAs (involving 203,800 accounts) came back to the IRS unresolved. The IRS pulled ACS employees from their existing inventories to work these cases. As it turned out, the IRS apparently did not work all of the cases that came back unresolved, and a report by TIGTA implicitly criticized the IRS for failing to do so.<sup>46</sup>

This makes little sense. Diverting ACS employees away from their existing work to handle unresolved PCA cases undermines the rationale for the PDC program. Instead of sticking to the rationale for the program – *i.e.*, allowing ACS employees to continue to work their existing inventories while the PCAs stepped into the breach and worked lower priority cases – we ended up with a situation where ACS employees dropped their inventories to work the PCA cases unresolved by the PCAs. Indeed, if the IRS's work prioritization is reasonable and if it continues to work cases assigned to the PCAs that come back unresolved, then expanding the PDC program will mean ACS employees will devote more and more time to finishing up PCA-type cases and will have less time available to work their current (presumably higher-ROI) inventories.<sup>47</sup> In theory, expanding the program enough could mean ACS employees will have to drop 100 percent of their existing inventories to finish working returned PCA cases! This is a second opportunity cost of the PDC program that should be considered. The more cases that come back from PCAs that ACS must work, the less time ACS employees will have to work their existing inventories.

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million were used in ACS and achieved an ROI of 20:1, the resulting revenue of \$248 million would have been more than three times the gross revenue collected by the PCAs.

<sup>46</sup> TIGTA, Ref. No. 2011-30-114, *Collection Actions Were Not Always Pursued on Cases Returned from the Private Debt Collection Program* (2011).

<sup>47</sup> I have consistently questioned the Collection function's work selection criteria and recommended changes. See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 124-164 (Most Serious Problems: *Problems Relating to IRS Collection Policies and Practices*) (including discussion of the Automated Collection System, collection procedures, collection statute expiration dates, and Collection Due Process hearings); see also National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*). During the pendency of the 2006-2009 program, the IRS stated that it would not choose to work the PCA inventory if it had additional resources because the "next best case" criteria it used prioritized other cases, such as older cases with higher balances due. The 2009 cost effectiveness study found that the IRS actually did better working the PCA inventory than working what it previously considered its "next best case." In my view, this realization is the one positive outcome of the 2006-2009 program. I continue to believe Collection must improve. I note, however, that the IRS has an incentive to prioritize its casework to maximize revenue collection, so it generally will seek to work the cases it believes will produce the highest ROIs.

11. **By mandating that the IRS operate a large-scale PDC program, the bill would require the IRS to continue the program even if it loses money. It also does not give the Secretary sufficient discretion to make modifications as problems inevitably arise.**

When Congress enacted IRC § 6306 in 2004 at the Treasury Department's request, the provision gave the IRS the authority to operate a PDC program but did not require it to do so. As a consequence, the IRS had the ability to decide which cases to assign to PCAs. As the IRS gained experience with the program, it changed the criteria for case assignment numerous times, generally expanding the criteria but sometimes contracting them. When the IRS ultimately terminated the program, it did so because it determined that the costs of running the program exceeded the benefits.

Section 304 of the EXPIRE Act would require the IRS to operate the program and require that all "inactive tax receivables" be assigned to PCAs, subject to limited exceptions. In addition to the general concerns I have described above, I have two specific concerns about the lack of administrative flexibility in carrying out this mandate.

First, the sole rationale for PDC is to raise revenue, yet the IRS concluded that the 1996-1997 pilot and the 2006-2009 program both lost money. Tax administration is rarely a high-priority issue and it is very difficult to persuade a majority of both houses of Congress to act. Therefore, if this legislation is enacted as written, it is likely the PDC program will become permanent even if it consistently loses money. Forcing an agency to operate a long-term program that is designed to raise revenue but instead loses revenue makes little sense. One alternative would be to sunset the mandatory nature of the program after three years unless Congress affirmatively votes to continue it. That way, the Treasury Department could maintain the program if it finds it to be profitable, but it would have the authority to cut its losses if the program again proves to be a revenue loser after administrative and opportunity costs are taken into account.

Second, the IRS will inevitably find as it goes along that certain cases should not be assigned to PCAs for one reason or another. By requiring the assignment of "all outstanding tax receivables" (subject to limited exceptions), this proposal does not give the Secretary discretion to modify the scope of cases assigned. As written, for example, the Secretary would have to assign assessments of employment tax, excise tax, and estate tax to the same extent as assessments of income tax. Thus, despite a carve-out for deceased taxpayers, PCAs would receive estate cases, since estates are distinct tax entities from decedents. Unintended results are inevitable. Therefore, administrative discretion to make adjustments is essential.

**12. We are uncertain what Section 305 of the bill is intended to accomplish.**

The committee report accompanying the bill states that the IRS would be required to use the 25 percent holdback “to fund a newly created special compliance personnel program.” The provision also “requires the Secretary to establish an account for the hiring, training, and employment of special compliance personnel.” The report further states that “[n]o other source of funding the program is permitted, and funds deposited in the special account are restricted for the use of the program, including reimbursement of the IRS and other agencies for the cost of administering the qualified debt collection program and all costs associated with employment of special compliance personnel and the retraining and reassignment of other personnel as special compliance personnel.” The report goes on to explain that special compliance personnel are “individuals employed by the IRS to serve as revenue officers performing field collection functions, or as persons operating the automated collection system.”

This provision raises questions and possible concerns. First, it appears to require the new account to cover both the administrative costs of the PDC program and additional compliance personnel. Based on prior experience, the 25 percent holdback was not sufficient to cover the administrative costs of the program, so there is a high probability there will not be sufficient revenue to achieve the objective. If that is the case, the IRS will have to dip into appropriated funds to administer the program and no funds will remain in the account to hire additional compliance personnel. Second, the IRS currently employs thousands of revenue officers and ACS employees. I am concerned that creating new categories of IRS collection employees and requiring segregated budgeting will unduly limit the agency’s flexibility, prevent the IRS from selecting the most productive cases to work, and impose unproductive administrative costs.

## **RECOMMENDATIONS**

For the reasons I have described above, I believe outsourcing the collection of federal tax debts is a bad idea. It disproportionately impacts low income and other vulnerable taxpayers, and despite two attempts at making it work, the program has lost money both times, undermining the sole rationale for its existence. To the extent the IRS is unable to perform its core work adequately, I have repeatedly recommended that Congress fund the IRS sufficiently to do so.<sup>48</sup> In theory, budget cuts have been made to help reduce the deficit. In practice, constraining the budget of the IRS – which, after all, is the government’s accounts receivable department – makes little sense. With ACS providing an ROI of 20:1, the better approach to reducing the budget deficit is to provide more funding for ACS – not constrain its funding and then develop far less productive work-arounds.

Despite my opposition to a PDC program, I offer the following suggestions to improve the pending proposal:

1. Adopt the Taxpayer Bill of Rights that I have repeatedly proposed and that the House of Representatives approved last July by a voice vote with bipartisan support.<sup>49</sup> This proposal has been non-controversial with respect to the IRS. I believe these rights should protect taxpayers in their dealings with PCAs as well.
2. Create statutory carve-outs from the PDC program for low income and other vulnerable populations, including (a) taxpayers with incomes not in excess of 250 percent of the federal poverty level, (b) taxpayers receiving Social Security retirement or disability benefits, and (c) taxpayers whose liabilities are attributable to provisions in the Affordable Care Act.<sup>50</sup>

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<sup>48</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 20-38 (Most Serious Problem: *IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 34-41 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); National Taxpayer Advocate 2011 Annual Report to Congress 3-14 (Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*); National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Key Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

<sup>49</sup> See H.R. 2768, 113<sup>th</sup> Cong. (2013). Since I first proposed a Taxpayer Bill of Rights and the House approved it, I have worked with the IRS Office of Chief Counsel to develop minor refinements. Therefore, if this proposal is added, I would be happy to supply slightly revised language.

<sup>50</sup> Congress and the IRS have both adopted 250% of the federal poverty level (FPL) as a proxy for low income. Congress has set 250% of FPL as the maximum income for qualifying for assistance from a Low Income Taxpayer Clinic. See IRC § 7526(b)(1)(B)(i). The IRS has developed a low income tax filter that excludes individual taxpayers who otherwise would be subject to the Federal Payment Levy Program (FPLP) if their estimated total income falls below 250% of the FPL. IRM 5.11.7.2.2.3. Under FPLP, the IRS can levy 15% percent of certain federal payments, including Social Security retirement and disability payments. Because the IRS

3. Authorize the Secretary to prescribe safeguards to protect taxpayer rights and taxpayer privacy and provide the Secretary with discretion to modify the pool of cases assigned to PCAs consistent with the program's objectives.
4. Provide that before a PCA is engaged, the IRS, in consultation with the National Taxpayer Advocate, must make a determination that (a) the PCA's policies and procedures comply with the taxpayer protections included in the Taxpayer Bill of Rights and (b) the PCA has adequate safeguards in place to ensure that taxpayer rights (as prescribed by statute and administrative rules) will be protected.
5. Require that before a case is assigned to a PCA, the IRS must notify the taxpayer in writing that the taxpayer may work directly with the IRS and may potentially be eligible for an offer in compromise or a partial payment installment agreement, and require the PCA on its first call with the taxpayer to reference the notice and advise the taxpayer of those options, including the availability of the Taxpayer Advocate Service.
6. Amend IRC § 7803(c)(2)(B)(ii) to require that the National Taxpayer Advocate's annual reports to Congress report on TAS's cases where there is PCA involvement, complaints about PCAs, and whether the PCA's policies, procedures, and conduct comply with the Taxpayer Bill of Rights.
7. Require PCAs to disclose their operational plans, policies and procedures, and calling scripts to the same extent as the IRS must do. This is an important taxpayer protection to allow third parties, including the National Taxpayer Advocate, to assess the extent to which the PCAs are respecting taxpayer rights and to report any concerns to Congress.
8. Require that the GAO conduct an annual cost-benefit analysis of the PDC program that takes into account the opportunity costs of using IRS resources to supervise and support the PDC program and the downstream costs of the program, including referrals to the Taxpayer Advocate Service or IRS Office of Appeals and litigation. The study should not credit debts collected by refund offset to either the IRS or the PCAs, as those revenues are collected through automation without the need for collection action.

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has established administrative guidance under IRC § 7526(b)(1)(B)(i) that would be helpful in this context as well, I recommend the carve-out be created by cross-referencing that provision. The rationale for excluding Social Security benefits from PDC is that because of the FPLP levy being served on taxpayers with incomes above 250% of FPL, the IRS is already collecting those tax debts – and it is doing so without having to pay 25% of each payment to a PCA as a commission.

9. Modify the bill so the requirement that the Secretary maintain the PDC program expires after three years. At that point, the Secretary should have the discretion to decide whether to continue to the program based on its results. Of overriding importance, the Treasury Department should not be required to continue to operate a program designed solely to raise revenue if doing so produces a net revenue loss.
  
10. Clarify that no case should go to a PCA until 365 days have elapsed after assessment. A substantial percentage of IRS collection revenue comes from refund offsets, notably in the first year. In my judgment, there is no reason for the government to send cases to PCAs immediately and pay 25 percent of collected amounts when there is a good chance the IRS will be able to recoup most or all of the liability via refund offset without paying commissions.

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I hope this information is helpful. If you have further questions, please contact me at (202) 317-6100, or your staff may contact Ken Drexler, my senior advisor, at (202) 317-3520.

Sincerely,



Nina E. Olson  
National Taxpayer Advocate