Joint Committee on Taxation
May 12, 2003
JCX-49-03

PRESENT LAW AND BACKGROUND RELATING TO PERMITTING PRIVATE SECTOR DEBT COLLECTION COMPANIES TO COLLECT TAX DEBTS

Scheduled for a Public Hearing
Before the
SUBCOMMITTEE ON OVERSIGHT
of the
HOUSE COMMITTEE ON WAYS AND MEANS
on May 13, 2003

Background and Present Law

In fiscal years 1996 and 1997, the Congress earmarked $13 million for IRS to test the use of private debt collection companies. There were several constraints on this pilot project. First, because both IRS and OMB considered the collection of taxes to be an inherently governmental function, only government employees were permitted to collect the taxes. The private debt collection companies were utilized to assist the IRS in locating and contacting taxpayers, reminding them of their outstanding tax liability, and suggesting payment options. If the taxpayer agreed at that point to make a payment, the taxpayer was transferred from the private debt collection company to the IRS. Second, the private debt collection companies were paid a flat fee for services rendered; the amount that was ultimately collected by the IRS was not taken into account in the payment mechanism.

The pilot program was discontinued because of disappointing results. GAO reported[1] that IRS collected $3.1 million attributable to the private debt collection company efforts; expenses were also $3.1 million. In addition, there were lost opportunity costs of $17 million to the IRS because collection personnel were diverted from their usual collection responsibilities to work on the pilot.

[1] GAO/GGD-97-129R Issues Affecting IRS' Collection Pilot (July 18, 1997).

The IRS has in the last several years expressed renewed interest in the possible use of private debt collection companies; for example, IRS recently revised its extensive Request for Information concerning its possible use of private debt collection companies.[2]

In general, Federal agencies are permitted to enter into contracts with private debt collection companies for collection services to recover indebtedness owed to the United States.[3] That provision does not apply to the collection of debts under the Internal Revenue Code.[4]

On February 3, 2003, the President submitted to the Congress his fiscal year 2004 budget proposal,[5] which proposed the use of private debt collection companies to collect Federal tax debts.[6] Shortly thereafter, the Department of the Treasury released its explanation of the President's revenue proposals.[7]

Over the last five years, the number of IRS staff in collection has remained relatively stable, while the number of returns filed has increased significantly. Table 1 provides statistics on the number of IRS staff in collection and the number of returns filed for the five most recent years for which this data is available.

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[2] TIRNO-03-H-0001 (February 14, 2003), at www.procurement.irs.treas.gov. The basic request for information is 104 pages, and there are 16 additional attachments.

[3] 31 U.S.C. sec. 3718.

[4] 31 U.S.C. sec. 3718(f).

[5] *See* Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2004* (H. Doc. 108-3). In general, the tax provisions are described in *Analytical Perspectives* (Vol. III), pp. 66-81.

[6] *Budget* (Vol. 1), p. 274.

[7] *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals*, February 2003.

Table 1.–Collection staffing and returns filed

	1998	1999	2000	2001	2002
Full-time equivalent staff in collection[1] employed in specified fiscal years	11,628	11,334	10,576	11,208	11,439
Individual income tax returns filed in specified calendar years[2]	123,049,600	125,389,700	127,657,400	130,094,300	131,247,900[3]
Corporate income tax returns filed in specified calendar years[4]	5,241,200	5,398,300	5,469,600	5,561,300	5,717,000[5]

1 Letter from Bob Wenzel, Acting Commissioner, IRS, to Mary Schmitt, Acting Chief of Staff, Joint Committee on Taxation, responding to questions in connection with the Joint Congressional Review, May 7, 2003, p. 55.

2 Statistics of Income Bulletin, Winter 2002-2003, p. 193 (except 1998 statistics from Winter 2001-2002, p. 223).

3 Estimated.

4 Statistics of Income Bulletin, 2002-2003, p. 193 (except 1998 statistics from Winter 2001-2002, p. 223).

5 Estimated.

Description of President's Budget Proposal

The proposal permits the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities[8] of any type[9] and to arrange payment of those taxes by the taxpayers. Several steps are involved. First, the private debt collection company contacts the taxpayer by letter.[10] If the taxpayer's last known address is incorrect, the private

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8 There must be an assessment pursuant to section 6201 in order for there to be an outstanding tax liability.

9 The proposal generally applies to any type of tax imposed under the Internal Revenue Code. The Treasury anticipates that the focus in implementing the proposal will be:
(a) taxpayers who have filed a return showing a balance due but who have failed to pay that balance in full; and (b) taxpayers who have been assessed additional tax by the IRS and who have made several voluntary payments toward satisfying their obligation but have not paid in full. The Treasury anticipates that the IRS will commence implementation of the proposal with debts owed by individuals.

10 Several portions of the proposal require that the IRS disclose confidential taxpayer information to the private debt collection company. Section 6103(n) permits disclosure for "the providing of other services ... for purposes of tax administration." Accordingly, no amendment to 6103 appears to be necessary to implement the proposal.

debt collection company searches for the correct address. The private debt collection company is not permitted to contact either individuals or employers to locate a taxpayer. Second, the private debt collection company telephones the taxpayer to request full payment.[11] If the taxpayer cannot pay in full immediately, the private debt collection company offers the taxpayer an installment agreement providing for full payment of the taxes over a period of as long as three years. If the taxpayer is unable to pay the outstanding tax liability in full over a three-year period, the private debt collection company obtains financial information from the taxpayer and will provide this information to the IRS for further processing and action by the IRS.

The proposal specifies several procedural conditions under which the proposal would operate. First, provisions of the Fair Debt Collection Practices Act would apply to the private debt collection company. Second, taxpayer protections that are statutorily applicable to the IRS would also be made statutorily applicable to the private sector debt collection companies. Third, the private sector debt collection companies would be required to inform taxpayers of the availability of assistance from the Taxpayer Advocate.

The proposal creates a revolving fund from the amounts collected by the private debt collection companies. The private debt collection companies would be paid out of this fund. Their compensation would be "based upon a number of factors, including quality of service, taxpayer satisfaction, and case resolution, in addition to collection results."[12]

Effective date.–The proposal is effective after the date of enactment.

Description of H.R. 1169 (Mr. Houghton)

On March 11, 2003, Mr. Houghton introduced H.R. 1169, a bill to provide for the performance of certain tax collection services by contractors. In general, the bill is the same as the President's budget proposal, except that the bill prohibits the payment of fees in excess of 25 percent of the amount collected under a tax collection contract. The President's budget proposal does not contain a statutory ceiling on fees.[13]

Inclusion of Proposal in S. 2

The proposal is included in S. 2, the "Jobs and Growth Tax Act of 2003," as passed by the Senate Committee on Finance on May 8, 2003.

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[11] The private debt collection company is not permitted to accept payment directly. Payments are required to be processed by IRS employees.

[12] Treasury *General Explanations*, p. 99.

[13] The President's budget proposal assumes that there will be competitive bidding for these contracts by private sector tax collection agencies and that vigorous bidding will drive the overhead costs down.

Analysis

One significant policy concern is whether the collection of taxes is so inherently a governmental function that it should not be delegated to the private sector. Similarly, there may be a constitutional issue prohibiting the delegation of a governmental function to the private sector. Proponents would respond that the actions being delegated to private sector debt collection companies are specific and do not permit the exercise of discretionary authority. In general, IRS employees have a significant scope of discretion in the exercise of their duties.[14] Before taxes are assessed, they have discretion, for example, in determining which returns to audit, how to proceed with an audit, and whether to compromise the amount of tax otherwise owed. Similarly, after taxes are assessed, IRS employees have discretion, for example, in determining what enforcement mechanisms should be utilized to collect the taxes owed. The proposal does not permit the private sector debt collection companies to exercise discretionary authority of this type (or any other). Accordingly, proponents believe that neither a policy concern nor a constitutional issue exists.

Another policy issue relates to the method by which private sector debt collection companies will be paid. One alternative is to pay them a flat fee for services rendered. Another alternative is to pay them a variable fee based, at least in part, on their success in actually collecting taxes that are due (by, for example, paying them a percentage of what they collect). This second alternative is generally the method by which the private sector debt collection companies prefer to be paid. Some may question whether it is appropriate to use a payment formula based in whole or in part on the success in collecting taxes that are due, because such a formula may be perceived to encourage inappropriate collection activities. Proponents would respond that the proposal prohibits inappropriate collection activities and that using a formula based upon the success in collecting the taxes that are due provides appropriate incentives for the most efficient providers of services to the Government.

Another policy issue is whether the proposal attempts to avoid the restrictions of the appropriations process. Opponents would argue that the proposal in effect provides additional employees to perform the tax collection duties assigned to the IRS, but does not require that those employees be paid for directly with appropriated funds. Proponents would argue that this policy issue has previously been addressed with respect to debt owed to many other parts of the Federal government, and a determination has been made that the mechanism employed in the proposal is appropriate. For example, the Department of Education utilizes private debt collection agencies to collect past-due student loans owed to the Federal Government.

The use of private debt collectors may free up IRS resources to focus on other taxpayer delinquencies, thereby increasing total collections. On the other hand, the use of private debt collectors also raises concerns about the ability of the IRS to properly supervise these contractors and protect taxpayer privacy. The IRS has a finite amount of resources to devote to contractor supervision. As the number of private debt collectors increases, the ability of the IRS to closely supervise those collectors and ensure that the collectors are using appropriate safeguards and

[14] There are limitations on the exercise of this discretion imposed by both the Code and internal IRS procedures (such as the Internal Revenue Manual).

computer security decreases. As a result, the potential for abuse of taxpayer return information could increase.

Another issue is the extent to which taxpayers will voluntarily pay the amounts owed in response to the private debt collectors or will raise procedural or substantive issues that will require referral of their cases back to the IRS.[15] It is possible that such referrals back to the IRS may consume considerable resources of the IRS.

Some have argued that the use of private debt collectors will displace government employees from their jobs. The IRS reports that it currently has $75.7 billion[16] in uncollected receivables,[17] owed by over 6.1 million individuals and businesses.[18] Others might respond that these numbers may be so large that the possibility of displacement of government employees may be remote for at least the foreseeable future.

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15 *See* "Compliance and Collection: Challenges for IRS in Reversing Trends and Implementing New Initiatives" GAO-03-732T (May 7, 2003).

16 Of this total, 64 percent represents individual income taxes (from the Individual Master File) and 36 percent represents corporate income taxes, employment taxes, estate and gift taxes, and excise taxes (from the Business Master File).

17 This is the dollar value of what the IRS calls the "Potentially Collectible Inventory;" it excludes amounts deemed to be uncollectible or duplicative assessments.

18 TIRNO-03-H-0001 (February 14, 2003), at www.procurement.irs.treas.gov. Attachment #3.