

**Management Advisory Report:  
Additional Options to Collect Tax Debts  
Need to Be Explored**

**July 2001**

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

July 24, 2001

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION

A handwritten signature in cursive script that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report - Additional Options to  
Collect Tax Debts Need to Be Explored

This report presents the results of our review to determine what actions the Internal Revenue Service (IRS) has taken regarding the use of collection agencies to assist in tax debt collection activities since its pilot test in 1996. This report is being provided for informational purposes to aid IRS management in its efforts to reduce tax debts.

In summary, the IRS has not pursued the use of collection agencies since its 1996 pilot test to assess the feasibility of using these agencies to assist in debt collection activities. Reviews of the IRS' pilot test identified legal and administrative barriers that prevented the pilot from being an effective test for using collection agencies. In June 1997, the Congress, based on information provided by the General Accounting Office, directed the IRS to stop the use of collection agencies in tax debt collection.

As tax debt receivables continue to rise (gross accounts receivables rose from \$216 billion in Fiscal Year (FY) 1996 to \$264 billion in FY 2000) with the IRS unable to adequately address the increasing number of delinquency cases, the IRS may want to reconsider the use of collection agencies to assist in tax debt collection.

Copies of this report are also being sent to the IRS managers who are affected by the report conclusions. Please contact me at (202) 622-6510 if you have questions or Walter Arrison, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

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## **Objective and Scope**

*The objective of the review was to determine what actions the IRS has taken regarding the use of collection agencies to assist in tax debt collection since its pilot test in 1996.*

The objective of our review was to determine what actions the Internal Revenue Service (IRS) has taken regarding the use of collection agencies to assist in tax debt collection activities since its pilot test in 1996.

To accomplish our objective, we:

- Obtained and analyzed prior audit reports evaluating the effectiveness of the IRS' pilot test of collection agencies.
- Obtained and analyzed key laws and provisions to determine the IRS' responsibilities relating to the use of collection agencies.
- Obtained and analyzed the IRS' tax administration strategy and modernization plans to determine whether they include outsourcing of tax debt cases to collection agencies.
- Interviewed IRS personnel in the Small Business/Self-Employed Compliance Policy and Customer Accounts Management Business Systems Modernization areas.

The review was performed at the National Headquarters from April to May 2001. The review was conducted in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

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## **Background**

During the period 1990 through 1994, the IRS' gross tax debt receivables<sup>1</sup> grew about 80 percent from \$87 billion to \$156 billion. However, during the same period, annual collections of delinquent taxes declined about 8 percent from \$25.5 billion to \$23.5 billion.

*In response to the IRS' growing tax debt receivables, the Congress directed the IRS to test the usefulness of collection agencies in tax debt collection activities.*

In response to the IRS' growing tax debt receivables, the Congress directed<sup>2</sup> the IRS to test the usefulness of collection agencies in tax debt collection activities. In November 1995, the IRS was provided with \$13 million to award contracts to collection agencies and private counsel law firms. In June 1996, the IRS awarded contracts to five collection agencies.

In September 1996, the Congress allocated<sup>3</sup> an additional \$26 million to the IRS to continue the outsourcing of tax debt collection cases and to initiate a second pilot project. However, reviews of the IRS' initial pilot test identified legal and administrative barriers that prevented the pilot from being an effective test for using collection agencies. In June 1997, the Congress, based on information provided by the General Accounting Office, directed that the IRS stop the use of collection agencies to assist in tax debt collection.

In addition to the above laws establishing the IRS' ability to outsource debt collection work, there are laws and provisions relating to taxpayer privacy and security that the IRS must ensure the contracted collection agencies adhere to. Appendix III of this report provides a listing and overview of the key laws and provisions.

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<sup>1</sup> Gross tax debt receivables include all unpaid assessments of tax, penalty, and interest recorded on taxpayers' accounts.

<sup>2</sup> Treasury, Postal Service, and General Government Appropriations Act, 1996 [Page 109 Stat. 468] Public Law 104-52, enacted November 19, 1995.

<sup>3</sup> Omnibus Consolidated Appropriations Act, 1997 104 P.L. 208.

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## Results

*Since the cancellation of its pilot, the IRS has not pursued the use of collection agencies to assist in reducing tax debt receivables.*

The IRS has not pursued the use of collection agencies to assist in reducing tax debt receivables since its 1996 pilot test. In addition, reviews of the IRS' tax administration strategy and modernization plans identified no specific actions the IRS plans to take relating to the future use of collection agencies.

However, subsequent to the cancellation of the pilot test (and outside of the normal IRS collection process) the IRS began participating in the Treasury Offset Program.<sup>4</sup> The IRS implemented the first phase (Federal Payment Levy Program) in July 2000 by beginning to levy federal retirement and federal contractor payments to offset tax debts owed by these individuals. As of March 2001, approximately \$8.4 million in delinquent tax debts had been collected. The IRS plans to expand its Federal Payment Levy Program to include the levying of federal wages and social security payments in July and October 2001, respectively.

We believe that, in addition to these efforts, the IRS should reconsider the use of other debt collection options.

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<sup>4</sup> The Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 app.) authorized the IRS to use its Federal Payment Levy Program to collect outstanding tax debts.

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*In June 1996, the IRS contracted with 5 collection agencies and provided them 168,521 cases on which taxes of over \$1.2 billion were owed.*

*Based on legal and administrative problems relating to the initial pilot project, the Congress directed the IRS to stop using collection agencies.*

On November 19, 1995, the Congress directed the IRS to test the usefulness of collection agencies in tax debt collection activities. On June 14, 1996, the IRS awarded contracts to 5 collection agencies and provided them 168,521 delinquency cases on which taxes of over \$1.2 billion were owed.

The role of the collection agencies was not to collect taxes but to assist the IRS in its collection efforts, including finding, contacting, and reminding taxpayers of their tax liabilities and/or securing commitments for full payments or installment agreements. In addition, the IRS hoped to gain familiarity with the business practices followed by the debt collection industry.

The Congress, on September 30, 1996, allocated another \$26 million to the IRS to continue the outsourcing of tax debt collection cases and to initiate a second pilot project. However, based on legal and administrative problems relating to the initial pilot project, House Committee members Kolbe,<sup>5</sup> Johnson,<sup>6</sup> and Horn<sup>7</sup> recommended that the IRS stop the use of collection agencies and work with the General Accounting Office (GAO) to develop legislative proposals necessary to conduct a successful program. The identified legal and administrative problems included:

- The IRS' legal interpretations prevented the pilot from being a true test of private contractors' ability

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<sup>5</sup> Jim Kolbe, Chairman, Subcommittee on Treasury, Postal Service, and General Government Committee on Appropriations.

<sup>6</sup> Nancy L. Johnson, Chairman, Subcommittee on Oversight Committee on Ways and Means.

<sup>7</sup> Stephen Horn, Chairman, Subcommittee on Government Management, Information, and Technology and Committee on Government Reform and Oversight.

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to collect delinquent taxes. For example, private contractors are not able to actually collect taxes owed.

- Systems and operations problems made it difficult to identify, select, and transmit cases to collection agencies.
- The pilot measurement plan did not include a comparison of the best practices of private collectors with the IRS' own collection techniques.

*The IRS ended its pilot test in June 1997 concluding that the pilot program was not a successful business venture.*

The IRS ended its pilot test in June 1997. In its *IRS Private Sector Debt Collection Pilot Project* report dated October 1997, the IRS concluded that the pilot program was not a successful business venture. The IRS estimated the pilot would cost approximately \$9 million with projected debt collections of \$27.5 million. In comparison, traditional IRS efforts would have resulted in a cost of approximately \$1.8 million with projected debt collections of over \$30.5 million.

The IRS' low return on investment was addressed in a December 1997 IRS Inspection Service (now Treasury Inspector General for Tax Administration) report.<sup>8</sup> We reported that the majority of cases delivered to the collection agencies were small dollar delinquencies that the IRS can collect at a minimal cost. For example:

- The contracts called for only 6 percent of the cases sent to the collection agencies to be small dollar delinquencies compared to the 53 percent that were actually provided.
- Over 5,000 cases provided to the collection agencies would result in the contractor being paid more than the taxes that would have been collected.

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<sup>8</sup> *Contracting Out Collection Activities* (Reference Number 080805, dated December 19, 1997).

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*After the termination of the pilot, the IRS informed the GAO that because of its reorganization, the use of collection agencies was not an appropriate use of resources.*

At the recommendation of the Congress when the pilot was canceled, the IRS and GAO met in February 1998. The IRS' Chief Operations Officer informed the GAO that because of the IRS' reorganization, contracting out tax debt collection activities was not an appropriate use of IRS resources since the reorganization was planned to take several years, and then the impact of the reorganization would have to be assessed. The IRS concluded that the contracting out to collection agencies would not happen in the short term and perhaps not in the long term.

Now that the IRS has reorganized into four business units that are focused on different segments of the taxpayer population, we believe the IRS should reconsider the use of collection agencies to help it reduce the growing tax debt receivables.

## **Conclusion**

The IRS continues to face challenges in collecting tax debt receivables. Gross account receivables rose from \$216 billion in Fiscal Year (FY) 1996 to \$264 billion in FY 2000. Although the IRS reports that a large percentage of these receivables are not collectible,<sup>9</sup> the IRS is still unable to adequately address the increasing number of delinquency cases. Given these factors, the IRS may want to reconsider the use of collection agencies in tax debt collection activities.

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<sup>9</sup> *Internal Revenue Service Annual Report for Fiscal Year 1999.*



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**Appendix I**

**Major Contributors to This Report**

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Russell Martin, Audit Manager  
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**Appendix II**

**Report Distribution List**

Commissioner N:C  
Commissioner, Wage and Investment Division W  
Director, National Program Filing and Payment Compliance S:C  
Director, Compliance Policy Collection Reengineering S:C  
Director, Strategy and Finance W:S  
Director, Legislative Affairs CL:LA  
Chief Counsel CC  
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O  
National Taxpayer Advocate TA  
Office of Management Controls N:CFO:F:M  
Audit Liaison:  
    Director, National Program Filing and Payment Compliance S:C

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**Appendix III**

**Key Laws and Provisions Dictating Actions Collection Agencies Must Adhere to When Acting as Instruments of the Internal Revenue Service**

*Fair Debt Collection Practices Act, 15 U.S.C. §§ 1601 note, & 1692-1692o (1994 & Supp. IV 1998)*

- Sets standards that collection agencies must follow. These standards include the manner in which the collection agency communicates with the taxpayer (e.g., calls must be made within certain hours) and that collection agencies may not engage in any conduct which is to harass, oppress, or abuse any person in the collection of a tax debt.

*Taxpayer Bill of Rights 2 (TBOR2), Pub. L. No. 104-168, 110 Stat. 1452 (1996) (codified as amended in scattered sections of 26 U.S.C.)*

- Requires the Internal Revenue Service (IRS) to ensure that taxpayers are informed of their rights during the collection process. These laws detail specific information to be included in tax delinquency notices and establish new guidance regarding installment agreements.

*Privacy Act of 1974, 5 U.S.C. § 552a (1994 & Supp. IV 1998)*

- Contains safeguards preventing the disclosure of information in government files if such disclosure would violate the privacy of individual citizens.

*Internal Revenue Code, 26 U.S.C. § 6103(n) (1994 & Supp. IV 1998)*

- Permits the IRS to make disclosures to contractors (collection agencies); however, the contractor can disclose information only as set forth by the IRS.