

TAX DEBT COLLECTION ISSUES

HEARING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTH CONGRESS
SECOND SESSION

APRIL 25, 1996

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TAX DEBT COLLECTION ISSUES

THURSDAY, APRIL 25, 1996

**HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
*Washington, DC.***

The Subcommittee met, pursuant to notice, at 9:39 a.m., in room 1100, Longworth House Office Building, Hon. Nancy Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
April 17, 1996
No. OV-12

CONTACT: (202)-225-7601

Johnson Announces Hearing on Tax Debt Collection Issues

Congresswoman Nancy L. Johnson (R-CT), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to examine a number of tax debt collection issues, including: (1) the status of the Internal Revenue Service (IRS) accounts receivable inventory; (2) issues relating to the use of private collection agencies to collect delinquent Federal tax debts; (3) provisions in H.R. 2234, the "Debt Collection Improvement Act of 1995" relating to IRS levy authority; and (4) H.R. 757, relating to Federal tax refund offset authority for purposes of collecting delinquent State tax debts. **The hearing will take place on Thursday, April 25, 1996, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be heard from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND:

The IRS accounts receivable inventory is composed primarily of delinquent taxes owed by individuals, corporations and other taxpayers. At the end of fiscal year (FY) 1995, IRS gross accounts receivable equaled approximately \$200 billion, of which 28.5 percent (\$56.9 billion) reflected accrued interest and penalties. This is a \$29 billion increase over the FY 1994 balance. For the past several years, both the General Accounting Office (GAO) and the Office of Management and Budget have identified accounts receivable as a high risk area for the IRS.

To enhance the IRS's efforts to collect delinquent taxes, GAO has recommended that the IRS test the use of private collection companies to support its collection efforts (see e.g., GAO/GGD-93-67, GAO/HR-95-6). The FY 1996 Treasury, Postal Service and General Government appropriation (P.L. 104-52) directed the IRS to use \$13 million of the funds appropriated for Tax Law Enforcement to conduct a pilot demonstration project on the use of private collection agencies to secure delinquent tax debt. IRS issued a "Request for Proposals" on March 5, 1996, to solicit bids from private collection firms and attorneys for contracts to perform certain IRS tax debt collection activities.

H.R. 2234, the "Debt Collection Improvement Act of 1995" contains provisions to enhance the IRS's current authority to collect delinquent tax debt by establishing an automated levy system whereby the IRS would levy upon non-means tested Federal payments. Currently, the IRS has authority to levy upon property (including wages, salary, and other income) to satisfy delinquent tax debt. However, the IRS does not have an efficient, cost-effective process in place with which to identify delinquent taxpayers receiving Federal payments or to expedite issuance of notices of levy upon Federal departments and agencies making payments to delinquent taxpayers.

H.R. 757, introduced by Congressman Andy Jacobs (D-IN), would expand the authority under Internal Revenue Code section 6402 to allow for offset of Federal tax refunds to satisfy past-due State taxes.

FOCUS OF THE HEARING:

The Subcommittee will examine the composition of the IRS accounts receivable and the effectiveness of measures put into place over the past several years to improve its management of the receivables inventory.

The Subcommittee will also examine issues relating to outsourcing certain Federal tax debt collection activities, including: (1) the IRS's pilot private collection demonstration project; (2) legal issues relating to outsourcing, including consideration of which tax debt collection activities carried on the IRS are "inherently governmental" and must be performed by Federal employees, and measures needed to ensure taxpayers' privacy rights; (3) the types of activities that can be outsourced to private collection agencies; (4) the experience at the State level of outsourcing the collection of State tax debts; (5) options for compensating private debt collectors for tax debt collection services; and (6) the effect of using appropriated funds for private debt collection services instead of additional funding for collection efforts by IRS personnel.

In addition, the Subcommittee will consider the ramifications of provisions in H.R. 2234 to enhance the IRS's current authority to collect delinquent tax debt by establishing an automated levy system, and issues relating to expanding the authority under Code section 6402 to allow for offset of Federal tax refunds to satisfy past-due State taxes.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Thursday, May 9, 1996, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available over the Internet at GOPHER.HOUSE.GOV, under 'HOUSE COMMITTEE INFORMATION'.

Chairman JOHNSON. The Subcommittee will come to order. Today, the Subcommittee will examine a number of Federal tax debt collection issues, including the status of the IRS' accounts receivable inventory; issues relating to the use of private collection agencies to assist in the collection of delinquent Federal taxes; provisions in H.R. 2234, the Debt Collection Improvement Act of 1995, relating to IRS levy authority; and H.R. 757, relating to the Federal tax refund offset authority for purposes of collecting delinquent State debts.

This hearing is held in furtherance of an exchange of letters between the Committee on Ways and Means and the Committee on Government Reform and Oversight during the deliberations on the Balanced Budget Act of 1995. Representative Steve Horn, Chairman of the Government Reform Committee's Subcommittee on Government Management Information Technology, offered an amendment to the Balanced Budget Amendment which embodied a modified version of H.R. 2234. A draft version of the Horn amendment contains several substantive tax provisions within the jurisdiction of this Subcommittee, including provisions relating to the IRS' use of private debt collection firms to assist in the collection of delinquent Federal taxes, provisions to give the IRS authority to impose continuous levies on non-means-tested Federal payments, and a provision to expand the Federal tax refund offset authority under the IRS Code, section 6402, to allow offsets of State tax debts.

At the request of Chairman Archer, these provisions were deleted from the Horn amendment and Chairman Archer and Congressman Horn entered into an exchange of letters with the understanding the Ways and Means Committee would review the provisions within its jurisdiction at its earliest convenience. The issues will be examined at the hearing today, including those items that were deleted from the Horn substitute amendment to H.R. 2234.

Mr. Horn will be testifying at the hearing this morning, as will the Ranking Democrat of the Government Management Subcommittee, Representative Carolyn Maloney. We welcome them to this Subcommittee and before that, we welcome our colleagues from this Subcommittee, Hon. Andy Jacobs and Hon. John Ensign, who will offer testimony on their bill, H.R. 757, relating to the expansion of the Federal tax refund offset authority for State tax debts. A similar provision was included in the Horn substitute.

Today, at this hearing, we will be looking at something that has been of great interest to me, personally, and that is the nature of what we call uncollectible taxes. Because part of dealing with this problem is to begin talking about what is uncollectible in a way that is more accurate and more specifically reflects reality; and in a way that will better communicate to the public what portion of that pot of about \$200 billion is collectible, what portion is not, and for what reasons under what circumstances.

I am interested in making changes in the law that will allow us to explain to ourselves, as a society, far more accurately what portion of the taxes due should have been collected and were not.

It is a pleasure to have you here, Mr. Jacobs and Mr. Ensign, and we will be happy for you to proceed.

[The opening statements of Ms. Johnson, Mr. Matsui, and Mr. Ramstad follow:]

**Opening Statement of the Honorable Nancy L. Johnson
Hearing to Examine Federal Tax Debt Collection Issues**

Today, the Subcommittee will examine a number of federal tax debt collection issues, including: (1) the status of the Internal Revenue Service accounts receivable inventory; (2) issues relating to the use of private collection agencies to assist in the collection of delinquent Federal taxes; (3) provisions in H.R. 2234, the "Debt Collection Improvement Act of 1995" relating to IRS levy authority; and (4) H.R. 757, relating to Federal tax refund offset authority for purposes of collecting delinquent State tax debts.

This hearing is being held in furtherance of an exchange of letters last November between the Committees on Ways and Means and Government Reform and Oversight. During the deliberations on H.R. 2491 (the "Balanced Budget Act of 1995"), Representative Steve Horn, Chairman of the Government Reform Committee's Subcommittee on Government Management, Information and Technology, offered an amendment to the Balanced Budget Act which embodied a modified version of H.R. 2234.

A draft version of the Horn amendment contained several substantive tax provisions within the jurisdiction of the Ways and Means Committee, including: (1) provisions relating to IRS's use of private debt collection firms to assist in the collection of delinquent federal taxes; (2) provisions to give the IRS authority to impose continuous levies on non-means tested Federal payments; and (3) a provision to expand the Federal tax refund offset authority under Internal Revenue Code section 6402 to allow offsets for State tax debts.

At the request of Chairman Archer, these provisions were deleted from the Horn amendment and Chairmen Archer and Horn entered into an exchange of letters with the understanding that the Ways and Means Committee would review the provisions within its jurisdiction at its earliest convenience. The issues that will be examined at the hearing today include those items that were deleted from the Horn substitute amendment to H.R. 2234.

Mr. Horn will be testifying at the hearing this morning, as will the Ranking Democrat on the Government Management Subcommittee, Representative Carolyn B. Maloney. We welcome both of you to the Ways and Means Committee.

The first witness this morning is our esteemed colleague on the Committee, Representative Andy Jacobs, who will offer testimony on his bill, H.R. 757, relating to the expansion of Federal tax refund offset authority for State tax debts. A similar provision was included in the Horn Substitute.

OPENING STATEMENT OF CONGRESSMAN MATSUI

Subcommittee on Oversight
Committee on Ways and Means
Thursday, April 25, 1996

Today, the Subcommittee on Oversight will be discussing several very important issues about IRS's management and collection of delinquent tax debts. The public expects not only that IRS collect taxes in a fair and equitable manner, but also that IRS collect taxes due the Federal Government in an efficient manner. I look forward to hearing from the Administration about its proposals to streamline the tax debt collection process, as well as from State tax commissioners about their experiences in collecting delinquent tax debts.

The IRS's accounts receivable inventory currently is approximately \$200 billion, which reflects an increase of about \$29 billion since the end of fiscal year 1994. This level of uncollected taxes can not be ignored. It also is important to note that more than half of the IRS accounts receivable amount is what IRS calls "currently not collectible", and IRS has estimated that about \$46 billion is "collectible."

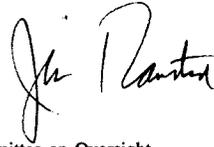
While it is true that no one loves the tax collector, I do think that it is very unfortunate that the fiscal year 1996 appropriations bill for the IRS cancelled one of IRS's major initiatives for collecting delinquent taxes. Specifically, I am referring to the Republican's failure to fund the second year of IRS's 5-year "compliance initiative" to collect over \$9 billion in additional revenues. During the first year of the initiative, IRS collected an additional \$803 million in taxes, more than double the amount expected.

Instead, the Republicans mandated that IRS spend \$13 million to establish a debt collection "project" using private collection agencies and attorneys. IRS will give private collection companies tax debt information on 125,000 taxpayers--individuals and businesses--in Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Washington, and Wyoming, for follow-up contact.

I want to note that the IRS Commissioner has been quite outspoken about her opposition to private debt collection in the tax area. The hard-fought taxpayer rights protections that this Committee, and particularly this Subcommittee, have developed over the past decade should not be cast aside in the search for a quick collection fix. Clearly, as IRS implements the mandated private debt collection "pilot program," it is imperative that IRS proceed carefully and protect taxpayer rights. At the conclusion of its test, I look forward to the results of the debt collection contract awards, and Treasury's analysis of the appropriateness of using private firms to collect delinquent Federal taxes.

In addition, the Administration proposes that the Committee adopt legislation to allow IRS to establish an automated levy process whereby 15% of a non-means-tested Federal payment would offset, on a continuous basis, to satisfy a delinquent Federal tax debt. While I recognize that IRS currently has broad authority to levy against taxpayer assets and income sources, including Social Security benefits, the Subcommittee should carefully analyze exactly how hardship cases and Social Security beneficiaries would be treated under an automated levy system. Of significance I should note that the non-tax debt collection provisions contained in the final fiscal year 1996 appropriations bill, which has been signed into law, provides Social Security beneficiaries with a \$9,000 annual exclusion, and Veterans with a complete exclusion, from administrative offset. I would hope that this Subcommittee would carefully consider the underlying policy and administrative rationale for providing such safeguards, in the context of Federal tax debts.

Finally, I look forward to hearing from my colleagues about the proposed offset of Federal tax refunds for certain State tax debts. Currently, more than 30 States, including California, offset State tax refunds for delinquent Federal tax debt. The States now seek reciprocal treatment from the Federal Government which I support. Congressman Jacobs and a distinguished panel of State tax administrators are here today to explain the value of providing State offset authority against Federal tax refunds, and their experience in refund offset programs to date. I personally would like to welcome Mr. Gerald Goldberg, the Executive Director of the California Franchise Tax Board.



Statement of Hon. Jim Ramstad
Before the House Committee on Ways and Means, Subcommittee on Oversight
April 25, 1996

Hearing on Federal Tax Debt Collection

Thank you, Chairwoman Johnson, for calling this hearing today.

It's always important, as we seek to privatize those functions of the federal government that can and should be contracted out, to make sure we are acting with appropriate deliberation and care.

While on its face the issue of whether to contract out to private debt collection services those cases which the IRS does not have the personnel to address seems to make sense -- especially given the fact that some \$200 billion in delinquent debt is currently in the accounts receivable inventory -- there are clearly complicated issues involved.

That's why it is important that this Subcommittee fully investigate the issue before recommending to the full committee the implementation of private collection of delinquent tax debt.

I look forward to the testimony of the witnesses and appreciate their coming here today to help us better understand the pros and cons of private collection.

Chairman JOHNSON. Mr. Jacobs

**STATEMENT OF HON. ANDY JACOBS, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF INDIANA**

Mr. JACOBS. Thank you.

The situation calls for me to be brief, Madam Chairman, and brief I shall be. The bill is H.R. 757. As far as I know, the only question about it is a so-called source tax which was outlawed prospectively but not retrospectively already and my suggestion is that this bill be amended to make clear that the same principal applies retrospectively, which is to say that any refund to any citizen of any State, a Federal tax refund, which is applied to a State tax could not be applied to—I should say a delinquent payment of a State tax—should not be applied in cases where that delinquency involves a source tax on the part of the State.

I think that would remove all controversy from the bill and probably all opposition to the bill. The whole idea is quite simple. Obviously, I am a former police officer who used to celebrate cooperation among police departments. God knows where we would be if we didn't have that cooperation, and this simply applies the same principal to the Federal and State governments.

Right now, I think 31 State governments allow attachment by the Federal Government of refunds to their citizens where there is valid claim by the Federal Government for delinquent taxes from those respective citizens. So, this would really be a matter of reciprocity as far as those 31 States are concerned. It would induce the cooperation of other States in the two-way street of instruments to recoup delinquent taxes.

I should add that the bill provides that these are not just delinquent taxes in the opinion of the tax collectors, but where final adjudication has occurred that they are, in fact, delinquent taxes.

That is about it.

Chairman JOHNSON. OK.

Mr. Ensign.

**STATEMENT OF HON. JOHN ENSIGN, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF NEVADA**

Mr. ENSIGN. Thank you, Madam Chairman.

I am very happy to hear what my colleague said about the amendment. That is the most concerning portion of the bill that affects residents from the State of Nevada or really any State who has people moving there from other States, especially retirees. The source tax was outlawed just recently and signed into law. It passed unanimously out of both the House and the Senate.

I recently had several townhall meetings on taxes in my district and I can tell you tax collection is one of the biggest issues with voters. Anything that concerns the IRS and expanding the powers of the Federal Government is very concerning to voters in my district but, also voters, I am sure, across the country.

It is normally easier for political bodies to raise revenue by increasing enforcement mechanisms for taxes already in law than it is to raise revenue by passing new taxes or increasing current taxes. This is not to say I oppose attempts to enforce collection from those who have avoided paying taxes legally owed. In fact, in

the recently passed health care bill, my long-term care amendment was paid for by a provision that enforced collection from billionaires who renounced their U.S. citizenship for the purposes of avoiding U.S. taxes.

As Federal legislators, we not only have the right but we have the responsibility to ensure our government's tax collection methods are effective, efficient, but also fair. I want to stress the fairness issue because it is at the root of my concerns with specific provisions of these bills. On January 10 of this year, as I mentioned, President Clinton signed into law the repeal of the source tax.

H.R. 2234, the Debt Collection Improvement Act of 1995 and H.R. 757 contain one provision about which I am very alarmed. The provision is that which expands Federal tax refund offset authority to the States. I understand the Federal Government currently has the ability to offset State tax refunds in the States Mr. Jacobs mentioned and that these States seek reciprocity.

Although I have misgivings about the tax refund expansion to States in collecting claims from their residents, I will not focus on this provision. What I am strongly opposed to are the sections of the bill that allow States to grab Federal tax refund checks from the residents of other States.

In my opinion, this would directly contradict the intention of the source tax repeal signed into law less than 4 months ago. And, in fact, it would allow States to recoup all past source-tax claims immediately upon enactment. It would also open up a new loophole for States to go after nonresidents.

As an example, for Federal tax year 1994, the IRS returned a little over \$87 billion to individual taxpayers in the form of Federal tax refunds. If, as I understand, about one-half of all the refund offsets would be taken from nonresidents, then that means about \$44 billion are available to be taken by the States from individuals who do not work, live, boat, play in the parks, or drive on the roads in the State that is taxing them.

In a time of tight budgetary times, such a policy would create tremendous incentives for States to look for ways to capture these refunds. There is also a concern regarding due process. Article V, section 1 of our constitution specifically addresses that States will interact with each other in full faith and credit.

My point is that our judicial system currently has a mechanism for States to collect claims from residents of other States through the courts. While we might agree this is not the most efficient system, I would oppose short-circuiting the judicial system by allowing fiscally aggressive States to bill my constituents or any non-resident.

As a representative from a State that was deeply affected by the source tax, I can tell you we and any other representatives will have to answer letters from constituents who can't understand why another State is taking their Federal tax refunds.

Let us remember that just last week this House passed TBOR, the Taxpayer Bill of Rights, which was written and courageously passed by you, Madam Chairman and Mr. Matsui. I am sure that many would agree we must be very careful in the new ways we look to increase revenue collection to ensure we do not create another tax monster we cannot control.

Allowing States to tap into refunds of nonresidents or source tax 2, as I call it, is such a monster, and I urge this Subcommittee to oppose it.

Thank you, Madam Chairman, for allowing me to testify.

[The prepared statement follows:]

JOHN E. ENSIGN
1ST DISTRICT, NEVADA
WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON HEALTH
SUBCOMMITTEE ON HUMAN RESOURCES

RESOURCES COMMITTEE
SUBCOMMITTEE ON NATIONAL PARKS,
FORESTS, AND LANDS
SUBCOMMITTEE ON WATER AND
POWER RESOURCES



Congress of the United States
House of Representatives
Washington, DC 20515-2801

April 25, 1996

STATEMENT OF
REPRESENTATIVE JOHN ENSIGN

Before the Committee on Ways and Means
Subcommittee on Oversight Hearing
on Tax Debt Collection Issues

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Good Morning Madam Chairwoman, thank you for allowing me the opportunity to testify before your subcommittee today on a specific matter in which I am very interested.

As the subcommittee is well aware, the level of debate surrounding our current system of taxation and the methods by which the government collects these taxes is at an all-time high. After a handful of town hall meetings back in southern Nevada 2 weeks ago, I can tell you how much interest my constituents have in both these areas because we spent hours discussing it. I believe it has raised the level of awareness of all elected officials who are in a position to make changes in our tax system.

It is normally easier for political bodies to raise revenue by increasing enforcement mechanisms for taxes already in law, than it is to raise revenue by passing new taxes or increasing current taxes. This is not to say that I oppose attempts to enforce collection from those who have avoided paying taxes legally owed. In fact, in the recently passed health care bill, my long-term health care amendment was paid for by a provision that enforced collection from billionaires who renounced their U.S. citizenship for the purposes of avoiding U.S. taxes. As federal legislators, we not only have the right, but we have the responsibility to ensure our government's tax collection methods are effective, efficient -- but, also fair.

I want to stress the fairness issue because it is at the root of my concerns with specific provisions of these bills. On January 10th of this year, the President signed into law a repeal of the pension Source Tax. For those not familiar with the Source Tax, it was one that Nevada legislators had been fighting for years because other states were abusing their ability to collect taxes deferred through pensions from prior residents of the state. It amounted to taxation without representation because individuals were receiving tax bills from states in which they hadn't lived for years or had never actually lived. This was wrong and its repeal was unanimously voted out of the House and the Senate on its way to becoming law.

H.R. 2234, the Debt Collection Improvement Act of 1995, and H.R. 757 contain one provision about which I am very alarmed. The provision is that which expands federal tax refund offset authority to the states. I understand that the federal government currently has the ability to offset state tax refunds and that the states seek reciprocity. Although I have misgivings about the tax refund expansion to states in collecting claims from their residents, I will not focus on this provision. What I am strongly opposed to are the sections of these bills that allows states to grab federal tax refund checks from the residents of other states. In my opinion, this would directly contradict intention of the Source Tax repeal signed into law less than four months ago. In fact, it would allow states to recoup all past-due Source Tax claims immediately upon enactment. It would also open up a new loophole for states to go after nonresidents.

As an example, for federal tax year 1994, the IRS returned \$87.3 billion to individual taxpayers in the form of federal tax refunds. If, as I understand, about half of all refund offsets would be taken by states from nonresidents, then that means that roughly \$44 billion are available to be taken by the states from individuals who do not live, work, vote, play in the parks, or drive on the roads of the state taxing them. In a time of tight budgetary times, such a policy would create tremendous incentive for states to look for ways to capture these refunds.

There is also a concern regarding due process. Article V, Section 1 of our Constitution specifically addresses that states will interact with each other in "full faith and credit." My point is that our judicial system currently has a mechanism for states to collect claims from residents of other states through the courts. While we might agree that this is not the most efficient system, I would oppose short-circuiting the judicial system by allowing fiscally aggressive states to bill my constituents or any nonresident. As a Representative from a state that was deeply affected by the Source Tax, I can tell you that we will have to answer the letters from constituents who can't understand why another state is taking their federal tax refunds.

Let us remember that just last week this House passed the Taxpayer Bill of Rights, which was written and courageously pushed through this body by Ms. Johnson and Mr. Matsui. I am sure that many would agree that we must be very careful in the new ways we look to increase revenue collection to ensure that we do not create another tax monster we cannot control. Allowing states to tap into refunds of nonresidents, or Source Tax II as I call it, is such a monster and I urge the subcommittee to oppose it.

Again, I want to thank you, Madam Chairwoman, and the other members for allowing me the opportunity to testify before the subcommittee. I am available to address your questions.

Chairman JOHNSON. Thank you, Mr. Ensign.

Before we proceed to question the two of you, I would like to ask our colleague, Mr. Horn, to come forward and make his comments. He needs to get back to chair a hearing, so, I would like to hear from him.

STATEMENT FROM HON. STEVE HORN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. HORN. Thank you, Madam Chairman, and Mr. Matsui, Mr. Hancock and, my good friend, Mr. McNulty.

I think what you are doing today in reviewing these issues is tremendously important for the average taxpayer. When we first examined this, the IRS situation, it was in the 103d Congress, when Gary Condit was my predecessor as Chairman of the Subcommittee. And, frankly, we were all very disturbed about how the financial records are kept and how the agency is managed and so forth.

When we got into the Debt Collection Act, and as you know Madam Chairman, that act is a product of the financial officer's council within the administration. Those are the 24 chief financial officers who are working to get a balance sheet for all Federal agencies by 1997. We have had the utmost cooperation of the administration, of the chief financial officers.

This bill that is not before you but is part of the Omnibus Appropriations Act, but does not include anything under the jurisdiction of this Subcommittee, that bill came out of my Subcommittee on a bipartisan basis, while the Ranking Minority Member and I might disagree on one or two things, they probably are the ones before this Subcommittee, we have had the utmost cooperation of the Democrats on the Subcommittee, as well as the Republicans.

We want to thank you and your staff, Donna Steele, in particular, working with the chief professional staff member on my side on this, Mr. Brasher, who is with me this morning, and Chairman Archer has been his usual gentlemanly self, because I talked to him before I began hearings on this. We hope that you will be able to sort out, perhaps more efficiently than we were, the amount of debt that the IRS has that it has not collected.

What shocked me when I got into this was the \$100 billion that they said, Well, we can't collect it. At that time, it was \$60 to \$64 billion in addition that they said they could collect. Well, I think the average taxpayer, when you are filling out your own forms and you are paying it and you are working 60 to 80 hours a week to find the money to pay the bills, rather resent that we have \$100 or whatever—and some say \$200 billion and I am going to let you sort that out—resent writing their checks when somebody is escaping with \$100 billion that is uncollectible.

In brief, the total Federal Government debt now that could be helped by what you are doing, I hope, and what we have been doing is equal to \$1,000 per person and child, elderly, whatever, in the United States. So, I think we do need to sort it out, and I think what you have before you this morning is, frankly, one of the major keys to solving this riddle and puzzle.

The Internal Revenue Service and the Customs Service do not have explicit authorization to use private collection agencies. I realize that is controversial. The employee unions are very unhappy

with us. They want to collect the debt. Well, if they had collected the debt, we would not be here. They haven't collected the debt and I am willing to give them 30 or 60 days or whatever at first crack in collecting the debt but I am not willing, as a citizen—nothing to do with being a Member of Congress—I am just not willing as a citizen to say, Hey, folks, we are going to leave it only in your hands and we are going to have another \$100 billion uncollected.

I think it is a scandal. I think the agency has been mismanaged, it is not new. As I said, the financial records and audits when they came before us in the 103d, Mr. Cox, who was the Ranking Republican on the Subcommittee said, If a corporation brought that balance sheet to you, you would have them indicted. And it is a pretty sad situation and I hope, together, that your Subcommittee and my Subcommittee can help sort some of these things out.

They say, Well, gee, there is a problem of confidentiality. Well, sure, there is. We don't have confidential tax records turned over to the private collectors. You don't need to do that. All you need to do is get the debtor's name, address, telephone number, and the amount of the debt. And you can write the Codes, just as many progressive States have done, that you can't go around saying so-and-so owes a tax debt. You knock on the door, you phone them up, whatever, and you try to get them into a situation where they can work out the payoff of what they owe the people of the United States, because that is who it is. It is hurting us when we don't collect that debt.

And, of course, is this a radical step? I don't think so. In 1993, Mr. Gore's National Performance Review recommended it in reinventing government. Two subsequent administration budgets in fiscal year 1994 and 1995, though not the current one, recommended it. The fiscal year 1996 Treasury Postal Appropriations bill recommended it. The General Accounting Office, our agent, the legislative branch to oversee the Federal financial operations, they have recommended it. And it is worth noting, that 30 States have private debt collectors who go out and collect the tax debt.

And on that subject, I must say just as an aside, I think Mr. Jacobs has made an excellent suggestion here and I hope the Subcommittee will look favorably on that. We need to have reciprocal cooperation between States and Federal Government.

So, as I mentioned earlier, the management problems at the IRS are major. And all of us, appropriations, your authorizing Committee, our oversight Subcommittee, we need to work together to help the IRS get the proper computer equipment, whatever it takes, to help do the job. But we can't just say because a few people are upset that we can't go out and collect \$100 or \$150 billion—and I know you are going to sort that out for us today and I wish you well on that—but Congress also needs to enact a provision for the continuous levy of Federal benefits to satisfy tax debts.

Now, we are taking good care of the ones that are not under your jurisdiction but what got me really started on this is when a person that owed the Farmer's Home Administration \$3 million for an operation he had in northern California, refused to pay it, and was given another loan when he took on an office building in Santa Barbara and built himself a million dollar home. I just don't think you can escape paying your Federal obligation and go off living high on the hog. That is sort of reminiscent of the savings and loan scandals.

So, I wish you well and I support Mr. Jacobs' bill. I think it is absolutely essential if we are going to get the job done that we have to have private collectors authorized to do the work.

Thank you, Madam Chairman.

[The prepared statement follows:]

STATEMENT OF HON. STEVE HORN

Madam Chairman and Members of the subcommittee:

We are pleased to be here today to assist in your review of IRS' collection practices. Every year IRS successfully collects over a trillion dollars in taxes owed the government, yet at the same time tens of billions more remain unpaid.

My testimony today discusses the debt collection challenges facing IRS and the potential benefits of involving private debt collectors in the tax debt collection process.

A number of long-standing problems have complicated IRS' efforts to collect its accounts receivable. Of foremost concern is the lack of reliable and accurate information on the nature of the debt and the effectiveness of IRS collection tools.

Without reliable information on the accounts they are trying to collect and the taxpayers who owe the debts, IRS agents generally do not know whether they are

resolving cases in the most efficient and effective manner and may spend time pursuing invalid and unproductive cases.

IRS also does not have reliable data on the effectiveness of its collection activities and programs. Consequently, it is unable to target its efforts specifically to the taxpayer and tax debt in question. IRS is currently trying to capture this data on its Enforcement Revenue Information System and other computerized systems. However, there are questions about the accuracy of the data produced by these systems.

The age of the debts in IRS' accounts receivable inventory is also a problem. IRS' inventory of tax debt includes delinquencies that may be up to 10 years old. As a result the inventory includes old accounts that may be impossible to collect.

In addition, the age of the receivable does not reflect the additional time it takes for IRS to actually assess

the taxes in the first place. It may be up to 5 years from the date the tax return is due before IRS assesses the additional taxes. The age factor significantly affects the collectibility of the debt because as both private and public sector collectors have attested, the older the debt, the more problematic collection becomes.

Another factor relating to the collectibility of tax debts owed by individuals is source of income.

Taxpayers earning their income from nonwage sources, such as pensions, self-employment, and investments are more likely to be delinquent in paying their taxes and often owe more than wage earners who have their taxes withheld. According to IRS data 74 percent of its inventory of tax debts owed by individuals is owed by taxpayers whose income was primarily nonwage. The average tax delinquency for these taxpayers was about 4 times greater than that of wage earners--\$15,800 versus \$3600.

IRS collection process is also a problem in that it was introduced decades ago, and is generally costly and

inefficient. While the private sector emphasizes the use of the telephone, a significant portion of IRS collections resources are in field offices where personal visits are made.

Updating its computer systems is another challenge facing IRS. Modernized systems could provide IRS collectors with on-line access to the information they need when they need it. Modernized systems would also help provide the management information needed to evaluate the effectiveness of IRS collection tools as well as the ability to adopt flexible and innovative collection approaches.

Moving now to the potential benefits of involving private collectors in federal tax debt collection, we believe these entities offer the potential for improving IRS debt collection practices. In May 1993 we recommended IRS test the use of private collectors to support its collection efforts. Many states use private collectors to supplement their own collection programs, thereby taking advantage of private sector capability in

managing receivables, gaining access to better technology, or avoiding the expense of hiring permanent staff.

Last month as directed in its 1996 appropriations act, IRS issued a request for proposals from prospective participants in a pilot private debt collection program. Under the pilot, the private collectors are to attempt to first locate and then contact delinquent taxpayers, remind them of their tax debt and inform them of available alternatives to resolve the outstanding obligation. An important limitation of the pilot is that the private collectors will not be able to actually collect the taxes owed; rather they will facilitate information exchange and contacts between IRS and the taxpayer.

During the pilot, the private collectors will face some of the same problems in working the pilot cases that IRS employees face. First, these are not new cases. All will have already gone through much of IRS collection process, and in some cases, the entire process. This

means in effect the debt may be 10 years old. The cases may also contain some of the other information problems we discussed earlier.

Regardless, the pilot could provide useful insight into the effectiveness of the techniques and technologies used by the private sector. For example, the pilot calls for 40 percent of the cases to be those in which IRS has been unable to locate or contact the taxpayer. The remaining 60 percent are cases in which IRS has successfully contacted the taxpayer, but has been unsuccessful in securing payment. To the extent that the private collectors can locate, contact, and arrange for payment on these cases, the techniques used may be helpful to IRS. Other useful information could also be obtained on what collection actions are most productive based on the type of case, type of taxpayer, and age of the account. Using the states' experience as an indicator, IRS can expect some additional collections from its proposed pilot, but not necessarily a significant windfall.

In closing Madam Chairman, IRS faces many challenges in its efforts to improve the management and collection of its accounts receivable. The key is to find solutions to the underlying causes of the problems that affect IRS' ability to collect delinquent taxes. Solutions will take time because the problems are pervasive and may involve all IRS functions and processes.

As we have previously recommended, IRS needs to develop a detailed and comprehensive long term plan to deal with the challenges it faces and their interrelationships. With such a plan, IRS could better assure itself and Congress that it is on the right track.

Madam Chairman, that concludes my statement. I would be happy to answer any questions the subcommittee may have.

Chairman JOHNSON. Thank you, Mr. Horn.

I appreciate the good work of your Subcommittee on this subject, and we look forward to working with you to assure that we have a good bill in place. It is very important, I think, to straighten out what is what in this area because of the \$200 billion in "uncollected taxes," about \$60 billion is interest and penalties, and about \$20 billion is taxes that we agreed, in the savings and loan negotiations, not to collect and about \$20 billion is liability that was added in when we extended the statute of limitations from 6 to 10 years and the likelihood of collecting that debt is very small.

So, I think we need to really understand more clearly what is in our \$200 billion pie and, therefore, what resources we need, what of those resources the government ought to supply, and what the appropriate role of the private sector is in helping us better assure that all citizens pay their fair share of our government service's costs.

I do want to just recognize my Ranking Member, Mr. Matsui, who has been a really strong ally as we work through a number of issues on this Subcommittee.

Bob.

Mr. MATSUI. Thank you very much, Madam Chairman.

I want to thank you for calling these hearings and certainly I apologize for being late. I was at a Democratic whip meeting and was able to finally get out. I understand you submitted my written statement for the record and I appreciate that.

Is it appropriate now for me to ask a couple of questions?

Chairman JOHNSON. Certainly.

Mr. MATSUI. Thank you.

I am just going to ask Mr. Horn and Mr. Ensign—and that is not because I just want to talk to Republicans—I am already on Mr. Jacobs' legislation as a cosponsor, so, I won't need to ask him questions.

But, John, and again, whenever you, from Nevada, bring up an issue I always get worried as a Californian. But, let me ask you because you raised an interesting point here and I want to understand it, because I think there may be some legitimacy to it. If, in fact, there is a State which is due State taxes and has a judgment—and I don't know quite how they obtain a judgment—but assuming they have a judgment, they would be able to go to the State of the residents of the one who is the taxpayer who owes the money. I use California and Nevada, it is easier that way. Go to Nevada, go to the court system there and then levy on the assets of the individual.

Now, if, in fact, there is a legitimate court decision from California, what would be the problem of allowing the State of California then to get the offset from the Federal Government on Federal taxes? It would seem to me you could skip the step of having to go to the Nevada court. You can reverse it, but—

Mr. ENSIGN. From what I understand in this legislation and where the problem comes in is that the State of California that levies this legally collectible debt, the person has to then go back to the State of California and it puts more of the burden on the individual. I am not a lawyer so I don't know the legal technicalities of this, but from the information that I have received, that is a big

problem. Now it takes this resident—if they disagree with whatever the ruling is—they have to go to the State of California and fight it in court.

Mr. MATSUI. I don't want to take a lot of time because I know we have a number of panels. But assuming that the—

Mr. ENSIGN. Because right now these are legally collectible debts under the courts.

Mr. MATSUI. Right. Assuming the debt is a legally collected debt and it has gone through the judicial process in California, then they could levy in the State of Nevada. I would imagine that if it is a bona fide judgment that it is due anyway. In other words, they have already gone through a judicial process. That is the part I— I mean I understand you wouldn't want to put a resident of Nevada or another State in a position where they would have to contest it across jurisdictional lines necessarily.

Mr. ENSIGN. We would certainly be willing to look into this, and work and if that is the case, then that is the biggest concern. And if that is something we can work out, we would be more than happy to.

Mr. MATSUI. I think maybe we are trying to reach the same point and I appreciate your raising it though because it could obviously be a legitimate issue.

Steve, can I just ask you one question. In terms of the private debt collectors, would you be willing to come up with some standards, maybe your Subcommittee in offering to us, because we want to ask, obviously, the agencies that same question. What kind of standards should we have in terms of the debt collectors?

You know there are some that are good, some that are not good.

Mr. HORN. Like confidentiality standards essentially.

Mr. MATSUI. Well, I think confidentiality standards, but also others. You know when I was a practicing lawyer, I told this to my staff. This goes 20-plus years back. The first thing I did because I was just starting off opening my own office, a debt collection agency said, you want to handle our work? And they gave me a flat fee, whatever it was, it wasn't a lot of money then. But after about 2 months I said I have to get rid of this because it was ruining my reputation. Those folks were levying on everyone and making midnight calls. It was a really scary situation. And I probably would have been disbarred if I would have kept this firm that I was allegedly representing, but they were doing bad stuff.

Since that time, the Unruh Act passed California, so there are some built-in protections. But one still needs to be careful because some of these folks come and go and would you propose standards? Because I would think that we would need to develop some level of standards if, in fact, we did do this in a way that was widespread.

Mr. HORN. Yes. I think you are absolutely right. We should have standards when we let a Federal contract to do some of the Federal business, if you will. We will be glad to work with you on that. There has been great progress made in many States.

You mentioned our own State, where you just don't do what you did 20, 30 years ago. I realize the reputation still sort of sits there but it has advanced far beyond that. And they obviously have to follow the rules on it, just as the IRS agents would follow the rules

on it. It is just simply a matter of management, getting the job done, and putting it out. You could bid some of the paper to have them bid on it, but we just can't let it sit there unprocessed, not followed up on. That is what concerns me as a taxpayer.

Mr. MATSUI. Thank you.

Chairman JOHNSON. Mr. Hancock.

Mr. HANCOCK. I don't think there is any question a lot of people are upset about the fact that some people seem to be able to participate in our society without paying their share. I think also the people that are paying their share think they are paying way too much of a share.

My question to you would be, How do you envision, when you start talking about private debt collection of \$200 billion, maybe \$150 billion, whatever the figure is, How do you envision the collectors being reimbursed?

Mr. HORN. I think I can give you one way to do it and this is clearly within your jurisdiction. The financial management service of the Department of the Treasury has an excellent reputation, I think, on the Hill and just by objective observers as a well-managed organization. And for the debts that are not collected, regardless of agency, whether it be Treasury, Agriculture, Education—Education has the second most outstanding debt. If we sent the debt that is owed over to financial management, let them review it, let the contracts. It could be by bid basis. You could retain people based on experience that have a proven record, just as you would grant any other contract under the Federal Government.

And it ought to be the quality of work as well as how much you collect. Some of this debt is clearly uncollectible. You have a small two-person business, it went bankrupt, couldn't pay the taxes, was not paying Social Security, they were using it to be cash flow. We have all had those cases in our offices. And we know it exists nationwide.

So, somebody has got to analyze that debt, sort it out, and if the private sector wants to bid on it that is one way. Retaining agencies by contract is another way, but you would have to prove a record of effectiveness.

Mr. HANCOCK. Well, naturally most private debt collection agencies operate on a percentage of what they collect.

Mr. HORN. Right.

Mr. HANCOCK. I am assuming that that is the same approach you would have to take for a government program.

Mr. HORN. Sure.

Mr. HANCOCK. Now, there is another question I would like to ask. Here again, it is kind of getting into the technicality of this thing. In some cases when you send an individual out to collect a debt, if you make the percentage big enough then they have got some room to negotiate the collection to get it settled.

That is where I am having a little bit of a problem. I don't think that we should try to indicate, if there is a \$100 billion collectible, that the government is going to end up with \$100 billion. The government is not going to end up with it, but instead maybe \$50 billion, maybe \$40 billion, and maybe less than that.

Mr. HORN. Yes. I would be happy with \$5 billion. I just want to get something out of it.

Mr. HANCOCK. I suppose that would be correct.

Mr. HORN. Let me just add something, if I might, Mr. Hancock, that one of the things we might also think, and this is clearly something you would have to wrestle with here, is an incentive for agencies to collect. And we had in one draft—did we get it in the final one? What is the percentage, 3? Oh, it is 5, OK. We would give the agency that collected this debt 5 percent which they could use in their budget. Now, obviously, the Appropriations Committee or the authorizing Committee could say, Wait 1 minute, what are you going to do with that 5 percent? But we would have it applied to things that help in debt collection, such as better computer technology. That would give the executive in that agency flexibility to really get the system up to speed.

Mr. HANCOCK. Well, I agree with that, but let's don't put them on a commission basis, if you don't mind.

STATEMENT OF HON. CAROLYN MALONEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mrs. MALONEY. If I could add, Mr. Hancock, I would like to request my testimony be put in the record in full, but in response to your first question about incentives. It is perfectly legal for the private sector to have incentives in collection of debt but the Taxpayers' Bill of Rights strictly prohibits the IRS from using enforcement goals or quotas. And also, whereas an IRS agent can be sued under the Taxpayer's Bill of Rights, a private collector cannot be.

For many years as a member of the city council, I conducted a study on what was owed the city. I did the same thing here and found that billions of dollars was owed the Federal Government in fines, fees, royalties, and then in the IRS. And our bill that we have worked jointly on is, I think, an excellent bill, but the one area where we do disagree is that I do not believe the Federal Government should use private collection agencies to collect debt that is owed.

I think we, as a government, can have oversight of the IRS, which we have, on ways that they can improve their collection, but I feel the people need a trust with their Federal Government, that there would be problems about privacy and historically when private collectors have been used it has been one that has resulted in a lack of trust and sometimes in a very ugly situation.

Most private collectors require at least 30 percent of the take. I think we can probably get more money in if we improve the techniques of the IRS. I feel one of the important parts of government is to have a trust between people and their government and to start using private debt collectors, clearly, violates the Taxpayers' Bill of Rights.

But I think the bill has many positive parts in it, centralizing collection and really commonsense approaches to collecting debt that is owed the Federal Government. But I do disagree on that one particular aspect.

[The prepared statement follows:]

Testimony of Congresswoman Carolyn Maloney

Thank you madam Chairwoman, members of the committee. I am delighted to be here today to talk to you about tax debt collection issues. Two of these issues are particularly important to me: enhancing the IRS's levy authority and giving the IRS the ability to use private collection agencies.

The first issue I wanted to talk about expanding the IRS levy authority. Congressman Horn and I have worked long and hard on a bipartisan debt collection reform bill, HR 2234. If passed, this bill would greatly improve the collection of debt across all of the agencies. One of the most important debt collection tools that our bill uses is the enhanced IRS levy authority tool.

Our bill would authorize the Internal Revenue Service (IRS) to automatically levy upon non-means tested Federal payments. For example, if a Federal employee was delinquent in paying their Federal tax, the IRS could levy a percentage of that employee's salary. This action would help recoup the delinquent tax and it would help reduce the deficit. According to the Administration's estimate, the automated levy provision would reduce the deficit by \$1.4 billion over 5 years.

That money belongs to the American people. As Congress continues to cut vital programs that benefit millions of Americans. I am pleased to offer this positive alternative.

The second issue involves allowing the IRS to use private collectors which sets a bad precedent. This country has never turned over the business of collecting Federal taxes to the private sector. The founders of the Constitution thought it was a bad idea, and so do I. Here are my concerns:

- **The public already has a low opinion of the IRS** - By using private collectors to collect personal taxes, the public's perception of the fairness of tax collection would only get worse. Private sector collectors who work on commission are not going to care whether their actions antagonize taxpayers, or erode the credibility of the IRS.
- **Using private collectors clearly violates the Taxpayers Bill of Rights on many accounts** - Bill collectors could circumvent the intent of the Taxpayer Bill of Rights by paying a commission to collectors. Although this is perfectly legal in the private sector, the Taxpayer Bill of Rights strictly prohibited the IRS from using enforcement goals or quotas. Also, whereas a reckless IRS agent can be sued under the Taxpayers Bill of Rights, a private collector cannot be.
- **Using private collectors clearly violates the privacy rights of all taxpayers** - Many taxpayers would decide to no longer comply once they learn that their tax information would be shared by private sector employees who operate outside of the Government's confidence. As a result, we may end up collecting less.
- **The IRS can collect taxes better than private collectors** - The IRS has had proven successes in collecting taxes owed. For example, the IRS telephone collection efforts yield about \$26 collected for every dollar expended. More complex and difficult cases dealt with in the field yield about \$10 for every dollar spent. Reforming the IRS does not mean cutting resources and staff or using private collectors, it means making the IRS more easy to use, more modernized and more efficiently run.
- **The use of private collectors will cost the IRS money and resources** - The Congress has cut funding levels and has forced reductions in staff for the IRS. However, to start up and run private collector programs, the IRS will need additional people to provide the necessary management and oversight of contractors.

No one likes to pay taxes, but the majority of the American people know that the system now in place aims to strike a balance between protecting the rights and privacy of taxpayers and collecting taxes owed. Using private collectors would tip this balance in the wrong direction.

Mr. HERGER [presiding]. Mr. Laughlin, do you have a question?
 Mr. LAUGHLIN. I have a brief question for Congressman Horn. In your testimony you were talking about some areas that were going to be impossible to collect. I think you used the word, two-man, two-person company that went bankrupt. Do you have any suggestions on whether this debt that is owed the Federal Government ought to be identified in some way, and how would you go about identifying that debt that is either legally or monetarily, financially impossible to collect even in the next 50 years?

Because it seems to me when we are sitting here talking about \$150 million, \$200 billion owed to the Federal Government, that it is deceptive if that figure contains an amount that is impossible to collect for whatever reason.

Mr. HORN. Well, I think we have got to look at the individual and their own taxpayer number. I'm not sure they have carefully followed up on that. When you have got somebody going out of business and suddenly declaring bankruptcy, we are not very good at finding when they have popped up again. And if they have popped up again and are simply bleeding their creditors and bleeding the taxpayers and the IRS on our behalf, then I have got a real problem, as a citizen, with that kind of conduct.

You and I know there are just too many people claiming bankruptcy. Some are very legitimate. We shouldn't interrupt with that chance to reorganize the finances of a business. On the other hand, if there is a pattern and a practice of deceit to avoid taxes, then we ought to be on top of that. And when the file is cold, it is a little hard to be on top of it.

You need to call when there is a debt, certainly, within 30 days. Pretty soon the person has just forgotten they owe you the debt, hadn't heard from you, no decent followup, not even by mail. We have got a real mess in this situation.

That is why I would say I would give the government agency 30 days. I would be willing to, if you want to give them 60 days, that's fine, but then let's get to work and get the job done. In fact, let's put them in competition. I think that would sharpen up the Federal agencies to be more effective than they've been. They have certainly not been effective, given the current record. Even if there is \$100 billion, that would be impossible from the beginning. I don't believe there is a \$100 billion from the beginning. I think starting in 1990 when they just started forgetting about a lot of this stuff, is when our problems began. They began in 1990, 1992, 1993, 1994, and 1995, right now. And we need to get it stopped.

Mr. LAUGHLIN. Thank you very much.

Mr. HERGER. Thank you very much.

And, Mr. Jacobs, I apologize for not being able to be here for your earlier testimony, but I understand you mentioned you would work with the Subcommittee on amending your bill, particularly with the collection.

Mr. JACOBS. Absolutely. That's an exception to the spirit of what we already passed. It should have been retroactive.

Mr. HERGER. On the postdue source taxes.

Thank you very much.

We do have a vote going, so we will recess. We will come back. [Recess.]

Mrs. JOHNSON [presiding]. The Subcommittee will resume. The hearing will resume with Cynthia Beerbower, Deputy Assistant Secretary for Tax Policy, the U.S. Department of the Treasury; and James Donaldson, Chief, Tax Service/Acting Chief Compliance Officer, Internal Revenue Service; to be followed by Lynda Willis, Director, Tax Policy and Administration Issues, U.S. General Accounting Office.

STATEMENT OF CYNTHIA G. BEERBOWER, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Ms. BEERBOWER. Thank you, Madam Chairman.

I am pleased to appear before you today to discuss some of the tax policy issues related to Federal debt collection practices and, in particular, the outsourcing of Federal tax debt collection. My written statement addresses each of the particular issues that you have asked us to discuss. And so, in the oral testimony I will just summarize the written testimony that we have already provided this morning.

The administration remains dedicated to protecting the rights of taxpayers in connection with our debt collection activities. We have worked in a bipartisan effort with this Subcommittee on TBOR, the Taxpayer Bill of Rights 2 legislation which, as you know last week was approved by the House, by a unanimous vote. Having established these very significant safeguards of taxpayer rights in TBOR 2, we are concerned these protections could be bypassed by a hastily conceived outsourcing of Federal tax debt collection to private contractors.

These private debt collectors are not subject to TBOR 1, or to TBOR 2, or to other provisions of the Internal Revenue Code that have been carefully designed over many years by this Subcommittee and by prior administrations to protect the rights of taxpayers.

We recognize there is a natural and inevitable tension that arises between guarding taxpayer rights and vigorously pursuing tax receivables. We appreciate a delicate balance must be achieved between urging increased collection productivity to reduce the inventory of Internal Revenue Service accounts receivable but, at the same time, perhaps slowing the process to guarantee that important taxpayer rights and safeguards are secured.

We would urge the Subcommittee to approach the subject of outsourcing Federal tax debt collection cautiously and carefully this morning and to evaluate any change in the system to make sure it is consistent with our shared concerns for taxpayer protections.

Tax collection is a unique area. Its uniqueness is reflected in the many checks and balances that are written into our current law to limit how the IRS must conduct collections. Not just the Taxpayer Bill of Rights, the two of them, but other provisions of the Internal Revenue Code that protect the unique and often, very private nature of information that is supplied to the government on one's tax return. Current government procurement law dictates certain collection activities are highly discretionary and they may not be able to be contracted away from Federal employees. The Prompt Deposit Act will constrain methods of compensating private contractors.

A key element of any proposal to privatize tax debt collection must be to evaluate the legal issues involved in these checks and balances and determine the extent of changes the Congress must make in these laws before plunging into the privatization of tax debt collection.

As you know, H.R. 2020, the Treasury Postal Service and General Government Appropriations Act of 1996 has authorized funding for a pilot program to test private debt collection of Federal taxes, and the IRS has this project underway. This pilot provides an opportunity to evaluate some of these issues.

I also comment directly in my written remarks on the methods of compensating private debt collectors. TBOR 1 prohibited the IRS from using amounts collected as a criterion for evaluations or compensation of IRS employees. We are aware and heard earlier this morning that contingent arrangements are commonplace in the private sector and that performance evaluations of employees usually reflect the extent of their collections in this area. We believe for the same reasons Congress was concerned about the compensation being based, perhaps, on collection activities, that we should similarly be concerned in any type of private debt collection initiative.

I also touch in the written testimony on two specific legislative proposals. First, H.R. 757, introduced by Mr. Jacobs, which would enhance the cooperation between Federal and State tax administrators by permitting Federal tax refunds to be offset to collect delinquent State tax debts.

The Federal Government already benefits by many States participation in the State Income Tax Levy Program under which States offset State tax overpayments by past due Federal tax debts.

We have testified on this subject before and we believe that reciprocal cooperation should be afforded by the Federal Government to the States. We support expanding the refund offset program to cover the State tax debts.

The other legislative proposal, H.R. 2234, originally contained proposed changes in the IRS' levy authority. And one of the provisions that was contained in that bill would have permitted a continuous levy to be made on certain types of recurring Federal payments we think would eliminate a lot of the repetitive paperwork burden that the IRS goes through. This provision would not change the kinds of property the IRS can reach with its levy authority. The bill also makes some changes in section 6334, exemptions from levy.

In conclusion, we obviously recognize that Federal tax debts must be collected. If a taxpayer pays his share of tax revenue that supports his government, he has a right to expect that others who don't pay their share should be vigorously pursued and collection efforts should result. However, before we make changes in our collection practices, we should do so only in a conscientious and thoughtful way considering all of the ramifications.

That concludes my oral testimony, and I am pleased to answer any questions that you have.

[The prepared statement follows:]

STATEMENT OF
CYNTHIA G. BEERBOWER
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Madam Chair and Members of the Subcommittee:

I am pleased to appear before you today in response to the Subcommittee's request to discuss some of the significant tax policy issues related to Federal debt collection practices. My testimony today will address the issues that you have expressly directed toward the Office of Tax Policy. In particular, you have asked for our comments on three issues related to outsourcing Federal tax debt collections: (1) which collection activities carried on by the Internal Revenue Service ("IRS") are "inherently governmental" and must be performed by Federal employees; (2) the appropriate method for compensating private debt collectors for tax debt collection services; and (3) the potential costs and benefits of using appropriated funds to contract with private debt collection agencies for Federal tax debt collection services compared to providing additional funding for collection efforts by IRS personnel.

You have also asked for our comments on (4) H.R. 757, which would expand the authority under section 6402 of the Internal Revenue Code of 1986 to offset Federal tax refunds to satisfy past-due State tax debts, and on (5) specific provisions of H.R. 2234, "The Debt Collection Improvement Act of 1995," that would enhance the IRS's authority to collect delinquent tax debts by establishing an automated system of levying on certain non-means tested Federal payments. After some preliminary comments on general policy issues raised by the private collection of delinquent taxes, I will discuss each of these five specific topics.

General tax policy concerns about private debt collection

A number of policy issues arise in the context of any tax debt collection proposal, and we would urge the Subcommittee to approach the topic of outsourcing tax debt collection especially cautiously. As you know, representatives of this Administration have previously expressed concerns about contracting out the collection of Federal taxes to private agencies. See, e.g., Letter from Commissioner of Internal Revenue Margaret Milner Richardson to Senator David Pryor (August 4, 1995), reprinted in 141 Cong. Rec. S11538.

The Treasury Department too has concerns about turning over collection activity to private contractors.

First, this Administration and this Subcommittee are dedicated to protecting the rights of taxpayers in connection with our debt collection activities. In this regard, I want to commend the Committee on Ways and Means and the entire House of Representatives for their recent passage of the Taxpayer Bill of Rights 2 ("TBOR 2") legislation. The significance of taxpayer rights and the broad bipartisan support for protecting them are clearly reflected in the unanimous vote of the House to approve that bill. The Treasury Department has been very pleased with the bipartisan cooperation that has been demonstrated in developing and refining the provisions of this legislation.

As you know, our commitment to taxpayer rights has led us voluntarily to implement many of the TBOR 2 provisions through administrative actions. In January of this year, we issued a Notice discussing the TBOR 2 items that we would be undertaking administratively, see Announcement 96-5, "Administrative Initiatives to Enhance Taxpayer Rights," 1996-4 I.R.B. 99, and in late March we announced that the 17 specific TBOR 2 items identified in the Notice have all been implemented. This effort to accomplish administratively as much of TBOR 2 as was feasible under our authority provides tangible evidence of the Administration's ongoing commitment to protecting the rights of citizens in their contacts with the Federal tax system.

There is inevitably a tension between protecting taxpayer rights and aggressively collecting tax receivables. In its recent report, the General Accounting Office ("GAO") expressed "concern" that "the IRS may be sending the wrong message to its collection employees" by such actions as prohibiting the evaluation of collection employees based on amounts collected, increasing the use of installment agreements, and making additional use of offers in compromise. General Accounting Office, Internal Revenue Service Receivables 25-28, Report No. GAO/HR-95-6 (1995). We are concerned that the protection of taxpayer rights not be sacrificed in the enthusiasm to increase tax collections. Congress (in the first and second Taxpayer Bills of Rights) and the IRS (in our administrative TBOR 2 initiatives) have taken significant steps to ensure that taxpayers are treated fairly throughout the collection process. It would be, in our view, inappropriate to apply these taxpayer protections to the activities conducted by the IRS but not to private collection contractors. At a minimum, therefore, we think it would be necessary to require that private contractors respect all provisions of the law governing taxpayer rights.

Second, we are concerned about the difficulties that would result from disclosure of taxpayer information to contractors. As the Subcommittee knows, section 6103 of the Code protects the confidentiality of taxpayer return information, and the Administration firmly supports the policy behind this provision. Disclosures of return information may be inevitable under any system of privatized tax debt collection. What if individuals or entities that are in the business of debt collection duplicate IRS data or merge that information with their own private data bases? Disclosure to contractors will also present the IRS with more individuals and more physical locations that it must supervise and audit for compliance with security conditions and safeguards

under section 6103(p) of the Code. Thus, any private system of tax debt collection must comply strictly with the privacy restrictions of section 6103 and related statutes.

In sum, we recognize that taxes must be collected, and that the system requires that where one taxpayer has paid his share and another hasn't, the IRS should pursue collection from the delinquent. However, the Administration believes that the important goal of improving debt collection procedures must be consistent with protecting taxpayer rights and maintaining taxpayer privacy and confidentiality. The proper resolution of this issue lies in a careful balance between these two aims and in thoughtful and well-considered implementation of any proposals.

As you know, however, in H.R. 2020, the Treasury, Postal Service and General Governmental Appropriations Act of 1996, Congress authorized \$13 million for the Treasury Department to conduct a pilot program to test private collection of Federal tax debts, and the IRS has the pilot project underway. This provides an opportunity to evaluate the issues inherent in outsourcing of debt collection.

I will now turn to the specific topics you have asked us to comment on.

1. "Inherently governmental" functions

The Constitution provides that Congress has the power to levy and to collect taxes. Congressional authority to collect taxes has been given to the Secretary of the Treasury. Tax collection is intrinsic to government as an exercise of the state's sovereign authority, and the Supreme Court has held that sovereign powers generally cannot be contracted away. See Contributors to Pa. Hosp. v. City of Philadelphia, 245 U.S. 20 (1917); Texas & New Orleans R.R. Co. v. Miller, 221 U.S. 408 (1911). A key element of any proposal to privatize tax debt collection must be to evaluate the legal issues surrounding any attempted delegation of authority. In particular, there may be impediments to outsourcing tax debt collection functions under current Federal procurement acts.

For example, functions cannot be delegated by contract to persons other than officers or employees of the United States if those functions are "inherently governmental," which the Office of Management and Budget describes as "so intimately related to the public interest as to mandate performance by Government employees," such as activities that require the exercise of discretion in applying Government authority or that involve tax collection. See Office of Management and Budget, Circular No. A-76 (August 4, 1983); Office of Management and Budget, Policy Letter 92-1, 57 Fed. Reg. 45096 (Sept. 30, 1992).

Examples of tax collection powers that would not be delegable under current law would presumably include the authority to compromise a tax debt for less than the full amount due, the ability to seize property before a judgment confirming the amount of the tax debt, or other similar situations involving the judgment of an Executive Branch officer. On the other hand, delegable functions that might be obtained commercially include: providing locator

services to establish a mailing address and phone number for delinquent taxpayers; mailing notices or letters that provide information on the amount of a tax delinquency and payment options; making telephone contacts to remind taxpayers of a delinquency, to provide information on payment options, and to secure intentions of repayment; providing lockbox service for receipt and processing of tax payments; providing data processing services that are performed in conjunction with tax collection activities; research and data gathering; and financial auditing support services. Id.

Further, certain ministerial acts are required under existing law, such as the prompt daily deposit into the Treasury of Federal taxes collected under section 7809 of the Code. This requirement parallels the similar Prompt Deposit Act, 31 U.S.C. § 3302, which generally applies in a non-tax context. The rule of these provisions would, for example, prohibit paying private collectors of Federal tax debts directly out of the amounts they collected. Also, rules related to tort liability, the applicability of state or Federal debt collection practices laws, and of course the taxpayer rights and privacy concerns discussed previously would all have to be examined.

Presumably, Congress can change all of these laws, but we would recommend that a thorough review of the extent of such changes be undertaken before Congress requires the IRS to privatize activities beyond the pilot program.

2. Compensation of private tax debt collectors

As this Subcommittee knows, the first Taxpayer Bill of Rights expressly prohibited the IRS from making compensation or personnel actions (such as evaluations) based on the revenue collected by its agents. See Omnibus Taxpayer Bill of Rights § 6231, Pub. L. No. 100-647, 102 Stat. 3730, 3734 (1988). The Administration supports this approach.

We are aware that contingent compensation arrangements are commonplace in private debt collection agencies. The Administration believes that the compensation for any private debt collection initiative should be subject to the same constraints as are imposed on the IRS. If such a contingent compensation arrangement is not allowable for our own employees, over whom we have supervisory control, why would we permit it for private contractors for whom the rights of citizens may not be the highest priority?

3. Use of appropriated funds

As I have noted, the prompt deposit requirements of existing Federal law would require private collectors of Federal tax debts to be paid with appropriated funds rather than out of the amounts they collected. We believe this restriction is a proper one.

Exceptions to the prompt deposit requirements have been rarely granted, and when they are, Congress closely monitors compliance. For example, in the TBOR 2 legislation recently passed by the House, the IRS was granted the authority to use the income earned in undercover activities to pay additional expenses of such operations. See H.R. 2337 § 1205. However, the authority

was extended only temporarily, and section 7608(c)(4) of the Code, which requires annual reports by the IRS to Congress under this authority, was amended to impose additional reporting requirements with respect to the undercover operations, proceeds, and expenditures. *Id.*, § 1205(c).

We believe that the general rule of payment only out of appropriated funds should apply to private debt collectors, and other approaches should only be considered after we have more experience.

Refund offset to collect state taxes -- H.R. 757

The Internal Revenue Code currently permits the IRS to offset Federal tax refunds in a variety of situations. Section 6402(a) authorizes offsetting Federal tax refunds in order to satisfy other Federal tax debts, and sections 6402(c) and (d) likewise authorize offsetting Federal tax refunds to collect past-due, legally enforceable debts other than delinquent Federal taxes. A taxpayer is entitled to a refund only to the extent that the tax overpayment exceeds these delinquent debts. The IRS thus currently has in place a four-tiered refund offset program, under which the IRS offsets Federal income tax overpayments by, in order of priority, the taxpayer's (1) delinquent Federal tax liabilities, (2) past-due child support obligations which have been assigned to a State under the Social Security Act ("AFDC child support"), (3) delinquent non-tax debts owed to other Federal agencies, most notably defaulted student loans, and (4) past-due child support obligations which have not been assigned to a State ("non-AFDC child support"). Each of these kinds of debts are offset based on a representation from the creditor agency that the debt is valid and enforceable and that certain procedural requirements have been met to ensure due process to the debtor. The IRS does not engage in an independent investigation of the validity of any claim.

H.R. 757 permits Federal tax overpayments to be offset to collect certified State tax debts. In general, the Treasury Department supports this proposal, which will foster and enhance cooperation between the Federal tax authority and State tax administrators. Treasury and the IRS identified some technical issues in the original bill introduced by Mr. Jacobs, involving the priorities for making offsets, the disclosure of tax information, and some other, relatively minor items. These technical problems have been resolved, and we expect the resolutions to be incorporated in the final drafting of the provision.

Some concerns have been expressed that States might ask the Federal government for refund offset of tax debts that are not valid or legitimate. H.R. 757 provides procedural guarantees intended to ensure that this does not occur. We would not support a refund offset provision that would require the Federal government to determine independently the validity of each underlying State tax debt presented to it for collection. Such a requirement would create a burden that would outweigh the benefit of the refund offset program to the Federal government.

Levy on Federal payments

Improving the Government's ability to recover delinquent debts is a priority of the Administration. Last summer, the Administration forwarded to

Congress draft legislation intended to achieve this goal, which was introduced by Representative Horn as H.R. 2234. This legislation will provide enhanced tools to recover delinquent debt owed to the Federal government more efficiently and effectively, while protecting the due process rights of the debtors. H.R. 3019, the Continuing Appropriations for Fiscal Year 1996, as currently pending, contains many debt collection provisions drawn from this bill that do not involve Federal tax debts. I will confine my comments to the tax policy aspects of the Administration initiative.

First, by way of background, Congress has granted the IRS power to collect Federal taxes by levying on "all property or rights to property" of the taxpayer under section 6331 of the Internal Revenue Code. In particular, section 6331(e) permits a "continuous" levy on certain types of regular or continuous payments, such as salaries and wages. This authority permits the IRS to attach all or a portion of such regular payments by serving a single notice of levy on the person making such payments to the taxpayer. Section 6334(a) of the Code grants certain exceptions to the IRS's levy power for specifically enumerated categories of property.

The Administration's debt collection initiative, as reflected in H.R. 2234, contains two changes to the IRS's levy authority. First, this provision would permit a "continuous" levy to be made on certain kinds of non-means tested, recurring Federal payments, while continuing to exempt certain other Federal payments. This proposal, which would not change the kinds of property that the IRS can reach with its levy authority, is essentially a way to reduce paperwork burdens. It would eliminate the need for the IRS to serve repeated notices of levy in order to attach all or a portion of a non-exempt, recurring payment; instead, the IRS could simply serve the notice of levy a single time. Since the continuous levy power is already available to the IRS to collect delinquent taxes from salary and wage payments, we believe that it should also be available to collect delinquent taxes from other kinds of Federal payments, including in particular regular payments to Federal contractors for services provided.

As is now the case, the authority to make a continuous levy on Federal payments would be used only on a case-by-case basis at the discretion of individual revenue officers. As the IRS witnesses here today can explain, the levy procedure is ordinarily a "last resort" for revenue officers to use in the collection process, usually employed only after a taxpayer has ignored repeated notices of the delinquent tax account or has otherwise failed to make adequate payment arrangements. The Administration expects that this will remain the case, and that continuous levy on Federal payments will be used only as one of the last steps to collect unpaid taxes.

The second part of the Administration's proposal would change the exemptions from levy, so that the following non-means tested payments from the Federal government would no longer be exempt: Federal workmen's compensation payments, which are currently exempt under section 6334(a)(7); and annuity or pension payments under the Railroad Retirement Act, and benefits under the Railroad Unemployment Insurance Act, both of which are currently exempt under section 6334(a)(6). We have also recommended a change in the exempt amount of Federal wages, salary, and other income under

sections 6334(a)(9) and 6334(d). Under current procedures, section 6334(d) provides a formula for computing a minimum exempt amount of wages, salaries, or other income received on a weekly basis. Because this formula is complex and unique to each taxpayer, we propose a new and simpler mathematical exemption, under which only up to 15% of Federal salaries or pensions would be subject to levy; in other words, at least 85% of such payments would continue to be exempt.

Congress has always permitted Social Security payments to be subject to levy, and the Administration's proposal would not change current law in this regard. As a practical matter, however, the authority to levy on Social Security is rarely used, and the only intended consequence of this proposal is to reduce paperwork burdens by making such levies continuous.

This legislation will improve collections while providing revenue officers with flexibility to take extraordinary situations into account. As noted above, the levy provisions are generally used only in the final stages of the collection process, after other efforts to collect delinquent taxes have failed. In the event that a levy on non-means tested Federal payments in excess of the exempt amounts were to cause a "significant hardship," the Administration anticipates that the Taxpayer Assistance Order procedure administered by local Problem Resolution Officers under section 7811 of the Code would provide additional relief.

Conclusion

The Administration looks forward to working with this Subcommittee in the future to enhance the collection of Federal tax debts, while protecting taxpayer rights and taxpayer information. In particular, we expect to report to the Subcommittee at the conclusion of the IRS private debt collection pilot project to evaluate the success of that program. Further, we ask that the Subcommittee favorably consider the two specific legislative proposals that I have discussed.

This concludes my testimony. I would be pleased to answer any question that you may have.

Mrs. JOHNSON. Thank you, Ms. Beerbower.
Mr. Donelson.

STATEMENT OF JAMES E. DONELSON, CHIEF TAXPAYER SERVICE, ACTING CHIEF COMPLIANCE OFFICER, INTERNAL REVENUE SERVICE; ACCOMPANIED BY RON RHODES, ASSISTANT COMMISSIONER FOR COLLECTION, INTERNAL REVENUE SERVICE

Mr. DONELSON. Madam Chairman and distinguished Members of the Subcommittee, I have a written statement that I request to be entered into the record.

With me today is Ron Rhodes, the Assistant Commissioner for Collection. We appreciate the opportunity to be here to discuss one of IRS' most critical responsibilities, the collection of the Nation's tax revenues. In discussing accounts receivable, it is important to know how IRS' accounts receivable differ from those of private businesses. Specifically, private businesses preapprove the creditworthiness of customers before extending them credit. The IRS makes assessments based on tax laws, regardless of collection potential. Failure to do so would seriously undermine the voluntary tax system and would be unfair to taxpayers who meet their tax obligations.

In the private sector, a liability is established when goods or services are purchased. The IRS must often establish the tax liability through audits. Thus, several years may elapse between the time a tax return is filed or is due to be filed and the time a liability is finally established.

Businesses do not continue to carry debt on their books when it becomes apparent, after attempting to collect, that it will not be paid. By law, the IRS must keep accounts receivables on the books for 10 years, even when we know they are not collectible. Our gross accounts receivable inventory does not only include unpaid taxes, it also includes the ever increasing interest and penalties related to those unpaid taxes.

Thus, unlike accounts receivable in the private sector, the IRS accounts receivable inventory is not a reflection of an annual underpayment of taxes, but it does reflect accounts receivable in the 10-year carryover of unpaid taxes, along with the aforementioned accrued interest and penalties.

At the end of 1995, our gross accounts receivable inventory equaled about \$200 billion of which 28.5 percent or nearly \$57 billion reflected accrued interest and penalties. The gross accounts receivable inventory is divided into two components, those considered currently not collectible and those that are active accounts receivable.

I would like to talk about currently not collectible taxes. Currently not collectible taxes are accounts that a collection employee has determined that cannot be currently collected or paid by the taxpayer. These accounts comprise about \$87.4 billion or nearly one-half of the gross receivable inventory. Accounts in this category are periodically monitored and if a taxpayer is able to pay within the 10-year statute period, the account will be collected so it can move out of the currently not collectible status and back into our active accounts receivable as it is being paid off.

Active accounts receivable are accounts that are potentially collectible and continue to be pursued through activities ranging from notices and telephone contacts, to installment agreements, offers in compromise, and ultimately enforcement actions such as liens, levies, and seizures.

Active accounts receivable comprise \$88.8 billion of the current gross inventory. As early as 1988, the IRS determined that the accounts receivable was a growing concern. Since that time we have continued to take steps to improve the management of the receivable inventory. We have focused on four specific areas.

First, making the composition of the accounts receivable inventory correct. Second, ensuring the accuracy of the assessments that were included in that inventory. Third, improving the currency of the inventory. And fourth, increasing the collection of the amounts in the inventory.

A number of specifics about what we have done in each of these four areas are covered in my written testimony, but today I want to only mention the results from our efforts to increase collection yield, because I think these results are quite promising.

From 1991 through 1993, collection yield had declined between 4 and 6 percent on an annual basis. Some of that decline was attributable to a decline in staffing. It was also a result of some decline in productivity on our part.

In 1994 our collection yield increased by 3 percent despite a 9.5-percent decrease in staffing. In 1995 we continued to increase our collection yield by over 7 percent. Despite the loss of the compliance initiative in 1996, I am pleased to report that halfway through the year, our collection yield has continued to increase, more than 17 percent over last year for the same period.

Before I conclude though, I would like to touch on two other things very briefly. One, I want to tell you about our efforts regarding contracting out a part of our collection activity, as provided in our 1996 appropriations budget. We intend to award up to 5 contracts and initially deliver approximately 125,000 cases relating to taxpayers who are delinquent in paying their tax obligations.

At this time, we are on schedule to deliver the cases to contractors at the last quarter of fiscal year 1996. Absent any delays in our schedule, an analysis of the results from this pilot project should be available in the last quarter of fiscal year 1997.

Payments under the contract will be performance based, however, they will not be contingency-fee contracts. Contractors will be given as much freedom as possible while ensuring that they and their employees will be subject to the disclosure laws, the Privacy Act, the Taxpayer Bill of Rights, and applicable sections of the Fair Debt Collection Practices Act.

Information provided to contractors by the IRS or collected by the contractors from taxpayers cannot be used for any purposes other than the fulfillment of the requirements for the awarded contract and cannot be sold or otherwise transferred by the contractor.

We are looking forward to seeing how this pilot project compares to the kind of collection productivity initiatives we have undertaken.

The other item I want to mention very briefly is one of the components of the proposed Debt Collection Improvement Acts of

1995—the IRS Levy Program. The IRS Levy Program will enhance our current levy authority on Federal payments and will provide another tool that we can use in appropriate cases to collect taxes that are due.

Currently, in order to levy upon a series of periodic payments, the IRS must serve notices of levy coincidental with each payment. These notices are sent to each Federal employee or payor one at a time or individually. Under the levy procedure in the proposed bill, IRS will send to FMS, the Financial Management Services, a tape to compare FMS' own records and determine if any of the delinquent taxpayers are receiving Federal payments.

If there is a match, FMS will reduce the Federal payment to the taxpayer by a certain percentage that we will work out. The levy will remain in effect and will be continuous until the taxpayer contacts the IRS and makes other arrangements to pay or the taxes are paid through the reduction of the Federal payments.

This eliminates the need for the IRS to interact with each Federal department or agency individually to determine whether a taxpayer is receiving Federal payments. We believe this is cost effective, saving time for the IRS, as well as for other Federal agencies.

However, this provision, in our opinion, will be most effective in collecting taxes owed from those business taxpayers who are delinquent in paying Social Security and income taxes withheld in trust funds from their employees if these businesses are receiving payments under one or more Federal contracts.

I want to take 1 minute to assure the Subcommittee that if the continuous levy proposal were enacted, the IRS would issue procedures to guard against any automatic levy action upon Social Security benefits. We just don't think that would be appropriate. Our procedures would require a case by case decision before a continuous levy could be used against any Social Security recipient or benefits.

In 1995 we issued approximately 2,000 individual levies against Social Security benefits and did those on a case by case basis, and that contrasted to nearly 2.7 million levies we sent out nationwide.

Taxpayers who are affected by this proposal would be afforded all their rights before a levy is affected against their Federal payments.

Madam Chairman, that concludes my remarks and Mr. Rhodes and I will be happy to answer any questions you might have.

[The prepared statement follows:]

**STATEMENT OF
JAMES E. DONELSON
CHIEF TAXPAYER SERVICE AND ACTING CHIEF COMPLIANCE OFFICER**

**BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS**

APRIL 25, 1996

Madame Chairman and Distinguished Members of the Subcommittee:

With me today is Ron Rhodes, Assistant Commissioner for Collection. We appreciate the opportunity to be here this morning to discuss one of the Internal Revenue Service's most critical responsibilities -- the collection of the nation's tax revenues. You asked that we specifically discuss the composition of the IRS' accounts receivable inventory, and our efforts over the past several years to improve the management and collection of accounts receivable.

April 15th, Tax Day, was just 10 days ago. We recognize that many Americans view paying their taxes as a burden. We are working hard to change this. In fact Madame Chairman, during the last year we have had the opportunity to work with you and Members of this Subcommittee on the Taxpayer Bill of Rights 2 (TBOR 2) and I was pleased to learn that TBOR 2 passed the House. It is particularly relevant in discussing accounts receivable because it is important to remember that the vast majority of Americans pay the taxes they owe on time. Out of fairness to those who meet their tax obligations, the IRS collects overdue taxes from those who do not.

Accounts Receivable

Generally, accounts receivable represent the credit sales of a business. How to handle accounts receivable is an important question for all businesses. One of the most effective accounts receivable management tools is to investigate the credit-worthiness of customers before extending them credit. Private businesses formalize the precise amount and terms of debt repayment when the debt accrues, and they manage their receivables by writing off those accounts that are uncollectible. Businesses do not continue to carry debt on their books when it becomes apparent, after attempting to collect, that it will not be paid.

Like businesses, the IRS has accounts receivable. Unlike private businesses, however, our customers are not purchasing products with their debt, and their credit-worthiness is not determined prior to a transaction.

It is important to understand what makes up the total amount of our accounts receivable inventory. When taxpayers either do not file returns or file inaccurate returns, we make assessments based on the tax laws irrespective of collection potential. Failure to do so would seriously undermine our voluntary tax system and would be unfair to those taxpayers who file timely and accurately. We record these unpaid assessments as accounts receivable and keep them on our books for as long as they are legally collectible. While we attempt to collect these debts, some accounts are obviously uncollectible for various reasons, for example: the taxpayer has died or is insolvent. In other words, we know at the outset that some of these assessments will not be collected.

But our gross accounts receivable inventory does not include only unpaid taxes, it also includes the ever-increasing interest and penalties related to those unpaid taxes. In addition, the law prescribes how long we must keep accounts receivable on the books -- 10 years. Thus, unlike private sector businesses, the IRS' accounts receivable cannot be written off even when we know that they are not collectible. As early as 1988, the IRS determined that accounts receivable were a growing concern, an

assessment both OMB and GAO agreed with. Since 1988, we have continued to take steps to improve the management of the receivables inventory.

Today, I would like to discuss with you our efforts to:

1. Determine the correct composition of the accounts receivable inventory;
2. Ensure the accuracy of assessments that are included in the inventory;
3. Improve the currency of the inventory; and
4. Increase the collection of accounts in the inventory.

1. Correct Composition of Accounts Receivable Inventory

In 1990, Congress extended the time the IRS would be required to keep accounts receivable on the books from 6 to 10 years. Thus, unlike accounts receivable in the private sector, the IRS's Accounts Receivable Dollar Inventory ("ARDI") is not a reflection of an annual underpayment of taxes, but includes current receivables, plus a ten year carryover of unpaid taxes, along with accrued interest and penalties.

At the end of FY 1995, IRS' gross accounts receivable inventory equaled \$200 billion of which 28.5% or \$56.9 billion reflected accrued interest and penalties. This is a \$29 billion increase over the FY 1994 balance. A significant portion of this growth was due to additional accruals of interest and penalties, the extension of time we must keep the receivables on the books from 6 to 10 years¹, and to our non-filer program. The non-filer initiative was started in 1992 to encourage taxpayers who were not filing returns to get back into the system. While we realized the non-filer program would increase our accounts receivable since many were not filing because of an inability to pay their tax obligations in full, we believed it was more important to get taxpayers filing again and then assist them with ways to meet their obligations through installment agreement and offers in compromise options.

The IRS' gross accounts receivable inventory for compliance purposes is divided into two components: Currently Not Collectible and Active Accounts Receivable.

- ▶ **Currently Not Collectible (CNC)** - are accounts that a collection employee has determined a taxpayer cannot currently pay. Accounts in this category are periodically monitored, and if a taxpayer is able to pay within the statutory 10-year period, the account will be collected. At the end of FY 1995, \$87.4 billion² -- or nearly half the gross receivable total -- is classified as CNC. Of this amount:
 - 37.6% (\$32.8 billion) is accrued penalties and interest.
 - Over 85% (\$75 billion) is not collectible because it is owed by defunct corporations; taxpayers adjudicated bankrupt; hardships; or our inability to locate or contact taxpayers.
- ▶ **Active Accounts Receivable** -- are accounts that are potentially collectible and that continue to be pursued through activities ranging from notices and telephone contacts, to installment agreements and offers in compromise, and ultimately, liens, levies, and seizures. At the end of FY 1995, \$88.8 billion³ is classified in the Active Accounts Receivable category. Of this amount:
 - 41% (\$36.6 billion) the largest portion of the active account has been assigned for enforcement action;

¹FY 1995 was the last year in which the ARDI would automatically increase because of the extension of time we must keep accounts on the books from 6 to 10 years.

²Not included in this balance are Trust Fund Recovery Penalty assessments of \$6.3 billion that are potentially duplicative.

³Not included in this balance are Trust Fund Recovery Penalty assessments of \$8.7 billion that are potentially duplicative and Resolution Trust Corporation assessments of \$9.0 billion that have not yet moved to Currently Not Collectible.

- 22% (\$19.1 billion) of the inventory is awaiting adjudication by a court or acceptance of an offer in compromise;
- 13% (\$11.7 billion) is currently being collected by sending notices to taxpayers;
- 13% (\$11.2 billion) is being collected through installment agreements;
- 2% (\$1.6 billion) is lower value cases that will be substantially collected through systemic monitoring, such as refund offsets and yearly notices to taxpayers.

Included in the \$88.8 billion active accounts receivable is \$18.5 billion of accrued penalties and interest.

2. Ensuring the Accuracy of Assessments Included in Accounts Receivable

There are several ways an account can be put in the accounts receivable inventory. For example, a taxpayer may file a tax return but not pay what is due, and the unpaid tax will be included in accounts receivable inventory. In addition, accounts receivable are created as a result of any number of compliance initiatives. Examinations and secured delinquent returns frequently result in an assessment which is not fully paid, and therefore becomes part of accounts receivable inventory. Tax payments that are erroneously posted may increase the accounts receivable, and we are actively seeking to minimize the erroneous assessments.

Between FY 1992 and FY 1995, the IRS has –

- ▶ Through rigorous pre- and post-assessment reviews eliminated \$276 billion of erroneous assessments, preventing these assessments from becoming part of the accounts receivable inventory.
- ▶ Created a new computer match that detects discrepancies between the amount taxpayers claimed were deposited and the amount shown in their accounts, an action which has prevented \$22 billion from becoming part of accounts receivable inventory.

Correctly accounting for taxpayers' payments is an important way to prevent the creation of a receivable and the expansion of electronic filing and electronic payments is a significant way to lower our error rate. For example, in FY 1995 taxpayers deposited \$232 billion using the TaxLink/Electronic Funds Transfer Payment System. This was a substantial increase over the \$6.2 billion deposited this way in FY 1994.

Electronic transfer of funds not only means that federal tax deposits are deposited into the Treasury a day earlier than under the paper deposit system, but the errors by taxpayers and us are significantly fewer. As more deposits are received electronically and more returns are filed electronically errors in posting and assessments will continue to decline.

3. Improving the Currency of the Inventory

The earlier a debtor receives a request for payment, the better the likelihood that it will be paid. Recognizing this, we have been working to make the receivables inventory as current as possible. Unlike in the private sector, where liability is established when goods or services are purchased, the IRS often must establish a tax liability through audit. To protect their rights, taxpayers who do not agree with an audit finding may use the administrative appeals process and litigation. Thus, several years may elapse between the time a tax return is due or filed and the time a liability is finally established.

During FY 1995, for example, more than \$17 billion in recommended additional taxes and penalties were not resolved with taxpayers during the examination process. The IRS can not take any collection action until the final liability is determined. Thus, when the FY 1995 recommended assessments finally become eligible for collection and are included in the accounts receivable inventory, several years will have passed.

Once a final determination is made, however, we are moving to contact taxpayers promptly. We are moving to collect tax at the earliest possible time -- by the Taxpayer Service function after account questions are resolved over the telephone or at the close of an agreed audit. During the past 3 years, we have shortened the time between when the delinquency arises and the first telephone contact with the taxpayer is made. Examples of our efforts and the results are:

- ▶ Decreasing the number of notices, shortening the notice period, and instituting earlier intervention by telephone. In January 1995, using 770 staff years of the FY 1995 Compliance Initiative in Automated Collection System (ACS) sites early intervention was implemented nationwide. Although the loss of Compliance Initiative funding in FY 1996 will have an impact, the early results of the increase in ACS staffing resulted in additional collections of \$111.2 million.
- ▶ Increasing emphasis on payment of agreed tax assessments at the conclusion of an examination. As a result, in FY 1995, Examination secured payment of 64.2% of agreed tax assessments - \$4.4 billion.
- ▶ Accelerating the collection of the largest corporate assessments by having the resolution of an issue in one year carried forward to later years without further examination. Under this procedure, taxpayers have agreed to about \$1.1 billion (tax and penalties) for the period FY 1993 through FY 1995.
- ▶ Under the FY 1995 Compliance Initiative, we placed 1,727 collection personnel in parts of the country with the most significant workload. Through this targeted placement, in FY 1995, we collected an additional \$545 million in unpaid taxes.
- ▶ Expanding installment agreement authority. Installment agreements offer the IRS an opportunity to keep taxpayers in the system who would otherwise not be able to meet their full tax obligations. Expanding the authority increased the dollars secured through installment agreements from \$2.28 billion in FY 1992 to \$5.4 billion in FY 1995.
- ▶ Expediting field enforcement action on taxpayers who have repeatedly been delinquent with emphasis on those who are delinquent in their payroll tax payments. A test in one site in 1994 resulted in a reduction to the receivables inventory by almost \$15 million. Nationwide implementation of this program began in FY 1995.
- ▶ Expansion of the Integrated Collection System (ICS) (the full automation of the IRS field collection activity) to 2 districts in 1995 and to 7 additional districts in FY 1996. In the two districts with ICS, productivity increased by more than 30% last year. ICS will be fully installed nationwide in FY 1999 and through FY 2004, this initiative alone will result in an additional \$2 billion in revenue collected.

A longer-term initiative that will continue the efforts to improve currency is the integration of our telephone resources by combining the ACS and the Toll-Free Service Center telephone operations. (In FY 1993 we had 70 sites; we currently have 34 sites and our goal is to reduce to 23 sites.) Combining the ACS and Toll-Free sites will give taxpayers "one-stop" resolution of their accounts. It will also provide uniform handling of account issues and allow the IRS to balance outgoing and incoming calls in a way that maximizes the collection of delinquent accounts.

4. Increasing the Collection of Accounts in the Inventory

The initiatives I have just described are designed to ensure the correctness of assessments and accelerate contact with taxpayers so that we collect taxes due without the need for enforcement actions, such as liens, levies, and seizures. I also want to describe our efforts to improve our effectiveness in collecting taxes that are due.

We are changing our business practices, our technology and our organizational structure. Our actions have focused on improving the use of existing collection tools coupled with increased productivity of our field operations. The results are quite promising. For the three years prior to FY 1994, collection yield had declined between 4% and 6%. Although some of this decline was attributable to a decrease in collection staffing, it was also the result of a decline in productivity. In FY 1994, IRS' collection yield increased 3% despite a 9.5% decrease in collection staffing. In FY 1995, collection yield continued to increase by over 7%. While we are making progress, the loss of the Compliance Initiative funding will make it difficult to sustain our increasing collection yield.

Our accounting systems will also significantly improve our ability to collect accounts receivable. We are developing an ARDI expert system. A prototype we will begin using this year will allow us to predict collectibility based on case characteristics.

This system will complement the Inventory Delivery System (IDS) which will be tested in FY 1996. IDS ensures cases are routed to the most effective point in the collection processing stream. These systems prioritize work so it is assigned to the point of most likely resolution as early in the process as possible.

Some additional changes to improve collection already under way include:

- ▶ Enhanced cooperation with state taxing authorities. The State Income Tax Levy Program involves agreements with states whereby they accept our levies on state income tax refunds. This resulted in collections of \$108 million from FY 1992 through FY 1994. Another example involves joint collection of delinquent employment taxes which includes joint installment agreements, levies and seizures.
- ▶ Proper use of certain collection tools, including installment agreements, offers in compromise, levies, and seizures.
 - In FY 1992, we modified the Offer in Compromise policy and stream lined procedures to enable field personnel to resolve accounts that previously would have languished in the receivables inventory. This resulted in additional collections of \$281 million in FY 1994 and \$295 million in FY 1995.
 - Effective use of levies resulted in over \$2.7 billion for FY 1994 and FY 1995.

The improvements we have made in the collection process, that I described earlier, not only helped us increase our collection yield over the last several years but these improvements are also helping us manage the accounts receivable inventory.

Use of Private Collection Agencies

Our FY 1996 appropriation required us to conduct a pilot project to contract out a part of our collection activity. On March 5, we issued the Request for Proposals (RFP) for the pilot. An Amendment to the RFP was issued on March 27. We intend to award up to five contracts and initially deliver approximately 125,000 cases relating to taxpayers who are delinquent in paying their tax obligations. At this time, we are on schedule to deliver cases to contractor(s) the last quarter of FY 1996. Absent any delays in our schedule, analysis of results from the pilot project should be available in the last quarter of FY 1997.

Payments under the contracts will be performance based; however, they will not be contingency fee contracts. Contractors will be given as much freedom as possible, while ensuring that they and their employees will be subject to the disclosure laws, the

Privacy Act, the Taxpayer Bill of Rights and applicable sections of the Fair Debt Collection Practices Act -- our own employees are subject to these federal statutes. Information provided to contractors by the IRS or collected by contractors from taxpayers cannot be used for any purposes other than fulfillment of the requirements for the awarded contract and cannot be sold or otherwise transferred by the contractor.

Debt Collection Improvement Act of 1995

One part of the proposed Debt Collection Improvement Act of 1995 -- the IRS Levy Program -- would enhance our current levy authority on federal payments without infringing on any of the taxpayer protections and rights that currently exist. Furthermore, the proposed IRS Levy Program would provide another tool that we can use, in appropriate cases, to collect taxes that are due.

Currently, before a levy is issued on a federal payment, the IRS must determine what payments or other benefits can be levied and how much money must be exempted from the levy. Then, the IRS prepares a document of levy and sends it to the federal employer/payor. The federal employer/payor must then research the account and prepare another document to send to the Financial Management Service (FMS). FMS then prepares a document so that the levied money is paid to the IRS. In order to levy upon a series of periodic payments, the IRS must serve notices of levy coincidental with each payment.

Under the levy procedure in the proposed bill, the IRS would send to FMS a magnetic tape identifying taxpayers who have failed to pay their taxes after receiving a series of IRS bills, the final notice of intent to levy, and the IRS has attempted to contact the taxpayer. FMS would compare the data on the IRS tape to its own records to determine if any of the delinquent taxpayers are receiving federal payments. If there is a match, FMS would reduce the federal payment to that taxpayer by a certain percentage. The levy would remain in effect until the taxpayer contacts the IRS and makes other arrangements to pay the taxes owed or until the taxes are paid through reduction of the federal payments. FMS would electronically transmit the money to the IRS and the IRS would credit the taxpayer's account with the levied amount. The taxpayer would be notified by FMS that the IRS has levied upon the taxpayer's federal payment and the taxpayer should contact the IRS with any questions.

The proposed levy procedure would apply to certain non-exempt, non-means tested federal payments. A non-means tested federal payment is defined as a federal payment for which eligibility is not based on the income and/or assets of a payee. Payments to federal contractors, annuity and pension payments are within the definition; loan payments are not. The IRS is currently authorized to levy upon Social Security and federal pensions under section 6334 of the Internal Revenue Code.

In addition to Social Security benefits, the proposed levy procedure would allow the IRS to have a "continuous" levy upon annuity or pension payments under the Railroad Retirement Act, benefits under the Railroad Unemployment Insurance Act and workmen's compensation. However, this provision, in our opinion, would be most effective in collecting taxes owed from those business taxpayers who are delinquent in paying over the social security and income taxes withheld from their employees; yet are receiving payments under one or more federal contracts.

The proposed bill eliminates the need for the IRS to interact with each federal department or agency individually to determine whether a taxpayer is receiving payments under a government contract because FMS already interfaces with these agencies as part of its responsibility for issuing checks on their behalf. This is cost effective -- saving time for the IRS, as well as for other Federal agencies.

I want to assure this Subcommittee that if the continuous levy proposal were enacted, the IRS would issue procedures to guard against "automatic" levy action upon

Social Security benefits. These procedures would require a case-by-case decision before a continuous levy could be utilized against Social Security benefits. Taxpayers who are affected by this proposal would be afforded their rights before a levy is affected against their federal payments. Taxpayers would receive the "standard" series of bills and a notice of intent to levy. At any time during this process, taxpayers can contact us to make other arrangements to pay or otherwise resolve the tax matter. Once the taxpayer receives a notice of intent to levy, under our new Taxpayer Bill of Rights II administrative provisions, taxpayers can appeal the levy action. And taxpayers have the right for reconsideration because of significant hardship. Generally, the IRS will release a levy if the taxpayer has a hardship, even if the taxpayer has ignored all previous attempts at resolving the delinquency. Furthermore, if a taxpayer feels that the request for hardship was unfairly denied, a Taxpayer Assistance Order can be filed with the Problem Resolution Office.

Conclusion

I have tried to demonstrate to you and the members of the Subcommittee the priority and significance that the IRS attaches to the collection of revenue through the effective management of the accounts receivable inventory and how the Debt Collection Improvement Act of 1995 would assist us in collecting some accounts in the accounts receivable inventory.

Madame Chairman, that concludes my remarks. Mr. Rhodes and I would be happy to answer any questions.

Mrs. JOHNSON. Thank you very much.

I appreciate your testimony this morning and let me start by asking you about the taxes that are owed that are below the thresholds of the regional offices. It is my understanding each regional office sets its own threshold below which they don't carry on any collection activities. And that this threshold varies considerably throughout the country. Now, first of all, the idea of a threshold varying is fundamentally and, in and of itself, unfair.

In a national system, if there is a threshold, it ought to be uniform in my estimation. It is my understanding that in some areas the threshold is as low as \$5,000 and in other areas it is as high as \$75,000.

So, I think that is an issue we need to look at here when we talk about tax collection. Are the underthreshold accounts, accounts that we might look at as accounts appropriate to turn over to private collection agencies since we have not been focusing publicly funded resources on that sector and the return is fairly small? Would that be an area in which with some safeguards, contingency fees might be appropriate?

Mr. DONELSON. Madam Chairman, let me address the issue of the below tolerance cases. We have a national standard that establishes in our internal system cases that reach the field or the district offices or the regional offices you referred to. But below a dollar standard which is not a published or a public number, we do have one standard for the whole country and those are generally on the low dollar end of the—

Mrs. JOHNSON. Excuse me, I didn't quite understand you. You do or don't have one standard?

Mr. DONELSON. We do have one, a standard for the entire country that is a low dollar number that we don't publish but we do have one standard.

In addition to that, though, you are correct in that in each district office we establish a queue score which is basically a decision point above which all cases are assigned to collection agents. Those queue scores are assigned based on collection potential, not necessarily dollar amount.

For example, business cases would receive a different score from an individual taxpayer case and different from a trust fund recovery penalty case based on the collection potential as much as the dollar amount. But the dollar amount is a major factor in determining the queue score. Those numbers you have referred to are not necessarily dollar figures but score figures.

But there is a close relevance to the actual dollar amount. You are equally correct to say we have a range in some districts at 5,000 points on the queue score up to 75,000 points in other districts, and that is largely because of the inventory of resources that we have, the people that we have available to work cases. In a situation where a geographical area might have a very bad economical situation occur, such as in California, Mr. Matsui's State, those cases may mount up as people are not able to pay their taxes, and our queue scores in California are generally quite high because they have a disproportionate number of cases there compared to the number of people we have working.

In another State with a low queue score, there may be sufficient resources available and people who are full-time employees, who have got a lower inventory of cases to draw upon. We prefer to have our resources where our cases are but we cannot always control that.

Mrs. JOHNSON. These underthreshold cases generally start out as small liabilities, isn't that correct?

Mr. DONELSON. Not necessarily. The underthreshold cases could be cases where a taxpayer simply didn't file a return. That's why we can't refer to it strictly for dollar amounts because some of the cases are tax delinquency investigations which involve the fact that a taxpayer just didn't file. So, they may have a different or a lower queue score.

Mrs. JOHNSON. So, in what percentage of the threshold cases does the IRS make an initial attempt to collect?

Mr. DONELSON. We make an initial attempt to collect all the cases. They all receive at least one or two notices. The cutting edge difference is that after the notice stream, only cases above the threshold tolerance, or deferred level, are actually sent to our call sites for telephone contact. All cases above tolerance level or deferred level are sent to the call sites and they have at least a call site attempt to collect. After they have gone through our call sites and attempts have been made to collect, anything still remaining goes into our queue system. After the queue system is able to assign a queue score to that, automatically through computerization, the cases reside in our queue.

Depending on the district, as we just discussed, and the resources available, those queue score cases would be assigned. Now, there are exceptions to that. There are some cases on a low dollar level that will be assigned directly to a collection agent because she or he already has cases related to that taxpayer assigned to him. So, a very low dollar case could come through the notice stream, the call site, the queue score system, and be assigned to somebody ahead of a larger dollar case simply because we already have an inventory of cases in the hands of that field agent.

Mrs. JOHNSON. Has there been any discussion of this sector as a focus of private collection activities?

Mr. DONELSON. The sample of cases I referred to in my oral testimony, the 125,000 cases, is made up of a cross section of all types of work. We plan on offering the opportunity for the debt collectors to work on the very low tolerance cases.

Mrs. JOHNSON. You do, in your testimony, suggest that in some of the new programs they have paid off because you went after a case immediately and there wasn't a long lag time between delinquency and action. One of the advantages of using the private sector where there are small cases involved, or small amounts involved, is that you can avoid lag time, the development of lag time because the agency isn't going to go after small amounts if they can use the same personnel to go after larger amounts.

So, is there some way of accelerating the attention that small amounts get by moving them far more aggressively and rapidly into a private collection system?

Mr. DONELSON. I think that is one of the things we will find out. I also want to point out that although we declare them below toler-

ance or defer level, 80 percent of those are collected through the statute period. So, we do get that money eventually, and we do get interest and penalties along with that.

But, your point is well taken, that would be an area we would be very interested in seeing how well this pilot works out.

Mrs. JOHNSON. In the currently not collectible accounts you have some that are not collectible because you can't locate or contact the taxpayers. Again, is this not a group that would be useful to turn over to the private debt collectors?

Mr. DONELSON. Absolutely. It would be an interesting category of cases to see if they can find the people we couldn't find, absolutely.

Mrs. JOHNSON. Thank you.

Mr. Matsui.

Mr. MATSUI. Thank you very much, Madam Chairman.

It has been my understanding and I am trying to understand all this in terms of what the position is of the Service and also the Treasury Department. I know that OMB favors contracting these, sourcing these out to private collectors. I am still trying to understand whether or not Treasury and/or IRS has a position on whether this is a good idea, a bad idea, or whether more funds could actually do the job in a more effective, efficient way.

In other words, you see, first of all, I want to thank Representative Johnson, her staff, and certainly Chairman Archer for asserting their jurisdiction over this issue because I think it is extremely complex and it requires a great deal of expertise. I think this Subcommittee staff, along with the agencies, have the expertise. Obviously, this has come to us because it was in another Committee's jurisdiction and not taking anything away from the expertise of the other Committee, but this Subcommittee and this Subcommittee's staff have been working on these issues for years.

This is not the first time we have talked about sourcing out debt collection from the taxpayers. But what I need to know, if it is possible to know this, what is the position of the administration or is there a position that is unified at this time? Because it could very well be it is not because you might have different interests. OMB just wants the increased revenues, obviously, as everyone does, but your interest may be a little different.

Ms. BEERBOWER. I think, Mr. Matsui, your question is a good one, and the sophistication of this Subcommittee appreciates that one simply cannot take a position on outsourcing Federal tax debt collection. It depends. Is there anything in the collection process that could be appropriately outsourced, as we have gone over and go over, in detail, in the written testimony.

There are a number of nondiscretionary types of functions that could probably be appropriately outsourced, and they do not present the same types of Taxpayer Bill of Rights, safeguards issues, as a total outsourcing of all Federal tax debt collection would do.

The support of any particular proposal would depend where on the continuum and what types of activities are being outsourced with what restrictions are being imposed on those activities.

The support or opposition of the administration would depend on the nature of what was being outsourced.

Mr. MATSUI. Yes. And see, I guess that is where my problem is, because if you look at what came out of the other Committee, the Government Reform Committee, one will find that there are not any standards on confidentiality and there are no standards in terms of these debt collectors, and, you know, what rules they comply with—State rules, or comply with Federal rules that we would have to promulgate, or the current IRS regulations. No one really knows at this time.

That being the case, I can understand why you cannot take a position. But the issue is, Do you believe you can come up with some safeguards that would allow it, and then what category of taxpayers. As you suggest, there may be some that certainly can be contracted out, but, again, are those easy ones, are those ones you are going to get money for anyway, and are you just going to give a 25- or 30-percent kickback to the debt collector, where then the Service loses money, or they skimmy.

The hard ones, the debt collections may not want and they will not do much work. So there are a lot of facets to this that I am trying to understand.

Ms. BEERBOWER. Absolutely.

Mr. MATSUI. I cannot seem to grapple with it because I do not know where the center of gravity is in this discussion at this time. But I think it is an important issue, obviously.

Ms. BEERBOWER. But I think it illustrates the great need for care and study before action in this particular area. I mean, clearly, one could study as a legal issue what can be outsourced. Then one could study as a taxpayer rights exercise what safeguards must be in any outsourcing.

Then one could study the economics of the cost benefit of outsourcing this particular activity. Is it cost efficient to do so? And in the end of that study, and certainly the pilot program offers some opportunity to begin this exercise—at the end of it one could conclude that certain kinds of activities meet whatever the criteria are that are established for successful tax debt outsourcing.

Mr. MATSUI. It would be my hope that—and I think what you are saying is entirely reasonable. It would be my hope that the Office of Management and Budget understands the complexities of this, so that they do not immediately throw something out and then all of a sudden we react to it, and then ask you to implement something that is unimplementable.

You see, maybe that is where the discussion has to start, from OMB, because I understand they were the ones who first raised this issue, and then it kind of had a life of its own.

So somebody needs to get to them, so that we can get some help on how we deal with this problem.

Now, we do have the problem of \$200 billion that is uncollectible. Now, I think a further analysis should be done—and again, I am not suggesting we raise more funds for the Service so they can do their job better—but maybe one needs to look at that as—again, you use the word “cost benefit.”

What is the most effective way to get this additional debt that is due the government, but is not being collected at this time?

I think we need to ask that question very fundamentally, and maybe that is where it should start before OMB begins to make rash statements, if in fact they are rash.

Let me move over, if I may. Mr. Donelson, you talked about the 125,000 taxpayers you will be seeking through this demonstration program, and I think that is excellent and obviously we look forward to the results of that in 1997.

You indicated there are safeguards. Do you have the safeguards promulgated yet, regs or rules?

Mr. DONELSON. Yes, Congressman, we have issued an RFP and it has been on the street, and it is now closed, and all the prospective reaction to that is in. So we are going through that process now.

We are well on schedule and should be able, without any delays in our schedule, that are unforeseen, to deliver cases as early as July this year.

Mr. MATSUI. OK. I suppose you will be able to give us some progress reports on this as times goes on.

Mr. DONELSON. Absolutely.

We are in the middle of the competitive procurement. The time for receipt of proposals has closed. The IRS was very pleased to receive more than 30 proposals. We are currently in the advanced stages of evaluating these proposals. Absent any delays, the contract should be awarded in about 2 months.

Mr. MATSUI. Because this obviously is an important issue. Over the years, this issue would come up but I have not thought it through as we are trying to think it through now, and I appreciate this opportunity.

Let me just ask one more, Madam Chairman. If I could just get into one last area.

In terms of the continuous IRS levies and the \$800 million potential levy on Social Security checks, I understand individuals, because of Social Security overpayments, or whatever the case, I understand that the veterans are not included in this. Right?

There is an exemption for veterans. And then the Social Security will not kick in until \$9,000. Is that my understanding?

Ms. BEERBOWER. It is my understanding, if you are addressing the debt—I mean, we have some confusion in terms of whether the proposal you are addressing is the one that is in the continuing resolution at the moment, or the original 2234, or whether it was the original administration proposal.

Mr. MATSUI. Does the proposal that is out there now exempt VA? I guess that is the first question I have. Does anyone know that?

Mr. RHODES. Mr. Matsui, I believe they are not exempted under the existing—

Mr. MATSUI. Because of the prior proposal, they are exempt, is that right?

Mr. DONELSON. Right.

Mr. MATSUI. They would not be exempt in this case.

Now, do we have a profile of this \$800 million, how many Social Security recipients will be impacted by this, and then how would you classify them?

Or maybe it is too early yet for that information?

Mr. DONELSON. I think it is too early. That is why in my oral statement, Mr. Matsui, I said that last year we had a little bit less than 2,000 situations where we had to levy. Some of those were the same taxpayer more than one time. We use that with managerial approval. It is not a step we contemplate until we have exhausted all of the levy sources. It is almost a position of last resort for us.

This proposal to have a tape to tape exchange has some dangers that go with that, that we are not going to tread on lightly. We will ask FMS, we envision asking FMS to score the tape, send us back a record, and tell us, "This is who might be getting a payment, do you still want us to do something with them?"

We will engage in some activity on a case by case basis, rather than some kind of an across-the-board action which is more likely to happen when we exchange a tape on business cases.

So we are going to be extremely careful with Social Security recipients, and we have not worked out all the issues with Veteran's Affairs, because obviously we have certain exceptions, even in today's environment, on paper levies. When we levy, one at a time, there are certain veterans that are exempt from levy on their benefits, and we would not envision going anywhere beyond that, maybe negotiate something less than that now.

Mr. MATSUI. Do you know when you might have the data available that—

Mr. DONELSON. We will wait and see if the bill passes, and we are working behind the scenes. I do not have a date for you yet.

Mr. MATSUI. OK. I want to thank all three of you.

I hope my comments are not meant to imply that I would not want to see contracting out. It is just that if in fact it should happen, I would hope we would have safeguards both in confidentiality and also standards in terms of collection. Obviously, your agencies will be the ones to have to put those together, and I am very guarded about this, because I would be very concerned, after passing a Taxpayer Bill of Rights, all of a sudden going in the opposite direction.

Because there are a lot of issues, and I do not want to take too much time, but if there is a breach of confidentiality by a collection agency itself, how do we impose enforcement in that situation?

Are there going to be fines, or will there be criminal penalties against the individual, against the collection agency?

We know what we can do to a Service employee who would do that—firing or whatever it might be—but when you contract it out to an independent contractor, you have a wide variety of issues.

I understand the interest in making sure there is separation, that information from the government cannot be used for other collection.

On the other hand, how do you make sure there is a "fire wall"? We have had that problem with the Bell Atlantic and AT&T on the telecommunications bill, and we still have not quite figured that out.

This is much easier to do if five people are in an office trying to collect money, and they say, "Well, I am getting it from Jim Jones, and what about you?" Why don't you—you know, it is easy to get those records, and I do not know how we deal with this, but we somehow, obviously, need your expertise.

Mr. DONELSON. Congressman, the RFP I think we have submitted to the Subcommittee staff, and will be glad to submit it for the record as well—the RFP outlines the provisions that would guard against any abuses, and what would happen if any abuses occur. [The RFP and amendment with attachments are being retained in the Committee's files.]

Mr. MATSUI. Would there be criminal penalties involved if somebody abuses records?

Mr. DONELSON. The same criminal provisions that apply to our agents.

Mr. MATSUI. OK.

Mr. DONELSON. Then there will be penalties regarding payment that could be defaulted on the award, if there are abuses.

Mr. MATSUI. I appreciate this, and thank all three of you.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. I thank the Chair and I want to thank Mr. Matsui for soliciting the administration's more precise position, and thank you for responding.

I think I understand it better now. That was my primary concern. I have a few specific questions.

The first one has to do with the contingency-fee arrangements.

Ms. Beerbower, in your testimony, you acknowledged that in the private sector, often the collection agencies do have an incentive built in which is a contingent arrangement.

You talked about the prompt deposit requirement that all funds collected by Federal agencies must be put in the general revenues, and so on.

I think that is generally correct. It is my understanding, though, that we also have a statutory exemption, or an exception to the act, which does grant general authority to other agencies, not in tax collection but in debt collection, that permits contingency arrangements.

Without getting into the merits, or demerits of that approach, I wonder why that would not apply equally well to the tax side, as it does to other Federal debt being collected, and to the extent it is used in the private sector, to the extent it makes sense as an incentive, why would it not make sense on the tax side as well?

Ms. BEERBOWER. Well, clearly, Congress can change the law and allow whatever it thinks is appropriate in terms of methods of compensation.

What we discovered in preparing for this hearing is that there is quite a bit of history back in the Taxpayer Bill of Rights I on the evaluation of performance that was based on amounts collected.

At that time—and certainly, one can review that record—Congress was very concerned about the message it sent to collectors, when they were told that their performance depended upon the amounts that were involved.

The suggestion that the amounts involved rewarded the particular collectors in particular ways was prohibited by Congress.

So while one could go back and revisit these issues, to determine, first, whether contingencies are appropriate, and second, the method of paying, it would dictate that these particular provisions be changed, were we to outsource Federal tax debt collection.

Mr. PORTMAN. The agency will be wanting to work with Congress, though, to see whether that makes sense. You are indicating we would need a statutory change—I think that is correct—to apply it to tax collection as well as debt collection, generally.

My question is, If we move down the road, as the National Performance Review suggested, as OMB seems to support, and as the department and the agency seem to want to try, at least, with this pilot study, would we want to look at what works in the private sector? That the incentive probably needs to be there.

A second question really goes to Mr. Donelson, and I guess this is just a general question. If you had that \$13 million to spend on IRS staffing, could you collect more?

Mr. DONELSON. It depends on what more the target is. We estimate—

Mr. PORTMAN. More than what you would get from the pilot program?

Mr. DONELSON. We do not know. We have to wait for the pilot program results to come in, but we are anxious to see those results.

Based on our own activity, we would invest that money in upfront collection activity. We would put it probably in our call sites, and based on our performance, we would collect that \$13 million, invest it in salaries and staffing, about \$325 million.

Mr. PORTMAN. What would be the amount collected based on a \$13 million investment?

Mr. DONELSON. About \$325 million.

Mr. PORTMAN. Would that be primarily from the third group, from the queue?

Mr. DONELSON. That would be from the automated collection, the second phase. After notices, the collection calls.

Mr. PORTMAN. The other question I have, and this is not specifically addressed to the testimony, I know it is difficult to come up with numbers, but the \$200 billion figure is used, and was used in the other Committee of jurisdiction. And others say it is significantly less than that.

Your own data, I think at the IRS, shows that \$63 billion of that represents taxes that may have been assessed, but are not valid receivables, and you talked a little about the difference between the private and the public sector as to how we look at the term accounts receivable.

In particular, you indicate they may really be place markers for compliance actions from nonfilers, so it is not so much taxes that have been assessed, but there is a compliance action underway that would lead to that.

My question is, Do you have a system in place to differentiate between those tax debts and other, what you would consider to be more traditional debts, in the private sector sense of the word?

If you do not have that differentiation, how does it make sense to ask debt collectors, or tax debt collectors to target, and to focus, where appropriate?

In other words, if the IRS does not have a system in place to differentiate, how are we really going to effectively be able to target and collect?

Mr. DONELSON. First of all, Congressman, the valid/invalid argument is an issue regarding our financial audit and our financial analysis of that already considerable inventory.

In fact we collect or pursue those "invalid" cases because we have no alternative, and oftentimes we have established those, as you imply, through a substitute-for-return process, either for a business or an individual.

We establish that debt in order to create some leverage opportunities for us to get the taxpayer's attention. Oftentimes taxpayers who do not file returns, and just try to drop out of the system, require us to create a return for them, so that we can then pursue them in a collection activity.

In the case of a taxpayer who does not file his income tax return, or his business taxes, we have very little leverage other than to establish an assessment.

After we do that, then we have a lot of leverage, either a seizure, enforcement action, and so forth.

So that is what is characterized, by the way, as an invalid assessment.

Mr. PORTMAN. Let me interrupt for 1 second.

So those invalid assessments would not necessarily be something that a private entity should not pursue?

Mr. DONELSON. That is correct.

Mr. PORTMAN. They are differentiated in—

Mr. DONELSON. But it gets very complicated when the private company perhaps would confront the taxpayer and say you owe x amount of money.

Mr. PORTMAN. When there has not been a formal assessment.

Mr. DONELSON. And the taxpayer would say, No, I do not, here is my return. Then we get into a situation where the inherently governmental aspects of this whole dilemma come to fore. Because we have the—

Mr. PORTMAN. But that can happen in any case.

Mr. DONELSON. It could happen in a "valid" case as well.

Mr. PORTMAN. It could happen whether it was the IRS undertaking the collection activity or whether it was the private collector.

Mr. DONELSON. You are absolutely right. But we have the tools to determine whether or not the taxpayer's claim is correct or not.

Mr. PORTMAN. That gets to some of the privacy concerns Mr. Matsui raised. If you give a private entity a name, address, and an amount owed, it might be appropriate to target them on the so-called valid assessments.

Mr. DONELSON. Valid. Exactly.

Mr. PORTMAN. Thank you very much.

Chairman JOHNSON. In letting the contracts for your pilot project, are all those contracts covered by the Taxpayer Bill of Rights protections and the other protections in the law for the taxpayer? In all those contracts, are those protections guaranteed?

Mr. DONELSON. In the \$13 million pilot, Madam Chairman?

Chairman JOHNSON. Right.

Mr. DONELSON. Yes.

Chairman JOHNSON. Has that made it difficult to get interest amongst private collection agencies?

Mr. RHODES. Madam Chairman, I think because of where we are in the procurement process, to comment whether or not we are having difficulty getting bids in might give some information as to whether or not we have had—

Chairman JOHNSON. OK. Right. I thought that might be the case. But we do need to know that, and how soon would we be able to talk about those things?

Mr. RHODES. Our plans are to award the contract this summer, June to July timeframe. At that point, we would be in a much better position to answer the question.

Chairman JOHNSON. And also about—

Mr. DONELSON. Madam Chairman, if I could just add. Without getting into specific numbers, we have had a very active reaction to this contract proposal, this RFP, and we have had lots of activity and interest in several—more than several. A large number of people—

Chairman JOHNSON. I was just wondering whether those protections were a sufficient disincentive to participate.

Mr. DONELSON. No, they have not been.

Chairman JOHNSON. They clearly are not.

Mr. DONELSON. No, they are clearly not.

Chairman JOHNSON. Your lack of ability to guarantee a certain portion of the collections as compensation has also not acted as a disincentive—

Mr. DONELSON. Absolutely not.

Chairman JOHNSON. [continuing]. To the private sector to be interested in this activity. That is helpful.

In the administration's debt collection initiative, which is now in the continuing resolution, it would expand the Federal Government's administrative offset authority to allow for the collection of Federal debts from non-means-tested Federal programs.

The administration exempted the first \$10,000 of Social Security benefits from administrative offset. Yet your IRS continuous levy proposal would allow up to 15 percent of Social Security benefits to be levied, with no exempt amount.

Why does the administration believe a \$10,000 exemption for Social Security benefits is appropriate for an administrative offset for other Federal debts, but not in the case of tax debts?

Ms. BEERBOWER. Well, certainly this Subcommittee is very familiar, there are a number of steps, procedures, investigations, and restrictions that apply to the Internal Revenue Service when it is pursuing its collections, and when there is evidence of hardship.

There are not only requirements, but there are a series of procedures that take place, that will counteract the prompt assessment or levy in a situation where there is hardship.

The administration is aware of those procedures that the IRS follows and is not concerned about levies being made inappropriately on people that cannot afford to pay.

In fact the IRS can comment on this, but it is my understanding that in a continuous levy situation, if there were a hardship, that that does not even go, in terms of being submitted for continuous levy, it stays within the Service for other types of collection.

So in the administration's judgment, 15 percent was an easy number for the financial management services people to admin-

ister, and we were not concerned about protecting situations that might be subject to hardship, for all the reasons that I have outlined.

Chairman JOHNSON. I will be interested, when you are done with this round of contracting, incidentally, in what performance standards you do use, since we are not going to use the amount of money collected.

We will be interested in looking at that, when that comes back.

On the issue of what it is we are trying to collect, does the IRS need legal authority to report taxes that have not been paid, differently?

It seems reasonable to treat, for example, taxes that have been specifically the subject of negotiation between the government and the private sector and have been specifically agreed as something that will not be pursued, as in some of the S&L agreements, to not include those taxes as part of our collectable taxes.

There are other kinds of liabilities that you include under the general rubric of reportable uncollected taxes, that I think genuinely mislead the public as to whether or not these taxes are collectible.

For instance, the taxes owed by bankrupt individuals or by corporations that are no longer in existence and have no assets.

Has the Service considered rethinking how it reports uncollected taxes?

Mr. DONELSON. Back in 1988, as I mentioned in my oral statement, we started to look at this, and one of the things we did at that time was to slice the accounts receivable into the many components that it is made up of, and we came up with the components you just referred to, and some others.

The whole idea of accounts receivable that is made up of business trust fund taxpayers or corporations, and also of individual responsible officers, which results in a double counting of that, has been included in our discounting to reach this \$200 billion number.

For example, if five people are deemed responsible for not turning trust funds over to us, we set up an assessment in their name, individually.

We carry the assessment on the books for the corporation, even though it is defunct, or out of business; but we have also set up an assessment against the five individuals who we deem responsible, so that we have been able to draw lines of distinction to determine what our accounts receivable truly are. We are able to discount those kind of situations so we do not double count.

The slices we have carved out for uncollectibles, and bankrupted and deceased taxpayers, and so forth, are in our overall uncollectible or currently not collectible part of the accounts receivable, which is also a further delineation of that.

So we have a number of cuts at that to determine what should be measured. However, I think Congress would have to look at a situation where we would agree to a point at which cases would be taken off the books; that is, the statute would not apply, the statutory limitations of 10 years would not apply.

That would be something Congress would have to do.

Chairman JOHNSON. Well, I would be interested in what categories specifically of dollar amounts ought to be in some other re-

port, because I think one of the reasons people are not very proud of their government is because their government does not provide them very accurate information about what they are doing, or why. I think to suggest to the public that there is 200 billion dollars' worth of uncollected taxes out there every year is to specifically mislead them as to the level of compliance our voluntary system is capable of.

So I am interested in what legal language you would need and what kinds of reports you would recommend in order to get some of the money that clearly is not collectible. We might want to at least know it is there. We may benefit more from a 5 year rather than 10 year collection statute. But I think we need to make some changes in how we talk about our tax debt in order to have a more accurate conversation with the citizens of this Nation.

I would like to have your thoughts on what changes need to be made in that regard, as part of this effort, and the legislation that Mr. Horn is interested in pushing forward.

I thank the panel.

Mr. DONELSON. We would appreciate that opportunity, too, Madam Chairman.

We are still analyzing the categories of CNC cases where the IRS would recommend a collection statute of less than 10 years. We should be in a position to share our thoughts with the Subcommittee in 30 days.

Chairman JOHNSON. Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairman.

Mr. Donelson, I want to follow up, I think, on the line of questioning that Chairman Johnson was asking.

There is an *x* stage process that one goes through with the taxpayer in terms of the collection of debt, first of all, making sure that it is a legitimate debt and then you go through a number of steps, even installment payments, and now through the Taxpayer's Bill of Rights, a waiver of penalties in certain kinds of cases.

Of these 125,000, how did you profile them? I mean, what level? Did you do it on the basis of years?

In other words, you have up to 10 years, 5 years, and forward. In other words, from 5 to 10 years you would take those debts and throw them in this 125,000. The power of attorney issue, for example, anybody that has a power of attorney, any taxpayer, you have excluded them from this category.

How did you do this? And for example, let us take the latter first, and then maybe you can explain the methodology used in this area.

Mr. DONELSON. Well, we have an array of cases, types of cases in this 125,000, and we think we did that for all the right reasons.

We wanted to, first of all, be very much evenhanded in our approach here, so that when we spent this 13 million in a pilot, it would tell us a lot, and we want to know whether the pilot will be effective on the low dollar cases, business cases, individual cases, cases that have been previously examined and deemed to be currently not collectible, as the Chairman said earlier.

Cases where we could not find the taxpayers, or could not locate their assets. That entire spectrum of cases.

But clearly, we had to stay away from some cases. There would not be an awful lot of sense in giving cases where people are de-

ceased, for example, and those cases that are currently not collectible because of a deceased taxpayer. It does not make any sense to give those kind of cases to the private debt collectors.

But we have a rather robust, I will call it, assembly of cases, or a variety of cases. I will let Mr. Rhodes add some more clarity to that.

Mr. MATSUI. Let me tell you, the reason I think the methodology is important, because obviously, at the end of the day in 1997, we are going to say, as Mr. Portman asks, "How much did you collect?" And you could play with the numbers.

If you skim, obviously you can have a lot of money collected with the \$13 million, and say, "My God, you know, we collected \$12 billion for a \$13 million investment." But that is if you are skimming. We will not know that unless we understand the methodology.

Or you could just make the very difficult cases that are uncollectible, and say, "Well, we only raised \$10 million through this process." And we say, "Well, geez, that is a waste of \$13 million." We only netted three, or we lost \$3 million. So your methodology is almost going to determine whether this is a good idea or a bad idea.

I suppose we really need to get into this. Probably a hearing process is not a good way to do it. But we do have to understand how this is being done. That is the reason I think this is a critical issue, that perhaps staff to staff should be meeting.

But perhaps Mr. Rhodes could discuss this.

Mr. RHODES. Well, Mr. Matsui, I think Mr. Donelson said earlier on, and I refer back to that section where he mentioned that we really made an honest attempt to try to build into this test a wide cross section—

Mr. MATSUI. Yes, and I am not suggesting there was any effort to mislead anyone.

Mr. RHODES. I understand.

Mr. MATSUI. It is just that that is my concern.

Mr. RHODES. But, really, by doing that, we feel at the end of the pilot, we will be in a position to fairly evaluate what works and what does not work in the process. I think we can talk much more about that with the Members of this Subcommittee as soon as the contract is awarded.

Mr. MATSUI. Thank you.

Chairman JOHNSON. I thank the panel and would like to call now—thank you very much, we look forward to working with you on this—Lynda Willis, the Director of Tax Policy and Administration of the GAO.

Ms. Willis, thank you for being with us today.

STATEMENT OF LYNDA D. WILLIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. WILLIS. Madam Chairman and Members of the Subcommittee, we do have a complete written statement we will submit for the record.

With your permission, I will briefly summarize that statement now.

Chairman JOHNSON. Thank you. I appreciate that.

Ms. WILLIS. We are pleased to be here today to assist in your review of IRS collection practices. Every year, IRS successfully collects over a trillion dollars in taxes, yet at the same time tens of billions more remain unpaid.

My testimony today discusses the debt collection challenges facing IRS and the potential benefits of involving private debt collectors in the tax debt collection process.

A number of longstanding problems have complicated IRS' efforts to collect its accounts receivable. Of foremost concern is the lack of reliable and accurate information on the nature of the debt and the effectiveness of IRS collection tools.

Without reliable information on the accounts they are trying to collect and the taxpayers who owe the debts, IRS agents generally do not know whether they are resolving cases in the most efficient and effective manner and many spend time pursuing invalid and unproductive cases.

IRS also does not have reliable data on the effectiveness of its collection activities and programs. Consequently, it is unable to target its efforts specifically to the taxpayer and the tax debt in question.

IRS is currently trying to capture this data on its Enforcement Revenue Information System and other computerized systems. However, there are questions about the accuracy of the data produced by these systems.

The age of the debts in IRS' accounts receivable inventory is also a problem. IRS' inventory of tax debt includes delinquencies that may be up to 10 years old. As a result, the inventory includes old accounts that may be impossible to collect.

In addition, the age of the receivable does not reflect the additional time it takes for IRS to actually assess the taxes in the first place.

It may be up to 5 years from the date the tax return is due before IRS assesses the additional taxes. The age factor significantly affects the collectibility of the debt, because as both private and public sector collectors have attested, the older the debt, the more problematic collection becomes.

Another factor relating to the collectibility of tax debts owed by individuals is source of income.

Taxpayers earning income from nonwage sources, such as pensions, self-employment, and investments are more likely to be delinquent in paying their taxes, and often owe more than wage earners who have their taxes withheld. According to IRS data, 74 percent of its inventory of tax debts owed by individuals is owed by taxpayers whose income was primarily nonwage. The average tax delinquency of these taxpayers was about four times greater than that of wage earners—\$15,800 versus \$3,600.

IRS' collection process is also a problem in that it was introduced decades ago and is generally costly and inefficient. While the private sector emphasizes the use of the telephone, a significant portion of IRS collections resources are in field offices where personal visits are made.

Updating its computer systems is another challenge facing IRS. Modernized systems could provide IRS collectors with online access to the information they need when they need it. Modernized sys-

tems would also help provide the management information needed to evaluate the effectiveness of IRS collection tools, as well as the ability to adopt flexible and innovative collection approaches.

Moving now to the potential benefits of involving private collectors in Federal tax debt collection, we believe these entities offer the potential for improving IRS debt collection practices.

In May 1993 we recommended IRS test the use of private collectors to support its collection efforts. Many States use private collectors to supplement their own collection programs, thereby taking advantage of private sector capability in managing receivables, gaining access to better technology, or avoiding the expense of hiring permanent staff.

Last month as directed in its 1996 appropriations act, IRS issued a request for proposals from prospective participants in a pilot private debt collection program.

Under the pilot, the private collectors are to attempt to first locate and then contact delinquent taxpayers, remind them of their tax debt, and inform them of available alternatives to resolve the outstanding obligation.

An important limitation of the pilot is that the private collectors will not be able to actually collect the taxes owed. Rather, they will facilitate information exchange and contacts between IRS and the taxpayer.

During the pilot, the private collectors will face some of the same problems in working the pilot cases that IRS employees face.

First, these are not new cases. All will have already gone through much of IRS' collection process, and in some cases, the entire process.

This means in effect the debt may be 10 years old. The cases may also contain some of the other information problems we discussed earlier.

Regardless, the pilot could provide useful insight into the effectiveness of the techniques and technologies used by the private sector.

For example, the pilot calls for 40 percent of the cases to be those in which IRS has been unable to locate or contact the taxpayer.

The remaining 60 percent are cases in which IRS has successfully contacted the taxpayer but has been unsuccessful in securing payment.

To the extent that private collectors can locate, contact, and arrange payment for these cases, the techniques used may be helpful to IRS.

Other useful information could also be obtained on what collection actions are most productive based on the type of case, type of taxpayer, and age of the account.

Using the States experience as an indicator, IRS can expect some additional collections from its proposed pilot, but not necessarily a significant windfall.

In closing, Madam Chairman, IRS faces many challenges in its efforts to improve the management and collection of its accounts receivable.

The key is to find solutions to the underlying causes of the problems that affect IRS' ability to collect delinquent taxes. Solutions will take time because the problems are pervasive and may involve all IRS functions and processes.

As we have previously recommended, IRS needs to develop a detailed and comprehensive long-term plan to deal with the challenges it faces and their interrelationships.

With such a plan, IRS could better assure itself and Congress that it is on the right track.

Madam Chairman, that concludes my statement. I would be happy to answer any questions you may have.

[The prepared statement follows:]

**STATEMENT OF LYNDA D. WILLIS
DIRECTOR, TAX POLICY & ADMINISTRATION ISSUES
GENERAL ACCOUNTING DIVISION**

Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its review of the Internal Revenue Service's (IRS) tax debt collection practices. Every year IRS successfully collects over a trillion dollars in taxes owed the government, yet at the same time tens of billions more remain unpaid. As Congress works to balance the federal budget, these unpaid taxes become increasingly important, as do IRS' efforts to collect them.

While most taxpayers voluntarily pay their taxes on time, some are unable or unwilling to do so. It is this latter group whom IRS must deal with in its efforts to collect delinquent taxes. In doing so, IRS faces several significant challenges, including a lack of accurate and reliable information on either the makeup of its accounts receivable or the effectiveness of the collection tools it has at its disposal, as well as receivables that are often years old, out-of-date collection practices, and antiquated technology. It is these problems and challenges--and their results--that led us, the Office of Management and Budget (OMB), and IRS to recognize IRS' accounts receivable as a high-risk area. To address these challenges, significant changes are needed in the way IRS does business, but IRS cannot do it alone.

Recently, the IRS Commissioner has compared IRS to financial service organizations such as banks, credit card companies, and investment firms. Like these organizations, IRS processes data, maintains customer accounts, responds to account questions, and collects money owed. We agree with the Commissioner's functional comparison and believe that, while there are significant differences between IRS and these private sector businesses, IRS may benefit from using private collectors as a part of its portfolio of collection programs, and it is reasonable to assume that IRS could learn from their best practices as it works to resolve long-standing problems with its debt collection activities.

My testimony today, which is based on past reports and ongoing work, discusses the debt collection challenges facing IRS and the potential benefits of involving private parties in the collection of tax debts.

LONG-STANDING PROBLEMS CONTINUE
TO UNDERMINE THE EFFECTIVENESS
OF IRS COLLECTION PROGRAMS

A number of long-standing problems have complicated IRS' efforts to collect its accounts receivable. Of foremost concern is the lack of reliable and accurate information on the nature of the debt and the effectiveness of IRS collection tools.

Better Information Needed

Access to current and accurate information on tax debts is essential if IRS is to enhance the effectiveness of its collection tools and programs to optimize productivity, devise alternate collection strategies, and develop programs to help keep taxpayers from becoming delinquent in the first place.

Without reliable information on the accounts they are trying to collect and the taxpayers who owe the debts, IRS agents generally do not know whether they are resolving cases in the most efficient and effective manner, and may spend time pursuing invalid or unproductive cases. Of the approximately \$200 billion currently in the IRS accounts receivable inventory, IRS data shows that approximately \$63 billion represents taxes that, although they have been assessed, may not be valid receivables, but rather are "place markers" for compliance actions.

For example, under IRS procedures, when IRS' information return matching process identifies a taxpayer who received a Form W-2 but did not file a tax return, IRS creates a return for the

taxpayer. Generally, this is done using the standard deduction and single filing status, and often results in the taxpayer owing taxes. IRS then sends balance due notices to the taxpayer reflecting the amount of taxes owed as calculated by IRS--to encourage the taxpayer to file a return with the correct tax amount owed. If the taxpayer does not subsequently file the return, IRS records the amount it calculated as taxes due and generates a receivable. However, when contacted by IRS collection staff, the taxpayer may demonstrate that either no tax or a lesser amount of tax is actually owed. To more efficiently account for and collect money actually owed to the government, IRS would have to be able to differentiate these IRS-calculated accounts from those where there is an acknowledged balance due.

In addition, IRS does not have reliable data on the effectiveness of its collection activities and programs. Consequently, it is unable to target its efforts specifically to the taxpayer and tax debt in question. IRS is currently trying to capture this data on its Enforcement Revenue Information System (ERIS) and other computerized systems. However, IRS has noted in the past that there are questions regarding the accuracy of the data produced by these systems.

Age and Nature of Tax Debts

The age of the debts in IRS' accounts receivable inventory is also problematic. IRS' inventory of tax debt includes delinquent debts that may be up to 10 years old. This is because there is a 10-year statutory collection period, and IRS generally does not write off uncollectible delinquencies until this time period has expired. As a result, the receivables inventory includes old accounts that may be impossible to collect because the taxpayers cannot be located, or are deceased, or the corporations are defunct.

Of the over \$200 billion total receivables inventory as of September 30, 1995, IRS data show that about \$38 billion was owed by either deceased taxpayers or defunct corporations. Out of a total of 460 accounts receivable cases that we reviewed in our audit of IRS' 1995 financial statements, IRS identified 258 as currently not collectible; 198 of these cases represented defunct corporations, while the remaining 60 cases represented entities that either could not pay or could not be located. These cases represented \$12 billion of the \$26 billion included in accounts greater than \$10 million.

The age of the receivable does not reflect the additional time it took for IRS to actually assess the taxes in the first place. Enforcement tools, such as IRS' matching programs and tax examinations, may take up to 5 years from the date the tax return is due until IRS finally assesses the additional taxes. This reduces the likelihood that the outstanding amounts will be collected.

The age factor significantly affects the collectibility of the debt because, as both private and public sector collectors have attested, the older the debt, the more problematic collection becomes. Because of these and other factors, IRS considers many of the accounts in the inventory to be uncollectible. Specifically, IRS has estimated that only about \$46 billion of the \$200 billion inventory of tax debt as of September 30, 1995, was collectible.

Another factor relating to the collectibility of tax debts owed by individuals is source of income. Taxpayers earning their income from nonwage sources, such as pensions, self-employment, and investments, are more likely to be delinquent in paying their taxes than wage earners who have taxes withheld from their wages. Taxpayers with nonwage income are required to calculate their projected income and make estimated tax payments to IRS during

the year. According to IRS data, the average tax delinquency for taxpayers with primarily nonwage income was about 4 times greater than that for wage earners--\$15,800 versus \$3,600. IRS data also show that, at the end of fiscal year 1995, about \$75 billion, or 74 percent of the \$101 billion in IRS' inventory of tax debts owed by individuals, was owed by taxpayers whose income was primarily nonwage.

Out-Of-Date Collection Processes

IRS' collection process was introduced several decades ago, and although some changes have been made, the process generally is costly and inefficient. The three-stage collection process--computer-generated notices and bills, telephone calls, and personal visits by collection employees--generally takes longer and is more costly than collection processes in the private sector.

While the private sector emphasizes the use of telephone collection calls, a significant portion of IRS' collection resources is allocated to field offices where personal visits are made by revenue officers. IRS has initiated programs and made procedural changes to speed up its collection process, but historically it has been reluctant to reallocate resources from the field to the earlier, more productive collection activities. IRS' fiscal year 1997 budget request states that, although "these [revenue officer] positions still comprise the lion's share of IRS' enforcement efforts, they also represent on the margin the least efficient use of IRS resources." Due to budget cuts, however, IRS is in the process of temporarily reassigning about 200 field staff to telephone collection sites to replace temporary employees who were terminated.

Antiquated Computer Systems

Upgrading its computer systems is another challenge facing IRS. IRS is in the midst of a massive long-term modernization effort--Tax Systems Modernization (TSM)--that if successful would, among other things, help IRS to better collect tax debts by providing its collectors with on-line access to information they need, when they need it. Modernized systems would also help provide the management information needed to evaluate the effectiveness of collection tools and the ability to adopt flexible and innovative collection approaches. Existing IRS computer systems do not provide ready access to needed information and, consequently, do not adequately support modern work processes.

Although TSM is not expected to be completed any time in the near future, IRS has started to automate some collection activities. For example, IRS is currently developing an automated inventory delivery system that is intended to direct accounts, based on internally developed criteria, to the particular collection stage where they can be processed most efficiently and expeditiously. This system, which IRS plans to test in July 1996, is intended to move accounts through the collection process faster and cheaper than under the current system.

Another effort under way involves the automation of certain field collection tasks. These tasks, like many in IRS, have for years involved the manual processing of paper, which has resulted in IRS field collection employees spending significant amounts of time on routine administrative duties. The Integrated Collection System (ICS) is a computer-based information system that is intended to automate some of the labor-intensive tasks performed by field revenue officers. While this effort is not a major technological advancement, it will be a step toward helping IRS employees be more productive by spending their time on more effective and efficient collection-related activities. Basic automation is a given in today's business environment, and if IRS

is to operate like a private-sector business as it says, systems that automate basic work processes are a must.

According to IRS, implementing this system in two pilot districts has resulted in increased collections, faster case closings, and less time spent on each case. IRS employees using the system were also very supportive of it and enthusiastic about its benefits. The system is currently operating in six districts, and IRS plans to roll it out in three additional districts this year. According to IRS, further implementation is dependent on future funding and final measurements of productivity.

POTENTIAL BENEFITS FROM
INVOLVING THE PRIVATE SECTOR
IN TAX DEBT COLLECTION

Many private and governmental entities are involved in debt collection. We believe that these entities offer the potential for improving IRS debt collection practices. For example, as is being tried currently, there may be a role for private debt collectors in collecting federal tax debt.

Potential Benefits of Using
Private Debt Collectors

In response to concern about the persistent nature of IRS' accounts receivable problems, IRS' fiscal year 1996 appropriations legislation contained provisions that earmarked \$13 million for a pilot program to test the use of private law firms and debt collection agencies to help collect delinquent tax debts.

In May 1993, we recommended that IRS test the use of private debt collectors to support its collection efforts.¹ IRS had looked into testing the use of private collectors as early as 1991, but had not carried through with any of its plans.

IRS issued a request for proposals from prospective participants in the pilot program on March 5, 1996. The proposals were due by April 12, 1996, and the pilot is to last 1 year. Under the pilot, the private collectors are to attempt to first locate and then contact delinquent taxpayers,² remind them of their tax debt, and inform them of available alternatives to resolve the outstanding obligation.

An important limitation of the pilot is that the private collectors will not be able to actually collect the taxes owed; rather, the intent is for them to facilitate information exchange and contacts between IRS and the taxpayer. There is an OMB policy determination and IRS Office of Chief Counsel guidance that specify that the collection of taxes is an inherently governmental function that must be performed by government employees. Private collectors, however, can perform collection-related activities, such as locating taxpayers and attempting to secure promises to pay.

In addition, the private collectors will face some of the same problems in working the pilot cases that IRS employees face. First, these are not new cases. All will have already gone through much of IRS' collection process, and in some cases, the entire process. This means, in effect, that some of the cases may have been in the accounts receivable inventory for up to 10 years, and some may involve even earlier tax years. The cases

¹Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993).

²Face-to-face contacts are not allowed.

may also contain some of the other information problems we discussed previously.

The pilot could provide useful insight into the effectiveness of the techniques and technologies used by the private sector in collecting older accounts. For example, the pilot calls for 40 percent of the cases to be those in which IRS has been unable to locate or contact the taxpayer. The remaining 60 percent are cases in which IRS has successfully contacted the taxpayer, but has been unsuccessful in securing payment. To the extent that the private collectors can locate, contact, and arrange for payment on these cases, the techniques used may be helpful to IRS in its efforts to improve its collection programs. The private collectors will be bound by the same taxpayer-rights and disclosure considerations as apply to IRS employees.

Other useful information could also be obtained from the pilot. For example, IRS could learn what actions are most productive based on the type of case, type of taxpayer, and age of the account. For the information to be useful to IRS and Congress in evaluating the pilot, however, the sample of cases must be drawn and the data captured in such a way that the appropriate analyses and tests can be done. We have not analyzed IRS' methodologies for selecting its sample of cases or for evaluating the pilot.

Industry Best Practices May Be Helpful to IRS

IRS faces many challenges in its efforts to improve the management and collection of its accounts receivable. The key is to find solutions to the major problems we previously discussed and their underlying causes that affect IRS' ability to collect more delinquent taxes. Solutions will take time because the problems are pervasive and may involve all IRS functions and processes.

Currently, IRS is making some changes to its collection process as a part of its modernization effort. We reported in the past that private collectors and states that are engaged in collection activities similar to IRS' may provide some best-practice examples for IRS to use in benchmarking its efforts.

Many states use private collectors to supplement their own collection programs, thereby taking advantage of private sector capability in managing receivables, gaining access to better technology, or avoiding the expense of hiring permanent staff. Although many states--including 33 of the 43 states that responded to our survey--have used private collectors, their experiences have varied widely.³

A majority of the states that responded to our survey used private collectors to collect delinquent individual income taxes owed by taxpayers residing outside their borders. Of the 28 states responding, 14 said that private collectors were effective in collecting individual income taxes. Regarding other types of taxes, the 12 states expressing an opinion were about evenly split on the effectiveness of private collectors. Using these states' experiences as an indicator, IRS could expect some additional collections from its proposed pilot, but not necessarily a significant windfall. IRS may, however, benefit and learn from the private companies' collection techniques and use of technology.

NEXT STEPS

³Because all states did not respond to all of our survey questions, our analysis is not necessarily representative of experiences in all states.

IRS faces significant challenges in collecting tax debts. As we have previously recommended, because the problems are pervasive across all IRS activities and processes, IRS needs to develop a detailed and comprehensive long-term plan to deal with the major challenges it faces and their interrelationships.⁴ With such a plan, IRS could better assure itself and Congress that it is on the right track and thereby better position itself to obtain the backing and support it needs.

Key to improving IRS' collections of tax debt is the need for up-to-date and accurate information as well as modern equipment and technology. IRS also needs to determine the most cost-effective ways to prevent delinquencies from occurring, as well as what it can do in its return, payment, and compliance processes to reduce the number of invalid accounts entering the collection process. To stay competitive in today's business environment, IRS must continually strive to improve collections by testing new and innovative approaches.

Madam Chairman, this concludes my prepared statement. I would be pleased to answer any questions.

⁴High-Risk Series: Internal Revenue Service Receivables (GAO/HR-95-6, February 1995).

Chairman JOHNSON. Thank you, Ms. Willis.

Can the IRS not tell us at this time of their delinquent taxpayers, how many have been delinquent for 10 years, 9 years, 8 years, 7 years, 2 years?

Ms. WILLIS. IRS can age the inventory of debt, but it is my understanding that in terms of being able to identify and tell you for specific cases, how old they are in the aggregate, they cannot do that.

Chairman JOHNSON. So they cannot bring up a list of cases that are 3 years old, by taxpayer?

Ms. WILLIS. I do not believe so.

Chairman JOHNSON. That is interesting.

If you were to restructure the presentation of what the uncollectible taxes are in America, would you change the way we do it now?

Do you think there is a case to be made for more clearly identifying tax debt—that is literally, by anyone's standards, uncollectible?

Ms. WILLIS. Yes, Madam Chairman, we do, and that is one of the issues that we get into in our audit of IRS' financial statements, that we think they need to do a better job of segregating out the various components of the debt, so that the Congress and the American public know exactly what is the makeup of the inventory and what parts of it are truly collectible.

Chairman JOHNSON. Would it be helpful if we changed the law, so that that kind of debt could be identified, would have to meet certain standards, and once it met those standards was put into some other category than uncollected taxes?

Ms. WILLIS. I am not sure how much the law would need to be changed at this point. I think there is an open question on the 10-year rule in terms of how long IRS does, indeed, have to retain that in its inventory, that they have indicated they are going to be looking at.

But I think, without question, we need to do a better job of segregating out what is collectible, what is not collectible, what is a financial receivable, what is a compliance place marker, as I call them in my testimony. And what that will allow us to do is not only better understand what moneys we have, that we can hope to collect, but also better target our efforts to the individual taxpayer and the individual account, which we do not do very well right now.

Chairman JOHNSON. Does the IRS have at its fingertips the number of delinquent taxpayers by region of the Nation? By State?

Ms. WILLIS. Yes, with some variability in terms of whether the taxpayer has a business in one location and lives in another location. Yes.

Chairman JOHNSON. When I suggest taking some of the uncollectible debt off the delinquent tax books, I see a great nervousness develop in those who I have talked to about this idea.

It seems to me, if we do not take it off, we at least need to have a separate account and name we put on it, because it is truly disturbing to have in the category of uncollected taxes, tax liabilities that we, as a government, negotiated with institutions to not collect, to consider as off the boards, and have used that to get people to carry on, take on difficult problems, solve difficult problems in

our society, and move ahead to put themselves in the position of being tax paying constituents.

So I would be very interested in your thoughts, in some kind of written proposal to us, about what kinds of known liabilities are in the collectible category now or reported as uncollected taxes now.

And how we would get them off the books. I do think we would need a statutory definition of a new category, and some criteria about what it takes to get in that category, or to just wipe them off the books.

The discomfort I have noted is a discomfort with wiping certain liabilities off the books. I think when the government has negotiated a liability away, that liability ought to be gone from the books as well.

There are some other liabilities in here that, for instance, with defunct businesses, where the principals might sometime be in a position to repay some of that debt, and perhaps you would not want to just wipe that off the books.

But I would like some help in rethinking how we report this material, and therefore, how we focus IRS activities and hold them more accountable.

Ms. WILLIS. Madam Chairman, we would be happy to work with you on that. I think there is going to be a continuum of categories we are going to look at, and a critical part of this is disclosure in terms of what is in that category and its probability of being collected, as you say, whether we have already given up on it, whether we have negotiated a different outcome, so that we understand what is in the inventory, and have a more realistic expectation in terms of what we can collect and what tools we need to be able to collect that debt.

Chairman JOHNSON. I think if we go through this exercise now, as part of this effort to work with Mr. Horn on the legislative initiative that needs to move forward, it is not just Mr. Horn who is interested in this. It is the administration, too.

Ms. WILLIS. Absolutely.

Chairman JOHNSON. A bipartisan effort. That we might also end up needing to provide some resources to the IRS to research certain categories of cases they have now, in order to be clear on exactly what is this problem, and to set up a system whereby in the future delinquent debt would be more accurately, labeled and managed, thereby diminishing the overall problem.

Ms. WILLIS. I also think we would probably want to do outreach to people in the private sector who do debt collection, who categorize accounts, and so forth, to learn from their best practices.

I think they can provide us with a lot of insights into ways of doing business differently than the government has traditionally done so we can learn.

Chairman JOHNSON. Thank you.

Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairman.

Given the fact that there is an RFP out now by the Service to look at 125,000 returns, and obviously by, I believe it was Mr. Donelson, said by the fourth quarter of 1997 he should have these

results, does it make sense for us to pass legislation now, suggesting contracting out the collection?

Or is this something we should perhaps hold more hearings on, discuss, meet with you, and work with the agencies to see if we can put something together?

I am a little concerned, if we are talking legislatively now, we may be moving a little quicker than we really should be, given the fact that we do have a pilot program out there.

Could you respond to that, and what your thoughts and recommendations might be on this.

Ms. WILLIS. Congressman, there are a lot of unresolved issues regarding the use of private debt collectors for the collection of Federal tax debt, a lot of which we have discussed here this morning.

GAO recommended in 1993 that we test the use of collectors, and I think testing the use of them is the first step that we need to make.

At the same time we are testing, I think there are other issues we need to study more and look more closely at, possibly before legislation is enacted.

I think one of the questions is the whole question of what is inherently governmental, and whether we need to address that in the process.

What we are going to do about taxpayer rights. There is a legitimate tension between taxpayer rights and the collection of Federal tax debt. But it is a tension that needs to be addressed in the policy arena in terms of the conditions that we place upon the collection of private debt, and the ways that we use private collectors in collecting tax debt.

Mr. MATSUI. I appreciate what you said. I think you seem to have hit it right on the nose in terms of what is a proper governmental function and what is a function that can be delegated to the private sector.

I know the States are doing it. Is California one of the States that contract out?

Ms. WILLIS. I believe they are.

Mr. MATSUI. I think I read that some place. I guess we need to, first of all, ask ourselves that question as we are doing these other things as well.

I appreciated your report, which I have not had a chance to read in a great deal of detail, but the need for the Service to try to come up with some long-term goals and get proper data is critical, I guess, to this entire discussion.

I know it was last year when Commissioner Richardson was before us, and she was discussing some of the steps that needed to be taken, but, you know, bringing a 1920 system into the 21st century, and obviously it is going to take resource, and the whole computer issue and modernization is a very difficult one, and somehow we have to come to grips with it.

I appreciate this. You had one final comment?

Ms. WILLIS. I would just like to say that in a number of cases, the answer to our accounts receivable problems may not rest in the collections function. As I stated earlier, the time it takes to assess the tax debt is a problem in and of itself, and we need to look at this as a part of the entire tax administration system.

As I stated about looking to private entities or lessons learned for best practices, I would highly recommend IRS and Congress also look to the States as we are doing here today.

We do a lot of work looking at State tax administration and there are a lot of fine examples out there of good programs the Federal Government can learn from.

We think reaching out to those people and learning from our tax administration peers will make this whole process easier.

I am sure a number of the States have dealt with the issue of taxpayer rights versus collection performance standards, that they could give us the insights of their experience there, and I do not think we would want to lose that empirical evidence as we go through this process.

Mr. MATSUI. Thank you.

Chairman JOHNSON. Thank you.

Mr. Portman.

Mr. PORTMAN. Just briefly, Ms. Willis. Thank you for your testimony again. It is always good to have you before our Subcommittee, and I guess I have two questions, following on your last statement.

I agree with you we need to look at the States, we need to look at the private sector.

One area that I wonder if you have looked into in the private sector is how collection agencies are successful in the private sector and how that might be applied to using private companies more in our collection efforts on the IRS side. Have you taken a look at that?

Ms. WILLIS. We did a report early in the nineties, I believe 1993, when we looked at different debt collection practices and potential lessons learned for the Federal Government, and we think there are some things there, including the private sector's ability to access newer technology, newer innovative approaches to debt collection.

It was a start. I think there is more work that needs to be done in this area, in terms of looking at what we can learn from the best practices.

Mr. PORTMAN. But from that you believe the IRS' own collection efforts from getting the private entity involvement could be improved, based on what you have seen in the private sector?

Ms. WILLIS. Yes.

Mr. PORTMAN. The second question is just a more general one.

Again, did you spend any time—and I know you are focused on the tax area—but looking at the private collection efforts in other parts of government?

One example would be the Department of Education, student loans, and I know there are other examples where the Federal Government as well as State governments have used private entities successfully in the collection of debt.

Have you spent any time looking at that?

Ms. WILLIS. No, Mr. Portman, we have not in our group.

Mr. PORTMAN. Has anybody else at GAO looked at that, to your knowledge?

Ms. WILLIS. The justice issue area has looked at the use of private debt collectors in nontax debt, and the pilot that was in the

early nineties, I believe, and I could certainly have them contact you to discuss what they found in terms of nontax debt.

Mr. PORTMAN. I would be interested. I know the other Committee of jurisdiction has some thoughts on that but it would be interesting to get a GAO perspective on it.

And finally, I would just say I hope you will follow the pilot program carefully, and that in 1997, we will have your independent analysis of that program as well.

Ms. WILLIS. We have already been in touch with the Subcommittee staff about doing that, and I assure you we will.

Mr. PORTMAN. Great.

Chairman JOHNSON. Thank you very much, Ms. Willis.

Ms. WILLIS. Thank you.

Chairman JOHNSON. We appreciate your being with us this morning.

The next panel are a number of commissioners from some of our States.

It is my pleasure to welcome Gene Gavin who is the commissioner from the Connecticut Department of Revenue Services, and has provided that department with really extraordinarily refreshing and effective leadership.

Tom Hoatlin, the commissioner of Revenue from the Michigan Bureau of Revenue. Gerald Goldberg, the executive director of the California Franchise Tax Board. Harley Duncan, the executive director of the Federation of Tax Administrators.

Thank you for being with us this morning.

Mr. Matsui.

Mr. MATSUI. I would just like to welcome all of the commissioners, but particularly Mr. Goldberg, who is a longtime friend, and somebody that I have worked very closely with, and borrowed his expertise over the years. Welcome to you, Mr. Goldberg, and all of you.

Mr. GOLDBERG. Thank you very much.

Chairman JOHNSON. It is a pleasure to have you here. As so often happens, States experiment more aggressively than the Federal Government really has the right to, and your experience will be very helpful to us as we move forward on this issue.

Mr. Gavin.

STATEMENT OF GENE GAVIN, COMMISSIONER OF REVENUE SERVICES, STATE OF CONNECTICUT, DEPARTMENT OF REVENUE SERVICES

Mr. GAVIN. Good morning, Madam Chairman, Congressman Matsui, and Members of the Subcommittee.

It is an honor for me to have this opportunity to provide testimony in support of H.R. 757 and also to describe, briefly, Connecticut's experience related to tax debt collection.

According to a recent nationwide survey, the number one priority of legitimate, honest taxpayers across the country is to get tax cheats and tax deadbeats onto the tax rolls.

Honest taxpayers know they are shouldering an unfair burden for those who are evading the tax system. And honest taxpayers are angry, with good reason.

In Connecticut, we are very serious about leveling the playingfield for all taxpayers, and that is why we see H.R. 757 as an essential tool to reach our goal of increasing voluntary compliance.

H.R. 757 could benefit all taxpayers. It closes loopholes in the tax systems that allow some taxpayers to skirt the laws. It benefits every State with an income tax by bringing in much-needed revenues that are due the State by law.

It is a cost-effective and efficient way of recovering tax moneys due the State when all other efforts to resolve tax debts are exhausted.

H.R. 757 provides a quid pro quo. It reciprocates the program of State offsets for Federal tax debts and can be expected to bring the remaining nonparticipating States into that same arrangement, thus boosting Federal revenues, annually, by \$8 to \$9 million a year.

I remind you that from the 25 States participating in 1994, nearly \$75 million, and that from the 32 States participating in 1995, nearly \$82 million was brought into the Federal tax coffers.

H.R. 757 is a logical next step in the efforts of the IRS and State tax administration agencies to foster cooperative strategies for greater tax compliance on all levels.

Connecticut has found that offset programs work well within our own State to assure that outside State vendors are current with all tax liabilities, and to assist other State agencies in collecting funds owed. The IRS offset program in Connecticut has come online only recently, and yet in the 2-week period that it has been in existence in Connecticut, Connecticut has already collected \$208,000 on behalf of the Federal Government.

H.R. 757 is framed carefully so that every taxpayer is protected. The offset cannot be made until the State tax agency has exhausted its collection process. After the offset has been made, the taxpayer has the right to appeal the action.

Both State and Federal legislation relating to confidentiality and taxpayer rights assure the States use of offsets cannot be abused.

As a taxpayer myself, I want to see tax deadbeats pay their fair share. No one likes to pay taxes. As commissioner of Revenue Services, I get no discount on taxes in Connecticut. But I abide by the laws that govern every person. I pay my taxes and I have more respect for a government that upholds its laws fairly and conscientiously.

In Connecticut, we give tax compliance and enforcement activities a very high priority and while we are a relatively small State, we think we can be a good example to everyone in the Nation, including the Federal Government.

The three essential elements of our compliance and enforcement program are, number one, a comprehensive internal strategy that focuses on efficient and effective use of personnel and technology.

This alone brings much of the tax revenues due the State with fair and evenhanded treatment of tax debtors, at a cost of about 6 cents per dollar.

Number two, a well-planned program of referring tax debt collection to private collection agencies for those tax bills that we have been unable to collect using our own system.

While the costs of this operation average 20 cents per dollar of tax revenue realized, these are the cases where each dollar brought in represents a much higher dedication of resources.

Number three, a carefully planned and timed tax amnesty program to bring in sizeable tax debt revenues that are due and owing the State, and to communicate to honest taxpayers and tax deadbeats alike, that we are taking a tough stand on compliance and will enforce the laws at the highest level possible.

Every dollar we brought into Connecticut's coffers during amnesty, over \$44 million, cost us only 2 cents. Amnesty can answer some of the most pressing budgetary problems of governments, and a Federal amnesty could expect to yield over \$100 billion.

That would certainly help close the Federal budget gap. Amazingly enough, the oldest debt that came in under the 1995 amnesty in Connecticut was one from 1973, 22 years old.

The biggest criticism that has been heard from some State and Federal tax administrators about tax amnesty programs is that honest taxpayers view it as unfair.

But if amnesty is coupled with the message that all tax and all interest is collected, only penalties are abated, that the tax laws will be enforced, that it is a cost-effective and cost-efficient means to put tax evaders on the tax rolls, that it is an opportunity for tax debtors to pay up and start a clean record, then honest taxpayers have overwhelmingly supported it.

That is what I am hearing, even 5 months after our amnesty program ended. As I close, I want to say one more thing.

Much time is being spent in the debate over lowering taxes or raising taxes. I personally and deeply believe, the real question each of us in government as well as every taxpayer should be asking is, Are we doing our very best to properly collect the taxes that are due and owing?

I submit that the answer may be no, and that H.R. 757, and improvements in tax debt collection methods and strategies could well be that answer.

Thank you very much.

[The prepared statement and attachments follow:]

**Testimony of
Gene Gavin
Commissioner of Revenue Services
State of Connecticut
before the
Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives**

Madame Chairwoman and Members of the Subcommittee:

It is an honor for me to have this opportunity to provide testimony to you describing Connecticut's strong support for H.R. 757 as well as our state's experiences related to tax debt collection, particularly as they might be applicable to Federal tax debt collection.

Connecticut, though a relatively small state with a population of 3.3 million, is a microcosm of the nation at large. I point to its broad spectrum of taxes, diversity of population and commerce, its pool of highly trained talent in state administration and strong leadership in state government. I believe that the experience and successful record of Connecticut in its administration of tax collection and compliance can be applied to the much larger scale of the Federal government.

Today, I would specifically like to urge this Subcommittee to recommend strongly the approval of H.R. 757, legislation that would establish a Federal offset program for legally enforceable past due state tax obligations. This legislation would be especially beneficial to participating states by reciprocating the offset programs they currently provide the Federal government for collection of Federal tax debts. Important also is the opportunity for the Federal government to increase its own annual tax debt collections by participation of all the states in the Federal offset program.

First introduced in 1994 with the bipartisan support of 20 cosponsors, H.R. 757 has been reintroduced for this Congress to take action. At no time during the past two years has any opposition been voiced from any Federal official or organization. Connecticut is one of the 32 states and District of Columbia that provide Federal offsets from its state personal income tax refunds. There are 9 income tax states that are not currently participating, but these could be expected to join the offset program if reciprocity were adopted.

Currently, the Federal government may levy on — essentially seize — state income tax refunds to satisfy delinquent Federal tax debts. In those jurisdictions where agreements have been made between the states and IRS, the process is satisfied through the states' own offset programs. States generally do not ask to be compensated by the Federal government for these offsets.

In 1995 alone, states collected \$81.68 million for the Federal government through their refund offset programs. Projections indicate that the Federal government would increase this amount by \$8 to \$9 million annually by participation of the nine states not currently participating. The revenues that states would receive in the early years of this program could be \$150 to \$200 million, an amount that would provide significant tax relief at a time when the states are experiencing budgetary pressures.

H.R. 757 contains all the necessary components to safeguard the Federal government, the states, and the taxpayers:

- it requires the states to notify taxpayers of their obligation and exhaust such other collection measures available prior to referral to the IRS;
- it requires that state tax debts not be satisfied from an offset until all Federal tax debts, past due child support and debts due other Federal agencies are satisfied;
- it authorizes the Secretary of the Treasury to charge the states for the offsets; and

- it amends IRC §6103 to permit the distribution of information regarding offsets to state tax agencies, when necessary.

This measure is of critical importance to the states, particularly as we struggle to improve our services to our citizens and hold the line on taxes. It is also one more way we, who administer the tax statutes, can demonstrate to honest taxpayers that we will pursue tax deadbeats using every avenue available to us.

I have also been asked to describe for you Connecticut's experience with other measures it uses to enhance tax revenue collection.

Connecticut maintains an aggressive revenue collection position. Based on the premise of fairness to honest taxpayers, we also adhere very strictly to Connecticut General Statute §12-39n, The Taxpayer's Bill of Rights (see Attachment A), whose purpose is "...to guarantee that the rights, privacy and property of Connecticut taxpayers are adequately safeguarded and protected during tax assessment, collection and enforcement processes administered under revenue laws of this state."

Three key revenue collection programs have been the focus of the Connecticut Department of Revenue Services ("DRS") in recent years: agency collection and enforcement activities, outsourced collection services and tax amnesty programs.

The Collection & Enforcement ("C & E") Division of the DRS is responsible for the collection of overdue taxes and the enforcement of the state's tax statutes and regulations for those who fail to voluntarily comply. The C & E Division annually manages approximately \$375 million of available accounts receivable, experiences an accounts receivable turnover rate of 73%, case turnover of 60% and maintains an average aged receivable of less than 300 days. The average monthly value of the receivable file is \$101 million, representing approximately 85,000 overdue accounts.

The C & E Division's staffing (approximately 105 employees) has not changed since the passage of a state personal income tax in 1991. Primarily as a direct result of the new personal income tax, which raises approximately \$2.5 billion annually, the C & E Division has experienced a related 30 to 40 percent growth in its collection portfolio. To meet the challenge of this growth while maintaining a zero growth rate in staff, C & E Division management has been creative in the use of personnel resources, new technologies and outsourcing. Internally, development of an automated collection system (see Attachment B-1) and installation of an automated dialing system (see Attachment B-2) have enabled us to increase contacts with overdue tax debtors by 25%. In addition, outsourcing, a direct DRS initiative, also provided for added efficiencies during the 1994-95 fiscal year.

After careful study, C & E Division management had determined that it should utilize independent or private collection agencies to assist in the collection of *out-of-state personal income tax debts only*. However, recognizing that C & E Division staff resources were stretched to the limit and could be better utilized to pursue large recurring business debts and high risk collections, the role of private collection agencies was expanded. Presently, all cases related to personal income tax debts, both in and out of state, are candidates for referral. Using its automated collection management system, the C & E Division prescreens and evaluates accounts for referral to collection agencies based on certain threshold system settings. Periodic adjustments are made to the threshold settings based on the C & E Division's work flow and relative ease to collect.

Prior to a case being assigned to a private collection agency, it follows a route through our internal system that entails a series of collection letters and phone contacts. When it is determined that we will not be able to collect the tax debt through our usual methods (bills, levy notices or tax warrants), it is referred to an outside agency. During the first full year of outsourcing (1994-1995 fiscal year), 3,550 accounts with an associated value of \$2.04 million were referred to independent collection agencies. Of these referrals, \$327,000 was collected and 484 (13.6 percent of the cases referred) cases were resolved. Based on our first year's experience with outsourcing collections and the general difficulty of cases referred, DRS was pleased with these results. As discussed below, our record was even more successful in the second year of outsourcing, which is still underway.

Thresholds for collection agency referrals are continually reviewed and revised to accommodate the elasticity of our portfolio. Connecticut's growth of its receivable file during

the past three years is directly attributed to the initiation of a state personal income tax in 1991, as mentioned above, and the general economic decline in the Northeast. During fiscal 1995-96, we have already referred to collection agencies 11,900 accounts with a value of \$9.2 million. To date, approximately \$1.4 million (about 15 percent of the value referred) has been credited and 3,300 cases (about 28 percent of the cases referred) were closed. Customer service-related problems, skip tracing and/or legal action which must be performed on these accounts are handled by DRS.

The C & E Division currently has a budget of \$180,000 for outsourced collection services. Contracts are written with individual vendors who are awarded contracts based on the state's bidding process. Currently, all revenues collected by these outside vendor collection agencies are remitted to the Department and the vendors submit bills for their services that are contracted at 15 to 23 percent of gross revenues collected.

Based upon the early success of the program, expansion of outsourcing for Connecticut's tax debt collection is continuously being evaluated. Currently, 10 percent of our case file, or 8,600 accounts, has been assigned to private collection agencies. The cost per dollar of revenue realized from outsourcing, at an average of \$20 per dollar, compares to our C & E Division's average cost of collection of \$.06.

Tax amnesty programs, by their definition, are limited in use. However, Connecticut's two such programs have proven to be highly successful supporting the state's tax debt collection strategy. Connecticut and 34 other states have raised well over \$1.5 billion in additional revenues by using amnesty (e.g., penalty waiver and promise of no civil or criminal prosecution) as the incentive. Connecticut alone, a relatively small state, has collected over \$100 million in back taxes during two amnesty programs, held five years apart. We have found that economic incentives sometimes produce better results than threats of enforcement actions. Private business has long recognized this principle.

Amnesty can offer dramatic results by turning the tax agency's accounts receivable file into cash and in adding new taxpayers to the rolls. Connecticut's experience is that in each of the amnesty programs, approximately 52 percent of the filers seeking amnesty were already known to us. While the argument has been made that these accounts would eventually be recovered, it is important to realize that minimal resources were expended to bring those revenues in during amnesty.

Amnesty also provides a cost efficient alternative to traditional collection procedures. Our own state's most recent amnesty program resulted in over \$44 million in revenues, of which \$19.6 million were accounts receivable known to our agency. If we had used other collection procedures available to us to bring in those same dollars, the C & E Division would have had to expend close to 58,500 staff hours and a conservative minimum expenditure for personnel alone of \$906,000. While it would be virtually impossible for any agency to deploy the resources to accomplish this level of collection in three months, the successful marketing and advertising of an amnesty program leverages available dollars with substantial benefits.

Our experience has been that honest taxpayers want tax cheats to be found and placed on the tax rolls. Honest taxpayers know they are subsidizing the tax deadbeats and they are becoming more angry and increasingly vocal about it. Amnesty brings in both tax debtors known and unknown to the tax agency, as well as those who have underreported tax liabilities. With those taxpayers being identified, and the accounts receivable portfolio being turned over faster, collection efforts can be focused more intensively on the more difficult and complex cases.

Because of the short term nature of amnesty programs, costs can be closely controlled. During Connecticut's 1995 Amnesty, no additional personnel were added and existing resources were redeployed to its support. Each dollar realized cost Connecticut \$.02 to raise — a sure win for all citizens in the state.

Amnesty programs work best when they are integrated with effective programs to improve voluntary compliance and enforcement. The long term results are expanded taxpayer rolls, increased turnover of the inventory of accounts receivable and a higher overall level of voluntary compliance.

The implications are overwhelmingly in favor of a Federal tax amnesty at this time. A poor Federal tax compliance rate has become recognized as fact. The collection gap has been

growing at astronomical rates over the past five years. The General Accounting Office ("GAO") has published data that demonstrates that the gross inventory of Federal tax debt — (i.e., monies known to be owed by specific tax delinquents, but not collected) grew from \$87 billion to \$156 billion — about 80 percent — between 1990 and 1994. At the same time, the IRS annual collection of delinquent taxes has declined from \$25.5 billion to \$23.5 billion — about an 8 percent decrease — since 1990. (see Attachment C — *Federal Tax Amnesty - Budget Gridlock Buster*, by Gene Gavin)

Lack of enforcement of tax laws at the Federal level has become common knowledge (see Attachment D — "Millions fail to file taxes," by Ralph Vartabedian, *Los Angeles Times* (copyright), April 14, 1996). Failing to file Federal income taxes is endemic across all income levels. By its own accounting, the IRS acknowledges that over 300 attorneys in New York City alone failed to file Federal income tax returns. And it estimates conservatively that at least 6.5 million Americans are nonfilers. Yet the IRS has consistently failed to acknowledge its endemic problems. Despite data from GAO to the contrary, the IRS maintains the same stance in 1996 as it did in 1990, that its enforcement is effective and its methods are the best ones available (see Attachment E — correspondence to Commissioner Gene Gavin from U.S. Treasury Office, Lowell Dworin, Director, Office of Tax Analysis, dated March 29, 1996).

Clearly, there is need to take strong corrective action on reducing the Federal collection gap. The IRS has been given funding to develop a comprehensive and aggressive compliance and enforcement program called "Compliance 2000." The timing for a Federal amnesty could not be better. The potential for raising over \$125 billion from accounts receivable files and the millions of nonfilers and underreporters of Federal taxes is very real. A one-time Federal amnesty would bring us a long way toward reducing the budget gap that is on everyone's minds, holding the line on taxes while maintaining the social service support that is being demanded and contributing to lowering the national debt (see Attachment F — "Tax amnesty and the federal budget", Editorial, *The Advocate*, January 23, 1996).

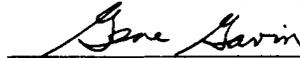
In closing, I would like to make the following points relative to cost effective and cost efficient tax administration. At every level of government, we are spending considerable time in debate over whether to lower taxes or raise taxes. I firmly believe that the real question each of us should be asking is, "are we collecting taxes that are due and owing properly?"

And I further contend that if we are doing everything in our power to collect the taxes properly, we can hold the line on taxes — yes, we can even reduce taxes, when all taxpayers are paying their fair share.

Therefore, I urge you to give consideration to developing opportunities to bring in all tax delinquents, at all levels, through a carefully framed plan of a Federal amnesty, followed closely by stepped up enforcement of the tax laws at all levels, and the use of private collection services when deemed appropriate for effective and efficient collections portfolio management.

Further, I recommend that you reciprocate the service that the states provide the Federal government through their refund offset programs by taking immediate actions that will assure passage of H.R. 757.

This concludes my formal statement. Thank you for the honor of speaking to you today. I will be happy to answer any questions.



Gene Gavin
Commissioner of Revenue Services
State of Connecticut

ATTACHMENTS

ATTACHMENT A

Sec. 12-39n. Taxpayer's Bill of Rights. There is created a Connecticut Taxpayer's Bill of Rights to guarantee that the rights, privacy, and property of Connecticut taxpayers are adequately safeguarded and protected during tax assessment, collection and enforcement processes administered under the revenue laws of this state. The rights afforded taxpayers to assure that their privacy and property are safeguarded and protected during tax assessment and collection are available only insofar as they are implemented in other parts of the general statutes or rules or regulations of the department of revenue services. The rights so guaranteed Connecticut taxpayers in the general statutes and the departmental rules and regulations are:

- (1) The right to available information and prompt, accurate responses to questions and requests for tax assistance.
- (2) The right to request assistance from a taxpayer's rights advocate of the department, who shall be responsible for facilitating the resolution of taxpayer complaints and problems not resolved through the normal administrative channels within the department, including any taxpayer complaints regarding unsatisfactory treatment by department employees.
- (3) The right to be represented or advised by counsel or other qualified representatives at any time in administrative interactions with the department and the right to have audits, inspection of records and interviews conducted at reasonable times and places.
- (4) The right to obtain simple, nontechnical statements which explain the procedures, remedies, and rights available during audit, appeals, and collection proceedings, including, but not limited to, the rights pursuant to this Taxpayer's Bill of Rights and the right to be provided with a narrative description which explains the basis of audit changes, proposed assessments, assessments and denials of refunds; identifies any amount of tax, interest or penalty due; and states the consequences of the taxpayer's failure to comply with the notice.
- (5) The right to be informed of impending collection actions which require sale or seizure of property or freezing of assets, except jeopardy assessments, and the right to at least thirty days' notice in which to pay the liability or seek further review.
- (6) The right to have all other collection actions attempted before a jeopardy assessment unless delay will endanger collection and, after a jeopardy assessment, the right to have an immediate review of the jeopardy assessment.
- (7) The right to seek review, through formal or informal proceedings, of any adverse decisions relating to determinations in the audit or collections process.
- (8) The right to have the taxpayer's tax information kept confidential unless otherwise specified by law.
- (9) The right to procedures for requesting cancellation, release or modification of liens filed by the department and for requesting that any lien which is filed in error be so noted on the lien cancellation filed by the department, in public notice and in notice to any credit agency at the taxpayer's request.
- (10) The right to procedures which assure that the individual employees of the department are not paid, evaluated or promoted on the basis of the amount of assessments or collections from taxpayers.
- (11) The right to have the department begin and complete its audits in a timely and expeditious manner after notification of intent to audit.

(May Sp. Sess. P.A. 94-4, S. 67, 85.)

History: May Sp. Sess. P.A. 94-4, S. 67 effective June 9, 1994.

ATTACHMENT B*Attachment B-1***AUTOMATED COLLECTION SYSTEM**

A computer assisted case management system which supports the Department's collection and compliance programs. Several important components of the Automated Collection System (ACS) are as follows:

- electronic routing of overdue tax data from DRS accounting system
- risk management assessment of collection portfolio via table settings
- electronic capture of collection history . . . contacts, promises, payment plan info
- automated notice and letter generation based on management settings
- electronic tracking of promises, dates and critical events
- aids in organizing work parameters . . . time and day when collectors make phone calls or perform research related functions
- electronic repository for bankruptcy filings, liens, levy notices and the related management tracking of these activities
- track historical collection data to help prioritize similar or same accounts for future follow-up
- provide appropriate management reports on collection activity

*Attachment B-2***AUTOMATED DIALING SYSTEM**

The Automated Dialing System is a computerized intelligent dialing system which complements the DRS Automated Collection System and helps maximize the number of outbound telephone contacts for overdue tax debtors. Several important features of this system are:

- automatically controls call queuing / dialing / screening so collectors can communicate throughout the day with maximum efficiency
- screens out answering machines, no answers and busy signals
- schedules recalls automatically
- passes live contacts and screens of data immediately and simultaneously to collectors
- provides on-line record updating with automatic updating of user-specific fields
- brings numbers in different time zones into the calling list automatically at correct time
- automatically adjusts calling rate to the external environments of each job and to collectors signing off and joining jobs
- provides system job control and monitoring for maximum management control of outbound calling
- provides for prioritization of individual call jobs based on management goals
- monitor collector performance from station to station
- provides all level of management reports . . . individual operator performance and exception reports

ATTACHMENT C



Gene Gavin
COMMISSIONER

STATE OF CONNECTICUT

DEPARTMENT OF REVENUE SERVICES

March, 1996

**FEDERAL TAX AMNESTY
BUDGET GRIDLOCK BUSTER**

Congress and President Clinton continue to grapple with ways to eliminate the federal deficit and balance the federal budget. They have not yet considered a nationwide federal tax amnesty program. They should.

On a state level, tax amnesty programs have proved to be a powerful tool to address budget deficits and convert accounts receivable into cash, quickly and efficiently. Connecticut and 34 other states have raised well over \$1.5 billion in additional and unanticipated revenues through this means. Connecticut alone, a state with a population of 3.3 million people, has collected over \$100 million in back taxes during its amnesty programs.

The Internal Revenue Service (IRS) estimates that its "tax gap" (i.e., the difference between what taxpayers owe and what they voluntarily pay) is approximately 17 percent of total federal income taxes due each year. This amounts to more than \$100 billion in federal taxes unpaid by nonfilers and under-reporters. Obviously, more than \$100 billion could go a long way to help resolve the current federal budget impasse. Additional and unanticipated revenues of over \$100 billion could allow both tax cuts and reasonable Medicare savings — the two biggest areas of controversy in the current budget debate.

In addition to the tax gap, the IRS suffers from a "collection gap." Over the period 1990 through 1994, the gross inventory of federal tax debt, including accounts receivable (i.e., monies known to be owed by specific tax delinquents, but not collected) grew about 80 percent — from \$87 billion to \$156 billion. At the same time, the IRS annual collection of delinquent taxes has declined from \$25.5 billion to \$23.5 billion — a decline of approximately 8 percent since 1990. Thus, the "collection gap" has been growing.

It has been suggested that the growth in accounts receivable may, in part, be attributable to the ineffective management of the receivables file. According to the General Accounting Office (GAO), IRS efforts to collect tens of billions of dollars in its accounts receivable file have been inefficient and unbalanced. The management of the IRS accounts receivable file has been hampered by both self-imposed and external constraints. The IRS has generally followed a lengthy and rigid three-stage process that begins with a series of written notices, or bills, sent to delinquent taxpayers over a period of about six months, followed by telephone calls; it ends with visits to delinquent taxpayers. As a result, the IRS management of accounts receivable has been recognized by GAO, the Office of Management and Budget and even IRS management itself, as a high-risk area. Tax amnesty can be the "carrot" that encourages these same taxpayers to come in on their own accord, thus saving the expense incurred with multiple contacts and generating much needed revenues to support government operations.

What is tax amnesty? In general, tax amnesty is a limited period of time (e.g., 90 days) during which individuals and businesses can come forward voluntarily to pay their back taxes and related interest without penalty or fear of civil or criminal prosecution, and possibly obtain a reduced interest rate. Tax amnesty programs have never involved abatement of the underlying tax liability. Nearly every amnesty program has included nonfilers and under-reporters, but states have been divided on whether to include accounts receivable in their programs. As a matter of good tax policy, amnesty should be part of a more broadly gauged program to improve voluntary compliance and strengthen tax enforcement. If tax amnesty is the "carrot," then new penalties and/or stronger enforcement practices must be the "stick" once the amnesty program ends.

Who would benefit from a federal tax amnesty? All taxpayers and citizens would benefit, not just the people and businesses who owe back taxes and come in under amnesty. Under a federal amnesty program, Washington would get much of the money it is due and could use it to balance the budget, pay for services and/or assist in cutting taxes for all taxpayers.

The IRS is currently well-positioned to launch its first-ever amnesty program. Recognizing its poor compliance rate (i.e., 83 percent), the IRS is presently engaged in "Compliance 2000," a program designed to improve the federal tax compliance rate to 90 percent by the year 2000. It is modernizing its computer and information technologies, working more closely with state tax agencies and instituting more taxpayer-friendly initiatives, such as the touchtone telephone filing system.

A federal tax amnesty program, supported by a well-publicized advertising and marketing campaign, would enhance the ability of the IRS to reach, perhaps exceed, its 90 percent compliance goal by:

- conveying an image to the public of the IRS as being responsive to complying taxpayers;
- heightening public awareness of federal tax laws to increase voluntary compliance;
- adding new tax filers to the federal revenue base for the long term; and
- communicating to the public the enhanced ability of the IRS to take a more assertive enforcement and collection posture against fewer tax cheats and deadbeats.

Some will be opposed to a federal tax amnesty program because it may be viewed as being unfair to honest taxpayers. Individuals and businesses who pay their taxes on time and/or fully comply with the tax laws are sometimes skeptical about amnesty programs. They see tax amnesty as an undeserved break for tax cheats and tax deadbeats.

However, as an honest taxpayer and one who pays his fair share of taxes, I do not share this view for the following reasons:

- legitimate taxpayers are currently subsidizing tax cheats and deadbeats, and that is patently unfair to the "good guys";
- it takes a great deal of taxpayer money for the IRS to not only uncover the "bad guys," but also to collect what is owed, once detected. As such, an amnesty program may be a cost effective way to perform an audit and collection function;
- tax amnesties do not reward the "bad guys" because the programs do not abate taxes and rarely abate interest;
- the waiver of civil and criminal penalties may be a small price to pay, particularly with nonfilers and under-reporters, since they have been previously undetected and, unfortunately, may never be detected;
- nonfilers and under-reporters who come in under amnesty not only produce a financial windfall in the year of amnesty, but also produce a steady stream of new revenues in the future as they join the tax rolls with the other "good guys"; and
- the information obtained through nonfilers and under-reporters under amnesty can be used to develop profiles and audit programs which, in turn, can enhance the detection of similar individuals and businesses in the future.

While a greater burden of justification exists for extending amnesty benefits to known tax delinquents (i.e., accounts receivable), a strong case can be made for inclusion on the federal level. According to a study conducted by the Federation of Tax Administrators (an association of all state tax agencies across the country), the inclusion of accounts receivable within the terms of amnesty generated considerably more revenue, both in absolute and relative terms, than did state programs limited to nonfilers and under-reporters. Connecticut, for example, collected approximately 25 percent more of its delinquent accounts as a result of tax amnesty. Since the IRS has recognized its inability to effectively manage its receivables file in the past, the inclusion of this category of tax delinquents would make a significant positive impact on the revenues collected under a federal tax amnesty. Furthermore, an aggressive enforcement campaign after the amnesty program could enhance future taxpayer compliance by eliminating the current impression that the IRS is neither fair nor serious about collecting overdue taxes.

Based on all the information available nationwide, a well-planned federal tax amnesty program could easily generate revenues exceeding \$125 billion. That is something worth talking about. Are you listening, Washington? I hope so! After all, 35 states can't be wrong.

Gene Gavin, C.P.A., M.B.A., J.D., LL.M., is Commissioner of Revenue Services for the State of Connecticut



ATTACHMENT D

New Women Register

NEWSSTAND

SUNDAY, APRIL 14 1996

SUNDAY EDITION

1847 YEAR, NO. 105, NEW HAVEN, CONN.

Millions fail to file taxes

■ **IRS knows it:** Yet few scofflaws suffer consequences.

By Ralph Vertabedian
Los Angeles Times

WARNING! — Charter Hughes was known around Santa Barbara, Calif., as an adept tax attorney, but he had an unusual strategy for his federal return: He just didn't file one.

When Internal Revenue Service agents finally caught up with Hughes in 1994, he owed \$38,727 in back taxes. Hughes pleaded guilty to federal charges but was sentenced to just 36 months probation, and today he is again practicing tax law.

Although the IRS has a reputation as a pit bull when it comes to

INSIDE
■ Tax prosecutors have until Tuesday

By Tom Page
Los Angeles Times

pursuing tax cheaters, about 6.5 million Americans — including a large number of professionals such as Hughes — ignore the federal tax collector every year.

"People tend to only think of the subculture — drug dealers — but it goes far beyond that," said Frederick Duffin, a San Francisco tax attorney. "It goes from the butcher to the banker to the banker. It is an amazing cross-section of America."

How can so many Americans

Please see Taxes, Page A8

Page A8 New Haven Register, Sunday, April 14, 1996

CONTINUED FROM THE FRONT PAGE

Taxes: Penalties often fail to deter

Continued from Page A1

avoid filing tax returns without running afoul of the IRS for years at a time?

Tax collection officials acknowledge that they don't have the resources to round up all the scofflaws, let alone send them to prison. Moreover, the agency's outdated 1960s-era computers have hobbled efforts to smoke out more non-filers.

Federal prosecutors also complain that legal penalties for not filing a tax return are too weak to intimidate would-be cheaters. Evading taxes by falsifying a return is a federal felony, while failing to file any return at all is only a misdemeanor.

IRS Commissioner Margaret Milner Richardson insists that her agency is doing an effective job of collecting taxes and that the nation's system of voluntary compliance — the government collects an estimated 86 cents of every dollar owed — is still the envy of the world.

Although the IRS has recently put greater emphasis on identifying and catching non-filers, the problem seems to be growing anyway for a variety of reasons, including an increase in the underground economy, the economic squeeze on the American middle class and a renewed tax protest movement.

The IRS has files on 6.5 million individuals and businesses who the agency knows do not file returns. But it is clearly missing many others who operate in a booming underground economy that includes narcotics, tree trimmers and musicians — not to mention the illegal sector of drug dealers, prostitutes and car thieves.

IRS policies emphasize gently herding non-filers back into the tax collector's fold. The IRS regards the vast majority of non-filers as congenial procrastinators or luckless deadbeats, not criminals.

Hardly anybody is prosecuted for not filing. In the 1994 tax year, just 240 people or businesses were

convicted — less than four of every 10,000 known non-filers. As a result, many non-filers have apparently come to regard the IRS with little or no fear.

IRS officials have noticed a huge jump in cases involving high-income non-filers, people who earn at least \$100,000 a year. The agency identified 138,717 such cases in the 1994 tax year, up 39 percent from 99,693 just the year before.

"We have more attorneys under investigation than I have ever had before," said Richard Speyer Jr., chief of the IRS criminal investigation division in Los Angeles. "I am very active in the investigation of crimes involving doctors and lawyers."

In New York, a cursory check by the IRS turned up 300 attorneys who were not filing in 1993. Some major law firms now require their partners to submit the first pages of their income tax returns to outside accountants each year.

Professionals can escape notice most easily if they are self-employed and their income is not reported independently to the IRS on W-2 forms. By avoiding traditional investments that yield interest or dividend income, which is also reported to the IRS, they can drop out of sight.

Federal officials never disclosed exactly how they caught Hughes, the Santa Barbara attorney. But his guilty plea indicated that he had failed to file returns for three years ending in 1989 and had unreported income of \$165,314. Hughes did not return three phone calls seeking comment.

Of the 6.5 million known non-filers, various types of businesses account for about 2.3 million and individuals account for about 4.2 million, according to the IRS. Their ranks include bank presidents, fading actresses, surgeons and accountants, according to the attorneys who represent scofflaws.

Militant tax protesters represent another component of the problem, according to Richardson, the tax

commissioner. Only last year, a 43-year-old unemployed car salesman and tax protester was arrested for plotting to blow up the IRS service center in Austin, Texas. Richardson said she was increasingly concerned about the safety of IRS officials.

At the other extreme are families in such financial straits that they have nothing left for the tax collector.

Non-filers win little sympathy from prosecutors, who believe that the federal laws that classify these cases as misdemeanors are too weak to deter the crime. "A misdemeanor? Get real," said Nora M. Manella, the U.S. attorney in Los Angeles. "It wouldn't be much of a deterrent even if you prosecuted all the non-filer cases if they are a misdemeanor."

And the government is a long way from universal prosecution. Although the Justice Department will not discuss it, defense attorneys in California say the government does not bother to prosecute tax cases involving less than \$80,000 in unreported income.

The misdemeanor for non-filing carries a maximum sentence of just one year in prison, compared with five years for the felony of tax evasion. The IRS can also slap non-filers with civil penalties of up to 47.5 percent of back taxes owed; accrued interest can add still more.

Ronald Rhodes, director of the IRS tax collection division, said the agency was not sure how much taxes it loses to non-filers. However, an out-of-date estimate in the early 1990s set the figure at \$10 billion a year.

Though a huge sum, it's still just a fraction of the \$150 billion to \$400 billion (enough to balance the federal budget) that tax cheating of all varieties costs the government every year, according to Rep. Jim Lightfoot, R-Iowa, chairman of the House Appropriations subcommittee that controls the IRS budget.

ATTACHMENT E



DEPARTMENT OF THE TREASURY
WASHINGTON

MAR 29 1996

Mr. Gene Gavin
Commissioner
State of Connecticut
Department of Revenue Services
Twenty-Five Sigourney Street
Hartford, CT 06106

Dear Mr. Gavin:

Thank you for your letter of February 9, 1996 to Secretary Rubin suggesting a Federal tax amnesty program. Your letter was referred to this office because it concerns a matter of tax policy.

We do not believe that a Federal tax amnesty program would generate a significant amount of net tax revenue. A Federal tax amnesty would be unlikely to be as effective as state amnesty programs, since the most successful state amnesties coupled amnesty with increased enforcement efforts that are already a part of the Federal tax program. Moreover, state amnesties have often been deemed to be successful because of their production of gross tax revenues. Where further analysis has been undertaken, there are indications that even successful state programs merely accelerate the collection of taxes that would have been collected anyway, so that net amnesty returns are very modest. For your information, we have enclosed testimony on this subject presented in July of 1990 by Michael J. Graetz, former Deputy Assistant Secretary (Tax Policy).

Thank you again for writing Secretary Rubin.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Lowell Dworin', written in a cursive style.

Lowell Dworin
Director, Office of Tax Analysis

Enclosure

For Release Upon Delivery
 Expected at 1 p.m.
 July 25, 1990

STATEMENT OF
 MICHAEL J. GRABETZ
 DEPUTY ASSISTANT SECRETARY (TAX POLICY)
 DEPARTMENT OF THE TREASURY
 BEFORE THE
 SUBCOMMITTEE ON COMMERCE, CONSUMER AND MONETARY AFFAIRS
 COMMITTEE ON GOVERNMENT OPERATIONS
 UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to present the views of the Treasury Department on the advisability of a Federal tax amnesty program.

The views we shall express here today are necessarily of a general nature. As you know, current interest in a Federal tax amnesty has been sparked largely by the widespread experience during the last decade of state tax amnesty programs. These programs, however, have been as varied as the states that conducted them.

There is no specific amnesty proposal before this Committee for consideration. Our testimony focuses primarily on a potential Federal tax amnesty program under which certain penalties would be waived for taxpayers who admit voluntarily to failing to pay the correct amount of tax in the past and who pay the full amount of the unpaid tax, including interest due.

We believe that such a general Federal tax amnesty program would be unwise. First, contrary to certain extravagant claims, we do not believe a Federal amnesty program would raise large additional revenues, and there is a risk that such a program, in fact, might lose revenue. Most states did not have effective income tax enforcement systems in place when their amnesty programs were instituted, and those state amnesty programs that have been most successful in raising revenue generally were coupled with increased enforcement efforts -- enforcement efforts that

already are a part of the Federal tax system. The Treasury Department is also concerned about the actual and perceived fairness of a Federal amnesty program, as well as about the possible adverse effects of an amnesty on taxpayer morale and compliance.

Carefully targeted relief from tax penalties for taxpayers who step forward to pay unpaid or understated taxes might be desirable in some cases, but only if such relief is linked with significant, additional enforcement programs, such as new withholding requirements. We caution, however, that even before targeted relief is provided, Congress should carefully consider the trade-off between collecting unpaid taxes, on the one hand, and the potential for damage to the voluntary compliance system, on the other hand.

My testimony today has three parts. First, I shall describe briefly the experiences of the states with amnesty programs. Second, I will outline important differences in the state and Federal systems that make it difficult to translate the states' experiences to the Federal level. Finally, I shall review the revenue implications of a Federal amnesty program and explain why we believe substantial revenue increases would be unlikely.

I. STATE AMNESTY EXPERIENCE

Beginning in December 1981, with Illinois, 29 states and the District of Columbia have conducted some form of an income tax amnesty program. Connecticut and Maine have scheduled tax amnesty programs for September 1 and November 1, 1990, respectively. Three states, Florida, Illinois and Louisiana, have offered two tax amnesty programs.

No agreement currently exists on the degree of success or failure of state amnesties, largely because data relating to the long-term effects are not available. Moreover, the specifications and conditions of amnesty programs have varied considerably from state to state. In general, state amnesty programs have offered reduced penalties to those individuals or corporations that voluntarily come forward and correct their situation with the state tax authorities. Some state programs have required amnesty applicants to pay interest and penalties, but with a reduced penalty rate; other programs have waived all penalties and interest. None have forgiven the actual tax liability.

State amnesty programs also have differed as to eligible participants. All state programs have included nonfilers. State programs, however, have varied concerning the eligibility of taxpayers who filed returns but underreported their taxes. Some state programs have allowed participation by people who are under investigation, or even with identified tax evaders.

A number of states have included accounts receivable under their amnesty programs. These accounts receivable represent tax liabilities that state tax authorities had already identified and

in some cases would have collected independently of the amnesty. States that have included accounts receivable have obtained significantly greater gross tax receipts through the amnesty than states not including accounts receivable. A 1987 Internal Revenue Service study showed that fully two-thirds of state amnesty revenue came from accounts receivable.

Many states' amnesty programs were instituted when enforcement of their tax laws was lax. Several states historically have had little or no auditing and many have long depended entirely on information provided by the IRS. For example, Kansas, Pennsylvania and Michigan do virtually no auditing. Virginia, Ohio, West Virginia, North Dakota, Nebraska, Colorado, Louisiana, Oklahoma and Hawaii have tended to rely solely on information provided by the IRS in conducting state income tax audits. As IRS audit rates fell over the last decade, many state enforcement programs have concurrently suffered.

The vast majority of state amnesty programs have been coupled with increased enforcement efforts and increased civil or criminal penalties for tax evasion. Twenty-four of the states conducting income tax amnesty programs instituted these programs just prior to, or in conjunction with, strengthening enforcement or penalties. Virtually every state vowed to pursue more vigorously tax delinquents and to impose harsher penalties.

In many cases, the states' enforcement and penalty increases were quite extensive. For example, Massachusetts enacted legislation that raised the crime of tax evasion to a felony, permitted the contracting out of tax collection, authorized the hiring of more revenue agents, and made tax compliance a prerequisite for obtaining or renewing a state license, for example, for doctors and other professionals. To take but one other example, Louisiana doubled the number of its auditors and collectors.

In general, the increased enforcement efforts included: (1) increased financial penalties for tax evasion and delinquency; (2) shifts in certain tax evasion crimes from misdemeanors to felonies and increased jail terms for certain crimes; (3) expanded efforts for property seizures; (4) improved automated systems; and (5) increased staff for audits and collections.

Advertisements emphasized the increased enforcement aspects of the states' amnesties, in particular, the significantly increased risk of tax delinquents being apprehended and subjected to stiffer penalties. The publicity campaigns were often dramatic:

- . California: "Get to us before we get to you."
- . Louisiana: "Pay now or pay later."
- . Minnesota: "Amnesty -- an offer you shouldn't refuse."

- . Colorado: "Don't say we didn't warn you."

. Maryland: "Are you sure you can beat Maryland out of back taxes? Come forward and come clean."

- . New Mexico: "We have got your number, have you got ours?"

Most recently, Virginia's amnesty program featured advertisements of a shark and "Jaws" music warning of impending increased enforcement of state tax laws.

Indeed, some states increased their enforcement efforts just before starting the amnesty program. For example, Massachusetts conducted a highly visible campaign of business and property seizures prior to its amnesty program. In California, enforcement actions also were stepped up shortly before the amnesty period and were widely publicized. Similarly, in Louisiana, tax enforcement was increased before the amnesty program through the use of strike forces. The enforcement component is widely agreed to have been central to successful state amnesties, and, in fact, amnesty programs without enhanced enforcement have gained little revenue.

In short, few states simply have used amnesties primarily as a quick revenue source. Rather, state amnesty programs have routinely been offered as the last chance for tax evaders to come clean in light of greatly increased levels of enforcement. State amnesty programs have been fashioned as one element in a statutory restructuring of tax enforcement, coupled with enhanced administrative capacities.

The gross revenue collected under state amnesty programs has ranged from 1000 and \$240,000 for North Dakota and Louisiana, respectively, to highs of \$182 million and \$401 million for New Jersey and New York. Gross amnesty revenue as a percent of the prior year's tax collections of the state ranged from a low of 0.2 percent in Idaho to 2.36 percent in New Jersey. These amounts represent gross liabilities shown on amnesty returns.

Very little information, however, is available on the net gain in revenue attributable to the state amnesty program. States such as Massachusetts, that substantially increased tax penalties and enforcement, almost certainly would have experienced significant revenue increases solely from the change in compliance policy. I shall discuss further differences between gross and net amnesty revenues toward the end of this statement.

First, state and Federal tax systems are rather different and measures that might increase compliance in one system may have little or no impact in another. Thus, for example, a significant amount of state noncompliance involves sales taxes, which do not constitute an important part of Federal tax collections. Also, a large component of some states' amnesty receipts result from out-of-state residents failing to report their state income. No similar opportunities exist for a Federal amnesty program to obtain such revenues.

Second, states have lower income tax rates than the Federal system. Thus, it generally is less costly for delinquent taxpayers to participate in a state amnesty program than would be the case with a Federal program. These higher costs may deter participation in a Federal program.

Third, most state amnesty participants had not filed state returns. Data from some state amnesty programs, however, indicate that most amnesty participants had already filed Federal income tax returns. This suggests that Federal enforcement efforts may have already identified and assessed most of the likely participants in an amnesty program. This leaves a pool of more knowledgeable and aggressive noncompliers who seem less likely to be influenced by an amnesty offer. If that is true, Federal amnesty participation (and consequently, revenue) would be lower than state amnesty participation (and lower than state revenue as a percentage of the prior year's tax collections).

Fourth, most state tax amnesties forgave criminal as well as civil penalties. At the Federal level, more than one-half the criminal cases currently being pursued involve nontax crimes, such as drug offenses and money laundering. Great caution must be exercised so that a Federal tax amnesty does not become an occasion for excusing people engaged in other criminal activities.

Finally, and most importantly, the state amnesty programs that achieved the greatest success were those coupled with increased enforcement programs. Many states that tried amnesty programs did so when enforcement had been virtually nonexistent. In contrast with these states, the Federal government has long pursued vigorous enforcement policies and, indeed, already has many measures that were instituted by the various states as part of their amnesty packages. For example, as part of its amnesty package, South Carolina conformed its tax penalty and interest provisions to those applicable under the Federal tax law. Even if the IRS received significant increases in its enforcement budget, the percentage increases in enforcement effort could not match those of states that started from much lower enforcement levels.

Moreover, the kinds of penalty reforms undertaken by many of the states are not feasible at the Federal level. Federal tax penalties were dramatically increased during the 1980s and a comprehensive penalty reform measure was included as part of

last year's tax Act. Three out of every four persons convicted of Federal tax crimes are now receiving prison sentences, and the recently promulgated Federal sentencing guidelines will tend to increase the prison time served. There is little room at the Federal level for the kinds of enforcement reforms adopted by the states. A successful amnesty needs sticks as well as carrots.

In short, the Treasury Department questions whether a Federal amnesty program would provide comparable incentives for many of those currently noncomplying taxpayers to come forward. The states' experience simply does not translate to a Federal tax amnesty program.

The Treasury Department is also concerned that enacting a Federal amnesty program could raise serious public concern about the fairness of the current tax system. The vast majority of taxpayers comply dutifully with the Federal tax laws and routinely pay their fair share of tax. They may feel cheated when others, who knowingly broke the rules, are allowed to escape punishment, or even to profit from their wrongdoing if the amnesty forgives interest on overdue taxes. Their natural reactions might be increased cynicism about the tax laws, which would undermine future compliance. Such a potential response would pose serious risks to a tax system that depends on taxpayers honestly reporting their own tax liability.

If a Federal amnesty program produces adverse responses from currently compliant taxpayers, it could have a substantial negative effect on long-term tax revenues. Even a program described as a "one-time" opportunity may lead taxpayers to believe the program might be repeated. Three states, for example, have already had two amnesties in this decade. The system's ability to raise revenues would suffer from any program that jeopardizes voluntary taxpayer compliance. A Federal tax amnesty program therefore is a gamble with our tax system's most important asset -- the general willingness of taxpayers to obey the law.

Unfortunately, we do not have data necessary to evaluate with confidence the net impact of an amnesty program on long-run compliance. State tax administrators have not collected the data necessary to measure the effects of amnesty programs on compliance levels, and in those many cases where enforcement initiatives and amnesty were married, such an analysis might not be possible.

Gross receipts from state amnesties significantly overstate the beneficial impact on revenues of an amnesty program because these receipts ignore the costs of an amnesty program. Net amnesty revenue is necessarily less than gross revenue shown on amnesty tax returns since some, and perhaps most, of the amnesty amount would be collected without the amnesty, although perhaps in a later fiscal year.

Net amnesty revenue consists of gross amnesty tax revenues less:

- Taxes that have already been collected, mainly through withholding.
- Accounts receivable and other known liabilities that would have been collected without an amnesty, payment of which is only accelerated. Accelerating the receipt of these amounts may not increase net revenue if the cost of acceleration is forgiveness of some or all outstanding penalties.
- Penalties that are forgiven during the amnesty on taxes that would have been collected during that same period without an amnesty and on taxes that would have been collected later without an amnesty. At the Federal level, forgiven penalties could amount to billions of dollars.
- Actual costs of administering and publicizing the amnesty program.
- The costs of transferring examiners and other tax administration personnel away from other work, offset by reduced audit and collection costs because some delinquent taxpayers use the amnesty program. The revenue foregone from transferring examiners to amnesty work may be significant. The IRS would have to review amnesty returns or run the risk that amnesty participants would be allowed to escape their past liability by auditing and paying only a small portion of their unpaid taxes. Not checking amnesty returns could also adversely affect future compliance.

One should also attempt to disaggregate gross revenues from state amnesty programs to identify revenues attributable to improved state enforcement activities. States that stiffened penalties and enforcement in conjunction with their amnesty programs no doubt would have experienced significant revenue increases solely from the change in compliance policy. The Federal government would also experience revenue increases from heightened enforcement efforts, with or without an amnesty. It would be a mistake to credit an amnesty program with such

No specific proposal is under consideration here today. Therefore, we are not providing any revenue estimate for a Federal amnesty program. However, the Treasury Department believes that there has been great overstatement of potential revenues that would occur from a general Federal tax amnesty forgiving penalties and criminal prosecution. We regard, for example, figures used by the Senate Budget Committee predicting many billions of dollars of increased Federal revenues to be very exaggerated.

One design feature that would affect the revenue estimate is the amount of time between the date a Federal amnesty program is announced to the general public and the date the amnesty takes effect. A long lead time might reduce net revenues. Once an amnesty were scheduled, taxpayers would have an incentive to do so without penalty. Tax receipts would be delayed, and some would be lost permanently. Anticipation of an amnesty could cause currently delinquent taxpayers to delay settlement of examinations and final payment until the beginning of the amnesty period in order to avoid penalties. At best, this would delay receipt of the payments, perhaps into a later fiscal year. Such a loss of penalties might quickly convert an amnesty from a small revenue gainer to a revenue loser. Moreover, whenever payments are delayed, it is inevitable that some will never be made, further reducing any potential revenue gain.

IV. CONCLUSION

In the current budgetary context, we should emphasize our conclusion that a Federal amnesty program has limited short-term revenue potential. Putting additional enforcement resources and weapons into place cannot occur immediately, but only over a longer term. Amnesty absent enhanced enforcement is simply not wise tax policy. And, in any event, the administrative demands of a Federal amnesty program would require a substantial delay between enactment and the beginning of the amnesty program. In sum, we have little comfort to offer those who are looking to a Federal tax amnesty as a relatively painless antidote to the current Federal deficit.

Our lack of support for a general Federal tax amnesty program should not be mistaken for a lack of concern with current levels of taxpayer noncompliance. Nor do we mean to preclude consideration of targeted tax enforcement programs, coupled with targeted tax relief. The principal lesson of the amnesty program is that an amnesty must be part of a package that includes enhanced enforcement. Thus, for example, even penalty relief aimed only at nonfilers should be considered only as part of a package including new IRS enforcement capabilities, and perhaps increased tax penalties or an extended statute of limitations on tax assessments or collections.

Finally the risks of long-term, adverse effects of an amnesty on voluntary compliance suggest that even targeted relief should be undertaken with considerable caution.

This concludes my prepared remarks. I would be happy to answer any questions.

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Editorials

Tax amnesty and the federal budget

Lawmakers are so serious about balancing the federal budget that they want to cut some of our country's most popular entitlement programs, from Medicaid, Medicare and welfare to possibly even Social Security.

But before that happens, Gene Gavin thinks Congress ought to consider the most obvious source of potential revenue for the United States: The Internal Revenue Service. Mr. Gavin doesn't want federal taxes to increase. But he is in favor of having the IRS go after those people who either have underpaid their federal taxes, or haven't paid them at all.

Mr. Gavin, an accountant and Westport resident, also is Connecticut's revenue services commissioner. He thinks the U.S. government could raise billions of dollars to ease the budget shortfall by sponsoring its first-ever nationwide federal tax amnesty program. For proof, he figuratively is submitting receipts from about \$100 million collected for Connecticut's Treasury during state tax amnesty programs held here in 1990 and 1995. And while he admits this would be a major undertaking for the IRS, he nonetheless maintains that we owe it to our citizens — particularly those who would be affected by drastic reforms in entitlement programs — to at least explore the possibility.

On that point, Mr. Gavin is right. If Uncle Sam truly is leaving no stone unturned in his quest for additional revenues, then he should at least consider tax amnesty.

Such programs give those who underpay taxes, or don't pay them at

The Issue:

Raising badly needed dollars, with help from the Internal Revenue Service.

all, an opportunity to settle their accounts over a set period of time. Under most amnesty programs, taxes owed are paid, along with the prescribed interest. The benefit to offenders is that they avoid stiff financial penalties and concern that they will be hauled into court — and possibly to jail — for breaking federal tax laws.

Connecticut does not have a corner on tax amnesty. Thirty-five other states have held such programs, most of them with great success, according to Mr. Gavin. But Connecticut is one of the few states to sponsor amnesty twice, and Mr. Gavin has become one of its most vocal proponents.

Tax amnesty is not without controversy. It irks law-abiding taxpayers, some of whom view amnesty as a perverse reward for tax cheats. Why should anyone follow the rules and pay their taxes every year, these people say, when you can pay them when you feel like it without fear of prosecution? Then there is the matter of secrecy and confidentiality. One of the reasons state amnesty programs — including Connecticut's — have been so successful is that the states agree not to disclose identities of the participants to the IRS. That way, those owing state taxes can repay them, without worrying that the state will turn around and snitch to the federal government.

Whether the IRS, or even individual states, would agree to such a lack of reciprocity is undetermined. Also unknown: Whether scofflaws would trust such a guarantee, even if it were offered.

There would be practical difficulties too. The IRS already is operating on a restricted budget. You may recall that budget deficits prompted the agency to close its Norwalk taxpayer assistance office earlier this year, so that it will not be open for tax season. If such restrictions continue (and we have no reason to believe that they won't), then the IRS will have even fewer people to deal with the additional workload generated by tax amnesty cases. Mr. Gavin counters that Connecticut did not hire additional people to conduct last year's amnesty program, which he predicted will generate more than \$44 million once all the paperwork is processed. The 1990 program brought in \$55 million.

Then there is the stick problem. Tax amnesty programs work because offenders worry about what will happen to them if they don't participate. Connecticut promised to be far more vigilant about pursuing offenders once its amnesty programs ended, for instance. To be effective, the IRS would have to make a similar pledge. The question is: Can it follow through? If not, then Uncle Sam will have tax cheats from Maine to Hawaii laughing behind his back.

Tough issues, to be sure. But Mr. Gavin argues that we must explore them if, as a nation, we are dedicated to making government as efficient as possible. The idea is worth considering.

Chairman JOHNSON. Thank you very much, Mr. Gavin.
Mr. Hoatlin.

**STATEMENT OF THOMAS M. HOATLIN, COMMISSIONER OF
REVENUE, STATE OF MICHIGAN, DEPARTMENT OF TREASURY**

Mr. HOATLIN. Good morning, Madam Chairman, and Members of the Subcommittee.

My name is Thomas Hoatlin. I am the revenue commissioner for the State of Michigan.

I am here to testify on Michigan's experience in using a private collection agency to support our collection efforts, and also to support H.R. 757.

The Michigan Department of Treasury had an amnesty program in 1986, which was immediately followed by the implementation of a number of improved enforcement tools to collect our delinquent taxes.

As a part of that process, the department contracted with a private collection agency to build and manage an automated collection site, the Michigan Automated Collection System.

The purpose was to collect delinquent taxes the department did not and could not collect with existing personnel.

The collection process in Michigan represents 16 tax types and 21 active debt types that we collect on behalf of other State agencies, and local court systems.

Accounts are assigned only after they are collectible, that is, all appeal provisions have run, and the liabilities are coded for current action.

Accounts are assigned to three different collection units. One, the Treasury central office; two, the Treasury field collectors; and then the automated collection system.

Michigan has contracted with a private collection agency for 10 consecutive years. The current vendor is responsible for five primary areas; that is, the management of the collection site, facilities management, programming staff to maintain and enhance the computer programs, the management of a bankruptcy unit, and the maintenance of a LAN system.

The site is open 12 hours a day, 5 days a week, and 4 hours on Saturday.

Over the 10-year period, starting in 1986, the annual collections have grown from \$29 million in 1986 to \$106 million in 1995.

Our experience with privatization of the collection process has been very good. The program, from its inception, was developed to collect delinquent taxes for which we lacked sufficient technology and personnel to collect in a systematic way.

Based on our experience, the automated telephone collection method is extremely cost effective and efficient. Whether it is performed by the public sector or private sector, telephone collections are extremely cost effective.

And the sooner the debt is collected, the better the collection. The older debts are much more difficult to collect.

There were no State employees that were displaced by the result of contracting with the collection agency. All contract employees are subject to the same confidentiality provisions as State employees.

The collection agency uses a telephone script that is approved by the State, and all levy and lien activity done by the private contractor is approved by State employees through an interface system.

Michigan also has an offset program that intercepts all vendor payments and all tax refunds through a main accounting system that is run against our accounts receivable.

The program in 1995 generated offsets of \$28 million. If the private contractor has been assigned an account on which an offset is taken, no commission is paid on that offset.

The offset programs have worked very well and I am only here to support H.R. 757. Michigan, at this point, does not participate, is not one of the 31 States that participate in the program, and we are more than willing to start as soon as the reciprocal agreement is approved.

Thank you.

[The prepared statement follows:]

**STATEMENT OF THOMAS M. HOATLIN
COMMISSIONER OF REVENUE
STATE OF MICHIGAN**

My name is Thomas Hoatlin. I am the Revenue Commissioner for the State of Michigan. I have been employed by the Michigan Department of Treasury for 36 years, spending all of my tenure in the area of tax administration and the collection of various state taxes.

I am here to testify on Michigan's experience in using a private collection company to support our collection effort. I am also here to offer support of H.R. 757.

The Michigan Department of Treasury had an amnesty program in 1986 which was immediately followed by the implementation of a number of improved enforcement tools for the collection of delinquent taxes. As a part of the collection process, the Department contracted with a private contractor to build and manage an automated collection site, the Michigan Automated Collection System (MACS), for the purpose of collecting taxes which the Department could not collect with existing personnel.

The collection process in Michigan involves 16 tax types and 21 active debt types collected on behalf of other state agencies. Accounts are assigned only after they are considered collectible, that is, after all appeal periods have run and the liability is coded for current collection responsibility. Accounts are assigned to one of 3 collection units:

1. Treasury Collection Division's central office;
2. Treasury field collectors; or
3. Michigan Automated Collection System.

Michigan has contracted with a private collection firm for over 10 consecutive years. The current vendor provides services in 5 primary areas:

1. Management of the automated collection telephone operations site, including approximately 280 contractor employees serving as account representatives and management staff.
2. Facilities management (operations, technical support, and maintenance) of the computer and the related network and peripheral equipment which supports the MACS application system and its interfaces to assure continuous system and data reliability and to assure the smooth transfer of data between Treasury and the MACS database.
3. Programming staff to maintain and enhance computer programs supporting collection activities and interfaces between the MACS database and the lien release system and the State Treasury Accounts Receivable (STAR) database on Treasury's mainframe computer.
4. Management of a 10-person bankruptcy unit whose efforts to track bankruptcy claims and discharges rely on a PC-based local area network (LAN).
5. Maintenance of a 3-person LAN management team to facilitate the operations of the bankruptcy LAN at the primary collection site and 66 PCs located at a second telephone collection site.

The site is operated 12 hours a day, Monday through Friday, and 4 hours on Saturday. The 1995 fiscal year collections on accounts assigned to the automated collection system totaled \$106 million. Over a 10-year period, starting in 1986, the annual collections have grown from \$29 million to \$106 million in 1995. An additional \$170 million was collected in fiscal year 1995 through the efforts of our central office and field operations.

Our experience with privatization of the collection process has been very good. The program, from its inception, was developed to collect delinquent taxes for which we lacked sufficient technology and personnel to collect in a systematic way. Based on our experience, the use of automated telephone collection methods is extremely efficient and cost effective, whether the work is performed by the public or private sector. The key to success in either case is the speed with which an account can be resolved; the older the debt, the more difficult it is to collect. No state employees were displaced as a result of contracting with the private collection agency.

All contract employees sign the same confidentiality documents that state employees sign. The collection agency uses a telephone script which is approved by the state and follows all of the courteous telephone etiquette responses that would be used by a state employee when contacting a taxpayer indebted to the state. We also reserve the right to monitor calls to verify the quality of the staff training and the interaction with the taxpayer. We do, from time to time, receive complaints--however, no more than we would receive when state employees are making such calls.

The State of Michigan is in the process of issuing a Request for Proposal (RFP) for a new automated collection system and improved telephone collection software. A component to be required in the new system software will provide a means to target the most effective collection methodology for a specific taxpayer based upon the compliance history and other factors related to that taxpayer. In terms of hardware, we intend to convert from a legacy mainframe system to a client/server environment. We also intend to modify the existing structure of the Collection Division to allow a longer period of time for internal collection efforts on tax debts prior to unresolved accounts being assigned to private collection agencies for enhanced collection efforts.

As many of our delinquent taxpayers represent new accounts receivable, rather than habitually delinquent debtors, we prefer to have a state employee make the initial contact with the debtor, in an effort to achieve early account resolution or, if necessary, account correction. Those taxpayers who are habitually delinquent may require a different collection effort.

Michigan intends to implement an integrated tax system which will enable us to discuss all existing delinquencies as well as those liabilities nearing a final assessment or for which recent returns have not been filed timely. For example, a taxpayer may have an income tax withholding assessment. S/he may also be delinquent for other taxes administered by the Department or debts owed to other state agencies for which Treasury has been assigned collection responsibility. With the integrated tax system, all liabilities will be readily visible on the computer monitor, including corporate officer liabilities, and serve to guide the discussion with the taxpayer regarding the totality of his/her debt with the goal of resolving the entire set of liabilities. Ultimately, our goal will be to encourage and foster more voluntary compliance with all tax laws, thereby reducing the growth in accounts receivable.

Michigan has an offset program that intercepts vendor payments and tax refunds to be issued by the state and applies the intercepted funds against all debts recorded on the state's accounts receivable database. In fiscal year 1995, this program generated an offset of \$28 million. If the private contractor has an assigned account on which an offset is taken, the firm does not receive a commission on that payment.

As I indicated, I am also here to support H.R. 757. There are several points I would ask you to keep in mind regarding the legislation:

- This legislation allows the states to participate in an existing federal offset program and allows the IRS to reciprocate for what many of the states are already doing. The IRS would be allowed to offset federal income tax refunds to satisfy legally enforceable, past-due state tax debts.
- These tax delinquencies will have already exhausted the period of time allowed for protests and appeals. The bill also affords some protection to the taxpayers as they will be given specific notification before any offset occurs. IRS would be paid for its expenses, even though states seldom require the federal government to pay for its participation in their programs.
- The states currently are offsetting over \$80 million annually on behalf of the federal government.
- This measure has been publicly aired before two hearings and has never received any public or government objections. The U.S. Treasury Department and IRS support the proposal.

I urge you to take all necessary steps to assure that this legislation is included in the next available bill.

This concludes my testimony. I want to thank you for the opportunity to describe two issues that are very important to the states.

Chairman JOHNSON. Thank you, Mr. Hoatlin.
Mr. Goldberg.

**STATEMENT OF GERALD H. GOLDBERG, EXECUTIVE OFFICER,
CALIFORNIA FRANCHISE TAX BOARD**

Mr. GOLDBERG. Thank you, Madam Chairman, Mr. Matsui.

My name is Jerry Goldberg and I am the executive officer of California's Franchise Tax Board, the State agency that is responsible for the collection of both personal and corporate income tax.

I would like to thank you for inviting me here to testify. My remarks will cover three areas. The Franchise Tax Board's experience with outsourcing tax debt collection, the Franchise Tax Board's experience with insourcing for county and other State tax collection, and California's support for the reciprocal fund offset legislation to authorize the Federal Government to offset Federal tax refunds to settle past due State tax debts, thus reciprocating the States in a program where California and 30 other States already offset State tax refunds to settle Federal tax debts.

With regard to outsourcing, California has had a program for referring certain types of tax debt to private collection agencies since 1984.

The primary purpose of the program was to increase the efficiency and fairness of our collection program in recovering debts owed on small accounts which otherwise would not be pursued.

The programs involved are known as the OSCAR Program for out-of-state collections of accounts referral, and the ISCA Program for in-state collection of accounts referral.

Accounts selected are selected based on their cost-benefit ratio, that is to say, in California, the benefits have to be less than \$5 of revenue to \$1 of cost.

Vendors are selected based on competitive bid. We monitor very closely the contractors. We actually colocate with them. We use our internal auditors to audit them, and in fact we provide training to the vendors.

We do clearly recognize that tax debt is significantly different than commercial debt. Because the accounts referred are small amounts, the Franchise Tax Board has never expected a great direct monetary return for the program, but, rather, as I said, it is an issue of effectiveness and fairness.

We also have an insourcing program and the Franchise Tax Board has one of the most sophisticated automated collection systems in the country, and as a consequence we use our collection system to not only collect tax debt but delinquent child support, delinquent vehicle license fees, delinquent county court-ordered debt, and of course various other items of debt as well.

Finally, I would like to speak to the issue of the reciprocal offset.

California has had an offset program since 1975. The IRS became a participant in the program in 1991, when it received roughly \$16.3 million from California from roughly 73,000 accounts.

In 1995 the IRS made 741,000 offset requests. In effect 25 percent of all of the offset requests made in California were requested by the Internal Revenue Service on behalf of the Federal Government.

Since 1991, California has remitted \$91.8 million to the Federal Government.

Clearly, California has an interest not just in reciprocity with the Federal Government, but also on its own behalf in terms of the moneys that we would collect, which otherwise would not be collected if there was not a Federal offset program.

We anticipate that California would receive in the first year of operation roughly \$80 to \$85 million, and in succeeding years it would be significantly less. Obviously, we would be collecting during the first year on a backlog. In future years the amount would be significantly less, but nonetheless, a significant amount of money.

We are obviously very supportive of Representative Jacobs' bill, H.R. 757, and are very hopeful this Subcommittee makes a positive recommendation with regard to it.

We do feel it would be very much a step forward in ensuring a cooperative attitude between the States and the Federal Government, and of course, more specifically, between the State tax collection agency and the Internal Revenue Service.

Again, I want to thank you for this opportunity to testify.

[The prepared statement follows.]



STATE OF CALIFORNIA
 FRANCHISE TAX BOARD
 P.O. BOX 942867
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**TESTIMONY OF GERALD H. GOLDBERG
 CALIFORNIA FRANCHISE TAX BOARD
 BEFORE THE OVERSIGHT SUBCOMMITTEE
 OF THE HOUSE WAYS AND MEANS COMMITTEE
 HEARING ON TAX DEBT COLLECTION ISSUES
 April 25, 1996**

EXECUTIVE SUMMARY

I am the Executive Officer of the California Franchise Tax Board (FTB) which administers the personal income tax and the bank and corporation tax for the State of California. This statement will serve to explain the FTB's experience with the outsourcing of certain kinds of tax debt, FTB's experience with the "insourcing" of other types of government debt which have been referred to FTB for collection, and discuss the question of reciprocal refund offsets and support for Federal legislation that would allow the Federal government to offset Federal tax refunds to settle past due tax debts as most States voluntarily do now for the Federal government.

Outsourcing State Tax Debt

California has had a program for referring certain types of tax debt to private collection agencies since 1984. The primary purpose of the program was to increase the efficiency of our collection program in recovering the debts owed on small accounts which would otherwise not be pursued. The programs involved are known as OSCAR (out of state collection of accounts referral) and ISCAR (in-state collection of accounts referral).

Because of the nature of the accounts referred to the private collection agencies, FTB never expected a great direct monetary return for the program. Revenue attributable to the collection agencies for an average twelve month period is approximately \$4.5 million for OSCAR and \$1.2 million for ISCAR. The specific cost-benefit ratio for the ISCAR and OSCAR programs is much lower than the ratio of in-house collections. Even with the low return per dollar expended, we feel that the ISCAR and OSCAR programs are valuable because they increase awareness in the community of the consequences of ignoring tax debt. In the case of both programs, if the accounts were not referred to the OSCAR and ISCAR vendors, no follow-up would occur after the automated cycles are completed.

"Insourcing" Other State Debts

FTB has created one of the most sophisticated automated collection systems in the country. In recognition of our success, California has been experimenting with "insourcing." FTB has been given responsibility for collecting some debts owed to other State and local agencies. Legislation was enacted granting FTB the authority to collect these debts as though they were tax liabilities. FTB has collected \$348.5 million in non-tax debt during the last three years.

Reciprocal Refund Offset Legislation

California has an offset program through which debts owed to other State agencies and the Federal government may be offset against tax refunds and lottery winnings. In 1995, California remitted \$26.3 million to the Federal government as a result of offsets of State income tax refunds which were used to satisfy Federal tax debts. Over the last five years, we have remitted more than \$91 million to the Federal government. If H.R. 757 were passed, the Federal government could use its offset program to collect certain state tax debts.

Madame Chairman and Members of the Subcommittee, thank you for inviting me here today to share the California Franchise Tax Board's experience with the outsourcing of certain kinds of tax debt. I will also touch on the FTB's experience with the "insourcing" of other types of government debt which have been referred to FTB for collection. Finally, I will discuss the question of reciprocal refund offsets and support for Federal legislation that would allow the Federal government to offset Federal tax refunds to settle past due tax debts as most States voluntarily do now for the Federal government. As you know, California uses its offset program to collect various Federal debts. In 1995 California remitted \$26.3 million to the Federal government as a result of offsets of state income tax refunds which were used to satisfy Federal tax debts. Over the last five years, we have remitted more than \$91 million to the Federal government. If H.R. 757 were passed, the Federal government could use its offset program to collect certain state tax debts.

I am the Executive Officer of the Franchise Tax Board, the State Agency responsible for administering the Personal Income Tax and the Bank and Corporation Tax for the State of California. In fiscal year 1994/95, the two tax programs produced over \$24.1 billion in revenues, or approximately 56.7 percent of California's General Fund. Of the total, Personal Income Tax accounted for approximately \$18.5 billion (43.3%), and Bank and Corporation Tax accounted for \$5.7 billion (13.4%). In 1994/95, 13.4 million personal income tax returns were filed, and nearly one-half million bank and corporation tax returns.

Outsourcing State Tax Debt

Background

1. California has had a program for referring certain types of tax debt to private collection agencies since 1984.
 - The primary purpose of the program was to increase the efficiency of our collection program in recovering the debts owed on small accounts which would otherwise not be pursued.
 - The programs involved are known as OSCAR (out of state collection of accounts referral) and ISCAR (in-state collection of accounts referral.)
2. The California Franchise Tax Board is a highly sophisticated and successful debt collector.
 - Each year we develop a collections workplan which prioritizes the debt so that our budgeted resources are devoted to the most cost effective collection models.
 - Our workplan puts highest priority on those accounts which can be collected through our automated collection system which issues notices during the voluntary collection cycle and can identify assets and issue levies during the involuntary cycle.
 - Only after an account has completed both the automated cycles is it referred to our collectors for manual resolution.
3. Manual collections are labor intensive and expensive.
 - Each year FTB is budgeted to work down to a specific level on the workplan.
 - Historically, this level has been at approximately the 5 to 1 level. That means that we only assign accounts for manual collection if they are expected to return at least \$5 for every dollar of State cost.
 - This system maximizes State returns but historically it meant that small debtors whose debts could not be collected during the automated process escaped all further collection action.
4. In 1984 the Franchise Tax Board sought legislative authority to begin outsourcing debts which were below the 5 to 1 ratio.
 - Our intent was primarily to increase the effectiveness and visibility of collection action among the group of small tax debtors because of its deterrent value.
 - We also hoped to marginally increase the return to the State even though we did not regard many of these small accounts as fully collectible.

How the Program Works

5. Accounts referred to private collectors must be in excess of \$100 and to have completed both the voluntary and involuntary automated cycles.
6. Private collection agencies are selected through competitive bids and multiple year contracts are awarded. The agencies FTB contracts with have to meet stringent criteria having to do with financial viability, staff training, and the ability to meet our strict confidentiality requirements.
 - In order to assure that the private collection agencies are adhering to our requirements we:
 - periodically send in our internal auditors to review their practices,
 - provide training for their staff,
 - co-locate our staff and collection agency staff so that we can do onsite review and problem resolution.
7. Private collection agencies are authorized to take standard manual collection actions - generally they send letters and make telephone contact with the debtor.
8. Collection of tax debt is different from the collection of much commercial debt in that the debtor often has questions about the underlying legitimacy of the debt. This is true even though the debtor has had previous notices and has not chosen to exercise his administrative protest and appeal before the debt "went final."
 - Taxpayers frequently feel that they do not owe the debt.
 - In other cases they may question the legitimacy of penalty or interest calculations.
 - They may assert that the debt was paid but credited to the wrong year or the wrong account.
9. The private collection agencies **are not allowed to take further collection action if the debtor raises questions about the authenticity of the debt or asserts that he has not been given due process.**
 - In these cases, the debt **must be referred back to FTB** and it is resolved by our collection staff who have access to the taxpayer's complete record.

Cost and Return to the State

10. Because of the nature of the accounts referred to the private collection agencies, FTB never expected a great direct monetary return for the program.
 - We refer approximately 24,000 accounts to OSCAR and another 24,000 accounts to ISCAR annually.
 - The accounts referred to OSCAR average \$4,400 while the accounts referred to ISCAR average \$1,500.
 - Of these, the program results in payment in full of approximately 10% of the referrals annually. In other cases partial payment is obtained or the debts are finally discharged as uncollectible.
 - Revenue attributable to the collection agencies for an average twelve month period is approximately \$4.5 million for OSCAR and \$1.2 million for ISCAR.
 - Vendors receive a fixed percentage of the dollars they collect. Under the current contracts, the OSCAR contract pays 15% of the dollars collected while the ISCAR vendor receives 20% of the dollars collected.
11. The specific cost-benefit ratio for the ISCAR and OSCAR programs is much lower than the ratio of in-house collections and the program required significant direct support from FTB collections staff.
 - FTB has 28 full time State staff assigned to the program.
 - They handle the responses to our final letter which informs debtors that their debts will be referred to a collection agency if prompt payment is not received.
 - They also handle all cases where the taxpayer has questions about the nature of the underlying assessment.
12. Even with the low return per dollar expended, we feel that the ISCAR and OSCAR programs are valuable because they increase awareness in the community of the consequences of

ignoring tax debt. In the case of both programs, if the accounts were not referred to the OSCAR and ISCAR vendors, no follow-up would occur after the automated cycles are completed.

13. In States which have less effective automated collection programs the difference between the return on the dollar for State efforts and private efforts may not be as great.

Problems Encountered with the Private Collection Agencies

14. FTB has encountered some problems with the ISCAR and OSCAR programs.
 - One in-State vendor declared bankruptcy while under contract to FTB and we had some difficulty assuring that all of our accounts were returned.
 - In the early days of the program we had some complaints about harassment and collection efforts which were too aggressive.
15. These problems have been resolved through better screening of vendors and the provision of increased training and oversight by FTB staff.

Relationship with the State Employee Unions

Section 19130 of the California Constitution permits "contracting out" under certain conditions one of which is that:

"The contract does not cause the displacement of civil service employees. The term 'displacement' includes layoff, demotion, involuntary transfer to a new class, involuntary transfer to a new location requiring a change of residence, and time base reductions."

This provision did not present a problem with regard to OSCAR since no State employees were collecting out of State debt. However, when legislation initiating ISCAR, the in-State collection program, was introduced in 1986, there was concern that State employees might be displaced. FTB staff met with the State employee unions and obtained their support for a pilot program. The unions were cooperative because FTB had never been funded to collect debts where the likely cost-benefit ratio was expected to be below \$5 to \$1. So long as the legislation required that the ISCAR referrals be made from the accounts below this level on the collection work plan, no State employees would be displaced.

"Insourcing" Other State Debts

Background

FTB has created one of the most sophisticated automated collection systems in the country. In recognition of our success, California has been experimenting with "insourcing." FTB has been given responsibility for collecting some debts owed to other State and local agencies. Legislation was enacted granting FTB the authority to collect these debts as though they were tax liabilities. FTB has collected \$348.5 million in non-tax debt during the last three years.

Child Support

Since 1994, FTB has been collecting delinquent child support referred to us by the district attorneys of 19 California counties. The program will eventually be available to all 58 counties.

- As of March 31, 1996, the program has collected \$87 million from 348,000 cases.
 - \$50 million was returned to counties as reimbursement for AFDC payment.
 - \$37 million went directly to families which are not on the AFDC rolls.
 - Another \$34 million in child support delinquencies was collected through referrals to our offset program in which we offset county debts against income tax refunds and lottery winnings.
1. We have been able to build an automated system to handle child support delinquencies which parallels our tax collection system.
 - By using the automated system as our primary collection vehicle, the return for each dollar of cost has been \$79 to \$1.

Vehicle License Fee Collections

1. Since 1994, FTB has been responsible for collecting delinquent vehicle license fees for the Department of Motor Vehicles.
2. When we received the program, it was primarily a manual process. For the first 18 months we ran a manual collection program while we developed an automated system.
3. With the completion of the automated system, our monthly collections have doubled from \$3 million to \$6 million per month.
4. Since the inception of the program, we have collected more than \$79 million from 475,000 accounts.

Court-Ordered Debt Collections

For nine months, FTB has been working with nine counties to develop and implement a program to collect court-imposed fines, penalties and restitution orders. By the end of fiscal 1995/96, we will have collected more than \$2 million from 32,000 cases. As we come to understand the nature of these debts, we hope to be able to develop an effective automated system in this area as well.

Due Process Concerns

In the case of accounts which FTB refers to OSCAR and ISCAR, the private collection agency must return all accounts to us for resolution if the taxpayer questions the legitimacy of the debt. In the case of debts which are "insourced" to FTB from other agencies, a similar rule applies. If the debtor questions the legitimacy of the debt, the amount of the debt, or asserts that he has not had due process, FTB returns the debt to the referring agency for resolution.

Reciprocal Refund Offset Legislation, H. R. 757

Current Federal Benefits Received from the California Offset Program

As you know, California has an offset program through which debts owed to other State agencies and the Federal government may be offset against tax refunds and lottery winnings.

1. The California program began in 1975. That year we intercepted tax refunds for 15 State agencies. We collected \$446,000 on 7,500 delinquent accounts.
2. The program has grown considerably. The IRS became an active participant in the California offset program in 1991 when it received \$16.3 million from 73,136 accounts.
3. In the 1995 process year we received 2.98 million request for offsets from county, State, and Federal agencies.
4. Of these, refunds were offset for 384,404 accounts for a total of \$76.9 million.
5. Federal offset requests made up 743,121 of the 1995 offset requests.
 - We were able to offset refunds for 92,691 Federal accounts and remitted \$26.3 million to the Federal government in 1995.
6. Since 1991, California has remitted \$91.8 million to the Federal government.

Potential Benefit to California from a Reciprocal Federal Offset Program

1. FTB has estimated the impact of expanding the Federal offset program to include the collection of State tax debts.
 - After matching a tape of State tax debts to a tape of IRS refunds we identified approximately 200,000 accounts which were on both tapes.
 - The value of the offsets which could have been made was \$85 million.
2. It is probable that California would recognize something in the order of \$85 million in the

first year of an expanded offset program.

3. It is unclear what the annual value of expanded Federal offsets would be once the outstanding debts had been recovered, however, it is likely to be a substantial amount on an ongoing basis.
4. The Federation of Tax Administrators (FTA) estimates that a Federal offset program could increase receipts to income tax States by about \$150 million to \$200 million annually in the early years and by somewhat lesser amounts as the inventory of receivables is reduced.

Safeguards Which Should be Included in a Federal Offset Program

Based on the Franchise Tax Board's experience with our offset program, I support the following concepts that are included in H.R. 757.

1. No account will be referred for offset until all the administrative protest and appeal processes have been exhausted and the taxpayer has received due process.
2. California has established a hierarchy of debts by statute which provide direction in case the offset amount is not sufficient to satisfy all outstanding State, local, and Federal debts. I support the provision in the Federal legislation that identifies such priorities as well.

Finally, I know that concern had been expressed that States might use a Federal offset provision to collect unpaid "source tax" debts from non-residents' pension income. In fact, Committee Chairman Archer raised that issue in a letter last year to California Governor Pete Wilson. The enactment of P.L. 104-95, pension source tax restrictions, has eliminated that possibility.

Conclusion

In conclusion, I want to thank you for inviting my testimony. I would gladly offer my assistance to the Subcommittee as these proposals advance. I would hope that the Subcommittee would soon act favorably on the reciprocal refund offset measure sponsored by Rep. Andy Jacobs. This measure enjoys bipartisan support and to my knowledge has not received any strong objections from members of this Committee. Passage of H.R. 757 will be of great help to the States as they strive to balance their budgets without raising taxes. It is always better to collect all of the taxes that are legally due and owing rather than imposing an additional burden on honest taxpayers. Passage of H.R. 757 will help the States to accomplish this goal. This measure is also a revenue raiser for the Federal government. The Joint Committee on Taxation has scored the measure as bringing in \$8 million dollars to the Federal government over five years in addition to the over \$80 million the Federal government now receives annually from those States who voluntarily assist the Federal government through their offset programs.

Chairman JOHNSON. Thank you, and also for your interesting numbers.

Mr. Duncan.

**STATEMENT OF HARLEY T. DUNCAN, EXECUTIVE DIRECTOR,
FEDERATION OF TAX ADMINISTRATORS**

Mr. DUNCAN. Thank you very much, Madam Chairman, Members of the Subcommittee. It is a pleasure to be here on behalf of the Federation of Tax Administrators, which is an association of the principal tax administration agencies in each of the 50 States, the District of Columbia, and New York City.

My purpose today is to first, share the results of a survey concerning the use by State tax administration authorities of non-government contractors for collecting State tax debts, and second, to urge the Subcommittee to approve H.R. 757, establishing a refund offset program for past due legally owing State tax debts.

The survey we conducted was done in April of this year to gather information for the purposes of the Subcommittee, on the State use of private collection agents.

Our results can be summarized, broadly, as follows. First of all, 39 of the 51 jurisdictions surveyed used outside agencies for the collection of tax delinquencies, and some have done so for as long as 10 to 15 years.

At the outset, most of these programs were primarily for the collection of individual income tax liabilities of persons who were no longer residing in the State.

Over time, there has been an evolution, however, to a greater use of outside collectors for in-State taxpayers. We now have 25 States that use it for in-State taxpayers as well as out of State, and for a broader array of taxes, both individual and business taxes.

The types of activities for which they use private collectors include skip tracing, collection letters, telephone calls, payment processing, and negotiating and approving payment plans.

Smaller numbers use them for asset seizure, liens, and levies, garnishments and negotiating compromises of the debt.

It is important to recognize that in no State is the collector given carte blanche authority, but as these gentlemen have indicated, each of them operates under a contract that is very specific with respect to the procedures that will be used, the timing of the calls, the training that is required, and the like.

Most State programs are small in relationship to the overall collection effort. Again, it focuses on individual income taxes.

But again, there is a growing number of States that are making the private collection agency an integral part of their overall collection effort, much like the State of Michigan. I would refer you to New Jersey, Delaware, and Pennsylvania in that regard.

States see these as fine complements to their own collection programs. With respect to compensation, they are largely compensated on a contingency basis, except where they are an integral part, where they may be on an hourly basis.

In terms of disclosure, generally, the collector is provided only with a name, address, Social Security number, tax type that is owed, and the amount that is owed. They do not have access to detailed account information.

We have provided complete results of this survey to the Subcommittee.

Let me turn, now, to H.R. 757 which would establish a program for the IRS and the Treasury Department to offset a Federal tax refund to satisfy past due, legally owing State tax debt.

State tax administrators see this as a simple, straightforward matter of reciprocity in tax administration.

As you have heard, 32 States currently provide this service for the Federal Government. H.R. 757 would allow them to reciprocate and include State tax debts as a part of the current Federal offset program.

There would be no State tax debt satisfied until all current debts are satisfied from the offset.

I want to speak a moment to the issue of using the offset program for nonresidents, and the concern that has been expressed.

We would urge the Subcommittee to move cautiously in this area and to avoid placing unreasonable restrictions on the types of State tax debts that could be satisfied under the offset program.

To deny the applicability of the refund offset program to all types of tax debts owed by all nonresidents is to suggest that income taxes imposed on any nonresident are, in some sense, illegitimate. Nothing could be further from the truth.

The Supreme Court has upheld the right of a State to levy an income tax against a nonresident for 75 years, and all States do so. It would be as if to say a resident of New York could travel to Connecticut every day to earn his or her livelihood and would have no liability to the State of Connecticut.

That is simply not the way our income taxes work.

The Subcommittee needs to remember that before a debt is referred to the offset program, it must be reduced to a judgment in the originating State, meaning it has to go through a process that meets the due process requirements of the constitution.

There is another required notice to the taxpayer before it can be referred to the IRS and that notice must go to the most current address known to the IRS.

Finally, if the taxpayer protests that last letter, the debt cannot ultimately be referred for offset. So we have all of the processes at the State level to reduce it to a judgment and a subsequent notice before it could ever go to the IRS for offset.

Finally, once the offset is made, there is still one more chance to contest the liability and to have the refund released in the name of the taxpayer.

As I have indicated, we think this is a matter of reciprocity in tax administration and look forward to working with your Subcommittee to produce an acceptable measure.

Thank you.

[The prepared statement and attachments follow:]

**STATEMENT OF HARLEY T. DUNCAN
EXECUTIVE DIRECTOR
FEDERATION OF TAX ADMINISTRATORS**

Madame Chairperson and Members of the Committee:

My name is Harley Duncan, and I am Executive Director of the Federation of Tax Administrators. My purpose before the Subcommittee today is twofold. First, I have been asked to share the results of a survey conducted by the Federation concerning the use by state tax administration authorities of non-government collection agents for collecting state tax debts. Second, I wish to urge the Subcommittee to approve the provisions of H.R. 757, establishing a refund offset program for past-due, legally owing state tax debts.

The Federation of Tax Administrators is an association of the principal tax administration agencies in each of the 50 states, the District of Columbia and New York City.

State Use of Private Collection Agents

Introduction

This survey of the 50 states and the District of Columbia was conducted in April of this year. Our goal was to learn as much as possible about the experiences states have had with non-government contractors, rather than to develop a statistical analysis. All 51 governments were queried; however, not every question fit each state's process. Thus, not every question was answered, and it would not be accurate to report in terms of what percentage of the states take one approach, and what percentage takes another. Instead, I will focus on the issues, successes and problems, and variations on approach that were revealed by the survey. A detailed compilation of the survey results has been provided to the Subcommittee.

Summary of Results

The broad results of the survey can be summarized as follows:

- A large number of state tax authorities (39) use outside agencies for the collection of tax delinquencies; some have done so rather extensively for ten or 15 years.
- At the outset, these programs tended to be primarily for the collection of delinquencies from individual income taxpayers who are no longer in the state. Today, in-state programs are increasingly popular, and outside collectors are assigned a broader array of state tax debts.
- The activities for which the largest number of states turn to private collectors include, skip tracing, collection letters, telephone calls, payment processing, and negotiating and approving payment plans. Smaller numbers use contractors for asset seizure, liens/ levies, garnishment, and negotiating debt compromises.
- While a large majority of states use outside collectors, these are typically small programs in relation to the entire collection activity. Several states, however, are now using outside agencies as a primary or integral part of the collection program rather than only as a method of dealing with residual debts remaining after state collectors have worked the account.
- Overall, states have reported to us that they find these programs to be a useful component of an overall collections program and that they generally do not receive complaints about the use of outside collectors.
- States generally do not disclose detailed account data to outsider collectors, and disclosure restrictions seem to provide adequate protection of taxpayer privacy.

Detailed Results

Types of Taxes. There are 39 states which use private or non-government agents in the collection of delinquent taxes. The oldest of these programs dates to 1975; most were instituted in the mid-1980s. About one-third of the states use outside agencies for the collection of individual income taxes only, while two-thirds have programs for the collection of all taxes, including individual income taxes.

A slightly higher number of state use outside contractors for out-of-state accounts than for in-state accounts, but my personal perspective is that this gap is shrinking. Fifteen states use outside agents for collecting certain types of debt pertaining to all

tax types for both in-state and out-of-state accounts, and four others use it for both in-state and out-of-state individual and business income accounts and sales tax receivables.

Contracting Agents. Most states contract with private collection agencies, although four states also have contracts with independent or prosecuting attorneys. We identified two states that contract with county sheriffs.

Seven states reported that they require their contractor to devote a special team to their work, so that a collector will not be working retail delinquencies and tax delinquencies at the same time.

While almost all states contract on a contingency or percentage-of-collection basis, there are programs for flat fees – that's usually reserved for collecting bounced checks – and two states tell us they add a collection fee to the total tax, penalty and interest.

Activities Contracted. States contract out for a wide variety of collection activities, including skip tracing, sending collection letters, making phone calls, and even receiving and processing payments. The activities that are least frequently contracted for are face-to-face visits, lockbox services and asset location.

The most frequent coercive action taken by an outside agent is to make phone calls. A large number of states – by actual count, 27 of the 39 – said they allow these agents to negotiate and usually approve payment plans; a smaller number give their agents the authority to negotiate compromises. However, the states must usually give final approval to each compromise.

We identified eight states which allow asset seizure, seven states which give the authority for wage garnishment, and more than a dozen which will permit the outside agency to undertake litigation, although this seems to universally require prior approval of the state.

A synopsis of the types of activities for which states use outside agencies is presented below.

Activity	Number of States	
	In-State	Out-of-state
Skip Tracing	17	20
Collection Letters	20	23
Collection Calls	22	27
Face-to-Face Visits	4	6
Receiving Payments	17	20
Lockbox Services	1	1
Asset Location	7	9
Litigation	9	15
Telephone Dunning	25	32
Asset Seizure	4	7
Issuing Liens/levies	6	5
Wage Garnishment	7	9
Negotiating Pay Plans	23	27
Approving Pay Plans	19	24
Negotiate Compromise	9	11
Approve Compromise	1	1

It's important to remember, as you consider these activities, that the outside collectors do not have a *carte blanche* authority. There are extremely important operational details that must be addressed by anyone entering into such an arrangement. Each state writes a contract with its outside collection agents that spells out such things as limitations, tolerances, calling hours, tone of messages,

training, oversight, supervision, disclosure restrictions, and even the quality of employee. The tax agency will strive to make sure, through the contract, that it has as much confidence in and control over the actions of a non-government collector as it will over its own employees.

Referral Criteria. There is no quick, easy and accurate to summarize the types of debts that are referred to the non-government collectors in terms of age, size, etc. It is however, fair to say that in a majority of states, they tend to be the older, smaller-dollar accounts, perhaps those that are being unworked or that have been unsuccessfully worked inside the tax agency. In other words, the outside agencies tend to receive the residual debt remaining after a variety of actions by the state tax authority.

However, this generalization does not hold in all cases. There are states which have rather extensive programs where the outside collection agencies are considered as a more of a partner in the collection process and even a collector of first resort. You will hear from some of them today. One state will send out a debt as young as 45 days, right after the first notice has been sent. A number of states told us they will refer debts of \$50 to \$100 – and in several cases even \$25. Another state works the debt with in-house personnel only after the collection agency has been unsuccessful in its efforts. For programs of this type, I would suggest that you analyze the use of outside contractors in states such as Michigan, New Jersey, Delaware, and Pennsylvania among others.

The short answer to the question seems to be that a state determines the criteria for referring accounts based on its own internal resources, the age of its technology, the type of tax debt – whether income, sales or business – and generally make a judgment about what makes sense within that scenario.

Collection rates. The differences in approach to the use of outside agents makes it impossible to effectively compare collection rates across states, and detail has not been provided in the materials presented to the Subcommittee. Clearly, the rate of collection has a direct relationship to the quality of debt that is referred. Beyond this, some general observations can be made. For many, the referral actually collected (in dollar terms) – before fees are subtracted – will be in the 5-8 percent range. These numbers will go higher – but probably never reach 50 percent – as a state expands its program and sends to the non-government collector newer and easier-to-collect debts.

I mentioned earlier that the non-government program tends to be small in comparison with the overall collections effort, although there seems to be a trend toward more outsourcing. For both in-state and out-of-state programs, our survey showed that the ratio of total delinquent tax collections by outside agencies compared to all delinquencies ranged from less than one percent to as high as 9 percent. That number will be higher in isolated instances.

Disclosure Issues

These non-government collectors generally have access only to the information necessary to collect the delinquency – the taxpayer's name, address, Social Security number (which is used for account control as well as locating assets and skip-tracing), the tax type, and the tax due. Other information may, but not always, be released to the non-government collector at the taxpayer's request. This is usually information necessary to resolve an account dispute. Also, an account collection history may be available to the collector.

There are a few states which routinely give the non-government collectors access to their agency computer files. Those agencies have contracted for a broader scope of taxpayer problem resolution. Those states reported that the non-government collectors are considered agents of taxation, and they are subject to the same disclosure rules as government employees.

In fact, the survey revealed that there are instances in which a contractor is subject to more stringent penalties for unauthorized disclosure of information, or abusive collection practices, than are the state employees. These penalties are usually spelled out as contractual or employment sanctions, but in some 20 states, there are also statutory criminal penalties for abusive or unauthorized practices, and frequently civil penalties and civil actions for damages apply.

Public Perception

Overall, the public seems to have no more problems dealing with non-government contractors as they do dealing with government employees. Seven states reported to us that they have never received a complaint from a government representative, such as a legislator, and another 13 states reported that such complaints were rare. Only five states told us that they received even occasional complaints from legislators and governors -- and none reported regular complaints. As for taxpayer complaints, they were rare or occasional; only one state said they were regular.

State Perspectives

Sixteen said the use of a non-government collector was a useful component of their collection program, and an additional 10 states reported their program was very successful. Four states told us they felt their programs were not very successful.

Finally, we asked states what they would tell others who are contemplating these programs. Their comments were quite positive -- for instance, these two comments: "We have found collection agencies to be responsive to our needs. They work effectively with taxpayers to resolve the delinquency." And "My experience with private collection agencies has been very positive."

A singular warning message also was revealed: don't underestimate the in-house staff resources necessary to properly launch and oversee a non-government collections contract.

To quote Arizona, "Tracking payments is tedious, as some are paid directly to the Department of Revenue instead of the agency. Other overhead includes fielding complaints and developing and maintaining systems to refer and update the inventory of assigned accounts."

Illinois warned that the process to change agencies is time-consuming and requires a great deal of intra-bureau cooperation in setting up. Maryland, which has extensive experience, said that developing the interface to and from the collection agency requires extreme planning. Oklahoma called it an "ongoing challenge."

Overall, I believe Oklahoma quite nicely summed up the states' experiences, as revealed in our survey, when it reported, "We feel, however, that the use of an outside agency is appropriate and useful if it is determined ahead of time where such activity fits."

Finally, I will tell you of the seven state agencies that have had a program in the past, and dropped it. One state dropped a 15-year program because elected officials preferred to have the work done by state employees. One upgraded its internal collection functions, and another put the resources it had spent on the outsourced program into internal collections and managed to increase its productivity. Yet another was dropped because of budget cuts. All but one of these programs were solely for the collection of out-of-state taxes.

Conclusion

The survey on state tax agency use of outside contractors for the collection of delinquent tax debts can answer several of the questions the Committee has. In particular, it answers questions on who is using outside contractors, the types of taxes and debts for which they are used, and the types of activities for which outside contractors are engaged. It is also instructive in gauging public perception regarding

the use of outside contractors, eliciting state administrator perceptions on their utility, and highlighting some of the operational concerns that will need to be addressed if they are used at the federal level.

What it does not and cannot speak to is the "economics of delinquent tax collection." By this I mean the relative rates of recovery for various types of taxes, the costs of in-house vs. contracted collectors and the break points for using various types of efforts. The variability among the states simply does not allow complete and accurate comparisons on these issues. For this reason, I would urge that any test of the concept of contract collectors be carefully designed such that at the "end of the day" the answers the Committee and Internal Revenue Service needs will be available.

H.R. 757 - Tax Refund Offset

Introduction

I will turn my attention now to a subject that is of the highest importance to state tax administrators -- the question of reciprocal refund offsets.

H.R. 757 would establish a program under which the Internal Revenue Service (IRS) and the U.S. Treasury Department could offset or withhold a federal tax refund to satisfy a past-due, legally owing state tax debt. State tax administrators see this issue as a simple, straightforward matter of reciprocity in tax administration between state and federal governments.

The federal government may levy on -- essentially, seize -- state income tax refunds to satisfy delinquent federal tax debts. The IRS currently is able to exercise its right to levy on state refunds in 32 states and the District of Columbia by working through those states' refund offset programs. This occurs under a cooperative arrangement between the state tax agency and the IRS district(s).¹ States generally are not compensated for these offsets. States collected \$81.68 million for the federal government through their refund offset programs in 1995.

IRS and Treasury do not currently possess statutory authority to reciprocate and offset federal tax refunds to satisfy state tax debts. H.R. 757 would provide such authority by adding the current offset program authorized under I.R.C. § 6402 to satisfy debts owed for child support and to other federal agencies an authorization to offset federal tax refunds to satisfy federal tax debts.

Description of Proposal

The proposed legislation would amend IRC § 6402 (the existing federal offset program) by adding a new subsection allowing the Secretary of the Treasury to establish an offset program for legally enforceable, past due state tax obligations. To be eligible for the offset, the delinquency must be one that has been reduced to a judgment under state law and is no longer subject to administrative or legal appeal at the state level. As with other federal agencies, states would be further required to take steps prior to referring the debt to the IRS to notify taxpayers of the obligation and to inform them that such debt will be referred to the IRS for offset if not satisfied in 60 days.

State tax debts would not be satisfied from an offset until all federal tax debts, assigned child support, non-assigned child support and debts due other federal agencies were satisfied. The Secretary could charge the states for the costs of the offset program in the same manner as other federal agencies are charged.

¹ There are 41 states, including the District of Columbia, with a broad-based individual income tax. Included in the 32 states with an offset program for federal tax debts is Alaska, which has no individual income tax. It does, however, have a unique state refund program that works in a similar manner.

Once an offset is made, taxpayers could still protest the amount due. The legislation also contains provisions allowing a joint federal refund to be split among both spouses if only one spouse owes the state tax debt. The legislation would also amend IRC § 6103 to permit the disclosure of information regarding the offset to state tax agencies when necessary.

History of Proposal

Rep. Andrew Jacobs (D-Ind.) and Rep. Jim McCrery (R-La.) introduced H.R. 4138 in the 103rd Congress. The House Ways and Means Subcommittee on Select Revenue Measures held a hearing on H.R. 4138 in October, 1994. Treasury formally voiced its support for the proposal.

Rep. Jacobs along with Rep. McCrery and Rep. Moran introduced the bipartisan H.R. 757 in February, 1995. Senator Orrin Hatch along with Sen. Conrad introduced the bipartisan S. 1408 in November, 1995. The bill was included in a package of miscellaneous tax proposals considered by the House Ways and Means Committee in July, 1995, when Treasury again said in written testimony that it had no objection to the provision.²

Neither during the hearings nor at any other time has the bill encountered opposition from any official or organization.

Reasons to Support H.R. 757

There are several reasons supporting passage of H.R. 757:

- The issue is simply one of reciprocity in tax administration. The legislation does nothing more than allow states to participate in an existing federal offset program and allow the IRS to reciprocate for what the states are already doing on behalf of the U.S. government, an effort which returns from \$50-\$100 million annually to the U.S. Treasury.
- These tax delinquencies which would be subject to the program have already completed all available protests and appeals within the state, i.e., taxpayers have exhausted or foregone available legal protests of the tax debt. Beyond this, IRS procedures require that taxpayers be given an additional specific notification before any offset occurs.
- IRS would be paid for its expenses, even though states seldom require the federal government to pay for its participation in their programs.
- Offsetting for state tax debts would not cannibalize any existing program because state tax debt would not be satisfied until all other currently authorized federal offsets are satisfied.
- Offsetting federal refunds for state tax debts will be an effective method of collecting delinquent debts owed the states. The Federation of Tax Administrators (FTA) estimates that a federal offset program could increase state receipts by about \$150 million to \$200 million annually in the early years of a program and by somewhat lesser amounts as the current inventory of receivables is reduced.
- A reciprocal program would also be expected to increase federal receipts because it is anticipated that the remaining income tax states would begin to offset for the federal government in order to participate in the IRS offset (except in any state where the Secretary of Treasury chooses to not have federal debts offset). The Joint Committee on Taxation has estimated that reciprocal refund offset legislation would benefit the federal government by some \$8 million.
- To the extent that refund offsets cost-effective way to collect debts are an effective debt collection tool, there is no reason why the state-federal program should not

² The Treasury Department did indicate that there were several technical concerns it wanted to address in the final version of the legislation. These technical issues have been addressed in S. 1408 as introduced by Sens. Hatch and Conrad. Reference continues to be made here to H.R. 757 in interests of simplicity, but the changes incorporated in S. 1408 should be included in any final legislation. An explanation of the changes made between H.R. 757 and S. 1408 will be provided to the Subcommittee.

be fully reciprocal. The principal policy issue surrounding refund offsets has been whether they affect voluntary compliance. If they do, the federal government should stop offsetting its debts against state refunds; if not, it should allow reciprocal offset of state debts against federal refunds. By making permanent the federal refund offset programs for child support and student loans, Congress has made the policy judgment that offsets are an effective collection tool that should be used. We agree.

- This measure has been aired before two hearings and has never received any public or government objections. The U.S. Treasury Department and IRS support the proposal.

The Nonresident Issue

Some concern has been expressed about using the refund offset mechanism to collect state tax debts owed by nonresidents of a state. We would urge the Committee to reject this notion and not place conditions on the types of state tax debts which could be satisfied under the program. We take this position for several reasons.

- To deny the applicability to tax debts of nonresidents is to suggest that all income taxes imposed on nonresidents are in some sense illegitimate. Nothing could be further from the truth. The U.S. Supreme Court has for 75 years sanctioned the levy of state income taxes against nonresidents who earn income within a particular state provided that certain tests of due process and equity are met.
- The Committee should remember that before any debt is referred to the offset program it will have been reduced to a legal judgment against the taxpayer in the state, meaning the taxpayer must have been accorded significant opportunities to protest and otherwise resolve the delinquency. In addition, before a debt is certified to the offset program, the taxpayer will have received one additional notice at the latest address contained on a federal tax return.
- The large majority of tax debts owed by nonresidents are very likely to have been accrued while the individual was a resident of the state. That is, experience shows that many nonresident debts are owed by persons who were former residents of the state, but have subsequently moved to another state.
- This is a matter of reciprocity in tax administration, not tax policy. If Congress is concerned about particular tax policies of the states, it should address those issues directly on their merits and not in a back-door fashion by denying the use of effective, legitimate collection tools.

Conclusion

This is a noncontroversial measure whose time clearly has come. We greatly appreciate the work of Reps. Jacobs and McCreery in drafting and sponsoring H.R. 757, as well as the support for the bill of the Treasury Department, especially the Internal Revenue Service. We appreciate the time they have devoted to drafting a bill that is acceptable to them. Federal-State cooperation in tax administration is increasing rapidly, and enactment of this bill would be a welcome step towards increased interdependence. State tax administrators urge you to take all necessary steps to assure that this legislation is included in the next available bill.

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Responses to FTA Survey B-10/96, Private Collection Activities

- Detail is given where provided by the state.
- "CA" refers to the California Franchise Tax Board, which collects income taxes for the state.
- The California Board of Equalization is designated as BOE; that agency is responsible for administering sales and other taxes in California.
- On the question of how the contractors' fees are determined, answers of "contingency fee," "percentage of dollars collected," and "commission" and "sliding fee commission" have been placed into the same category entitled "contingency."
- Responses from states that do not have a current contract have been compiled separately and are at the end of the survey.
- Certain additional details and analyses provided by the states are attached.
- On the question of how accounts are selected for referral, answers are compiled so as to assist the reader in following all the criteria required by each individual state. Thus, the matrix is somewhat spread out.
- On the question of volume, Oregon's answers were given based on monthly volume; the answers have been multiplied by 12 to arrive at an approximated 12-month annual figure.
- The responses to questions about gross recovery rate are not given because respondents do not track that statistic in a consistent manner, and because the answer is heavily dependent upon the type of debt referred.

**Private Collection Activities
RESPONSES FROM STATES
WITH A CURRENT PROGRAM**

1. Do you use private or non-government agents in the collection of delinquent taxes? What year did the program begin?

Yes

AZ (1987), AL, CA¹ (1986), CO (1988), CT, DE (1981), HI (11-95), IA (1983), IN (1983), KS (1-96), KY (1986), FL (1986), ID (1970), IL (6/84), LA (11-90), ME (3-84), MD (1986), MA (1983), MI (1985)², MN (1977), MO (1984), MS (1988 & 1994)³, MT (1975), ND (1976), NE (1982), NJ (1993 deficient, 1995 delinquent), OK (11/94), OR (1983), OH (1986), PA (1975), SC (1987), TN (2-93), UT (June 1995), VA (1986), VT (1991)⁴, WA (1992), WI (1982), WV (1989).

Texas does not have an outsourcing program per se, but it does have a contract with a temporary employment service that supplies personnel to staff the state's Automated Collections Center. Details are attached.

2. How are referrals currently made to your outside "collection agent"?

By this agency only

AZ, AL, CA, CT, DE, HI, IA, IL, IN, KY, LA, ME, MD, MA, MN, MO, MS, MT, ND, NE, NJ, OK, OR, OH, PA, SC, TN, UT, VA, WA, WI, WV

From another contractor (No responses)

3. What types of outside "collection agents" do you use? Check all that apply.

Independent attorneys

IN, ME, OH

Private collection agencies

AZ, AL, CA, CT, DE, HI, IA, IL, IN, LA, ME, MD, MA, MN, MO, MS, MT, ND, NE, NJ, OK, OR, OH, PA, SC, TN, UT, VA, WI, WV

Firms of a certain size or related criteria (please specify)

DE

MA (experienced and capable of handling large volumes of accounts)

WA (nationwide)

Skip tracing service specialists (no responses)

Other (specify)

AZ Attorney General for high-dollar balances and accounts that may be litigated.

ME County Sheriff Association, mailing service for certified mail, in-house collectors that work with the state employees.

IN Sheriffs within each county that they serve also collect taxes for the state.

MO Prosecuting attorneys.

4. If you use private collection agencies, do you require that your accounts be worked by a dedicated team (as opposed to a private collection agent collecting retail debts and delinquent taxes during the same shift)?

Dedicated team required

IL, MA, MO, MS, NJ, OH, PA,

We have no such requirement

AZ, AL, CA⁵, CT, DE, HI, IA, IN, LA, ME, MD, MN, MT, ND, NE, OR, SC, TN, VA, WA, WV

We have no such requirement, but that is how our accounts are worked anyway

UT, WI

¹ See additional explanations for California FTB attached.

² Currently developing a modified ACS system RFP. There will be significant changes to the existing structure of private sector involvement.

³ Out of state accounts only began in 1988 and expanded to a full-time procedure on Jan. 1, 1994.

⁴ We have recently passed legislation to allow outsourcing of all tax types. Prior to this year, in-state income accounts were completely off limits and business taxes were limited to trust taxes more than 540 days old.

⁵ Note, however, that collection agency staff are prohibited from using state information in the collection of non-state debts.

5. For which taxes do you use non-government collectors?

	<u>In-State Accounts</u>	<u>Out-of-State Accounts</u>
Individual Income	CA, HI, IA, IL, ME, MD, MI, MN, OK, OH, UT,	CA, HI, IA, IL, MD, MI, MN, MS, ND, OK, OH, UT,
Business Income	IA, IL, MI, MN, OH	CA, IA, IL, MN, MI, ND, OH
Sales / gross receipts	IA, IL, ME, MI ⁶ , MN, OK,	FL, IA, IL, MS, MN, ND, OK, WA
Excise		WA
All tax types	AZ, CT, DE, KS, IN, MA, MO, MT, NJ, OR, PA, SC, VA, WI, WV	AZ, AL ⁷ , CT, CO, DE, ID, IN, KY, LA, ME, MA, MO, MT, NJ, NE, OR, PA, SC, TN, VA, VT, WI, WV

6. For which of the following activities do you currently use private collection agents?

	<u>In-State Accounts</u>	<u>Out-of-State Accounts</u>
Skip tracing OR, OH, PA, SC, UT,	CA, DE, HI, IA, IN, MD, MO, MT, NJ, MS, NJ, OR, OH, VA, WI, WV	AL, CA, DE, HI, IA, IN, LA, MD, MO, MT, PA, SC, UT, VA, WI, WV
Collection letters	AZ, CA, CT, DE, HI, IA, IN, MD, MA, MO, MT, NJ, OK, OR, OH, PA, SC, UT, VA, WV	AL, AZ, CA, CT, DE, HI, IA, IN, LA, MD, MA, MS, MO, MT, NJ, OK, OR, OH, PA, SC, UT, VA, WV
Collection calls	AZ, CA, CT, DE, HI, IA, IN, ME, MD, MA, MO, MT, NJ, OK, OR, OH, PA, SC, UT, VA, WI, WV	AL, AZ, CA, CT, DE, HI, IA, IN, LA, ME, MD, MA, MO, MS, MT, ND, NJ, OK, OR, OH, PA, SC, UT, VA, WI, WA, WV
Face-to-face visits	CA ⁸ , MD, MT, PA	CA, LA, MD, MT, ND, WA
Receiving Payments	AZ, CA, DE, HI, IN, IA, MD, MA, MT, OK, OR, NJ, ⁹ SC, UT, WI, WV	AZ, CA, DE, HI, IN, IA, LA, ME, MD, MA, MS, MT, ND, OK, OR, SC, UT, WI, WA, WV
Lockbox services	MT	MT
Asset location	CA, DE, IA, MT, OR, UT, WI	CA, DE, IA, LA, MT, TN, OR, UT, WI

Other

NE: Processes as necessary to collect delinquencies (out of state)

IL: Collection of referred accounts, both in-state and out-of-state.

TN: All collection activities after the state has declared an account non-collectible.

⁶ Also uses non-government collectors for state agency debts.⁷ Except ad valorem⁸ While all of the listed activities are permitted, face-to-face visits are believed to occur only rarely.⁹ Contract related only

7. What activities or coercive actions are your outside agents permitted to take?

	In-State Accounts	Out-of-State Accounts	Subject to These Limits
Litigation	CA, DE, HI, IA, IN, MT, MN, PA, WI,	CA, DE, HI, IA, IN, LA, MT, MN, MS, NE, PA ¹² , ND OR, WA, WI	AL ¹⁰ , IN ¹¹ , LA ¹³ , IA ¹⁴ , MT ¹⁵ , CA ¹⁶ , OR ¹⁷ , WI ¹⁸
Telephone dunning	AZ, CA, CT, DE, HI, IA, IL, IN, MA, ME, MD, MN, MO, MT, NJ, OK, OR, OH, PA, SC, UT, VA ¹⁹ , TN, WI, WV	AZ, AL, CA, CT, DE, LA, HI, IA, IL, IN, MA, NE, ND, ME, MD, MS, MN, MO, OK, OR, MT, NJ, OH, PA, SC, UT, TN, VA, WA, WI, WV	VA ²⁰
Asset seizure	DE, MT, TN, UT,	CA, DE, MT, ND, NE, UT, WA	DE UT ²²
Issuing liens/levies	DE, MT, NJ, OR, SC, TN	DE, MT, NJ, OR, WA,	DE
Wage garnishment	IN, MN, MT, OR, SC, TN, UT,	IL, IN, MN, NE, ND, MT, OR, UT, WA,	UT
Negotiating payment plans	AZ, CA, IL, DE, HI, IN, IA, MA, ME, MD, MO, MN, MT, NJ, OK, OR, OH, PA, SC, TN, UT, VA, WI	AZ, AL, CA, HI, IA, IL, IN, DE, LA, MA, ME, MN, NE, MD, MO, MT, NJ, ND, OK, OR, OH, PA, SC, VA, UT, WA, WI	
Approving payment plans	AZ, CA, IL, DE, IN, MA, ME, MD, MN, MO, MT, NJ, OK, OR, OH, PA, UT, VA, WI	AZ, AL, CA, IL, DE, IN, LA, MA, NE, ME, MD, MN, MO, MT, NJ, OK, OR, OH, ND, PA, UT, VA, WA, WI	IN ²² UT ²²
Negotiate compromises	DE, IA, MN, MO, MT, PA, SC, TN, WI	DE, IA, NE, MO, MT, ME, ME, MN, PA, SC, WI	DE
Approve compromises	PA	PA	MN

¹⁰ Requires prior approval¹¹ With written approval from the state¹² Detail of limitations is attached.¹³ With Department approval and Attorney General approval.¹⁴ Prior approval¹⁵ Must contact and we assign debt to¹⁶ Occurs rarely and requires approval¹⁷ Requires Attorney General approval.¹⁸ Subject to the state's approval; in-state litigation is hardly ever used.¹⁹ Activities for in-state accounts have been done in the past on a pilot basis only, but full implementation of in-state delinquent account collections by private contractor will begin in July 1996.²⁰ State approves of calling hours and days²¹ With prior approval and expenses paid from the standard collection fee; same limit applies to wage garnishments.²² To be paid off within 12 months.²³ Up to 12 months

8. How do you assign or select accounts for referral:
8. (a) of IN-STATE ACCOUNTS.

Age				
<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
HI > 1 year ²⁴				IA > 120
IL > 6 mos	IL > 1 yr	IL > 1 yr		IN
MO 7-9 months	MO 7-9 months	MO 9-12 months	MO 12 mos	DE > 120 days
ME 1 month				OR
MA > 120 days	MA > 120 days	MA > 120 days	MA > 120 days	MA > 120 days
MN > 90 days	MN > 90 days	MN > 90 days		
MT > 2 ²⁵				NJ 45 days ²⁶
OK > 6 months		OK > 6 months		PA 2-3 yrs
OH < 3 years	OH < 3 years			SC > 2 years
VA > 2 years	VA > 2 years	VA > 2 years		WI > 3 years
UT 2 years				
Dollar amount (greater or less than?)				
<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
CA ²⁷ > \$100				AZ > \$50 < \$50
HI < \$5,000				CT > \$500
IL > \$50	IL > \$50	IL > \$50		IA < \$500
		ME < \$5,000		DE > \$501.
		MT > \$100		MO \$25; OR,
MA < \$10,000	MA > \$100	MA > \$100	MA > \$100	MA > \$100
MN > \$25	MN > \$25	MN > \$25		
NJ \$25	NJ \$200			SC
OK > \$50		OK > \$50		PA \$100,000
OH < \$25	OH < \$25			VA > \$25
UT \$25-\$1,000				WI > \$50 ²⁸
WV < \$500		WV < \$1,000		
If skip-tracing is required				
<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
CA ²⁹ , HI, IL, OH UT	IL, OH	IL		IA, IL, IN, MO, MT, NJ, OR, PA, SC, VA, WI > 3 years
If not being worked in-house (unworked accounts)				
<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
CA, HI, OH	OH			AZ ³⁰ , IA, IN, MO, MT, ME > 2 years
MA < \$10,000	MA > \$100	MA > \$100	MA > \$100	MA > \$100
OK, UT		OK		NJ, SC, VA
WV < \$500				

²⁴ 70 percent of the accounts referred are older than one year outstanding; 30 percent of the accounts referred are less than one year outstanding.

²⁵ Montana assigns all accounts over \$100.

²⁶ After first notice

²⁷ The referral criteria indicated are applied only to accounts with projected cost/benefit ratios insufficient to be worked in-house. See cover for discussion.

²⁸ \$250 if this is a second placement.

²⁹ No distinction is made between cases on the basis of whether or not skip-tracing may be required.

³⁰ Within limits

If in-house personnel were unsuccessful

<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
HI, IL MD >\$100	IL	IL		AZ, DE, IA, IN, MO, MT, OR, MA >\$100 PA, SC, VA WI > 3 years WV
MA >\$100 OK, OH, UT	MA >\$100 OH,	MA >\$100 OK	MA >\$100	

Other: New Jersey deficiencies go to a private vendor first; they flow in-house if unsuccessful.

8 (b) OUT-OF-STATE ACCOUNTS

<i>Age</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
<i>Indiv. income</i> HI > 1 year, IL > 6 mos., ME 1 month; MA >120 days MO 7-9 months MT > 2 years MN > 90 days ND 6 months OK > 6 months OH < 3 years	IL > 1 year; MA >120 days MO 7-9 months MN > 90 days ND 6 months OH < 3 years	IL > 1 year; MA >120 days MO 7-9 months MN > 90 days ND 6 months OK > 6 months	— MA >120 days MO 12 mos.	DE > 120 days; IA > 120 d; MA >120 days IN NJ OR PA 2-3 years; SC > 6 months TN 90 days WI (any age)
VA > 2 years UT \$25 WV	VA > 2 years WV	VA > 2 years WA < 10 years WV		

Dollar amount (greater or less than?)

<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
CA > \$100 HI <\$5,000 IL > \$50	CA > \$100 IL > \$50	IL > \$50 ME <\$5,000 MA >\$100 MN > \$25 OK > \$50 OH < \$25 UT	MA >\$100	AZ > \$50 IN \$25 IA <\$500 DE >\$501 MO \$25; MA >\$100 NE >\$200 NJ OR, PA \$100,000 SC, VA > \$25 WI > \$50/\$250

If skip-tracing is required

<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
HI, IL, OH, UT	IL, OH,	IL		AL, IA, IN, NE, NJ, MO, MT, OR, PA, SC, VA

If not being worked in-house (unworked accounts)

<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
CA, HI, MN, MA <\$100 OK, OH, UT	CA MA >\$100 OH,	MA >\$100 OK	MA >\$100	AZ ³¹ , IA, ID, IN, MO, MA >\$100 MT, NE: All accts NJ, OR, SC, VA

³¹ Within limits

If in-house personnel were unsuccessful

<i>Indiv. income</i>	<i>Business income</i>	<i>Sales/ gross receipts</i>	<i>Excise</i>	<i>All tax types</i>
HI, IL, MN, UT	CA, IL, MN	IL, MN	---	AL, CT, DE, IA, IN, LA ³² , MO, MT, NE NJ, ME >\$2,000 OR, PA
MD > \$100				
ND	ND	ND		
OH, UT	OH,	WA	WA	SC, VA, TN

Other responses:

Mississippi - The Collection Division is responsible for the research and collections of delinquent accounts when the taxpayer is a nonresident of Mississippi and/or the taxpayer has assets or employment outside the state. After all reasonable in-office collection procedures have been exhausted and it is determined that there are no assets in Mississippi, then it is turned over to the out-of-state collection private agency.

9. If available, please provide us with your volume.

Results are:

accounts referred /
dollars collected /

Percentage of total delinquent collections to contracted collections

In-State	Out-of-State	Both (combined)
AZ 7,203	AZ 5,326	AZ 13529/\$1,146,401/0.8%
	AL 736/\$44,432/0.26%	CT 5,542/\$226,350/5%
CA 24,000/\$1,219,000/0.09% ³³	CA 24,000/\$4,527,000/0.32%	HI 4,000/\$147,000/3%
		IA 13,123/\$851,412/5%
IN \$ 18,123,081	LA 1,412/\$242,149 ³⁴	OK 54,421/\$5,571,485
ME 23,000/\$9.7 mil	ME 3,000/\$1.3 mil	ME 24% (not broken down)
NJ 67,829/\$26 million/42% ³⁵		MO 49,000/\$7.1/7.8%
		MN 1,528/\$2,775,000
OR 2,400/\$162,000/6%	OR 3,600/\$384,000/16%	
OH 100,000/<\$1 million	OH 2,500	DE, 12,258/\$11 million/9%
SC ³⁶ 32,560/\$2.7 mil/2%	SC 1,504/\$410,000/9%	IL, 40,702/\$3,187,396/0.06%
UT 3,316/\$124,743	UR 3,953/\$248,719	UT 11 % (not broken down)
	WA 1,027/\$440,371/0.04%	
WI 2,600/\$66,000/<1% ³⁷	WI 5,000/\$1.5 mil/1-2%	MD 53,536 ³⁸ /\$7,500,500
WV 12,000/\$1.256 mil/16%	ND 393/\$133,115/3.87%	MA 66,111/\$9,037,770/5.57%
		MS 1,098/\$310,845
		MT 5,000/\$4 million
		NE 103/\$19,952/0.122%
		PA 3,813/\$187,125/2.3%

VA: Beginning July 1997 we anticipate placing approximately 12,000 accounts per month for 18 months, after which volume should decrease to approximately 3,000 per month.

³² No assessments are placed, only returns, non-sufficient funds (bad checks) and audits.

³³ For California's FTB, the percentage refers to the percentage of contracted collections to total delinquent tax collections, rather than percentage of total delinquent tax collections to contracted collections.

³⁴ Accounts assigned are accounts placed in "uncollectible status." The total collections from all department billings was \$144 million for FY 1994-95.

³⁵ 42 percent of total dollars collected, 65 percent of total collection adjustment (cases closed).

³⁶ Figures are for the year ending Feb. 1996

³⁷ Figures are for six months because the in-state program began only last year.

³⁸ This number represents the number of periods referred; the percentage is not available, but the total amount of delinquent tax collected for FY 95 included dollars collected by collection agencies was \$89.7 million.

10. How do you determine the payment to your outside collection agent?

Contingency fee AL, AZ, CA, CT, HI, IA, IL, IN, LA, ME, MA, MN, MO,
MS, MT, NE, ND, OK, OR, OH, PA, SC, VA, WA, WI,
WV

Hourly rate ME, NJ

Other:

DE Based on contract
ME Flat fee per bounced check collected
MD Commission of dollars collected
MS 33 1/3 added to the total tax liability (tax, penalty and interest)
TN Fee added to amount of tax, penalty and interest owed

11. Do you provide the outside collectors with access to taxpayer returns or other information (other than delinquent amount, tax type, and basic identification information)?

No AZ, AL, CA, CT, HI, IL, IN, MD, MS, MT, OR, TN, UT, VA, WI, WV

Yes IA, LA, ME, MA, MI, MO, NE, NJ, ND, OK, OH, PA, SC, WA

Detail given by "no" states: AZ: Account number, tax type, balance, name, address - no confidential information. DE: If requested/authorized by taxpayer; HI: name, address, social security number, years delinquent, and amounts delinquent; MD: SS, name, address, phone number, tax, interest and penalty by tax period; IL: Tax type, delinquent amount and basic identification information; IN: base tax, penalty, interest and damages, general info on warrant; OR: collection history notes, billings, last known address; AL: name, last known address, telephone number, social security or FEIN number, assessment date, amount due, period covered, type of tax, and lien date.

Detail given by "yes" states:

IA: When necessary to resolve account, state tax information only. If amount due resulted from adjustments from federal audit, that information is NOT available to the collection agency.

LA: When requested by the taxpayer, information needed to verify the liability.

ME: Most individual income tax is privatized; they do problem resolution as well as collections. Other collectors can get any information needed to settle or collect the case.

MA: If taxpayer disputes the delinquency we will inform the outside collector of the reason for the delinquency; they will inform the taxpayer.

MO: Automated collection system gives account collection history

MN: In litigation, and to substantiate amounts per taxpayer request.

NJ: Routine collection process allows access to Division Computer Systems and other taxpayer information as required. As agents of taxation, they have the same access as Division employees.

NE: On request of the outside collector, the taxpayer returns that created the liability (will be) assigned to the outside collector.

ND: Copies upon request of all information.

OK: Information is provided at the department only - there is no on-line access. Available are copies of returns and assessments.

OH: Access is provided to the returns if the taxpayer sends them to the outside collector to adjust an estimated assessment; the information is that provided on the tax return.

PA: Criminal profiles, corporations merging, taxpayer's request, etc. (even then limitations exist); information depends on the type of case and the restrictions.

SC: The collectors have in-house personnel and have access to any application or return information. Outside collectors are subject to the disclosure rules within the agency.

WA: Returns require written taxpayer approval; available also are all collection notes, documents and lien information.

**RESPONSES FROM STATES
THAT DO NOT HAVE
A CURRENT PROGRAM**

1. Do you use private or non-government agents in the collection of delinquent taxes?

No

Alaska, Nevada, New Hampshire, Wyoming

Considering implementing

GA (finalizing RFP; responses are based on plans.)

NY (considering the use of collection agencies for follow-up on cases which have gone through the collection process and have been determined to be currently not collectible.)

Have had a program in the past

AK (1986-88) Ceased participation because we upgraded our internal collection function.

Calif. BOE (1986-88). Ceased participation because recovery amount was minimal and private collector elected not to renew the contract.

(early 1980s). Program was in effect for a very short time and was not successful.

NY (1981-1989). Contracts were terminated in 1989 and have not been renewed.

NC. Ceased participation because of budget cuts.

NM Ceased participation because of low return on investment.

RI. Have used a private collection agency but only in very limited circumstances. We only engaged the agency for taxpayers who are located out of state and had no in-state assets. In addition, we did not refer those cases until we had made attempts to collect ourselves and only after the matters were reduced to judgement in our courts. We never referred more than a handful of cases and the collection agency was not successful in the matters referred. As a result the practice has been dropped over the years.

SD (1980-1995). Ceased participation because the Governor decided to perform the work with government agents.

2. How are referrals currently made to your outside "collection agent"? (no responses)

3. What types of outside "collection agents" do you use? Check all that apply.

Private collection agencies

AK

BOE

GA

Firms of a certain size or related criteria (please specify)

NY (those that provided full service operations, including skip-tracing, asset location, dunning and collection contact, and the ability to retain outside counsel for litigation efforts related to assigned cases.)

4. If you use private collection agencies, do you require that your accounts be worked by a dedicated team (as opposed to a private collection agent collecting retail debts and delinquent taxes during the same shift)?

Dedicated team required

GA

We have no such requirement

BOE

Other: NY did not require a dedicated team but at least one of its agencies did assign certain members of its staff to work exclusively on the tax collection cases.

12. Other than the federal Fair Debt Collection Practices Act, what protections and sanctions could apply if there were an unauthorized disclosure of taxpayer information or abusive collection practices?

	By the Private Collector	By a State Tax Agency Employee
Statutory criminal penalties	AZ, AL, CA, HI, IL, IA, ME, MA, MO, MT, NE, ND(ud) ³⁹ OK, OR, TN, UT, VA, WI, WV	AZ, AL, CA, HI, IL, IA, MA, ME, MO, MT, NE, NJ, ND(ud), OR, TN, UT, VA, WI,
Civil penalties	AZ, CA, IL, MA, MN, MO, MT, OR, ND (ud), OH, PA, VA, TN, WA,	AZ, CA, MA, MN, MO, MT, NJ, OR, VA, ND (ud), WA,
Civil actions for damages	AZ, CA, IA, MA, MN, ND (ud/a) ⁴⁰ MO, OR OH, PA, UT, VA, TN, WA, WV	AZ, CA, IA, MA, M, MN, MO, NJ, OR, ND (ud/a), TN, UT, VA, WA,
Contractual or employment sanctions by your agency	AZ, AL, CA, DE, IL, LA, ME, MD, MA, MN, MO, OR, ND (ud/a), OH, PA, SC, TN, UT, VA, WA, WI, WV	AZ, AL, CA, DE, IA, ME, MD, MA, MN, MO, MS, NJ, OR, OH, PA, VA, TN, WA, UT, WI, ND (ud),
Other (please specify)		

OK: Immediate dismissal
of employee upon request

OK

OK

LA: Required by the contract to comply with state statute LRS 47:1508

NJ: State tax uniform procedures, Treasury Code of Ethics, private vendor sanctions, IRS Code of Ethics.

13. What has been your frequency of complaints about outside collectors?

	From Taxpayers	From Government (Legislators, etc.)
Never		AL, CT, LA, MS, OR TN, WA,
Rarely	AL, DE, ME, MD, MO, MN, NE, TN, WI,	AZ, DE, IA, ME, HI, IN, MN, MO, OK, PA, SC, UT, WI,
Occasionally	AZ, CA, CT, HI, IL, IA, IN, LA, MA, MS, MT, ND, OK, OR, OH, PA, UT, SC, VA,	CA, IL, MA, OH, VA,
Regularly	W A	

14. Overall, how do you judge the success of your outsourced collection program?

Not very successful	AZ, AL, MT, TN
A useful component	CA, CT, HI, IA, IN, LA, MD, MA, MS, NE, OK, OR, VA, WA, WI (more so out-of-state), WV
Very successful	DE, IL, ME, MN, MO, ND, OH, PA, SC, UT

³⁹ For unauthorized disclosure

⁴⁰ (a) For abusive collection practices

15. Has your experience yielded any benefits, problems, or issues that you would wish to share with others?

AZ: Tracking payments is tedious, as some are paid directly to the Department of Revenue instead of the agency. Other overhead includes fielding complaints and developing and maintaining of systems to refer and update inventory of assigned accounts.

AL: Over the past 11 years, the Alabama Dept. of Revenue has used two private collection companies to collect out-of-state accounts only. However, all efforts are exhausted to collect these accounts in-house prior to making a referral. Since we have a minimum collection statute of 10 years, many of the accounts are already very old when a referral is made. This factor contributes greatly to the low gross recovery rate.

DE: Information attached.

IL: Should award more than one-year contract. The process to change agencies is time-consuming and requires a great deal of intra-bureau cooperation in setting up.

ME: We have at least six various contracts for different types of enforcement/collections. Each is very different, which makes it impossible to fit the contract results in to your survey.

MD: Developing the interface both to and from the collection agency requires extreme planning.

MA: The highest recovery rate lies within the primary accounts. Obviously, the older the "paper" the less the success rate of recovery. New accounts assigned as early as possible prove to be the most fruitful.

MN: We are working on giving on-line access to our collection system. This will benefit us and the agency. We are collecting money that may not otherwise have been collected.

MO: We have found collection agencies to be responsive to our needs. They work effectively with taxpayers to resolve the delinquency either by payment or obtaining documentation to resolve the account.

NE: The accounts are worked quite extensively before they are referred so the recovery is not as great as it might be if they were referred sooner.

ND: My experience with private collection agencies has been very positive in the past 23 years. Two of the main reasons are because the two state employers I have worked for emphasized background scrutiny and references to ensure that the private collector hired lived up to claims of competence. The other reason for success has been the intense education provided the private collector's staff, which enables them to pursue complex liabilities with confidence, which results in increased success.

OK: Integrating the private collection agency into the overall collections process is an ongoing challenge. We feel, however, that the use of an outside agency is appropriate and useful if it is determined ahead of time where such activity fits.

PA: No problems or issues; good rate of recovery is the benefit.

SC: bankruptcies tend to be a big problem.

UT: Referring our "older" delinquent accounts to a private collector allows our in-house collectors to focus on collecting new liabilities and increasing compliance. Also, the agency we contract with has the ability to locate taxpayers using an automated collection system which we don't currently have. Our skip tracing resources are minimal and the cost of developing our own automated collection system which would include a skip-tracing function is prohibitive. Using a private collector is a very useful component of our collections program.

WV: It has enabled us to concentrate our collection efforts to high dollar delinquencies.

5. For which taxes did you use non-government collectors?

	<u>In-State Accounts</u>	<u>Out-of-State Accounts</u>
Individual Income	AR	AR
Sales / gross receipts		BOE
All tax types		GA NC NY (however, tried to exclude certain types of assessments issued for nonfiling of corporation franchise tax returns, based on the experience that these were relatively non-renumerative cases.)

6. For which of the following activities did you use private collection agents?

	<u>In-State Accounts</u>	<u>Out-of-State Accounts</u>
Skip tracing		BOE GA
Collection letters		BOE GA
Collection calls		BOE GA
Face-to-face visits		BOE
Receiving Payments		BOE GA
Asset location		BOE

7. What activities or coercive actions are your outside agents permitted to take?

	<u>In-State Accounts</u>	<u>Out-of-State Accounts</u>	<u>Subject to These Limits</u>
Litigation		BOE GA	
Telephone dunning		BOE GA	
Negotiating pmt plans		BOE	
Approving pmt plans		BOE GA	

New York: Contracts provided that the agencies would make contact, by mail or telephone, with debtors to collect the debt through payment demands or short-term payment arrangements. Agencies unable to collect through these means could also request litigation of individual cases where recovery prospects seemed promising. If the state approved litigation the collection agency would initiate suit in the debtor's home state. Agencies were not authorized to negotiate contracts, but they were permitted to recommend penalty waiver under "relaxed" criteria to facilitate debt recovery.

8. 8(a) in-state accounts - no responses

8 (b) referral of OUT-OF-STATE ACCOUNTS

	Sales/ gross receipts	All tax types
Age		GA (>2 years)
Dollar amount		GA
If skip-tracing is required		GA
If not being worked in-house		GA NC
If in-house unsuccessful	BOE	GA NC

New York: Out-of-state accounts for any tax type where the balance was greater than \$100, excluding the corporate tax, withholding tax delinquency assessments (eg, failure to file). For higher balance cases (the threshold varied), cases were not assigned unless state staffers had worked the cases to completion. No bankruptcy or protest cases were assigned.

9. If available, please provide us with your volume.

NC: Out-of-state, 25 percent

10. How did you determine the payment to your outside collection agent?
Contingency fee

AR, BOE, GA, NY (17 to 30%), NC

11. Do you provide the outside collectors with access to taxpayer returns or other information (other than delinquent amount, tax type, and basic identification information)?

No AR, BOE, GA, NC

Yes NY (warrants filed; other information only when approved litigation required certified copies of basic documents to substantiate the liability.)

12. Other than the federal Fair Debt Collection Practices Act, what protections and sanctions could apply if there were an unauthorized disclosure of taxpayer information or abusive collection practices?

	By the Private Collector	By a State Tax Agency Employee
Statutory criminal penalties	BOE, GA, NY	BOE, GA, NY
Civil penalties	AR, BOE, NY	AR, BOE, NY
Civil actions for damages	BOE	BOE
Contractual or employment sanctions by your agency	BOE, GA	BOE, GA
Other (please specify)		

13. What has been your frequency of complaints about outside collectors?

	<u>From Taxpayers</u>	<u>From Government (Legislators, etc.)</u>
Never		BOE
Rarely	BOE	AR, NC
Occasionally	AR, NY, NC	
Regularly		

14. Overall, how do you judge the success of your outsourced collection program?

- | | |
|---------------------|---|
| Not very successful | BOE
NY (useful at first but less productive as state workers became more proficient at collecting out-of-state accounts) |
| A useful component | NC |
| Very successful | |

15. Analysis of the program

NY: A study in 1989 suggested termination of the contracts in favor of utilizing resources to supporting in-house efforts. As a result, out-of-state collections increased from \$1.4 million in 1988-89 to \$10.2 million in 1990-91.

16. Has your experience yielded any benefits, problems, or issues that you would wish to share with others?

Arkansas: The majority of accounts closed by payment were smaller (under \$150) accounts. We were able to close a moderate number of accounts by locating taxpayers for whom we had an estimated assessment.

California BOE: A significant amount of staff time was used for providing documentation to support the liability to the private collection company.

NY: The major negative factor we found was the extent of staff time and effort to support the outside firms' collection actions.

EXHIBIT B

The State of New Jersey, Division of Taxation entered into two contracts with PAYCO General American Credits, Inc. for the purposes of collecting delinquent and deficient taxes.

The goal of each contract is to increase collection of revenue due to the State through the specialized use of trained telephone collectors.

Since the inception of the deficiency contract in February 1993, PAYCO has collected \$51,529,476 in known deficiencies. PAYCO has been paid \$11,328,543 for an overall revenue to expense ratio of 4.5:1.

Deficiency contract collections by fiscal year and associated statistics are as follows:

FISCAL YEAR	COLLECTIONS	EXPENSE	RATIO
'93	\$ 2,102,059	\$ 870,671	2.4 : 1
'94	12,175,480	2,841,557	4.3 : 1
'95	21,847,481	4,287,458	5.1 : 1
'96	15,404,456	3,328,857	4.6 : 1

The delinquency contract, which targets known delinquent taxpayers, started in October 1995 and has collected a total of \$1,380,121. PAYCO has been paid \$349,181 on this contract for a 3.9 : 1 revenue to expense ratio.

Both of these contracts have proven to be a cost effective way to increase revenue collections while reducing the Divisions workloads. Also, by taking advantage of outsourcing, the Division is able to reallocate permanent staff in other areas within the Compliance Activity.

EXHIBIT A

Although comparisons have been made between the private collector and the in-house employee, a complete analysis would be inconclusive. Our original mission for the private vendor was twofold - to help reduce our backlog of unanswered correspondence; and attempt to collect low liability accounts. The private collector was assigned accounts with liabilities of \$200.00 to \$10,000.00 and our employees worked accounts over \$10,000.00. That original mission has since changed. The private collector will be the Division's first attempt to collect a debt after the taxpayer has been notified of a deficiency and any rights to appeal have expired.

However we can appreciate their cost effectiveness in other quantitative ways. For instance, 1995 the private vendor collected 42% of the total liability assigned for collection. In addition to collections, a total of 65% of the cases assigned were closed through collections, adjustments, or account correction.

TO: Harley Duncan
FROM: Ken Rudio
Department of Administration
State Debt Collection
DATE:
RE: FTA Survey on Private Collection Agencies

The Department of Revenue of the State of Montana referred this survey to my collection section to complete.

I have enclosed a copy of the services we offer all State agencies, the IRS, and the county governments. It may help to explain some of my answers. It also provides you with some of the statistics we have with private collection agencies.

The collectibility of the debts referred to private collection agencies is only about 5% (five percent). The private collection agencies have 5 (five) million dollars of our debts referred to them. We basically use private collection agencies as a last resort effort and to pursue the accounts that will be expensive to collect. This is the reason for their high cost and low rate of return.

In 1995 private collection agencies charged us \$97,000 to collect \$270,000. Our internal collection program charged the agencies using our service \$44,000 to collect \$593,000. Prior to 1990, we used private collection agencies almost exclusively. What we learned was that we were paying collection fee's to the private collection agencies on debts we could collect ourselves.

DEPARTMENT OF ADMINISTRATION
ACCOUNTING AND MANAGEMENT SUPPORT DIVISION



MARC RACICOT, GOVERNOR

MITCHELL BUILDING
PO BOX 200102

STATE OF MONTANA

Accounting Bureau
Rm. 255 (406) 444-3092

Management Support Bureau
Rm. 176 (406) 444-4644

Helena, Montana
59620-0102

Department of Administration
Debt Collection Services
Mitchell Building

The Bad Debt Collection Services within the Department of Administration provides three specific categories of service regarding bad debts. These categories are as follows:

1. A collection service for receivables transferred from state agencies which provides location, asset verification suit, garnishment and payroll withholding, and offset of state warrants to recover state receivables. This includes referral to private collection agencies.
2. A tax offset only and locate service that allows state agencies to intercept state warrants and information without physically transferring the debt to this office.
3. A "write-off service" for state agencies for debts totally uncollectible and debts that have been through the full collection effort performed by the Debt Collection Division.

The 1991 Legislature gave the Bad Debt Collections Division of the State Auditor's Office the authority to charge state agencies a collection fee for debts transferred to it for collection. The collection fee charged is based on the appropriation authorized and the collections generated from debts collected by the Division through conventional methods and tax offsets. No collection fee is charged for collection made by state debts referred to private collection agencies as they have already charged a collection fee.

Any excess fees collected above the authorized appropriations are carried over into the next fiscal year to reduce the percent charged the agencies; i.e., FY 92 authorized appropriation \$150,000 - projected collection \$882,352 requires 17 percent collection charge - Division collects \$1,000,000 in FY 92 means \$170,000 in commissions; therefore, \$20,000 is carried over into FY 93 budget \$150,000 - projected collections \$1,000,000. Since we carried over \$20,000, we need to generate \$130,000 in

commissions. That means we charge a collection fee of 13 percent for FY 93.

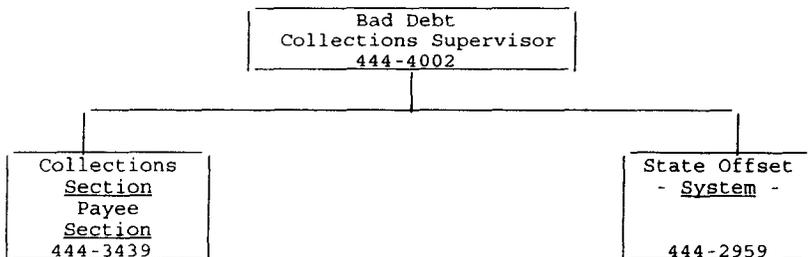
We proposed this idea to the legislature because the old method didn't fairly distribute the cost of collection. Fifty percent of our collections were from debts that didn't come from the state general fund. One hundred percent of the Division was funded from the general fund. Also, many agencies had the legal authority to add on collection charges, thus it didn't result in any revenues being lost.

Our major objective is to get the collection fee charged the agencies down to the lowest cost possible and still provide a total collection effort for all state agencies which includes a statutory write-off service for all state agencies. We want to request that when a state agency certifies and transfers a debt to our office for collection, they cease all collection activities on the account. All questions on the account of the debtor should be referred to the Debt Collections Division. Any questions we have will be obtained from the agency transferring the debt to us. The general rule for charging a collection fee is that the Debt Collections Division must be able to show it performed a collection effort on the debt. If an agency still maintains an internal means to collect a debt transferred to us, we won't charge a fee under reasonable circumstances:

- i.e., income tax debt where amended return filed;
- i.e., college loan where transcripts are held until loan paid;
- i.e., workers' compensation initial deposit applied to premium when payroll received on an estimated premium.

The circumstance can arise that a debtor whom we are holding an offset on will pay off a debt to avoid our collection charges. Our position will be to hold out the collection fee on the amount we are offsetting. The major objective is to collect the debt. We will be reasonable in determining if a collection fee should be charged. It has been our experience that cancelling and returning referred accounts from collection agencies causes the agency performing the collection service to pursue the account less aggressively if the debt is subject to return. These are just some basic guidelines to use to make the collection service more effective and avoid problems.

The Division flow chart is as follows:



Management memo 2-1100 explains the process of transferring a debt to the Bad Debt Collections Division for collection. It contains examples of the forms and explains the procedures for completing them. We developed another method of transferring debts for full collection electronically. This method allows the agency to obtain from Bad Debt Collections Division a format to keypunch all the information contained in the Bad Debt Certification and Transfer Form and transfer it to the Bad Debt Collections Division through a shared data set on the mainframe computer of the Department of Administration. The Bad Debt Collections Division will produce a Bad Debt Certification and Transfer Form which it will return to the agency for its signature. This eliminates the ordering of the Bad Debt Certification and Transfer Form. The Bad Debt Collections Division does not have to punch each debt into the computer as they will be electronically entered. We urge all agencies to use this method. Please contact the Bad Debt Collections Division and we will be glad to assist you.

Contact the Department of Administration, Collections Division, P.O. Box 200102, Sam Mitchell Building for further explanation of the services offered by the Division.

KR/kd

FY1995
Report of Collections, Debts Referred, Written Off
and Computation of Collection Charges for 1996

REVENUE COLLECTED	FY95	FY94	FY93	FY92
Internal Collections	549,353	711,400	521,987	493,686
Tax Offsets	1,258,673	1,366,267	896,697	612,019
Private Collection Agencies (Less Commissions)	271,519 <u>(97,474)</u>	247,651 <u>(90,627)</u>	131,308 <u>(48,897)</u>	171,392 <u>(50,525)</u>
TOTAL COLLECTIONS:	<u>\$1,982,071</u>	<u>\$2,234,691</u>	<u>\$1,500,095</u>	<u>\$1,226,572</u>
DEBTS REFERRED FOR COLLECTION	\$9,183,557	6,526,492	5,637,092	5,850,002
DEBTS WRITTEN OFF	\$5,386,933	9,185,152	1,982,218	161,179

COMPUTATION OF COLLECTION CHARGES

Revenue Generated to Operate State Collection Program:				
Internal Collections:	\$ 549,353			
Tax Offsets:	<u>1,258,673</u>			
Total:	<u>\$1,808,026</u>			
This generated in REVENUE:	\$ 135,602			
Carry Over from FY94:	<u>56,029</u>			
Total Revenue FY95:	191,631			
Total Expenses FY95:	<u>(191,631)</u>			
Carry Over to FY96 Budget:	\$ -0-			
Authorized appropriation FY96:	\$ 204,240			
Amount carried over from FY95:	<u>-0-</u>			
FY96 BUDGET:	<u>\$ 204,240</u>			
PROJECTED COLLECTION FY96:	\$1,685,226			
Assume we will collect same amount in FY95:		\$1,808,026		
Less I.R.S. Collections:		(490,000)		
Add Special Refund:		<u>367,200</u>		
Projected FY96 collections:		\$1,685,226		
Comparing Budget to Projected Collections = % to charge agencies:	<u>\$ 204,240</u>	=	12% = FY96 Fee Charged	
	<u>1,685,226</u>			
In FY96 we will charge agencies <u>12%</u>				

HIGHLIGHTS: FY95

1. In 1992 we proposed to fund the State Debt Collection Bureau exactly like private industry. The fee charged the state agencies using our services comes directly from the debt owed the agency. We gave our general fund appropriation back to the general fund. We have collected \$6,944,429 in the 4 years we have been self funded. It cost the agencies using our services \$778,827. During the 17 years the program was funded by general fund, we collected \$5,540,343 with a cost of \$899,362 to general fund. Under the self-funding program, we are returning 1.73 million dollars per year to the taxpayer. Under general fund funding, we were returning \$272,999 per year to the taxpayer.
2. We were referred \$9,183,557 in debts from 30 state agencies. This is the largest number of debts ever referred to the State Debt Collections Bureau. I feel this was due to the great rate of return the state agencies were getting for our services. 7.5% translates into a thirteen (13) dollar return for every dollar spent.
3. The legislation to help counties collect delinquent personal property tax passed. I estimated that there is from 11 to 20 million

in delinquent personal property taxes. When collection procedures are fully implemented we should recover 1/2 million dollars annually for the counties. New sources of revenue are what keeps our rates at such a low percentage and encourages agencies to use our services.



STATE OF CALIFORNIA

FRANCHISE TAX BOARD

P.O. BOX 1468
SACRAMENTO CA 95812-1468
(916) 845-4166

April 11, 1996

Mr. Harley T. Duncan
Executive Director
Federation of Tax Administrators
444 North Capitol Street NW
Washington, DC 20001

Dear Mr. Duncan:

Attached is your completed questionnaire concerning California's experience with the collection of delinquent income taxes utilizing the services of private collection agencies. We hope that this information is useful to you. The following additional information is provided to enhance your perspective in consideration of our responses.

California's in-house collection activities are centered on automated systems that identify delinquent accounts, initiate requests for payments, match accounts with employment and asset ownership data and, as needed, initiate liens or levies. Accounts not fully resolved by these automated systems are candidates for possible supplemental processing by either our own staff and/or private collection agency.

In general, accounts worked by our staff are those expected to yield the highest returns. This is achieved by modeling the accounts in accordance with historical revenue return rates and by staffing at levels sufficient for our staff to work all models expected to generate an overall return rate of \$5 revenue per \$1 cost. Only accounts not meeting this overall criteria are available for referral to our private collection agents.

In regard to question No. 15 and the relative cost of contracting with agents in comparison with the cost of in-house personnel, such comparisons are particularly difficult because the kinds of work to be done are different. The agent's actions are limited to locating debtors and obtaining payments of debts not disputed. Any disputes as to the amount or validity of the debt are necessarily referred back for resolution. In respect to agency referrals, this has the effect of saving us the cost of attempting to seek out debtors that cannot be located but increasing the cost of resolving accounts of debtors who are located, since the latter will require both account resolution activity by our staff as well as payment to the private agent out of the debt proceeds.

If you or your staff have any questions or would like any additional information, please do not hesitate to call me at (916) 845-4166.

Sincerely,

A handwritten signature in black ink that reads "Tom Rogers".

Tom Rogers
Manager, Collection Program Administration

cc: G. Goldberg
J. Vranna



Additional Detail - Ohio

Ohio

**DEPARTMENT OF
TAXATION**

Harley T. Duncan
Executive Director
Federation of Tax Administrators
444 North Capital St., N.W.
Washington, D.C. 20001

Dear Mr. Duncan:

The Federation of Tax Administrator's survey has been referred to me for response.

Your survey would be better addressed by Mr. William Hopper of the Attorney General's Office. I have, therefore, requested he assist in the completion of this survey.

The collection process in Ohio involves the Attorney General's Office as well as the Tax Department. The actual collection activities and/or legal actions are the responsibility of the Attorney General's Office.

In Ohio, the Tax Department's role in collection is to bill, assess (legal collection notification) and refer accounts remaining unpaid after a specified time period to the Attorney General for collection. The department remains involved throughout the entire process in that various information is referred after certification which may require adjustment of liability or response to the taxpayer on technical tax matters.

The Attorney General's Office is the owner of the Ohio Automated Collection System. The Automated Collection system handles the assignment of cases. How assignment for collections are made, types of outside collection activities performed by collection agencies, assignment of accounts, revenue collected, payment of fees to agencies, etc., is information which the Attorney General's Office would maintain.



P.O. Box 1090
Columbus, Ohio 43266-0090

The Automated Collection System supports the major taxes in Ohio (i.e., Individual Income, Employer Withholding, Corporate and Sales). Sales liabilities enter the system at the point of assessment. Personal income, Withholding and Corporate enter the system at the point of certification.

Our contact with the "outside" collection agencies retained by the Attorney General's Office has been very positive.

If I can be of future service, please let me know.

Cordially,



Barbara A. Mitchell
Administrator
Assessment Division

BAM/rm

cc: William Hopper

WHEN WE STARTED OUTSIDE AGENCY COLLECTIONS.

In 1981, we entered into our first contract with an Outside Agency for collections of the Divisions' receivables. The early years can be described as having varying degrees of success. Our first endeavor dealt with the placement of Non-Resident Taxpayers Personal Income Tax delinquency, then over the years it was expanded to include Resident Taxpayers. During the mid 80's a large number of accounts dealt with unable to locate. While the end of the 80's saw us expanding the program to include the total mix of delinquency for Personal Income Tax of Resident, Non-Resident, Unable to Locate, and for the first time the placement of these account directly after the completion of the billing process. It should be noted that all placements at this time would have had a judgment place against the taxpayer(s).

In the 90's, the Division revamps its information systems and we move from a multiple receivable system to a single integrated system; from a decentralized accounting and control to a centralized accounting and control; from a paper based system to an image system. With these information systems in place, we can now manage and control receivables. We expanded our Outside Agency Collection (OCA) Program to include all taxes administered by the Division, as well as, the number of collection agencies from one (national firm) to three (two national and one local firm). They now received two types of cases.

One, all delinquencies directly after billing between a dollar range set by the division; additionally, no judgments have been place against the taxpayer. We have found that over the course of years, that if you can make contact with the taxpayer very early in the enforcement program process that not placing the judgment yielded a higher collections. When a case is returned from the OCA it will be examined to a set of criteria and a judgment filed when it meets the conditions set forth in our rule processor.

Two, accounts that the Bureau of Tax Collections recommends; they may or may not have judgments in place.

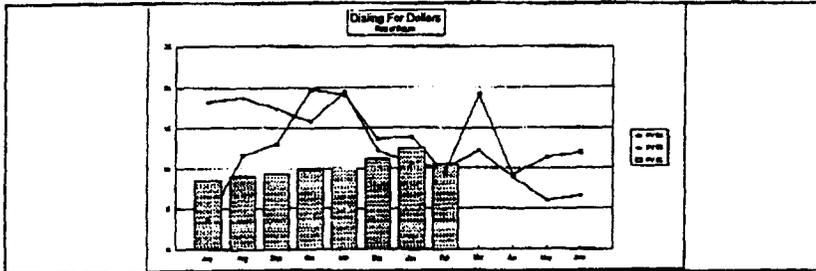
It should be noted that since the beginning of our OCA Program, we have had the ability to have the agency litigate the case on behalf of the Division for out of state cases. The Division has only recently began to exercise this means of enforcing problem accounts in which all other efforts have failed.

We experienced a 101% increase in dollars collected when comparing FY '94 to FY '95, which was the first full fiscal year of operations, having expanded our OCA Program from one to three participants.

WHEN WE STARTED WITH DIALING FOR DOLLARS

In May of 1993, we engaged an outside collection firm to provide for collection personnel on site at the Division for aiding us in the collection of Personal Income Tax accounts. June of 1994, we increased the number of collectors to 4 and formulate a team. The team consisted of a Tax Examiner (Problem Resolution Person) to assist the 4 on site collectors with problem accounts. All issues with regard to computation of tax, penalty, and interest are handle by the four collectors. Issues concerning compound and complex tax issues are then forward to the PRP, who in turn will review and respond to the taxpayer's inquiry. January 1995, we expand by adding two more collectors and including the Business Taxes into our Dialing For Dollars Program. We are currently re-evaluating the mix of collectors to PRP's with anticipation of a new Business Tax Gross Receipts System brought on-line September 1995 and a anticipated a new Corporate Reconciliation System sometime in the first quarter of 1996.

Below is a chart showing the rate of return for utilizing the rent a collector to Problem Resolution Person team. The ratio followed our traditional Personal Income Tax filing activity of April through December. We anticipate some change, as we go forward with the installation of new Business Tax Reconciliation Systems, but we will still see peaks for the Personal Income Tax activity.



The Dialing For Dollars program has shown a program average ratio of 11.78 to 1. We feel this return rate will remain in excess of 6 to 1 even as we bring on the new Business Tax Reconciliation Systems.

WHEN WE STARTED SECONDS

RFP's specifications for the placement of second referrals of delinquent cases were sent to 36 firms in the month of September 1995. The closing date is September 28, 1995, and the anticipated contract negotiation are expected to take approximately 30 days. We look forward to a installation date of November 1, 1995. At this time, we are uncertain as to the rate of recovery, but inlight that we will only pay for recovered dollars, all dollars collected is monies the Division would not have seen.

WHAT THE DIVISION GAINED.

The Division has made great strides to increase the collection program performance, as you can see by the increase of 101% in dollars collected via the OCA and the 11.78 ratio of return for the Dialing for Dollars programs. Another benefit to the Division is, the Bureau of Tax Collection permanent staff has been reduced by 20% with the recently installed Dialing for Dollars program. The professional staff that had been assigned to Bureau has now been reassigned to the Bureaus dealing with the Examine/Audit activities within the Division.

THE FUTURE.

The Bureau of Tax Collection will continue to reassess the performance of its programs of OCA and Dialing for Dollars and like opportunities to further reduce the cost of enforcement collections; thereby, saving taxpayer expense.

ADDENDUM TO FTA SURVEY ON PRIVATE COLLECTION ACTIVITIES

The Texas State Comptroller's Office does not currently utilize private collection agencies to collect delinquent taxes. However, since May of 1994, we have maintained a contract with a private temporary employment service that supplies us with contract personnel to staff our Automated Collections Center (ACC). Under the contract, we employ approximately 40 individuals who, under direct supervision of agency personnel, make outgoing collection calls on primarily delinquent sales tax accounts.

These phone "agents" have limited access to account information, and use prepared scripts when making their calls. Their main responsibilities are to make phone contact with delinquent taxpayers, establish/estimate liability, obtain a commitment to pay, and/or update limited account information if necessary. If the phone collection approach is unsuccessful and the established liability becomes final, the accounts are sent to the field for contact by agency collection personnel.

This process has proven highly effective in reducing the backlog of sales tax accounts, and allowing our field personnel to concentrate on priority accounts (high dollar). In the first full year of operation (FY95) under this new concept, collections for the ACC increased 17%. The biggest reason for this increase was the change in procedure from an in-depth account analysis by experienced agency personnel, to a "quick hit", "dialing for dollars" approach requiring limited account research. The result was a decrease in time per call, increased taxpayer contacts, and increased collections. It is interesting to note that though collections per direct phone hour decreased by 10%, the increase in taxpayer "hits" combined with the decrease in overhead resulting from the use of contract personnel actually increased the ACC's rate of return by 23%.

Though using contract personnel to assist in our collection process has proven fiscally responsible, it has also had its share of problems. The most obvious shortcoming is the lack of expertise to handle taxpayer questions, resulting in an additional burden on our field personnel. To reduce this burden, we have recently re-hired a small group of specialists to take incoming collection calls referred by our contract personnel. A second problem is the transient nature of temporary service personnel. Since it takes several days to train and get agents accustomed to making collection calls, the constant turnover limits the ACC's potential productive capacity. And finally, for both of the aforementioned reasons, we have had to limit the scope of collection activity of these contract agents to our two major taxes, sales and franchise. This has resulted in a backlog of smaller, low priority taxes that are rarely worked by our field personnel.

In summary, we have been very pleased with the effectiveness of this new program. Delinquent collections continue to increase as we adjust our processes to best utilize the contract staff. One of our goals for the coming year is to determine an optimum staffing level based on workload and productivity factors. Though we realize the inherent problems associated with a transient workforce will remain with us, we expect the program's pros will continue to outweigh its cons.

Chairman JOHNSON. Thank you very much.

I would like to ask the panel if you have had any problem in using private debt collectors in the privacy area, in the appeals area. Have you had any problems of the kind that we are being cautioned to avoid?

Mr. GOLDBERG. The one problem we did have in California, initially, was one wherein we did not take proper consideration of the financial viability of vendors. So consequently one of our vendors went bankrupt. While none of the moneys were at risk, we had some difficulty, initially, getting some of the accounts back from the bankrupt vendor.

Beyond that, we did have some initial complaints, but I think those were more a matter of training than the collection agencies not wishing to actually participate properly, and once we provided that training, those problems appear to have gone away.

Chairman JOHNSON. So have you had no problem of commingling of tax and nontax data? Those privacy issues that people are worried about?

Mr. GOLDBERG. We have not had any significant problems in that area.

Mr. GAVIN. In Connecticut, under our State laws, the only information that is provided to outside collectors is that which is already public information, available to the public. What do I mean by that?

In Connecticut, under our statutes, if a tax debt exists after all appeal rights have been exhausted, 90 days after that, that person's name, the tax type, and the amount, is public information, and the address.

Not the Social Security number. So when we outsource to private collectors, the only information they are getting is public information—name, address, amount of tax, and the type of tax.

Based on our experience—and we have been doing it for 2 years now—the number of complaints, there have been some complaints but no different than the amount of complaints we normally receive as a tax agency ourselves.

So we have been very pleased with the results, so far, and have in fact now increased the amount of use of outside private collectors to 10 percent of the number of our accounts.

If any customer service-related issues come up, it is their instructions, the outside collection agency, to refer them to us and we handle that.

Chairman JOHNSON. And one last question. In your experience with the amnesty program, have any of you had long enough experience to feel confident it does not provide an incentive for people not to pay their taxes, assuming there will be yet another amnesty program?

Mr. GAVIN. Connecticut was the first State to have two full-blown tax amnesties. We had one in 1990 and in 1995. Now, the reason we had one in 1995 was that in 1990, when we had our original, we did not have a personal income tax.

Connecticut is still in its infancy stages, really, with the personal income tax, and based on our studies of the 35 States that have had tax amnesties, those that had personal income tax, the number one applications came in from individual income tax filers.

That held true in 1995, and that is the reason why we could perform a second tax amnesty. I believe that a tax amnesty should be considered a one-time opportunity unless unique circumstances require or suggest that a second one should be performed in Connecticut.

I can say to you that the Governor and the General Assembly approved that, thought that that was the case, and based on our analysis, since the bulk of the money did come from personal income tax filers—and let me just tell you this, which is also an interesting fact when we talk about accounts receivable.

In our experience in both programs, approximately 52 percent came from people who were on our accounts receivable file, and the remaining 48 percent were new filers, or underreporters. You have to remember that another great benefit of a tax amnesty program is not only are you going to get an influx of money in the year of the amnesty, but with some good marketing and advertising, and following up with strong enforcement tools after an amnesty, you are going to have those new filers on the tax roles forever and get a new stream of income, and that reduces the burden for everyone.

Chairman JOHNSON. Thank you.

Mr. Matsui.

Mr. MATSUI. Very briefly.

Mr. Duncan, you seem to have answered Mr. Ensign's concern. He testified. As you know, you were in the audience. Are you from Washington or are you outside of Washington?

Mr. DUNCAN. No. We are based here.

Mr. MATSUI. I would recommend that you perhaps—and maybe you have already done this—visit Mr. Ensign and discuss this with him because obviously, if we do anything on the offset—and I believe we may—it certainly would be helpful, perhaps if you met with him, and chatted with him.

I think the issue that there would be a judgment might alleviate some of the concerns, which you have stated in your comments, in your testimony. So I would just make that recommendation, and maybe you have already made a note of that.

Mr. GOLDBERG. Mr. Matsui.

Mr. MATSUI. Yes, Mr. Goldberg.

Mr. GOLDBERG. I might just also point out with regard to Representative Ensign's comments, he indicated that roughly 44 percent of the offset amount would be from nonresidents. Our calculations at the Franchise Tax Board would indicate that the amount would be less than 4 percent as opposed to 44 percent.

Mr. MATSUI. I see. Are they all in Nevada? [Laughter.]

Gambling debts, huh?

I want to thank all four of the panelists. I appreciated this. Obviously, we are going to be looking to your expertise over the next few months, or years.

Thank you.

Chairman JOHNSON. Thank you much for your input.

Would you like to question, Mr. Cardin?

Mr. CARDIN. No questions, Madam Chairman.

Chairman JOHNSON. Thank you.

I thank the panel and would call forward the last panel, Joseph Lane of the National Association of Enrolled Agents; Curtis Prins,

a legislative consultant, American Collectors Association; and Saul Moskowitz, a partner in Dean Blakey and Moskowitz.

I would ask that Mr. Lane proceed.

Mr. MATSUI [presiding]. I want to thank all three of the gentlemen.

Chairman Johnson had to take a phone call that came in. She needs to take this now, and so I am going to call Mr. Lane to start.

Mr. Lane.

**STATEMENT OF JOSEPH F. LANE, ENROLLED AGENT,
NATIONAL ASSOCIATION OF ENROLLED AGENTS**

Mr. LANE. Thank you. We appreciate the opportunity to appear again before the Subcommittee and give our opinions about this proposal.

Before I start my comments, and Mr. Chairman, we have written comments we have submitted for the Subcommittee. We would hope you would just accept, and I will summarize.

Mr. MATSUI. They will be so entered in the record.

Mr. LANE. Thank you.

NAEA, the National Association of Enrolled Agents, strongly supports the concept of IRS studying ways to improve its service to taxpayers and achieve efficiencies in the management of the public revenues entrusted to it. In addition, we want to point out that over 90 percent of our members own and operate their own tax representation practices.

So, we certainly are supportive of small business entrepreneurship. Having said that, I advise the Subcommittee we are absolutely opposed to the concept of outside collection agencies getting involved in the collection of Federal taxes.

The confidentiality of tax return data is of paramount importance to our voluntary compliance system. At one time in America, we could say the same about most of our financial dealings, but unfortunately, that is no longer true.

The confidentiality of income tax return data is the last remaining bulwark, and we believe it should be retained.

We have been before the Subcommittee several times in the last year, and we have, at various times during that testimony, pointed out problems we had with individual specific employees of the Internal Revenue Service or some of the policies they may have enacted, that we disagreed with.

But we want to recognize the overwhelming majority of IRS employees that are dedicated, ethical individuals interested in performing their difficult jobs, within the guidelines set out by the Service and the Congress.

The IRS does extensive background investigations to help eliminate potential problem employees before they are selected.

Once on the job, they have very strict rules of conduct which employees are expected to adhere to, and there is an established disciplinary process in place to deal with employees who violate those rules.

In sharp contrast to the relatively high caliber of IRS recruits and the tightly regulated systems within the Service to protect taxpayer data, we have been appalled at the "horror stories" in exposés we have read about the commercial collection industry.

This industry has such low hiring standards and such shoddy and unethical practices, that Congress itself has been forced to regulate it many times over the last three decades.

We would urge that if this pilot program does go forward, that the IRS be required to look at the Federal Trade Commission records on the companies that are bidding on this contract.

If you call some people from the Federal Trade Commission before this Subcommittee, I think you will find out that many of these firms have been cited for violations of their business practices and fined significant amounts.

Those types of firms should not be allowed to participate in the IRS test, if it goes forward.

In preparation for our comments today, we did an E-mail poll of our members and asked them for comments concerning their dealings with the private collection agencies utilized by the State and municipal taxing authorities around the country. We have not received a single positive comment. Our members have related tales of taxpayers being threatened with legal actions not permitted under law; with threats of additional penalties not authorized by the taxing authorities; with demands for delinquent taxes without any explanation about the cause for assessment; with demands for taxes that had expired statutes for collection; with demands for excessive financial information disclosure; with demands that taxpayers file delinquent tax returns, not with the State agency but with the collection agency; and finally, for demands for taxes already discharged in bankruptcy proceedings.

One member alerted us to the fact that the city of Philadelphia has contracted with a 250-person firm, and the name of that firm is the Municipal Tax Bureau. If ever was a name intentionally designed to confuse taxpayers, that is it.

We are concerned about the production quota environment. The IRS has long realized that in a production quota environment, the first casualty is taxpayer rights. I was a collection division chief in the IRS when we first implemented the restrictions for keeping enforcement statistics on individual employees, and I can vouch for the impact this had throughout the whole organization.

Gone immediately were the last week of the month seizures of taxpayer assets just because someone was behind on a chart hanging in the group area.

Gone immediately were local district policies of seizing any business taxpayer with delinquent payroll taxes within 24 hours of receiving the case, and that was the case, gentlemen.

I have on a wall in my office, an award I received as a revenue officer in the collection division, for making the most seizures in my group that month.

In contrast to that environment, one of the collection agencies around the country located in Texas, as I understand it, has a leather bomber jacket in a glass case in their lobby, and it gets awarded every month to the collection "ACE" that shoots down the most money.

Is this really what we want to be broadcasting to taxpayers? Do we really want to restrict government employees who must meet strict hiring qualifications and are fully accountable to a defined chain of command regarding their actions, while leaving unfettered

commercial firms who can dragoon anybody off the street, regardless of qualifications, and give them this confidential material to work with? We think not.

We are very concerned about the way the proposal has been written by IRS, and the bonus payments on full pay cases. I do not know if you have had a chance to review the RFP, in detail, but there is a multiple paid to the contractor that gets a full paid case.

Mr. MATSUI. Mr. Lane, could you try to wrap up your testimony. I do not want to interrupt any one of the three of you, but we are trying to limit everyone to 5 minutes, and this room will have to be used later, by someone else, and so we are trying to move ahead.

Mr. LANE. That is fine.

Mr. MATSUI. If you will proceed, and if you can conclude.

Mr. LANE. We are concerned about the bonus paid, and we have certain suggestions we have submitted to the Subcommittee. There are a total of five suggestions, which spell out how we think the IRS could utilize outside resources by contracting, but not involve the potential violation of taxpayers' rights. We spell those out, in detail, for the Subcommittee in our written report.

We also are in favor of, in general, most of the items covered in the proposed 6402 changes with the exception that we would not want to see non-means-tested Social Security payments subject to an automatic levy. There are just too many elderly people in this country that have the potential to have too many errors made, that wind up having 15 percent of their Social Security check withheld, and they do not have the resources to pay professionals to go out and get these levies released and get their money back.

So, I will be happy to take any questions.

[The prepared statement follows:]

**STATEMENT OF JOSEPH F. LANE
ENROLLED AGENT
ON BEHALF OF NATIONAL ASSOCIATION OF ENROLLED AGENTS**

Madam Chair, Members of the Subcommittee, my name is Joseph F. Lane. I am an Enrolled Agent in private practice in Menlo Park, California. I thank you for your invitation to testify on behalf of the National Association of Enrolled Agents regarding the proposal to permit the IRS to contract out some of its Collection work to outside collection agencies and the proposal to expand levy authority under the Internal Revenue Code.

I am testifying today on behalf of the more than 9,100 members of the National Association of Enrolled Agents (NAEA). As the members of the Subcommittee well know, Enrolled Agents are the only tax professionals possessing a Federal license to represent taxpayers before the Internal Revenue Service and our members represent more than four million (4,000,000) individual and small business taxpayers annually. NAEA is especially appreciative of the interest this Subcommittee has taken in the matter of Internal Revenue Service practices and procedures and their impact on taxpayers. We pledge our support to further assist the Subcommittee in the future on issues which effect the general taxpaying public.

NAEA is Opposed to the Outside Collection Agency Test

Before I begin my remarks, I want to make the point that the NAEA strongly supports the concept of the IRS studying ways to improve its service to taxpayers and achieve efficiencies in its management of the public revenues entrusted to it. In addition, it should be pointed out that since over 90% of our members own and operate their own tax representation practices, that the NAEA is certainly supportive of small business entrepreneurship. Having said that, I must advise the Committee that we are fervently opposed to the proposed outside collection agency test.

History of Tax Return Confidentiality

Up until recently, there has been a sacred agreement between the taxpayers who file their returns and the government. The confidentiality of tax return data is of paramount importance to our voluntary compliance system. At one time in America, the same could be said of most of our financial dealings. Unfortunately, with the wide-spread expansion of credit availability and the enhancements to computerized technology, there has been a devolution in the confidentiality of much of our previously privileged financial lives. The confidentiality of income tax return data is the last bulwark remaining. It should be retained.

Reliability of Internal Revenue Service Employees

While we have, in past hearings, complained to the committee about specific actions taken by some Service employees or specific policies with which we disagreed, NAEA recognizes that the overwhelming majority of IRS employees are dedicated, ethical individuals interested in performing their difficult jobs within the guidelines set forth by the Service and the Congress. The Service has always set high standards of qualification for employment in its field positions and, we believe, does an excellent job in vetting the applicants it considers. The background investigations it performs help to eliminate many potential problem employees and weed out those who would attempt to abuse the power entrusted to them in their official capacities. Once on board, the Service clearly delineates through its Rules of Conduct and on the job training regimen exactly what expectations it has of its employees. There is an established disciplinary process in place, and often used, to insure that all employees meet the high expectations set out for them.

Even given all of these safeguards, we have seen press reports in recent years where hundreds of Service employees have had to be disciplined because they were "browsing" confidential taxpayer data they had no right to look at. The reason these violations were discovered is because the Service has stringent controls over who may access certain computer files and has programmed tracking devices into the software to identify those who attempt to access information not already assigned to them.

The Commercial Collection Industry

In sharp contrast to the relatively high caliber of IRS recruits and the tightly regulated systems within the Service to protect taxpayer data, we have all been appalled at the "horror" stories and exposes we have read concerning the commercial collection industry. This industry has such low hiring standards for employees and a reputation for such shoddy and unethical business practices that Congress has passed legislation over the past three decades to rein in its abusive methods. It is inconceivable to us that any serious thought is being given to turning over confidential tax data to an industry with the track record "enjoyed" by the commercial collection industry. We would urge the Committee to ask the Federal Trade Commission about the reliability and ethical conduct of many of these commercial collection agencies. At the very least, the FTC records ought to be considered by the Service in evaluating the companies bidding on the current proposal.

Our Members' Comments

In preparation for today's hearing, we polled our members via e-mail and received many comments back concerning their experiences dealing with commercial collection agencies currently used by state and municipal taxing authorities around the country. We have not received a single positive comment. Our members have related tales of taxpayers being threatened with legal actions not permitted under law; with threats of additional penalties not authorized by the taxing authorities; with demands for delinquent taxes without any explanation about the cause of the assessment; with demands for taxes with expired statutes for collection; with demands for extensive financial information disclosures; with demands that taxpayers file delinquent tax returns, not with the state agency but, with the collection agency, and finally for demands for taxes already discharged in bankruptcy proceedings.

In almost every instance, our members have cited the lack of professionalism of the collection agency personnel compared to the state revenue department employees. One member reported that revenue department employees are "more knowledgeable, friendlier and LESS bureaucratic" than those working for collection agencies. Many commented on the lack of knowledge of the people they spoke with, the single concentration on collecting the amount due regardless of the accuracy of the assessment and no awareness of how to resolve cases where the accuracy was at issue. One member related how the City of Philadelphia has contracted with a 250 employee firm which calls itself the Municipal Tax Bureau (clearly a name chosen to mislead taxpayers) thereby permitting this independent enterprise to get direct access to Federal records and bypass the State of Pennsylvania tax department. This has to raise serious questions as to how this group uses the information they get and how secure their systems are. Who regulates these hired guns?

Production Quotas

A major concern of NAEA members is the negative impact on taxpayers derived from turning over their cases to an industry noted for its heavy emphasis on production quotas. The IRS long ago realized that in a production quota environment the first casualty is the taxpayer's rights. It is precisely for this reason that the Service prohibits its managers from keeping enforcement statistics on individual employees. It rightfully recognizes that any evaluative system which permitted these statistics to be used would create a competitive atmosphere not conducive to protecting taxpayer rights. It is tough enough to work in the tax collection environment without adding "production quotas" to the mix.

I was a Collection Branch Chief when we implemented the restrictions on keeping enforcement statistics and I can vouch for the impact this had throughout the organization. Gone immediately were the last week of the month seizures of taxpayer assets just because someone was behind on the chart hanging in the group area. Gone immediately were local District policies of seizing any business taxpayer with delinquent payroll tax liabilities within 24 hours of receiving the case. Instead, enforcement actions were taken when warranted in the good judgment of the Revenue Officer assigned the case. Contrast this environment with that of the Texas company with a leather bomber jacket in the glass case in its lobby that gets awarded every month to the

Collection "ACE" who "shot down" the most money that month! Is this really what we want to be broadcasting to taxpayers? Do we really want to restrict government employees, who must meet strict hiring qualifications and are fully accountable to a defined chain of command regarding their actions while leaving unfettered commercial firms who dragoon anyone off the street to work on such confidential material. We think not!

IRS Solicitation 96-0014, Collection Related Activities

We have reviewed the IRS Request for Proposal issued on this topic and we are concerned about many aspects of the solicitation. The proposed procedure would assign cases to outside collection agencies only on taxpayers who did not have a Power of Attorney on file with the Service. In other words, the most vulnerable taxpayers would be the first to go. Those taxpayers who had the least knowledge of their rights would be cast to the commercial agencies.

We also are concerned about the methodology of bonus payments for full pay cases. While it is understandable from a business incentive perspective, it is precisely this mind-set we object to. The Service would never permit one of its group managers to award a Revenue Officer in the field more pay because a greater percentage of that employee's cases were closed with full payments as opposed to some other method of disposition. That would create a motivation to collect full pays regardless of the facts of the case and could easily lead to mishandling the case.

If the Service can see the wisdom of this restriction on its own valued, trusted and reliable employees how can it suggest that it not also be applied to those it has little, if any, control over?

NAEA Proposals for Privatization

We believe that there are several areas the Service could consider for privatization which would achieve the benefits of increased efficiency and cost reduction and not involve the risks to taxpayer rights and confidentiality we addressed above.

First, the increased number of bankruptcy filings has created a much higher inventory of such cases. The Service could contract out the task of representing the Government in the bankruptcy forum. This would provide for the retention of specialists in a narrow field of expertise, affect very few taxpayers, insure taxpayer rights since most of the taxpayers involved would be represented by counsel or trustees, and perhaps insure a greater monetary return to the Service than it currently secures.

Second, the Service recently implemented National and Local standards for purposes of making Collection case decisions. This process could now be automated by permitting practitioners to electronically submit completed payment arrangements directly into the Service's computers. The Service already has the power under Circular 230 to regulate the practice of Enrolled Agents, CPAs and attorneys who represent taxpayers. We can easily see the efficacy of an automated system which permitted the practitioner to process everything needed for the installment payment arrangements directly into the IRS system without involving any IRS employee.

Third, the Service should consider entering into joint Federal-State agreements to permit State Departments of Revenue to collect delinquent IRS accounts at the same time they are working the state accounts. In many instances, taxpayers owe both agencies at the same time and the effort to jointly resolve cases would accrue to everyone's advantage. We have been testing the feasibility of joint payment agreements between the IRS and the California Franchise Tax Board for delinquent taxes for just over a year now. The State of Minnesota established an entity called the Minnesota Collection Enterprise which provides collection services for 13 different State agencies collecting student loans, child support, OSHA fines, pollution fines, restitution claims and benefit overpayments in addition to taxes. Since many of these program have Federal funding approximately 50% of the total dollars collected are returned to the Federal government. We believe this option also ought to be explored by the Service.

Fourth, the Service should consider licensing the rights to sell tax information publications to practitioners and the general public. Given the recent increases in the price of paper and postage and in light of their current budget situation, the Service is currently considering discontinuing certain valuable taxpayer information publications. We believe these are valuable enough to most users that a reasonable fee could be charged to cover the production costs and this should be considered before discontinuing publication.

Fifth, the Service should consider contracting with a national payroll service firm to handle the withholding, depositing, filing and paying of the employment taxes owed by companies who have histories of non-compliance with their payroll tax responsibilities. We believe that significant cost savings could be realized by quicker follow-up on high risk repeater trust fund tax violators and feel that the commercial payroll services are better suited for this monitoring function than the Service's Collection Division.

Proposed IRC Section 6402 Changes

We are generally in support of the changes outlined in H.R. 757 and H.R. 2234, with one very major exception. We are opposed to the inclusion of Social Security benefit payments under the automated levy offset program. We agree, in principle, that the automated offset procedure be adopted for most non-means tested disbursements but are especially concerned for the elderly taxpayers who depend on their monthly Social Security benefit for the necessities of life. The current Internal Revenue Manual requires supervisory approval prior to levy upon Social Security benefits and we believe this is well considered and should be retained. There are too many instances where erroneous information is processed through the system and assessments are generated to risk that any elderly taxpayer be deprived of a major source of their retirement income and necessitate their seeking out professional help to secure a refund of an erroneous levy. Many of our senior citizens have remarked on how the complexities of financial life today overwhelm them. We see no need to add to their concerns about Social Security. The current system works fine, it is not broken and does not need to be fixed.

Summary

We thank the Committee for the opportunity to appear today and will be happy to respond to any questions the members may have about our remarks.

Mr. MATSUI. Thank you, Mr. Lane.
Mr. Prins.

**STATEMENT OF CURTIS A. PRINS, LEGISLATIVE CONSULTANT,
AMERICAN COLLECTORS ASSOCIATION, MIDDLEBURG,
VIRGINIA**

Mr. PRINS. Mr. Matsui, Mr. Cardin, ACA, the American Collectors Association is a worldwide trade association of debt collection professionals with some 3,400 members in the United States.

Today, I would like to clear up some of the myths about the debt collection industry, particularly as they pertain to collection of debts for the Federal Government, including the Internal Revenue Service.

Currently, private collectors handle accounts for some 80 programs of the Federal Government, including the Department of Education, where they have collected some \$1 billion in delinquent student loans, including \$650 million in just the last 2 years alone.

We are also collecting taxes for 32 States, including your home State of Connecticut, Mr. Chairman, your home State of California, Mr. Matsui, and your home State of Maryland, Mr. Cardin.

Legislation currently before Congress would allow all Federal agencies to use private collectors and ACA strongly supports that initiative.

More than \$200 billion in delinquent taxes are owed the Internal Revenue Service and the General Accounting Office estimates that the figure increases by 8 percent each year.

Unless private collection agencies are used to collect IRS tax debt, a large portion of the \$200 billion will be lost forever. Everyone is concerned about taxes. How can we justify the loss of perhaps as much as \$200 billion in tax revenue, particularly at a time when the country faces severe budget cuts?

Why should people who pay their taxes have to subsidize those taxpayers, or perhaps we should call them tax delinquents, who are responsible for the \$200 billion in tax delinquencies?

How many new roads could be built with that money? How many child care facilities built, and perhaps even a cure for cancer or AIDS discovered with those funds that will be lost forever if we do not act?

Here is what ACA proposes to solve the problem. When an IRS tax delinquency reaches 180 days, it should be turned over to the Financial Management Service of the Treasury Department which has broad experience with private contractors, who will then turn the accounts over to private collection agencies.

This will free up the IRS to concentrate its efforts on the most collectible accounts, and relieve the agency of handling outside collection contracts.

Our plan will not result in the loss of any jobs at IRS, since most of the accounts that would be turned over to the private collection agencies are not actively being worked by IRS.

How will private collection agencies be able to collect on these accounts when the IRS has failed?

Private collection agencies have state-of-the-art technology, both hardware and software, and that equipment is updated constantly.

Our collectors undergo continuous training to improve their collection skills and we are able to increase our work force and equipment inventories without government budget constraints.

Contrast this with the IRS operation. The GAO has stated in testimony before the Appropriations Committee that the IRS is still using fifties and sixties collection technology.

Let me turn to some of the major concerns that have been expressed about IRS using private collectors. Privacy is one of the first issues that should be addressed.

There have been unfounded fears that collectors will have access to tax records. That is not the case, nor is it the case when collectors work for State, local, or commercial concerns.

The collector will be given the name of the individual or company that owes taxes, and the amount, an address, phone number, if available, and place of employment, if known. That is it. We will not get, and do not want tax files or any unimportant personal information about the taxpayer.

If you are worried about privacy, consider the Department of Energy, which has not received a single privacy complaint involving a private collector in the 14 years that the agency has used private firms.

On the other hand, remember the 1,300 IRS employees who have been caught snooping into taxpayer records since 1989. Yes, there may be a privacy problem, but it is with IRS, not private collectors.

Payment for private collectors is also an area that must be addressed. Under current law, contingency fees are not allowed. That should be changed, so the collectors only get paid when they collect.

That is the way the system works for all other Federal Government agencies in the private sector, when using private contractors.

Congress should not wait until the current IRS test program is completed before adopting changes in the IRS delinquent tax collection program. The test program is so flawed that many PCAs are not bidding on the contract, and those that are bidding are convinced that they will lose money, but hopefully will get in on the ground floor for later contracts.

It has been mentioned that this is a fair contract by people who are promoting it. I would suggest, Mr. Chairman, that the IRS test collection program is not as honest as professional wrestling.

Mr. Chairman, and Members of the Subcommittee, we cannot afford the loss of \$200 billion of tax revenue.

ACA has presented a plan that prevents such a loss. We urge you to adopt that plan and to do so quickly, so that additional tax dollars will not be lost.

In conclusion, let me make this offer to you and your staff.

There are many collection agencies within a few minutes' drive of the Capitol. I would be more than happy to entertain the Subcommittee to come out and see exactly how we work and to put to rest the myths that have sprung up during this hearing.

Thank you very much.

[The prepared statement follows:]

Testimony of Curtis A. Prins, Legislative Consultant
 American Collectors Association
 Before the Oversight Subcommittee
 Ways And Means Committee
 U. S. House of Representatives
 April 25, 1996

Madam Chairwoman: ACA is a worldwide trade association of debt collection professionals with some 3,400 members in this country. We are the largest association of collection agencies, representing agencies from the mom and pop size to ones with 400 to 500 collectors.

The collection industry is one of the least understood but perhaps one of the most important businesses in our economy. Each year, our industry collects some \$18 billion that might otherwise be lost to businesses, state and local government and to the Federal Government. According to the Financial Management Service of Treasury, private collectors currently handle 80 collection programs for Federal agencies, including the Department of Education, where since 1982, we have collected more than \$1 billion in delinquent student loans, including \$650 million in the last two years alone.

In the last few weeks, an ACA member, National Credit Management Corporation (NCMC) of Hunt Valley, MD., received a contract from the Nuclear Regulatory Commission (NRC), the Federal Trade Commission and the Comptroller of the Currency to provide demand letters, a collection service where the collector sends letters to debtors asking for payment. The contract, which any Federal agency can use, pays NCMC 54 cents for each letter sent. In addition, the company is paid for any additional work such as searching for assets. In just a few short weeks, this company has collected \$141,895 for the Federal Government at a cost to the Government of only \$1,175.30.

Now, compare this to what it costs the Government to send a letter. A senior official at the Office and Management and Budget has told me that the agency estimates that it costs the Government \$24 to send a single letter, when all costs are factored in-- personnel, equipment, material, etc. Simple math tells us that it would save the Government \$23.46 a letter to use the services of a company such as NCMC. Only three agencies are using the NCMC contract, even though it has been available to all departments for some two years

Since this hearing is to deal with the Internal Revenue Service, let me move quickly to the main topic. Private collectors currently collect taxes in 32** states, including you home state of Connecticut Madam Chairwoman. According to a 1994 General Accounting Office study, the states generally give high marks to these private collectors. We note that the GAO study shows a gross recovery rate for private collectors doing state tax collections as high as 45%

**Alaska, Arkansas, California, Colorado, Connecticut, Delaware, Hawaii, Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, New Jersey, North Carolina, North Dakota, Oklahoma, Pennsylvania, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin and Wyoming.

As we move to the Federal IRS program, it is important to remember the timeliness concept. The current IRS Request for Proposal (RFP), based on the age of accounts, is certainly not a true test. In the pilot program, of the accounts that are in the business tax category, 91% are more than three years old and 52% are more than six years old. In the individual area, 77% are more than three years old and 28% are aged over six years old. At the same time, in both categories, of the accounts being turned over to private collectors only 3% are under one year old.

It is ACA's belief that the collection of delinquent taxes, either at the state or federal level has a direct bearing on the timeliness with which the accounts are turned over to private collectors. A study done by ACA clearly illustrates that point. For example, on accounts placed for collection within 30 days of delinquency, the average recovery rate is 53%. After 90 days, the rate drops to 29% and after one year, the rate falls to 10 percent. When an account is placed after 421 days of delinquency, the collection rate is only 4%. We do not have adequate statistics to show the collection rate on accounts that are two, three, five or more years old. We do know however, based on experience in collection student loans that government loans that are multi-year delinquent have a much higher private collection rate than similar aged accounts in the private sector. So even the older IRS accounts can be collected if turned over to private collectors.

In discussing the IRS collection program, the first and most important given is that the IRS wants to collect delinquent taxes. If that is not given, then the alternative is to continue with the current system, which according to GAO sees an increase of 8% a year in uncollected delinquent taxes.

Currently, IRS has some \$200 billion in delinquent taxes facing collection. In the last two years, IRS had to "write off" \$60 billion in delinquencies that fell into the Currently Not Collectible (CNC) category. That is \$60 billion that is most probably lost to the Treasury forever, unless it is turned over to private collectors. As this Congress struggles with budget constraints, wouldn't it be nice to have that \$200 billion to either help fund the Government or to be used to reduce taxes. How many new roads could be built with that money? How many child care facilities built and could a cure for cancer or AIDS be discovered with those funds that will be lost if we don't act?

Here is what ACA proposes. Let IRS work those accounts that are the most current and have the highest dollar value. Once an account reaches 180 days past due, it would be transferred to Financial Management Systems in the Treasury where it would be sent out for collection by private companies. This would not result in the loss of any jobs at IRS and would allow the agencies to better use their in-house collectors. Most importantly, it would increase the amount of tax dollars collected directly and would greatly reduce the accounts that would have to be written off.

ACA believes that the only way to solve the current IRS collection problem is with direct legislation and the longer the wait for passage of that legislation the greater the loss to the Treasury.

There are those who say nothing should be done until the end of the IRS test program--that is wrong. The test program has been designed in such a way that it will not be a true or even fair test. The requirements of the program are so cumbersome, the cost to a collection agency that win a contract are so high and the potential return so small, that many outstanding collection firms that should be bidding on this contract are sitting this one out.

What is even more shocking about the IRS test program is that it is a direct slap in the face at the Congress. The House committee report on the legislation establishing the test program said "...to insure that the initiative receives an opportunity to flourish...the Committee is adamant that the IRS assign cases that "would fit the profile of a private sector collection agency." Certainly when 91% of the accounts in the business category are over six years old, hardly meets the Committee's directive. But even more shocking was the IRS's totally disregard for the Committee's direction that the "Committee insists that the contracts should include the opportunity for smaller collection agencies to participate.

Because of the myriad requirements in the contract including a \$300 investigation fee for every employee who works on the contract, no "smaller" collection agency can afford to take a chance on this contract. The best opportunity for small businesses, then, would be as sub-contractor, a practice that many large collection agencies follow. Not only does the RFP discourage subcontracting, however, but, in response to a question from a collector who wrote, "Does the IRS expect the direct subcontracting of the actual collection work to small business?" The IRS wrote "Absolutely Not." In fact, a contractor, who sent accounts to a smaller collector would be in violation of the security requirements of the contract. So much for the "Committee insists."

One of the common misunderstandings about collection work, particularly if it is for the IRS, deals with privacy. Collectors don't want copies of tax records. They simply want name, address, telephone number, amount owed and employment information, if possible. I would point out that under the Fair Debt Collection Practices Act, passed in 1977, even the disclosure of that basic information to a third party by a collector would be a violation of the Act and subject the collector to severe monetary penalties. Earlier I mentioned that the Department of Education has used outside collector since 1979. During that period the agency has not received a single complaint about a collector violating a borrower's privacy. By contrast, since 1989, some 1,300 IRS employees have been caught snooping into taxpayers records. Who has the privacy problem?

In conclusion, Madam Chairwoman, if the Congress wants tax delinquencies reduced, less writeoffs, and reduced collection costs to the Government, then require the IRS to turn over accounts to FMS when they become six months delinquent and let the private collection agencies do the job that they do every day for every sector of the business world. If you want results, at a small cost to the Government and I might add, if we don't collect, we don't get paid, then using cost effective private collection agencies is the course to follow.

Thank you very much.

Chairman JOHNSON [presiding]. Thank you, Mr. Prins.
Mr. Moskowitz.

**STATEMENT OF SAUL L. MOSKOWITZ, PARTNER, DEAN
BLAKEY & MOSKOWITZ**

Mr. MOSKOWITZ. Madam Chairman, Mr. Cardin, thank you for allowing me the opportunity to testify before the Subcommittee today on IRS debt collection activities.

My name is Saul Moskowitz and I am a partner in the Washington law firm of Dean Blakey & Moskowitz.

My background in student loan collection policy, which is what I am here to talk about today, is described, in detail, along with the points I am making in my written statement.

I have 17 years' experience with student loan collection issues as a government attorney, as a policy director for the Student Loan Program, and in private law practice, working with various members of the industry.

The 17 years of experience that the Department of Education has in student loan collections can teach us quite a bit about what would happen if the IRS used these private collection firms to work the debt that the IRS has now given up on, or at least is not actively collecting.

The results which are described in more detail in my written testimony—and you can refer to appendix C, if you like, which kind of goes through this—what I believe would result is, number one, billions of dollars in new revenue.

There are approximately \$40 billion of accounts receivable in the, what they call the ARDI at the IRS, the accounts receivable dollar inventory, that are not actively pursued today by the IRS, that I believe are appropriate for referral to PCAs, private collection agencies.

These include the deferred accounts, the accounts that have been in the collection queue for more than 90 days, and the accounts classified as CNC, currently not collectible, because of the IRS' inability to locate the debtor, to contact the debtor, even though they know where the debtor is, or that have been categorized as CNC because of a lack of known assets or income to pay the debt without financial hardship.

Private collection agencies have been collecting more than 19.6 percent of student loan debt referred to them, even though those accounts are harder to collect than many of the receivables I have just described.

The reasons for that, I will be happy to go into with you, and they are set forth in detail in my written testimony.

It is important to note that this 19.6 percent is net of the fees paid to the private collection agencies. The second thing that would result is taxpayer privacy would be fully protected.

How do we know? The Department of Education—and I am not telling anyone who has been experienced lately in applying for Federal student financial aid, anything they do not already painfully know—the Department of Education receives more confidential financial information from a student loan applicant than the IRS gets from many taxpayers. Yet there has never been, as Curtis pointed out, a single unauthorized disclosure we know about, of

that information by a private collection agency collecting student loans.

There is no magic to it, they simply are not given access to this information and what they do not have, they cannot disclose.

Third, debtor complaints would be extremely rare. The Department of Education receives less than one complaint for every 50,000 debtor contacts by their PCAs.

The fact is the contractual penalties, the applicable legal requirements, and the contractor selection process, in the first place, ensure that debtor harassment does not take place, and the compensation scheme, which has been maligned over the course of this hearing, actually works to help this because it makes sure the collection efforts are focused on the truly collectible accounts.

It is simply a waste of money for a private collection agency, paid on a contingency-fee basis, to spend time going after a debtor who truly is unable to pay.

Fourth, inherently governmental functions would not be usurped. The department's contract ensures that inherently governmental functions such as resolving disputes with student loan debtors, initiating litigation against those borrowers, that these are performed only by government employees.

Similarly, the IRS could, by contract, ensure that private collection agencies do not assess tax liabilities, do not resolve tax disputes, and do not seize assets, issue levies, or garnish wages. It is a matter of what you put in the contract.

Finally, no appropriated funds would be needed. The Department of Education, as with all other Federal agencies, other than the Customs Service and IRS who are excluded, under the Debt Collection Act, can pay collection firms from proceeds collected.

Each of these points, as I mentioned, is reviewed in more detail in my testimony.

Finally, with respect to the RFP, I have taken a close look at the RFP, and I have compared it to what the Department of Education uses in its contracts as a result of its 17 years of experience, and my analysis indicates that the RFP is deficient in numerous respects and is not going to produce useful information with respect to the use of private collection agencies.

The detail on why I say that: Again, there is an appendix to my testimony that gets into it. Briefly, the series of accounts that are included exclude important categories of accounts. The private collectors are not given critical information, basic information, like the debtor's telephone number to use, to locate the debtor.

The system of online telephone transfers is doomed to failure, and the compensation approach is going to discourage diligent efforts, not encourage them.

I should mention the IRS did confer with the Department of Education in developing the RFP, and yet makes the same mistakes that the Department of Education made and learned from years ago.

It clearly could have made better use of the expertise that resides there.

In conclusion, I would like to emphasize that private collectors have been used, successfully, not only by the Department of Education, but also by—I understand now we are at 39 States and growing, with respect to tax collection, and over 1 million private creditors.

Thank you very much for the opportunity to appear today and I will be happy to answer any questions.

[The prepared statement and attachments follow:]

**STATEMENT OF SAUL L. MOSKOWITZ, PARTNER
DEAN BLAKEY & MOSKOWITZ
WASHINGTON, DC**

Madame Chair and other members of the Subcommittee, my name is Saul L. Moskowitz and I am a partner in the law firm of Dean Blakey & Moskowitz in Washington, D.C. I am grateful for the opportunity to testify before the Subcommittee in support of the Subcommittee's oversight of IRS debt collection activities. With April 15 having just passed, and over \$200 billion owed to the Federal government in delinquent tax debt, this hearing is certainly timely.

INTRODUCTION

On behalf of a coalition of private collection agencies, I have been working with various experts on the IRS tax collection function to analyze the IRS Accounts Receivable Dollar Inventory (ARDI) and the extent to which the use of such firms would help improve the collection of federal taxes. Today my statement will focus on the experience of the Department of Education (ED) in collecting defaulted federal student loans and the lessons that experience can teach us about the use of private collection agencies (PCAs) to help collect delinquent federal taxes. For the reasons I will discuss today, I am convinced that, if PCAs were given a prominent role in collecting certain portions of the delinquent federal tax debt that is not now being worked by the IRS, billions of dollars in new revenue would be produced. Furthermore, this new money would be generated without compromising taxpayer privacy, harassing taxpayers, or involving PCAs in inherently governmental functions.

I. My Background in Student Loan
Collection Policy

Prior to joining Dean Blakey & Moskowitz in 1990, I served at ED as an Attorney-Advisor in the Office of the General Counsel (OGC) from August 1979 until approximately February 1988. In that capacity, I provided legal advice to ED officials in connection with various programs, including the Guaranteed Student Loan (now the Federal Family Education Loan) Program (FFELP).

Beginning in approximately 1982, I became the lead program attorney for the FFELP. In that capacity, I was the primary attorney responsible for advising ED officials regarding the statutes, regulations and policies relevant to the FFELP. Through my daily consultations with program officials, I was intimately familiar with the policy decisions of ED regarding collection of defaulted loans.

In February 1988, I became Chief of the Guaranteed Student Loan Branch of the Division of Policy and Program Development within the Office of Student Financial Assistance. In this position, I served as principal policy official for the FFELP and worked closely with Debt Collection Management and Assistance Service in improving ED's collection of defaulted loans, including expanding and improving ED's relationship with its PCA contractors.

Since leaving ED in 1990, I have worked extensively with FFELP lenders, servicers, guarantors, and PCAs on student loan collection issues and have had numerous opportunities to see first-hand how these various parties pursue the collection of delinquent loans. During this period, I have also worked closely with PCAs that have contracts with FFELP guarantors and ED and have become very familiar with the structure of those contracts and the evolution of those contracts over time.

II. The FFELP

To understand FFELP defaulted loan collection procedures, it is essential to have a basic understanding of how the FFELP operates and, particularly, the extensive level of collection activity that defaulted loans undergo prior to being referred to PCAs by ED.

The FFELP is the largest Federal student aid program in higher education, providing over \$23 billion in funds to over 6.7 million borrowers in 1994 alone.

Under the FFELP, private lenders make loans to eligible students attending postsecondary institutions. These loans are guaranteed up to 98 percent by state or private nonprofit guaranty agencies. (Currently, there are approximately 47 guarantors throughout the country.) In turn, the guarantors are reinsured for up to 98 percent of the loan's balance by ED.

A flow chart illustrating the collection efforts that are undertaken on a delinquent FFELP loan is attached as Appendix A. As the chart illustrates, before a borrower defaults (defined as the failure of the borrower to make a payment on a loan within 180 days of its due date) and the lender files a claim with the guarantor for reimbursement, the lender must attempt to collect the loan for at least 180 days and must engage in at least the minimum collection efforts set forth in ED regulations. In addition, it must notify the guarantor of the delinquency. The guarantor then attempts to collect the loan at the same time the lender is doing so, in a process known as "pre-claims assistance". If all of these efforts fail, the lender may file a claim with the guarantor.

Upon paying the claim, the guarantor becomes the holder of the loan. The guarantor then commences 225 days or more of further collection action on the loan, culminating in litigation (or administrative wage garnishment) against the debtor if the debtor has sufficient assets or income. Also during this period, any Federal tax refund the debtor might be due is intercepted and applied to the debt.

FFELP guarantors have been quite proficient in their post-default collection efforts, collecting over \$2.2 billion in the last two (2) years, excluding amounts collected by tax refund offset. It is interesting to note that, with one exception, every guarantor contracts with private collection agencies (PCAs) to perform post-default collection activities.

Despite the collective efforts of the lender, the guarantor, and the guarantor's PCAs, some student loans remain uncollected. ED has the authority under the FFELP statute to require a guarantor to assign defaulted loans to ED. Accordingly, ED requires guarantors to assign various categories of defaulted loans on which the guarantor and lender have been unsuccessful in collection and on which litigation and/or administrative wage garnishment is not deemed to be appropriate. ED thereupon sends letters to the debtors in an effort to collect the debt. If these efforts fail, ED then places the debt with a PCA under contract with ED.

Thus, before a PCA under contract with ED gets a chance to collect a defaulted student loan, that loan has been deemed to be inappropriate for litigation or administrative wage garnishment, and has been through more than a year of exhaustive collection efforts by the lender, the guarantor, one or more PCAs under contract with the guarantor, and ED.

III. Department of Education Experience with PCAs

ED entered into its first contract with a PCA in 1979. ED's contract approach has undergone significant changes since then, resulting in steady improvement in the performance of contractors and the increased efficiency in ED's use of its resources to administer the contracts. PCAs collected more than \$650 million on defaulted student loans for ED in the last two years alone.

A. Contract Structure

Currently, ED is about to request proposals for a new series of contracts with 10-12 PCAs. The PCAs will compete head-to-head, with the top performers receiving substantial bonuses above the contractual commission percentage. As with the current contracts, contractor performance bonuses will be based on collections (net of fees), quality of litigation preparation and administrative resolution activities, and compliance with laws governing debtor rights and collection practices.

ED pays the PCAs from the amounts collected, as permitted by the Debt Collection Act. **No appropriations are needed.**

B. Collection Success Rate of PCAs

As noted above, PCAs receive loans from ED only after exhaustive collection efforts have been attempted by lenders, guarantors (including their PCAs), and ED. Moreover, none of these accounts are appropriate candidates for litigation due to the fact that the borrower is either unlocateable or does not appear to have sufficient assets or income to justify the cost of litigation. ED's PCA contractors are nevertheless recovering over 19.6 percent of the account balances referred to them. And that is after deduction of their fees.

C. PCA Activities Under the ED Contract

Under the ED contract, PCAs perform skip-tracing (attempting to locate delinquent borrowers) and telephone collection activities on referred accounts. They do not make personal visits, receive payments, resolve disputes, or sue defaulters.

The telephone collection efforts of ED's PCAs are designed to elicit information indicating whether or not the debtor has the income or assets to make payments on the debt, assist the debtor in understanding the options for resolving the default, and explain the consequences of the debtor's failing to do so. Since these

are, after all, telephone calls, any effort to harass or bully the debtor (in addition to being illegal and a violation of the contract) is likely to result in the debtor hanging up and refusing to cooperate further. Thus, the most common technique employs the so-called "indifferent" approach, with the collector reading (often in a flat monotone) from a prepared script. At the first sign of a willingness to cooperate from the debtor, the collector offers to assist the debtor in understanding and selecting the best option for resolving the debt. Because of the collector's training and expertise, he or she is often able to obtain cooperation from the debtor where others have failed. Thus, the stereotype of "Bruno from New Jersey" bears no resemblance to the actual telephone collection techniques used by PCAs on defaulted student loans.

PCAs are successful because they employ state-of-the-art credit-scoring techniques to identify the most collectible accounts and are able to access sources of borrower and asset location information that are often unavailable to lenders, guarantors, and ED. However, probably the most important element in a PCA's ability to collect a student loan where others have failed stems from its ability to provide substantial performance incentives to individual collectors. These incentives help collectors maintain their enthusiasm in the face of what can often be an extremely unpleasant job. After all, most student loan defaulters are not happy about being contacted for collection of their debt by anyone. They are usually uncooperative, and often abusive with whoever performs that function. By providing a system of performance incentives that no government agency can match, PCAs have succeeded where lenders, guarantors, and ED have failed.

D. Frequency of Borrower Complaints

PCAs working for ED generate an extraordinarily low volume of debtor complaints, the vast majority of which are baseless. In fact, ED receives less than one complaint for every 50,000 contacts with debtors by its PCAs.

E. Debtor Privacy

Debtor privacy is a critical concern in the student loan program due to the extensive personal financial information that an applicant must provide to ED to get a loan in the first place. PCAs have posed no problems for ED in this area.

In order to qualify for an FFELP loan, a student must first fill out the "Free Application for Federal Student Assistance", or "FAFSA". A copy of this form is attached to my testimony as Appendix B. ED uses the information on this form to determine the student's eligibility for Federal aid, including FFELP loans.

The FAFSA requires the applicant to submit extensive information regarding educational plans and student status. In addition, and of particular relevance here, the FAFSA requires the applicant to provide ED with detailed financial information taken directly from the student's and his/her parents' tax returns, as well as detailed information concerning the student's and parents' assets. Thus, the confidential financial information an individual must provide to ED in order to receive an FFELP loan often exceeds the information provided to the IRS on a taxpayer's Form 1040.

Yet, ED's PCAs have never disclosed any of this information to third parties. This is simply because they are never provided access to that information. The fact is that a PCA does not need this information to do its job. ED's PCAs are only provided with the information necessary to assist them in locating and contacting the debtor regarding the debt, such as debtor address and telephone number, employer name, employer address and telephone number, and the amount of the debt.

F. Regulatory Incentives for Use of PCAs by Guarantors

ED's belief in the benefits of using PCAs is reflected in the requirements it imposes on guarantors.

The FFELP regulations mandate detailed collection activities that a guarantor must follow on a defaulted loan in order for the guarantor to be reimbursed for its default claim payments by ED. However, if a guarantor uses PCAs in a "competitive environment" that rewards the best performers, the regulations relieve the guarantor of significant portions of those requirements and allow the PCAs to collect as they see fit. This is because, quite simply, ED believes that a guarantor that uses multiple competing PCAs has, by that step alone, ensured that the defaulted loans held by the guarantor will be collected in an efficient and effective manner.

IV. Analysis of IRS Accounts Receivable Dollar Inventory (ARDI)

In order to assess the relevance of ED's experience with PCAs to the IRS, I have consulted a number of experts on IRS collection matters, including IRS experts at Coopers & Lybrand. This analysis indicates that several segments of the ARDI bear a close resemblance to the student loan accounts that PCAs have successfully collected.

Based on recent data provided by the IRS to the Subcommittee on Government Management, Information & Technology of the House Government Reform & Oversight Committee, several large blocks of accounts in the ARDI, together totalling more than \$40 billion, appear to be excellent candidates for referral to PCAs. These categories are as follows:

1. Deferred Accounts (approximately \$1.8 billion according to the IRS) -- These accounts are below the IRS dollar threshold for further active collection efforts, but are probably very collectible. For example, the State of Illinois has reported that, when it referred similar "older-year" state income tax receivables to PCAs, approximately 30 percent of the debt was collected.
2. Accounts in the Queue for More than Ninety (90) Days (amount presently unknown, probably exceeds \$5 billion) -- These accounts have received a low "RMS score" by the IRS, indicating that IRS believes they should not receive priority for referral to revenue officers.
3. "Currently Not Collectible" (CNC) Accounts So Classified Due to IRS' Inability to Locate or Contact the Debtor or the Debtor's Lack of Known Assets or Income (approximately \$35 billion according to the IRS) -- These accounts have been determined to be "currently not collectible" by the IRS.

These categories of accounts in the ARDI are at least as collectible, and probably more collectible, than the student loan accounts that PCAs collect for ED on a daily basis. This is true for several reasons:

a. Source of the debt. It is important to remember that the FFELP is designed to induce lenders to make loans to disadvantaged students who could not otherwise receive credit, so that those students can obtain a postsecondary education. By definition, these borrowers have little or no assets or present income, only the hope of future income. Moreover, according to the latest ED data, 56 percent of the loans being collected by PCAs under contract with ED were made to borrowers who attended for-profit trade or technical schools. Many (if not most) of those defaulters failed to complete even that level of training. Thus, the income prospects of the typical student loan defaulter are usually quite modest, not at all the "deadbeat doctor" paradigm that is sometimes portrayed in the media.

In contrast, the taxpayers who owe the amounts to the IRS indicated above at one time had income significant enough to generate the tax liabilities that now remain uncollected.

b. Prior collection efforts. As noted above, PCAs only receive referrals from ED of accounts that have already been the subject of exhaustive collection efforts for over a year and have been deemed to be inappropriate candidates for administrative wage garnishment or litigation. This level of prior effort greatly exceeds the effort expended by the IRS on most of the ARDI accounts described above.

c. Debtor resources. Even ARDI accounts that the IRS has determined cannot be collected because the debtor lacks assets or income are assigned to that status only based on assets or income that the IRS knows about. Obviously, the hundreds of billions of dollars of income generated annually in the so-called "Underground Economy" are not taken into account. Further, a debt can remain in inactive status for as long as three (3) years even after the government receives information indicating that the debtor has acquired assets or income that could be used to pay the debt.

**V. ED's Use of PCAs --
Lessons for Federal Tax Collection**

The Department of Education's experience with PCAs described above teaches us several lessons about what results could be expected if PCAs were given a prominent role in the collection of those portions of the ARDI described above under contracts similar to that used by ED. A summary of these points is attached to my testimony as Appendix C for your reference.

Specifically, ED's experience shows that, if IRS issued contracts similar to ED's allowing PCAs to collect delinquent federal tax debt not now being worked by the IRS, the following would result:

1. **Billions of dollars in new revenue.** PCAs are netting back to the government more than 19.6 percent of the student loan debt referred to them, even though, as discussed above, those accounts are harder to collect than many of the receivables IRS has given up on.
2. **Taxpayer privacy would be fully protected.** As noted, ED receives more confidential financial information from student loan applicants than the IRS receives from many taxpayers, yet there has never been an unauthorized disclosure of that information by a PCA collecting student loans. This is simply because the PCAs are not given access to this information.
3. **Debtor complaints would be extremely rare.** ED receives less than one complaint for every 50,000 debtor contacts by PCAs, and the vast majority of these complaints are baseless. Contractual penalties and applicable legal requirements effectively deter debtor harassment, and a compensation scheme based on dollars collected ensures that PCAs concentrate on truly collectible accounts.
4. **Inherently governmental functions would not be usurped.** ED's contract ensures that inherently governmental functions such as receiving payments, resolving disputes, and initiating litigation against debtors are performed only by government employees.
5. **No appropriated funds would be needed to pay the PCAs.** ED pays PCAs' fees from amounts collected, as permitted by the Debt Collection Act.

It is important to note that ED's positive experience with PCAs is far from unique. More than 32 states use PCAs to help collect delinquent state tax debt. As with student loans, large amounts of new revenue are collected without loss of taxpayer privacy, harassment of debtors, or usurpation of inherently governmental functions.

VII. Recommended Structure of IRS Contracts with PCAs

In order for IRS to duplicate the success ED has enjoyed in using PCAs, IRS should adopt the contract structure and compensation approach that ED has developed over the past 17 years. Instead of "reinventing the wheel", IRS has the opportunity to learn from the ED experience.

The key components of an IRS contract with PCAs would include the following:

1. **Competitive environment.** Experience shows that, when PCAs are required to compete head-to-head for bonuses and additional placements, performance is maximized.

2. **Modified commission compensation structure.** A commission-based compensation approach is necessary to produce excellence in performance and to ensure that the PCAs concentrate on the most collectible accounts. In fact, this approach creates a strong disincentive for pursuing debtors lacking the means to pay the debt. The basic commission should be supplemented by substantial bonuses and penalties based on performance, with performance measured by net collections, compliance with procedural and technical requirements of the contract, and compliance with all applicable laws protecting the rights of debtors.

3. **Prohibit access to taxpayer financial information.** As noted above, it is not necessary for a PCA to have access to a debtor's financial information in order to efficiently collect the debt. To do its job, all the PCA needs is "directory information", such as address, telephone number, employer information and type and amount of debt.

4. **Inherently governmental functions should not be delegated.** As with ED's contract, IRS's contract should specifically enumerate the activities that the PCA may undertake, so as to prevent the PCA from performing such inherently governmental functions as receiving payments, resolving disputes, seizing assets, issuing levies, or initiating litigation against debtors. PCAs should be limited to locating debtors and assets and engaging in telephone collection efforts.

In addition, I would recommend that IRS closely examine the contracts issued by the many states that have successfully used PCAs to help collect state tax debt.

For its part, Congress needs to insure that the IRS, which has recently reversed its long-standing position and now opposes use of PCAs, carries out the contract in a good faith effort to maximize its effectiveness. As discussed below, the numerous deficiencies in the Request for Proposals issued by the IRS on March 5th to pilot test the use of PCAs cast some doubt on the willingness of the IRS to put forth such an effort. Accordingly, the Congress should consider tying IRS appropriations to its performance in carrying out PCA contracts and/or assigning the task of issuing and administering such contracts to the Financial Management Service (FMS) within the Department of Treasury. Unlike the IRS, the FMS is enthusiastic about the use of PCAs and has carefully studied the ED approach in an effort to improve the collection of other non-tax debt owed the Federal government.

VIII. IRS Request for Proposals to Pilot Test the Use of PCAs

I have closely examined the March 5, 1996 Request for Proposals (RFP) issued by the IRS to pilot test the use of PCAs to collect delinquent tax debt, and have compared it to the contract terms and structure of the ED contract with PCAs. My analysis indicates that the IRS RFP is unlikely to produce useful information regarding use of PCAs. The IRS RFP omits important categories of accounts in the ARDI from the test, prevents the PCAs from doing a good job by withholding critical information (such as the telephone number of the debtor), creates an unworkable system of on-line telephone call transfers, imposes extremely onerous up-front expenses on contractors, and employs a compensation approach that is likely to discourage diligent collection efforts by the contractors. The specific problems I see with the RFP are described more fully in the Critique attached as Appendix D to my testimony.

Although it is my understanding that IRS conferred with ED in the development of its RFP, the RFP makes many of the same mistakes that ED made, and learned from, years ago. Clearly, IRS could have made better use of ED's expertise in drafting the RFP.

CONCLUSION

PCAs have been used successfully by the Department of Education, dozens of states, and over 1 million private creditors for many years. With over \$200 billion in delinquent federal tax debt now outstanding, the question is -- why not the IRS?

Thank you very much for the opportunity to appear before you today. I would be happy to answer any questions you may have.

Chairman JOHNSON. Thank you very much, panel, for your comments.

Mr. Cardin.

Mr. CARDIN. Thank you, Madam Chairman.

First, let me thank all three of you for your testimony. Mr. Moskowitz, I could not agree with you more, that the classification of debt is the first step in trying to collect debt. That some debt just is not worth going after. The commercial enterprises can write off debt. IRS does not write off debt unless it meets certain standards, that are certainly not commercial standards.

So we have an immediate problem in that we tend to group into our accounts receivable for debt certain items I think the private sector would not so generously list as, realistically, receivables.

The student loan analogy goes a certain way. I mean, clearly, there has been success in private collection agencies with student loans.

But the Internal Revenue Code is much more complicated. We are trying to deal with the complications of the Internal Revenue Code in this Subcommittee in looking at alternative tax structures to the current way that we collect revenues.

The Internal Revenue Service is not only instructed to collect revenues, but to make sure that there is compliance with the Code. And there are certain parts, and relief that a taxpayer can receive, that is not analogous to the private sector.

When you get from a commercial enterprise a debt to collect, your responsibility is to collect that debt, whereas, the Internal Revenue Service's responsibility is not only to collect the debt, but to make sure there is compliance with the Code.

So no matter how many requests I get to my office about taxpayers who are having a concern with the IRS on collection, and their concern that the Code has not been complied with, I guess my question would be, How would you proceed if you just get the basic information—the name, address, telephone number, employment, and the taxpayer you are able to reach says, "Well, I had a conversation with the IRS," or "I believe that I do not owe them money under IRS rules because here is my income, here is this," and starts to go through some of the specifics. How do you deal with that if you are going to stay pure to not getting the information that would be on a tax return?

Mr. MOSKOWITZ. That is a very good question, Mr. Cardin, and it is a question—and my friends who deal with some of the most complex health care programs, for example, I am convinced that the Student Loan Program is at least as complicated, if not more so than, say, Medicare or Medicaid.

Do not underestimate the complexity of the Student Loan Program, and by the same token, of course, I would not want to gain-say the complexity of the Internal Revenue Code.

Mr. CARDIN. Yes. Do not underestimate the complexity of the IRS Code.

Mr. MOSKOWITZ. I do not think it is possible to overestimate it. Having said that, the Student Loan Program involves a great deal of variety in the kinds of relief borrowers can get, and a lot of issues about eligibility and educational costs that we simply, just as

with the Internal Revenue Code, we do not want private collectors making those kinds of decisions, resolving those kinds of disputes.

It seems to me the inherently governmental function we are now talking about is the resolution of a tax dispute, and just as with the resolution of the amount of a debt in the Student Loan Program, as soon as a dispute becomes apparent in the Student Loan Program, that debt is pulled from the private collection agency and is sent back to the Department of Education with the people with the expertise to resolve those questions. That is the way I believe the IRS should proceed on its contracts as well, and I believe it does in the RFP.

I have said some bad things about the RFP. I do believe it is flawed in numerous critical respects, but on this point I think it does the right thing, which is if a dispute is raised by the taxpayer, the account is pulled, it goes to the IRS who makes the call on the tax issue.

Mr. CARDIN. I would point out there are very few people who owe money who will not raise some excuse for not paying or some justification for not paying, and you need to have some degree of subjectivity in determining when it is a real dispute over the underlying debt and when it is just an excuse to try to avoid payment.

So there has got to be some subjectivity in these determinations, and I guess that is the concern many of us have when you are dealing with IRS debt.

Mr. PRINS. Mr. Cardin, if I could answer that.

Under the pilot program, once the situation that you have suggested arises, the collector has to, at that point, turn the taxpayer or the tax delinquent, if you will, over to an IRS official. There is a transfer of the phone call from the collector to IRS officials in their field office, who goes through those problems and works it out.

Let me also suggest one of the problems with that is if we locate the taxpayer, someone who has been missing for years, and the taxpayer refuses to talk to the IRS, but we give them the name, the address and the phone number, but the gentleman or the person will not talk to IRS, we do not get paid a dime for that.

So there is no incentive for us to argue with taxpayers.

Mr. CARDIN. Thank you all.

Chairman JOHNSON. I was very interested, Mr. Prins, in your written statement, and I did not catch this in your oral statement. But there was very clear direction from the Congress that the program to pilot privatization of debt collection include a reasonable sampling of collectible debts.

In your testimony, you say that—I think it was 91 percent are over 6 years old.

Mr. PRINS. Ninety-one percent of all of the debts are over 3 years old in the business category, and 51 percent are over 6 years old. Only 3 percent of all the debts in the pilot program are under 1 year old.

Chairman JOHNSON. That is extremely distressing, because in the end, this is not about 6-year old debts. This is not about 3-year-old debts.

What we are trying to do is see if you collect debts promptly, if, after the first round of effort fails, and you move into a different

system immediately, then are you going to prevent the 3-year and 6-year problems from developing.

So it would be more realistic to have no problems that were more than 3 years old than the opposite. But that is very distressing, that such a high number are old.

Mr. Lane, did you want to comment?

Mr. LANE. I think the reason that it is structured that way, from my understanding of the RFP, is that what IRS wanted to see was if these commercial collection agencies had the ability to either initiate contact with a taxpayer they were not able to locate, so therefore the case had been in what is called the queue, or the deferred work that they mentioned earlier.

So that is one of the reasons you get this stuff so old. By the time you go through the IRS notice process, it is 18 months.

Chairman JOHNSON. As I made clear earlier in the hearing, I am very interested in a far more aggressive effort to collect from that category where location is an issue, where communication is an issue.

But a pilot program should not direct itself to that uniquely difficult collection group, especially when below a certain threshold no center in America is going after delinquent taxpayers who may be 1 year, 6 months, 1½ years behind with small amounts.

Mr. LANE. The problem I have with this—and I ran out of time, but if I could bring it out in this question—the way the RFP is structured—and that is the problem we have, primarily, is with the production quota environment.

If you gave brandnew cases to these collection agencies, under the terms of the program, if they got a full pay, they would get eight times what they contracted for on that case.

Now let us say you had a \$500 delinquency, and they paid \$50 a case to get it. IRS would be paying them \$400 to collect that \$500.

At the same point, if they had a two—

Chairman JOHNSON. I do not follow that. Why would they not get \$50?

Mr. LANE. Because there is a graduated bonus structure in here based on the disposition of the case. This is what our big complaint is about. Let us say the collection agency bids IRS, they will pay \$50 for each case, for the right to work that case.

Under this proposal—it is spelled out in the RFP—if the collection agency gets a full pay on that, in other words, the taxpayer sends them a check, the IRS will pay a bonus of eight times the \$50 to the collection agency.

Now you literally have a situation where if they collected \$300, they would get paid \$400 by IRS. You literally could have IRS losing money in this for every full pay.

Chairman JOHNSON. Well, we will look back more carefully on the RFP, because a number of issues have been raised about it here today. But I would hope that the enrolled agents would work with us on what kind of private sector program we ought to have.

Mr. LANE. We gave the Subcommittee five suggestions, where they could utilize law firms and public payroll services. Five separate suggestions where you could take the same \$13 million, put it in an environment where you did not address the concerns we

have about the violation of taxpayer rights and undefended people dealing with these commercial collection agencies.

Chairman JOHNSON. Thank you very much.

Mr. LANE. Thank you.

Chairman JOHNSON. We certainly are committed to protection of taxpayers. I have been very interested at the small amount of information that collection agencies need to do their job, and this has been a very fruitful hearing for us.

I thank you very much for your participation.

Mr. LANE. Thank you for your invitation.

Chairman JOHNSON. The hearing will conclude.

[Whereupon, at 12:47 p.m., the hearing was adjourned.]

[Submissions for the record follow:]



NEWS

APRIL 25, 1996

**WRITTEN STATEMENT OF THOMAS A. SCHATZ,
PRESIDENT, CITIZENS AGAINST GOVERNMENT WASTE**

BEFORE THE

**COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT**

UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 25, 1996

Madame Chair, as President of Citizens Against Government Waste, I appreciate the opportunity to offer this testimony concerning the problem of uncollected delinquent tax debt. Our concern about this issue corresponds with our ongoing effort to expose what we consider to be examples of waste of the taxpayers' money.

I am deeply concerned about the \$200 billion in delinquent federal taxes currently outstanding and I call on this committee to consider a new approach to this serious problem. Unrecovered revenue represents billions of dollars which could be used for deficit reduction, tax relief, or other important public investments.

Despite the efforts of the IRS, this boondoggle is getting steadily worse. The IRS's inability to control the growing gap between what is owed and what is actually collected each year is evidenced by the dramatic \$29 billion jump in IRS accounts receivable since just last year alone. This drain on the federal treasury is forcing honest taxpayers to pick up the tab for deadbeats and it must be stopped.

I strongly urge the committee to give serious and swift consideration to using all reasonable, effective tools to combat this growing deficiency. There is no good reason the IRS should not turn some of the responsibility for collecting these overdue accounts to the private sector. The successful use of private collection agencies by thirty-nine states and numerous federal entities, including the Department of Education, proves that private collection works.

As this committee grapples with how to stem this drain on the federal treasury, the private sector should be considered as part of an overall strategy. Taxpayers deserve a frontal assault on this problem. They will not understand why a solution with a proven track record of success -- one that costs them nothing -- is not at least given a try.

**WRITTEN STATEMENT OF
THE FAIR SHARE COALITION**

The Fair Share Coalition was established in January 1996 to support legislation requiring the IRS to use private collection agencies (PCAs) in the collection of delinquent federal tax debt. It is comprised of four PCAs with extensive experience in collecting government receivables. With over \$200 billion in delinquent accounts receivables owed the IRS, this step is long overdue and is necessary to ensure that all taxpayers pay their "fair share." Below is a discussion of some of the issues that surround this proposal.

**I. SHOULDN'T CONGRESS WAIT UNTIL AFTER THE RESULTS
OF THE IRS DEMONSTRATION PILOT ARE IN
BEFORE PROCEEDING FURTHER WITH THIS IDEA?**

No. This idea has already been thoroughly tested with extremely positive results at the state level by 39 state tax authorities, at the federal level by most federal credit agencies, and in the private sector by over one million businesses.

Secondly, waiting 2 1/2 years will cost the taxpayers large amounts of revenue that will never be recovered.

Finally, after careful review of the Request for Proposals (RFP) issued by the IRS on March 5, 1996, it is our opinion that, unless substantial modifications are made in the approach the IRS has proposed, the Pilot will produce little if any helpful information regarding the ability of PCAs to help collect delinquent tax debt.

Some of the significant problems with the RFP include the following:

1. Omission of deferred accounts;
2. Omission of CNC cases so classified based on the debtor's lack of known assets/income;
3. Critical location information such as debtor's phone number, and employer address and phone number will not be provided to PCAs by the IRS;
4. PCAs will not be given asset location authority;
5. Enormous start-up costs are involved;
6. The requirement that PCAs have an IRS representative on site at all times while carrying out their duties under the contract will greatly impede productivity due to restricted working hours of IRS staff;

7. PCAs must pay IRS a \$300 investigation fee for each employee working on cases referred by the IRS; and
8. A counter-productive compensation structure.

II. AREN'T THE COLLECTION ACTIVITIES CONTEMPLATED BY THIS LEGISLATION "INHERENTLY GOVERNMENTAL" IN NATURE AND THUS SHOULD ONLY BE PERFORMED BY GOVERNMENT EMPLOYEES?

No. The collection activities that would be authorized under this legislation include merely locating debtors, conducting credit checks, mailing collection notices, and making collection calls. The Office of Management and Budget (OMB) has specifically confirmed that these activities are not "inherently governmental" in nature and are appropriate subjects for contracting out by the IRS.

The legislation would not authorize PCAs to receive funds, compromise debts, sue debtors, seize property, or levy against assets. Because these activities are considered "inherently governmental" by OMB, the power to perform these activities will remain solely with IRS collections staff.

III. WOULDN'T THIS LEGISLATION LEAD TO BREACHES OF TAXPAYER PRIVACY?

No. Under the legislation, PCAs would not have access to entire individual tax return information. The only information that would be disclosed to PCAs by the IRS is the debtor's name, address, telephone and social security numbers; the employer's name, address and telephone number; and the type and amount of the debt owed.

In addition, to date, in the millions of collections that PCAs have undertaken for debts owed the U.S. Department of Education, there has been no documented case of breach of privacy.

IV. WHAT TYPE OF FEE ARRANGEMENT WOULD THESE CONTRACTORS BE COMPENSATED UNDER?

Under the Horn proposal (H.R. 2234), PCAs would be compensated on a modified contingency fee basis (i.e. PCAs would keep a percentage of the proceeds they collect).

Although the Taxpayers' Bill of Rights (TBOR) prohibits the evaluation of IRS employees on the basis of their performance, the

Debt Collection Act of 1982 specifically authorizes contingency fee arrangements for government contractors. Over the years, the Department of Education has thoroughly reviewed the issue of compensation arrangements with its contractors and has found that the contingency fee arrangement produces the best results. In addition to providing adequate incentive to the PCAs under the contract, the contingency fee arrangement is appealing because PCAs would be paid directly out of the proceeds they collect, eliminating the need for any Congressional appropriation.

Under the Horn proposal, the IRS contracts would be modeled after the Education Department contracts. Specifically, the base compensation for the contractors would be calculated as a percentage of account dollars collected or included in repayment schedules agreed to by debtors. Also, as with ED, a competitive environment would be structured that would reward productive contractors who comply with the law and do not generate debtor complaints, and penalize unproductive and noncompliant ones.

**V. WOULDN'T THIS LEGISLATION TAKE JOBS AWAY
FROM FEDERAL WORKERS?**

No. Under this legislation, only tax debt not actively being pursued by the IRS would be referred to PCAs, so no IRS employees would be displaced. This legislation would simply complement the work of IRS collections staff by doing a job that is now being ignored.

**VI. WOULDN'T TAX DOLLARS BE BETTER
SPENT HIRING MORE IRS
COLLECTIONS STAFF THAN BY
CONTRACTING WITH THE
PRIVATE SECTOR?**

No. PCAs collect roughly \$5 for every \$1 spent for the Department of Education. In contrast, Robert Tobias, head of the National Treasury Employees Union (NTEU), stated at a September 1995 House Subcommittee hearing that IRS employees collect only \$3 for every \$1 spent. Furthermore, the IRS lacks the overall resources necessary to do an adequate job of collecting taxes and is far from acquiring technological advancements already being used by private collectors.

**STATEMENT OF ROBERT M. TOBIAS
NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION**

The National Treasury Employees Union, (NTEU), is the exclusive representative of over 150,000 federal government employees, including all of the eligible employees of the Internal Revenue Service. On behalf of the men and women who collect the revenue for the Federal Government, I welcome this opportunity to submit written comments to the members of the Subcommittee on Oversight, Committee on Ways and Means, regarding tax debt collection issues.

NTEU shares the concern of the members of this Subcommittee that money owed to the Federal Government must be collected and used to reduce the federal deficit. We strongly believe, and our members have demonstrated, that the Internal Revenue Service can make a major contribution toward balancing the federal budget by 2002 if given the necessary resources on a consistent basis. As an example, in FY 1995, the IRS received the first year of funding for what had been a five (5) year plan to improve compliance and reduce the federal deficit. The FY 1995 accomplishments were impressive. The IRS closed an additional 676,000 examinations, audit coverage increased from 1.08 percent to 1.63 percent, and the IRS collected an additional \$803 million directly attributable to this compliance initiative. Clearly, the collection of tax liabilities during the first year of this five year initiative far exceeded the \$331 million that was originally projected. The IRS was well on its way to collecting the estimated \$9.2 billion in additional revenue which had been targeted for deficit reduction as a result of this five year tax compliance initiative. During the FY 1996 appropriation process, the second year of this compliance

initiative was not funded. As a result, the collection of millions of dollars in tax revenues was delayed. Such delays significantly increase the difficulty of collecting such liabilities.

Also during the FY 1996 appropriations process, Congress restricted an additional \$13 million of the current IRS budget to be used for a pilot program to test the use of private law firms and debt collection agencies to assist the Agency in collecting delinquent tax debt. IRS issued a request for proposals (RFP) on March 5, 1996. Proposals were due on April 12, 1996. As the IRS moves forward with the implementation of this private tax debt collection pilot program, NTEU would like to raise several issues that should be considered in assessing the overall success or failure of this pilot program and that must be considered prior to a decision being made with regard to the continuation of such a controversial policy.

TAX COLLECTION - AN "INHERENTLY GOVERNMENTAL" FUNCTION:

The Constitution of the United States provides Congress with the power to levy and collect taxes. While Congress has retained its Constitutional authority to levy taxes, it has delegated its authority to collect taxes to the Secretary of the Treasury. Any serious discussion regarding the contracting out of federal tax debt collection to private contractors must be preceded by an analysis of the legal issues inherent in such a decision. GAO testified before the Subcommittee on Oversight, Committee on Ways and Means, on April 25, 1996, that "there is an Office of Management and Budget (OMB) policy determination and IRS Office of Chief Counsel guidance that specify that the collection of taxes is an inherently governmental function that must be performed by

government employees." OMB defines an inherently governmental function as an activity that is "so intimately related to the public interest as to mandate performance by Government employees." OMB specifically cites the collection of taxes as an example of an inherently governmental function.

However, while the actual collection of taxes is, in fact, an inherently governmental function which cannot be contracted out to private contractors, GAO also stated in its testimony that "private collectors could perform collection-related activities such as locating taxpayers and attempting to secure promises to pay."

As a result, the question is not whether private contractors should collect tax debts, but whether private contractors should be used to perform collection-related activities. If such a decision is to be seriously considered, it is critically important that both economic considerations, e.g., return on investment, and taxpayers' rights and due process protections be addressed as intricate components of any future decision.

Our current federal income tax system is based upon the voluntary compliance of individuals and businesses. When a question arises regarding the amount of tax due or the legitimacy of an assessment, an inevitable tension arises between a taxpayer's rights, including his or her due process rights, and the authority of the government to collect taxes owed.

As an example of this tension, in a recent report entitled, Internal Revenue Service Receivables, 25-28, Report No. GAO/HR-95-6 (1995), the GAO stated that "the IRS may be sending the wrong message to its collection employees by such actions as prohibiting the evaluation of collection employees based on amounts collected, increasing the use of installment agreements, and making additional use of offers in compromise." In other

words, GAO raised the question concerning whether IRS collection employees should be offered incentives as a means of increasing rates of collection. On the other hand, Public Law No. 100-647, the "Taxpayer Bill of Rights" (1988) prohibits the IRS from making compensation or personnel actions such as performance evaluations based on the amount of revenue collected.

Congress has consistently sought to maintain a "balance" between the rights of taxpayers and the collection of taxes in this country. The principal statutes and regulations which govern the IRS' collection activities include:

- * The Internal Revenue Code of 1986
- * The Privacy Act of 1974
- * Internal Revenue Code; Sections 6103, 7213, and 7431
- * 18 U.S.C. 641 (Criminal penalties for conversion of government records)
- * 15 U.S.C. 1962; Fair Debt Collection Practices Act
- * Taxpayer Bill of Rights (1988); Public Law No. 100-647

The House of Representatives recently passed an enhanced "Taxpayer Bill of Rights" which includes thirty-two items which give taxpayers additional powers in any potential dispute with the IRS. Clearly, the fair treatment of taxpayers has been of paramount importance to Congress over the years. In order to maintain this "balance" between taxpayers' rights and the right of the federal government to collect its accounts receivables, the above cited statutes and regulations must also apply to any private contractors who may seek to perform tax collection activities on behalf of the federal government.

Private debt collectors have already begun to voice their opposition to some of the critical components of this balance. On April 25, 1996, Mr. Curtis Prins, Legislative Consultant for the American Collectors Association, testified before the Subcommittee on

Oversight, Ways and Means Committee, that the "payment of private collectors is an area that must be addressed. Under current law, contingency fees are not allowed. That should be changed so that collectors only get paid when they collect." Mr. Saul Moskowitz, a partner in the private law firm of Dean Blakey & Moskowitz, and a strong advocate for the use of private debt collectors to collect federal tax debt, stated in his testimony before the same Subcommittee that "probably the most important element in a PCA's [private collection agency's] ability to collect student loans where others have failed stems from its ability to provide substantial performance incentives to individual collectors."

Such a change would completely reverse one of the key components of Public Law No. 100-647; the Taxpayer Bill of Rights (1988). Ms. Cynthia Beerbower, Deputy Assistant Secretary for Tax Policy, U.S. Department of the Treasury stated that "the Administration believes that compensation for any private debt collection initiative should be subject to the same constraints as are imposed on the IRS. If such a contingent compensation arrangement is not allowable for our own employees, over whom we have [direct] supervisory control, why would we permit it for private contractors for whom the rights of citizens may not be the highest priority?"

Debt collection "production quotas" and contingency fees are also a major concern among members of the National Association of Enrolled Agents. Mr. Joseph Lane, an Enrolled Agent, stated on behalf of the National Association of Enrolled Agents, that "a major concern of NAEA members is the negative impact on taxpayers derived from turning over their cases to an industry noted for its heavy emphasis on production quotas." He went on to cite as an example a private debt collection company in Texas which keeps

a leather bomber jacket in a glass case in its lobby that gets awarded every month to the collection "Ace" who collects the most money per month. Mr. Lane then raised the question, "Is this really what we want to be broadcasting to taxpayers?"

Finally, the issue of taxpayer privacy must not be underestimated in its importance to individual taxpayers. Taxpayer privacy and the privacy of taxpayer information must be seriously considered as an important component of any decision to contract out the collection of tax debt in this country. A recent survey conducted by Anderson Consulting revealed that 59% of Americans oppose state tax agencies contracting with private companies to administer and collect taxes while only 35% favor such a proposal."

It is unclear to what extent private contractors value or understand the critical importance of a taxpayer's right to privacy. In both its oral and written testimony before the Subcommittee on Oversight, Committee on Ways and Means, the American Collectors Association, either underestimated, or intentionally attempted to downplay the critical importance of taxpayer privacy. Again, Mr. Curtis Prins, Legislative Consultant for ACA stated that, "one of the common misunderstandings about collection work, particularly if it is for the IRS, deals with privacy. Collectors don't want tax records. They simply want names, addresses, telephone numbers, amounts owed and employment information, if possible." In an oral statement submitted to the Subcommittee, Mr. Prins stated that "there has been unfounded fear that collectors will have access to tax records. That is not the case, nor is it the case when collectors work for state or local governments or even commercial concerns. The collector will be given the name of the individual or company that owes taxes and the amount, an address, phone number, if available, and place of employment. We won't get, and do not want, tax files or any other unimportant personal

information about a taxpayer." Nowhere in his written or oral testimony did Mr. Prins substantively address the issue of taxpayer privacy or the responsibilities of private collection agencies under the Privacy Act of 1974.¹⁾ Today, taxpayers expect that all of the all of the information that is provided to the Internal Revenue Service will be kept confidential, especially income and salary levels, taxes paid, and the amount of tax due.

In defense of private debt collectors' access to confidential taxpayer information, Mr. Saul Moskowitz, a private attorney who cites his more than fifteen years of experience with the Department of Education's Student Loan program, both as an attorney for the Department of Education and currently in private practice, stated that the confidential financial information an individual must provide to ED [the Dept. of Education] in order to receive an FFELP loan often exceeds the information provided to the IRS on a taxpayer's Form 1040." Mr. Moskowitz apparently fails to make the significant distinction between information that is voluntarily provided as part of a student loan application and information that is mandated by the federal government as part of a federal tax return. While such a statement may be true, it completely ignores the terms under which such information is provided.

^{1.)} It is also of interest to note that in both statements before this Subcommittee, the American Collectors Association referenced their interest in receiving employment information. This is not information that is to be provided to private contractors under the current IRS Request for Proposals, nor is it information that is commonly provided to private tax debt collectors by states.

THE "UNIQUE" NATURE OF IRS ACCOUNTS RECEIVABLES:

Federal tax liabilities, including penalties and interest, are commonly referred to as "accounts receivables." The level of voluntary compliance with tax laws in the United States has remained relatively constant for the past decade. In 1995 voluntary compliance stood at 86%. The IRS has been working to develop a business plan to increase voluntary compliance levels to 90% by the end of the current decade. As Congress continues to focus increasing attention on efforts to balance the federal budget and decrease the deficit, the IRS accounts receivable inventory has come under increasingly greater scrutiny as a potential source of revenue which could be used for this purpose.

At the conclusion of FY '95, IRS' gross accounts receivable inventory totaled approximately \$200 billion. Of this total, \$143 billion represented taxes due to the IRS. The remaining \$57 billion consisted of accrued interest and penalties.

The IRS further divides its accounts receivable inventory into two primary categories: Currently Not Collectible (CNC), and Active Accounts Receivable (AAC). At the end of FY '95, \$87.4 billion was classified as CNC. Approximately 85% of this \$87.4 billion was owed by defunct corporations, bankrupt taxpayers, deceased taxpayers, or taxpayers that have been determined to have significant hardships. A small percentage of the CNC inventory consisted of taxpayers that the IRS has been unable to locate or contact.

On the other hand, at the end of FY '95, \$88.8 billion was classified by the IRS as "Active Accounts Receivables." Of this amount, \$36.6 billion had been assigned for enforcement action; \$19.1 billion was awaiting adjudication by the courts or acceptance

of an offer in compromise; \$11.7 billion is currently being collected through the notice process; \$11.2 billion is being collected through installment agreements; and \$1.6 billion represents lower value cases that will be collected through systemic monitoring such as refund offsets and yearly notices to taxpayers.

When the American Collectors Association (ACA) argues its case, it is quick to point to the IRS' alleged \$200 billion in accounts receivables as justification for its involvement in the collection of federal tax debt. What ACA fails to point out is that in the private sector approximately 80% of this alleged \$200 billion would have been written off as "uncollectible" long ago.

In addition, the majority of the accounts which currently make up the IRS accounts receivable inventory do not appear "to fit the profile" of the types of cases that private collectors want to contract with the IRS to collect. Mr. Philip Rosenthal, Chairman of the American Collectors Association's National Legislative Council stated that "the [IRS] test program is made up of collection cases which are anything but the type that would fit the profile of a private sector collection agency. Of the cases in the business queue that are currently being offered under contract to private collectors as part of the IRS pilot program, 91% are over three years old and 52% are greater than six years old. In the individual queue, 77% are more than three years old and 28% are greater than six years old. In every category, cases less than one year old represent the smallest percentages." Although Mr. Rosenthal may be correct in his statement that such cases are anything but typical of the types of cases that fit the profile of private sector collection agencies, these are typical profiles of the types of cases that are currently in the IRS accounts receivable inventory that has generated so much interest from private sector collection agencies.

It may be that by their own admission, private collection agencies are not well suited to collect on the typical profile of cases that currently make up the IRS accounts receivable inventory.

Of all of the issues being discussed concerning the most effective methods of collecting federal tax debts in this country, public and private sector debt collectors agree that the earlier a debtor receives a request for payment, the greater the likelihood that such a debt will be collected. That is why private debt collectors do not want to work cases that are more than one year old. Private collectors want to work on the collection of federal tax debt that is approximately 180 days old. In the same testimony referenced earlier, the ACA's proposed solution to the IRS accounts receivable inventory is that "when an IRS tax delinquency reaches 180 days, it should be turned over to the Financial Management Service of the Treasury Department. FMS, which has broad experience with private contractors will then turn those accounts over to private collection agencies (PCA's)." In other words, private collectors want to work those cases that are the easiest to collect! This would leave older, more difficult cases, (allegedly the profile of cases which have been unfairly offered to private collection agencies during the current IRS test), for IRS collection employees to work. Clearly, agreeing to contract out the collection of accounts receivable cases that are only 180 days old would only expose the IRS to greater criticism as its average cost of collections increased and its effective rate of collection decreased.

Furthermore, it appears that, on average, private collection agencies may not be effective in the collection of such debt. Referencing its own study, ACA stated that "on accounts placed for collection within 30 days of delinquency, the average recovery rate

is 53%. After 90 days, the rate drops to 29%. After one year, the [collection] rate falls to 10%. When an account is placed after 421 days of delinquency, the collection rate is only 4%."

GAO's survey of states which have used private collectors tends to support such a notion. GAO found that "although many states, including 33 of the 43 states that responded to its survey, have used private collectors, their experiences have varied widely." Later in the same context, GAO stated that "using these states experiences as an indicator, IRS could expect some additional collections from its proposed pilot, but not necessarily a significant windfall."

One of the most fundamental differences between the collection of tax debt and non-tax debt is the point at which such a debt is actually established and becomes due. In the private sector, a liability is established voluntarily when goods or services are purchased or when a lender approves a voluntary application for debt. Upon the approval of such an application, or upon the purchase of such goods or services, the debtor voluntarily agrees to pay such a debt, in full, at the time of the transaction or over a period of time through installments. If a debtor who has entered into a voluntary agreement to pay such a debt defaults on such an agreement, the collection process begins immediately subject to the terms and conditions of the installment agreement and the law.

Tax liabilities and the collection of such liabilities is dramatically different. Tax liabilities are not established voluntarily. The IRS establishes a great deal of its accounts receivable inventory through the audit process. Taxpayers who disagree with the results of such an audit and the tax liabilities assessed, may exercise their rights through the administrative appeals process and pursue litigation. As a result, several years may pass

between the time a tax return is filed or due and the time that the tax liability (account receivable) is finally legally established. Such a time lapse, in conjunction with the involuntary nature of tax liabilities, makes the collection of tax debt distinctive from the collection of non-tax debt.

Mr. Gerald H. Goldberg, Executive Officer of the California Franchise Tax Board, reported similar conclusions based upon the State of California's experience with the use of private debt collectors. Mr. Goldberg stated that "the collection of tax debt is different from the collection of much commercial debt in that the debtor often has questions about the underlying legitimacy of the debt. This is true even though the debtor has had previous notices and has not chosen to exercise his [or her] administrative protest and appeal rights before the debt became final. Taxpayers frequently feel that they do not owe the debt. In other cases they may question the legitimacy of penalty or interest calculations. Or they may assert that the debt was paid, but credited to the wrong year or the wrong account." Under the California private debt collection program, if a taxpayer or debtor raises a question regarding the legitimacy of his or her outstanding liability, private collectors are not allowed to take any further action to collect on such a case. Such cases are simply referred back to the California Franchise Tax Board for further action.

Of the cases referred to private collectors, the State of California reports that it receives payments in full from approximately 10% of the cases it refers. In other cases partial payments are received or the debt is simply written off as uncollectible. Such an experience tends to support GAO's statement that "using these states' experience as an indicator, IRS could expect some additional collections from its proposed pilot, but not

necessarily a significant windfall."

CONCLUSIONS TO BE DRAWN:

NTEU adamantly opposes the use of private debt collectors to collect federal tax debt in this country. Clearly, it is no mystery that private debt collectors view the collection of federal tax debt as a potential source of new profits. In their testimony before the Subcommittee it was clear that they want to work the most recent cases, (less than 180 days old), on a contingency fee basis which is currently prohibited by statute. This dream of easy cases and big contingency fees is also the dream of many Revenue Officers and other IRS collection employees! But it is only a dream. Our tax system, which depends upon good faith and the voluntary compliance of our citizens, would not function as effectively as it currently functions if such a dream were allowed to become a reality. If we are to continue to maintain the delicate balance between taxpayers' rights and the federal government's right and responsibility to collect taxes, including delinquent tax debt, Congress must refrain from contracting out the collection of such debt to private contractors motivated by profit.

Instead, Congress must focus its attention on the needs of IRS collection employees. These employees want to do the best job that they can. When properly funded and equipped with up-to-date technology, IRS collection employees can increase their efficiency and effectiveness and decrease this country's accounts receivable inventory. The success of the FY '95 Compliance Initiative proved this fact. There are other examples as well. The IRS Integrated Collection System, (ICS), which is currently

operational in two IRS districts and is currently being installed in six (6) additional district offices this fiscal year, has increased the dollars collected by Revenue Officers in these districts by thirty (30%) percent. With this new technology, these employees are working more cases, closing them faster, and collecting more dollars than ever before. These are the types of programs that Congress must continue to support and provide adequate funding for in the future in order to increase the rate of federal tax debt collection.

NTEU would suggest that if this Subcommittee continues to pursue the use of private contractors to perform collection-related activities, it would be well served to also look to the seven (7) state agencies that have had private debt collection programs in the past and have dropped them. We would also recommend that the Subcommittee refer back to the numerous hearings which were held several years ago by former Chairman of the House Subcommittee on Oversight, Government Operations Committee, Congressman Doug Barnard, which thoroughly investigated and brought to an end the practice of evaluating IRS collection employees based on the amount of revenue collected.

STATEMENT OF UNITED CREDITOR ALLIANCE CORP.**I. INTRODUCTION**

United Creditor Alliance Corporation ("UCA") is pleased to submit this written statement for the record for the April 25, 1996 hearing on Tax Debt Collection Issues before the Subcommittee on Oversight, House Committee on Ways and Means.

UCA strongly supports efforts to privatize certain collection activities relating to appropriate IRS outstanding tax debt and looks forward to working with the Subcommittee on this important initiative.

II. BACKGROUND

UCA is a division of the National Revenue Corporation, which out of over 6,000 collection agencies is the 4th largest in the country. The National Revenue Corporation is a subsidiary of Deluxe Corporation, a large New York Stock Exchange Company. The National Revenue Corporation is a pioneer in the industry and was a winning bidder on a U.S. Department of Treasury collection contract in the early 1980's. Its division, UCA, recently won a contract to collect state taxes in Ohio, and has contracts with other states and municipalities.

UCA is a national credit collection agency that has extensive expertise in a wide variety of collection activities gained from many years of handling millions of government, health care, retail consumer and commercial collection accounts. UCA has located and contacted hundreds of thousands of individuals and resolved hundreds of millions of dollars worth of outstanding debt. UCA's acquisition of key experienced management and line collection personnel as well as its expansion of other resources in the last several years has yielded a corporate clientele that includes many major U.S. companies including, American Express, Bank of America, Sprint Communications, Ameritech, Citicorp and AT&T Universal Card Services.

UCA subscribes to the highest ethical standards and recognizes the basic dignity of each debtor. UCA has developed Quality Programs and Incentive Programs that ensure a high degree of professionalism, minimize employee turnover and create an atmosphere of teamwork.

UCA has an open-minded approach to individual client accounts and prides itself on its capacity to specifically tailor its programs for each client's situation while at the same time maintaining its ability to manage, direct and control large scale collection projects.

UCA has developed a system of team management that enables it to respond quickly to the needs of its clients and has developed techniques and implemented methodologies which have resulted in collection recoveries that are among the highest in the industry. UCA has pioneered the development of non-alienating collection techniques because this helps improve collection success and also because such techniques support the debtors dignity and retain the goodwill necessary for continued success.

UCA believes that the knowledge, experience and expertise gained over the years by UCA and other private collection firms in the debt collection area can be applied to IRS debt collection activities in a manner which will increase Federal revenues, while maintaining the safeguards and protections expected of our Federal tax collection system.

III. ISSUES RELATED TO THE PRIVATIZATION OF TAX COLLECTIONS

The Department of Treasury and the Internal Revenue Service have expressed several concerns relating to the privatization of tax debt collection services. These concerns focus on taxpayers' rights; the danger of disclosure of taxpayers confidential

information; and, the delegation of functions that are inherently governmental in nature. UCA shares the concerns registered by the Department of Treasury and the IRS and offers the following comments:

A. Respect of taxpayers' rights. UCA has invested a great deal of energy and man-hours in developing non-confrontational collection methods that are premised on the utmost respect for the basic dignity of the debtor. In addition to the statutory bars to certain collection methods, UCA recognizes that without the cooperation of the debtor, most collection attempts will be in vain. Typically, UCA will trace debtors to update information relating to current addresses and employers and spend time with the debtor to make the debtor aware of the debt, its amount, payment options and any reporting requirements. UCA employees endeavor to offer these services with a customer service mentality so that the debtor will remain as comfortable as possible while dealing with our professionals. Any failure on the part of UCA personnel to maintain this demeanor in dealing with debtors will only result in the ultimate disservice to our clients.

As applied to the collection of IRS tax debt, UCA supports the application of all provisions of the law governing taxpayer rights to private collection firms. In addition, UCA supports the application to private collection firms of all the provisions of the "Taxpayer Bill of Rights 2," a bill which recently passed the House of Representatives. Application of these rules of law to both the IRS and private collection firms will ensure that taxpayers are fairly treated throughout the collection process.

B. Disclosure of taxpayers' confidential information. Depending on the structure of the collection contract with a client, UCA has as much or as little access to debtors files as its clients desire. In many cases, UCA simply provides tracing

and contact services for clients so that the only information to which UCA personnel have access is rudimentary information, such as the debtor's name, last known address, telephone number, employment information and the amount owed.

UCA believes control over IRS tax records or other sensitive information should remain in the control of the IRS. As stated above, UCA fully supports the application of all laws governing taxpayers rights to private collection firms.

C. Delegation of inherent government functions. The Department of Treasury and the Internal Revenue Service have both registered concerns relating to the delegation of inherent government functions.

UCA believes that many of these concerns can be addressed in the contracting process. No power should be delegated to a private collector that the government would not want delegated. If Congress and the federal government ultimately determine that implementation of private collection contracts is in the best interest of the country, then the rules and guidelines governing the underlying service contracts with any debt collection firm can appropriately incorporate the powers and techniques that should be delegated. If a private collection company was not granted the authority under a contract to compromise tax debt for less than full value or to seize property on behalf of a client before a judgment confirming debt, then this practice would not take place. There would be no economic incentive for a collection agency to implement these techniques, especially a collection agency for the federal government, if the success of the collection would be compromised by illicit collection activities. It is simply not worth jeopardizing a contract to act beyond the scope of activities allowed by that contract.

There are many collection services that are deemed permissible by the Department of Treasury and the IRS and that could be incorporated in a contract with a private collection firm. These permissible services include permitting a private collection firm to trace and recover delinquent taxes. According to the Department of Treasury and the IRS, a private collection firm could provide locator services; mail notices of debt due and include information on the amount owed and payment options; contact debtors by telephone to remind them of their debt; secure intentions to repay on the part of debtors; provide lock box services for receipt and processing of payments; provide data processing performed in connection with tax collection; provide research and data gathering services; and provide financial audits of support services. All done through a contracting process which will govern the scope of private collection firm activity.

UCA supports the ability of the IRS to contract out the above described activities. Other permissible activities may also be appropriate and could be reviewed as part of the privatization initiative.

Concern has also been raised over the types of debt which should be initially subject to a privatization effort. UCA believes that a reasonable approach should be taken and supports the use of private collection activities for IRS "Deferred Accounts" (those that the IRS does not pursue because they fall below an IRS-established threshold), and certain "Currently Non-Collectible" ("CNC") accounts.

UCA does not believe it would be efficient or in the best interest of the government or taxpayers to pursue at this time accounts which the IRS has already reviewed and deemed inappropriate to pursue. UCA, therefore, does not believe "CNC-

Hardship" cases should be initially subject to privatization efforts.

D. **Payment for services.** UCA has noted that there is concern over the ability of the federal government to structure payments under collection contracts on the basis of the amount collected. There has also been general concern raised in the wisdom of allowing this type of payment structure. UCA appreciates the concern that any payment structure based on the amount collected could ultimately lead a collection agency to use overly aggressive collection methods. But at the same time, the government must evaluate the overall effectiveness and efficiency of the system that it wishes to create.

Any payment system that does not place a premium on collections will not work to the advantage of the government. The simple fact of the matter is that if a company receives a flat fee for collections, the incentive to consistently improve and refine its collection methods does not exist. The government must place confidence in the fact that the types of collection methods can be regulated by law and under the contract with a private collection agency. So regulated, those methods will be respected. Any collection company that acts contrary to these mandates will lose its contract and suffer any other consequences proscribed by law. This is more than enough incentive to work within the collection parameters demanded by the government.

To the extent that this type of payment arrangement is prohibited under the Prompt Deposit Act¹ or section 7809 of the Internal Revenue Code, the Congress should consider revisiting these statutes to make sure that the system that they propose to create has the opportunity to function properly.

¹ 31 U.S.C. §3302.

UCA believes that a payment system involving premiums and other incentives can be established in a manner to ensure taxpayer rights and government protections. UCA believes this type of system is the most efficient and beneficial for both the government and the private collection firms and urges the Subcommittee to consider this form of payment for services in more detail.

IV. CONCLUSION

UCA looks forward to working with the Committee, Congress and the Department of Treasury in constructing a private collection system for IRS outstanding tax debt that works to the advantage of all parties in the system.

We thank the Committee for the opportunity to submit this written statement for the record.

WATKINS, MEEGAN, DRURY & COMPANY, L. L. C.

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April 24, 1996

Phillip D. Mosely, Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Re: Hearing on Tax Debt Collection

Dear Mr. Mosely:

During the upcoming hearings to be held by the subcommittee concerning the management of the Internal Revenue Service accounts receivable inventory and the effectiveness of measures put into place over the past several years to improve the Service's management of the inventory, we would propose that the subcommittee also look at the possibility of offering a federal tax amnesty program.

Numerous states and local governments have offered such programs in the past and one state currently has such a program in place. Several states have even offered amnesty programs more than once. To our knowledge, not one of these states has suffered a loss of tax revenue because of the program, and, in fact, the states have placed taxpayers on the tax rolls who had not been paying their share of taxes in the past.

We have been to numerous meetings and seminars where representatives of the Service have spoken about this issue. The thrust of their comments is that it would not be fair to the majority of taxpayers who are paying their taxes. The Service seems to be quite proud of the fact that they have budgeted more than \$100 million to the area of finding and collecting taxes from non-filers. The subcommittee is meeting to discuss the use of private collection agencies to collect delinquent federal taxes. Again more funds would be expended for delinquent taxpayers and unpaid taxes.

Phillip D. Mosely, Chief of Staff
 Committee on Ways and Means
 U.S. House of Representatives
 April 24, 1996

There are several reasons why taxes are not paid nor returns filed, not all of which have a criminal intent. We have obtained numerous clients who stopped filing because of a sudden health crisis, loss of records due to natural disasters, and just fear of not being able to pay the tax due and then being prosecuted for this failure. Many times an event causes the taxpayer to miss filing for one year and out of fear, ignorance, or other reasons, they continue with this non-filing pattern. Many of these people feel a real sense of relief when they finally deal with the issue and file returns that are past due.

We would suggest that it is unfair to the majority of taxpaying citizens to continue spending millions of dollars to collect past due taxes as opposed to taking a step that many states have taken to get people back on the tax rolls. If a federal amnesty program were put into place for six months, we believe that many of the delinquent taxpayers would come forward and file delinquent returns and pay the back taxes. More importantly, they would be back on the tax rolls and would pay taxes in the future. The cost of such a program would be the abatement of penalties that in many cases would be eliminated or negotiated through an offer in compromise or bankruptcy proceeding. The time has come to address this issue realistically and not let the Service's statements dictate how the law abiding taxpayer feels about the issue of a federal amnesty program.

The thrust of the subcommittee hearings could then be focused on how to prosecute those taxpayers who do not take advantage of this program. Many states deal with this issue and it would serve the public if it were addressed at the national level in a forum that serves the public.

Very truly yours,

WATKINS, MEEGAN, DRURY & COMPANY, L.L.C.

James C. Wagenmann
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JCW/pf

WATKINS, MEEGAN, DRURY & COMPANY, L.L.C., CERTIFIED PUBLIC ACCOUNTANTS

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