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The Honorable Nancy L. Johnson
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Subject: Internal Revenue Service: Issues Affecting IRS' Private Debt Collection Pilot

Dear Chairman Johnson:

This letter responds to your request that we summarize the key issues we discussed during our May 13, 1997, briefing[1] on the Internal Revenue Service's (IRS) pilot program, which was established to test the use of private collection companies to assist IRS in collecting delinquent federal taxes. As we pointed out in our briefing, our work focused on identifying the key issues affecting the implementation of IRS' pilot program. These issues included the limitations that (1) certain IRS legal interpretations place on contracting out for tax-related collection activities and (2) IRS' computer systems and operations place on the selection and referral of cases to private collectors. We also pointed out that the program lacked a mechanism to capture information on the best collection practices used by the contractors that could be adopted by IRS.

BACKGROUND

IRS was directed in its fiscal year 1996 appropriations to test the use of private collection companies, and Congress earmarked $13 million for that purpose. With the passage of IRS' fiscal year 1997 appropriation, Congress earmarked

[1]Also present at the May 13 briefing were the Chairman of the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform and Oversight; the Chairman of the Subcommittee on Treasury, Postal Service, and General Government, House Committee on Appropriations; congressional staffers; and cognizant IRS and GAO officials.

another $13 million and directed that IRS extend the initial pilot for a second year. An additional $13 million was also earmarked in IRS' fiscal year 1997 appropriation for a second pilot–to be managed by the Department of the Treasury–to further test the use of private collection companies to assist IRS in collecting delinquent taxes.

Prior to our May 13 meeting with you and the other subcommittee Chairmen, IRS officials briefed us on the results of their assessment of the pilot. The issues disclosed by IRS officials during this meeting were basically the same as those we provided in our briefing to you. However, a major focus of IRS' briefing was that total revenues collected during the pilot had been significantly lower than anticipated. IRS reported that through January 1997, private collectors successfully contacted about 14,000 taxpayers and had attributable total revenues collected of about $3.1 million. IRS also reported that pilot design, startup, and administrative expenses through January 1997 were about $3.1 million. Performance payments to the private collectors were reported to be $1,049,648. In addition, IRS cited lost-opportunity costs of about $17 million because it had to move collection personnel off line to work on the pilot.

As you know, subsequent to our May 13 briefing, you and the other subcommittee Chairmen sent a letter to Treasury directing that it not move forward with plans to award contracts for the Treasury-managed pilot at this time. In addition, IRS officials with concurrence from the Subcommittee on Treasury, Postal Service, and General Government, House Committee on Appropriations, also discontinued plans to exercise the second-year option for the initial pilot contract.

RESULTS

IRS' efforts to design and implement the private debt collection pilot program were hindered by limitations that affected the program's results. One set of limitations involved the effect of certain legal interpretations on the contracts with private collection companies. Specifically, the Office of Management and Budget and IRS consider the "collection of taxes" to be an "inherently governmental" function that must be performed by government employees. Therefore, the program's private collectors were hired to assist IRS only in locating and contacting taxpayers to remind them of their outstanding tax liability and to suggest various payment methods. Under IRS' interpretation, the collectors were barred from actually collecting the funds to settle delinquent accounts.

Another IRS legal interpretation barred collectors from being paid a percentage of the amount of taxes collected as a result of their efforts. Instead, they were paid a fixed fee for actions such as successfully locating and contacting delinquent taxpayers. This performance fee arrangement provided the same payment to collectors regardless of the amount of the account collected.

A second set of limitations involved IRS' reliance on its computer systems and procedures, which made it difficult to identify, select, and transmit collection cases to private collectors. IRS did not envision taxpayer cases being released to private collectors, and its data systems contain sensitive taxpayer information that IRS considers inappropriate for release outside of the agency. Therefore, IRS required additional processing time to develop the criteria and computer programs that were needed to screen cases to (1) exclude those individuals whose circumstances–for example prisoners and potentially dangerous, deceased, and bankrupt taxpayers–IRS determined precluded their participation in the pilot program and (2) assemble the appropriate taxpayer information on individuals who were identified for referral to the collectors.

In addition, IRS computer systems and technology and the inability to transfer data from one service center to another impeded IRS' ability to refer cases to the collectors. As a result, service centers often spent additional time and resources running duplicate processes to identify and extract cases for referral. Once the cases were identified, IRS experienced difficulties in transmitting them to the collectors.

During the pilot, the number and types of cases referred to the collectors were significantly different from those anticipated in the pilot program's original design. For example, in the original design the inventory of cases to be sent to the collectors was to include a small percentage (about 6 percent) of cases in the "deferred" category. Cases in this category have balances due that are lower than other delinquent cases; and according to IRS data, IRS is generally quite effective in collecting the taxes owed on these cases with little collection action (e.g., by offsetting amounts due from future refunds). However, as of December 1996, private collectors had received about 153,000 cases, of which about 53 percent (versus the original 6 percent) were in the "deferred" category.

The final issue we discussed in our May 13 briefing involved the pilot program's measurement plan, which did not include a comparison of the best practices used by the private collectors with IRS' own collection techniques. Part of Congress' intent in approving the pilot was for IRS to learn more about collection techniques used in the private sector. IRS' measurement plan identified two performance measurement factors: (1) gross financial gain measured by total dollars collected versus total costs to collect and (2) net financial gain measured by total dollars collected minus dollars expected to have been collected without intervention versus total costs to collect. The written design did not include mechanisms to identify and capture information on successful collection techniques used by the contractors that could be adopted by IRS. In commenting on this letter, IRS officials cited plans to collect and evaluate the best practices used by the private collectors. According to these officials, they are currently developing procedures to identify which practices worked well during the pilot so that they can be compared with IRS' current practices and appropriate changes can be recommended.

SCOPE AND METHODOLOGY

To gather information for the briefing, we visited, interviewed, and obtained information and relevant data from responsible officials at IRS' National Office who planned the pilot and developed its methodology; the Fresno, CA, Service Center who managed the Referral Unit that processed contractor-developed taxpayer information; and the Ogden, UT, Service Center who selected the cases and transmitted data on them to the private contractors. We also visited, based on their proximity to available staff, three of the five private debt collectors that were selected for the pilot and used a structured questionnaire to obtain information from all five private contractors.

We conducted our review between October 1996 and June 1997 in accordance with generally accepted government auditing standards.

AGENCY COMMENTS

We obtained IRS' comments on a draft of this report from IRS' Assistant Commissioner for Collections and the Chief, Management and Administration on June 26, 1997. While these officials generally agreed with the facts presented, they provided clarifying information, and we made technical corrections where appropriate.

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Copies of this letter are being sent to the Ranking Minority Member of your Committee, the Chairmen and Ranking Minority Members of other congressional committees with jurisdiction over IRS and tax matters, the Director of the Office of Management and Budget, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. It will also be made available to others upon request.

Major contributors to this letter were Joseph E. Jozefczyk, Carrie Watkins, Willie E. Bailey, Thomas Venezia, and Alex Lawrence. As agreed with your office, no additional work will be performed on this request. If you have any questions regarding this letter or any of our previous work, please call me at (202) 512-8633 or Joe Jozefczyk at (202) 512-9053.

Sincerely yours,

Lynda D. Willis
Director, Tax Policy and
Administration Issues

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