

GAO

Report to the Chairman, Subcommittee  
on Oversight, Committee on Ways and  
Means, House of Representatives

May 1993

**TAX  
ADMINISTRATION**

**New Delinquent Tax  
Collection Methods for  
IRS**



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**United States  
General Accounting Office  
Washington, D.C. 20548**

**General Government Division**

**B-251900**

**May 11, 1993**

**The Honorable J.J. Pickle  
Chairman, Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives**

**Dear Mr. Chairman:**

**This report is in response to your request that we study options available to the Internal Revenue Service (IRS) to enhance its collection of delinquent federal taxes. Specifically, this report addresses whether IRS could strengthen its tax collection programs by adopting private sector and state collection techniques and by increasing cooperation with state governments.**

## **Results in Brief**

**We believe that IRS could make a number of changes that would enhance its collection of delinquent federal taxes. IRS' ability to collect delinquent taxes has been hampered by self-imposed and external constraints. Because of convention, IRS has generally followed a lengthy and rigid three-stage collection process that begins with a series of written notices, or bills, sent to delinquent taxpayers over a period of about 6 months, followed by telephone calls, and ends with visits to delinquent taxpayers. Because of legal restrictions, IRS handles all aspects of delinquent tax collection itself and does not evaluate or reward its collection staff on the basis of collection performance. Because of inadequate information systems, IRS pursues delinquent accounts without knowing whether the amounts recorded in the accounts are valid receivables and with only limited knowledge about the characteristics of the delinquent taxpayers.**

**In contrast, many state tax departments and private sector collectors have collection processes that emphasize early telephone contact with delinquent debtors. Officials of the companies and state tax departments we contacted believe that the sooner telephone contact is made, the better the chances of collecting. Unlike IRS, many companies and states contract with private collection companies to supplement their collection resources. In addition, to motivate staff, private collectors routinely use collection performance statistics as a basis for evaluating their collectors and for determining compensation and incentive awards. Further, private sector companies are increasingly using debtor profiles and specific debtor characteristics to customize their debt collection procedures.**

Although IRS and state tax departments currently cooperate in many tax administration projects, only about 10 percent of these projects are directly related to tax collection. IRS may have opportunities for expanding cooperative projects with states that are directly related to collecting delinquent federal taxes. Based on our survey of states, more than half of the states with an opinion about participating in joint tax collection projects with IRS indicated they would consider engaging in such projects if they were compensated.

IRS competes with private collection companies and state governments for payments from debtors. For IRS to be a successful competitor, it will have to adopt collection strategies that are more effective than its current approaches. More effective strategies include early telephone contact with delinquent taxpayers, customized handling of delinquency cases, and expanded use of cooperative efforts with state governments. The use of private collection companies could prove to be an effective strategy as well.

## Background

IRS is responsible for resolving tens of billions of dollars of accounts receivable each year through its three-stage collection process. The same collection process is generally used for all accounts, regardless of the size of the delinquency. During the first stage, IRS attempts to collect unpaid taxes by sending the taxpayer a series of written bills that can take up to 6 months. If the account is not resolved during the billing cycle and the liability is under a predetermined dollar threshold, IRS suspends active collection efforts and classifies the account as "deferred."

During the second stage, IRS prioritizes unresolved accounts over the dollar threshold and sends them to its automated call sites, where IRS employees may telephone taxpayers to request payment. Employees also begin taking collection enforcement actions, such as seizing taxpayers' liquid assets held by third parties. At the end of this stage, IRS sends all remaining unresolved delinquent accounts to its district offices for further work by revenue officers.

During the third stage, revenue officers attempt to collect the higher priority accounts through personal visits to the taxpayers and other collection enforcement actions. In some districts, staff are unavailable to work all the cases, and lower priority cases can receive virtually no additional collection action but remain in the inventory until the 10-year statutory collection period expires.

IRS can accept several payment options, including installment payments and offers in compromise.<sup>1</sup> IRS cannot accept credit card payments. However, if proposed legislation is enacted and IRS resolves issues such as the treatment of credit card tax payments in bankruptcy proceedings, then IRS will be able to accept tax payments by credit cards. Appendix I contains a discussion of credit card issues for federal tax payments.

If the delinquent taxpayer does not voluntarily pay, IRS has many collection enforcement methods at its disposal. It can confiscate bank deposits and wages, seize a taxpayer's physical property, or place a tax lien on real property. But some of the collection methods routinely used by private collection companies, other federal agencies, and state tax departments are currently not available to IRS because of restrictions in the law.

The Debt Collection Act of 1982 gave most federal agencies, except IRS, the authority to use private collection companies, private attorneys, and credit reporting agencies to collect delinquent accounts. For IRS to disclose tax information to private collection companies, one of the exceptions to the general rule of nondisclosure under Section 6103 of the Internal Revenue Code must apply. Under the general rule, tax information is confidential and disclosure is prohibited. IRS is also prohibited by the Taxpayer Bill of Rights from using collection statistics to evaluate, compensate, or reward its collection staff.<sup>2</sup>

## Objective, Scope, and Methodology

Our objective was to determine whether IRS could increase the collection of delinquent taxes by adopting collection strategies of state tax departments and private companies and by expanding cooperation between its district offices and state governments.

To obtain information on IRS' collection procedures, we interviewed officials from IRS' National Office, all seven regional offices, and the St. Paul, Chicago, and Honolulu district offices.

<sup>1</sup>Under an offer in compromise agreement, IRS accepts less than the full amount of taxes owed to resolve the liability in full because there is doubt regarding the amount of the liability or there is doubt as to the taxpayer's ability to make full payment of the liability.

<sup>2</sup>The Omnibus Taxpayer Bill of Rights was contained in subtitle J of the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647).

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To obtain information on how states collect taxes, we sent a questionnaire to tax administrators in all 50 states and the District of Columbia.<sup>3</sup> Also, we talked with tax officials in California, Florida, Illinois, Maryland, New York, Michigan, and Minnesota about their tax collection methods. These states were selected because they either rank among the highest in terms of state tax receipts or have tax collection programs of special interest to us. We also gathered information pertaining to specific tax collection programs in Hawaii and Montana.

To obtain insights into how private collection companies operate, we contacted the American Collectors Association, a trade group that represents over 3,000 private collection companies. We met with four private collection companies, including three of the nation's largest, to discuss their collection practices. We also contacted two large private sector firms with their own collection staffs and two large companies that collect and manage receivables for other companies. We discussed issues relating to IRS' use of private collection companies with the Office of Management and Budget (OMB) because it supports IRS' testing of new strategies to increase the collection of delinquent taxes. To obtain additional information on private sector collection strategies, we attended professional education seminars given by two large firms that specialize in business management training.

To determine the extent of cooperation between IRS and state tax departments, we talked with IRS' federal and state relations division; selected IRS regional and district officials; the Federation of Tax Administrators, an organization of state and municipal tax and revenue agencies; and tax officials in nine states.

To address issues related to IRS' acceptance of credit card payments, we obtained information from those states we contacted that allow taxpayers to pay taxes with credit cards; officials representing major credit card companies, including Visa, MasterCard, and Discover Card; and the Financial Management Service (FMS) within the Department of the Treasury. We also contacted the Bankcard Holders of America, an organization that represents consumers.

We did our work between September 1991 and September 1992 in accordance with generally accepted government auditing standards.

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<sup>3</sup>The preliminary survey had an 82-percent response rate (42 of the 51 survey instruments were completed). This report includes survey results pertaining to specific topics only. Our overall survey results will be reported separately.

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## How IRS Can Increase Collection of Delinquent Taxes

Over the past few years, the growth rate of IRS' accounts receivable inventory has outpaced its ability to collect delinquent taxes. IRS recognizes that this trend needs to be reversed, but despite its efforts, the inventory is continuing to grow and age. Collections of delinquent taxes over the past 5 years have not changed very much; they actually declined in fiscal year 1991 and again in fiscal year 1992.<sup>4</sup> Over the same 5 years, the accounts receivable inventory has been growing at a steady pace. Today's competitive collection environment forces IRS to consider techniques to increase collections of delinquent tax accounts that may be different from those it currently uses. Some of the collection techniques being used by private sector firms and state tax departments offer IRS new opportunities to increase tax delinquency collections.

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## Make Early Telephone Contact

Contacting a debtor by telephone within 60 days after an account is determined to be past due was standard for the private companies we contacted. For six of the nine states we contacted, telephone calls were usually made to delinquent taxpayers between 30 and 90 days after taxes were past due. This is because the sooner telephone contact is made, the better the chances are of recovering past due money. According to private and state collectors, early telephone contact is cost-effective and allows the collector to determine why payment has not been made, establish future payment schedules, and update information on the debtor's status. Collectors can also discuss with the debtor possible adverse actions that could be taken if payment is not received.

Despite collectors' telephone emphasis, at least one bill is usually sent to debtors before any telephone calls are made. In some instances, a bill is required by law to inform the debtor about the delinquency and any rights the debtor has under the law.<sup>5</sup> Company officials we contacted said that while bills were important, bills could be continually ignored and were therefore less effective at obtaining payment than were telephone collection techniques. No private companies we surveyed repeatedly send bills for up to 6 months before attempting to establish telephone contact, as IRS usually does.

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<sup>4</sup>Collection of delinquent accounts was \$25.5 billion in fiscal year 1990, \$24.3 billion in fiscal year 1991, and \$24.2 billion in fiscal year 1992.

<sup>5</sup>The Fair Debt Collection Practices Act regulates third party collection companies. It prohibits collectors from using abusive collection practices and requires that debtors be notified in writing regarding a debt that is being pursued by a private collection company on behalf of another creditor. State laws may also require written notification.

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States that now emphasize telephone collection have reported increased collections. For example, based on one state's experience, collections rose to \$260 million in fiscal year 1991, the first full year it emphasized telephone collection techniques, compared to \$186 million the prior year. This state also attributes the reduction in its accounts receivable inventory, despite the continuous influx of new cases, to telephone collection techniques. An official of another state that calls taxpayers weekdays during evening hours and on Saturdays said that the calls had been very effective.

We believe IRS could benefit from initiating early telephone contact with delinquent taxpayers in conjunction with sending bills. IRS may be at a competitive disadvantage if it waits for its billing cycle to end before contacting delinquent taxpayers by telephone because other collectors may have already contacted some of the same debtors by telephone and perhaps even received payment. By telephoning delinquent taxpayers early in the collection cycle, fewer bills may be needed and the delinquency may be resolved much sooner, either with collections or with error corrections.

One IRS regional office experimented with making telephone calls during the billing cycle to taxpayers who had large delinquencies (more than \$100,000 owed). Many of the assessments were erroneous so collections did not increase substantially, but errors were corrected sooner. While IRS has not required that early telephone calls be made to taxpayers with large delinquencies nationwide, it has allowed each regional office to decide whether to make such calls.

As part of an early telephone contact initiative, IRS has an opportunity to expand its use of telephone contact at the automated call sites by reassigning other collection staff to the call function. Even though collectors working at the automated call sites contact taxpayers by telephone after the billing cycle has ended, they still collect more money than staff in district offices. In fiscal year 1991, call site collectors averaged \$1.5 million in collections, while the district office staff averaged \$331,000. However, 65 percent of IRS' collection staff work in district office positions.

IRS officials said that the equipment currently used in their automated collection system is inadequate to handle the number of calls that would be required if all delinquent taxpayers were called earlier in the process. While this may be true, we believe that IRS could reach more taxpayers, using the current equipment more intensively by allocating additional staff

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to the call function. The new equipment that IRS plans to acquire as part of tax systems modernization should make the call function even more productive and enable IRS to collect more revenue faster. In addition, if IRS were to focus on contacting taxpayers by telephone during the first two collection stages, we would expect the workload reaching district offices to decline in volume, be more accurate, and generate more revenue per staff year.

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## Customize Collection Procedures

Companies increasingly are using information about debtors to customize debt collection procedures. Debtor modeling techniques, also referred to as behavioral collection scoring, base collection priorities and methods on projections of debtors' future payments. The models use variables such as past payment histories, age of accounts, recent account balances, and previous collection actions to forecast the probability that debtors will pose serious collection problems. The result is a custom-tailored profile of each debtor based on that debtor's characteristics.

Some private companies attribute increased collections to these enhanced modeling techniques. According to one private collection company, modeling is a proven technique that it has used for several years. Officials from another company said that their model, which considers more than 50 characteristics, has improved customer relations and increased collections. Another company uses debtor modeling for risk analysis of its accounts and bases collection strategies on the assigned risk designations. Accounts with high risk designations would receive aggressive collection action such as a telephone call demanding immediate payment or a notice of pending legal actions, while accounts with low risk designations might receive a past due notice.

We have recommended that IRS develop information on each account to determine how best to handle it.<sup>6</sup> Detailed information about delinquent receivables is critical to customizing collection strategies. Not having information on the validity and characteristics of the accounts receivable has been a long-standing problem for IRS in reporting and collecting delinquent taxes. The lack of this information has hampered IRS' ability to identify the causes of the growth in the accounts receivable inventory and hindered its ability to devise a more effective and better targeted collection strategy. Although IRS has developed information on the age of delinquencies, the types of taxpayers and taxes making up the inventory,

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<sup>6</sup>IRS' Accounts Receivable Inventory (GAO/T-GGD-90-19, Feb. 20, 1990).

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and the sources of receivables, it has not developed the detailed information it needs to profile the delinquent taxpayers.

IRS officials told us that the Resources Workload Management System (RWMS) prioritizes delinquency cases using taxpayer characteristics. While RWMS assigns priorities to the collection workload, it is not based on taxpayer profiles or specific characteristics. RWMS also does not give IRS the information that would be needed to customize collection techniques. All delinquent taxpayers, whether they are first-time delinquents or chronic ones, are subjected to the same rigid IRS collection process. Potential benefits, including better treatment of taxpayers, a less expensive collection process, and more collections, may result if IRS customizes its approach to delinquent taxpayers.

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## Reward Collection Staff With Incentives

Private firms measure their collection programs' success in terms of dollars collected, and a key premise is that incentives based on individual collection performance motivate collectors. According to information from a professional education seminar, collectors should be given attainable collection goals and rewards should be based on collection performance. Information from another seminar on current collection practices showed that individual expectations and performance measurements are important in effectively managing a company's credit and collection programs.

A 1987 survey by the American Collectors Association found that 80 percent of the private collection companies that responded paid their collectors a salary plus incentives. Eleven percent of the companies paid collectors straight commissions, and 7 percent paid collectors salaries without any commissions. Similarly, most companies we contacted paid their collection staff regular salaries plus incentives and bonus pay. The basis for incentive and bonus pay plans varied but included variables such as the number of contacts made, the amount collected, the number of promises to pay obtained, and other selected quality measures. One official said that his company also considered customer relations measures, such as complaints against collectors, as part of its evaluation of collectors' performance.

Some states also used collection performance results in evaluating their staff. Information from the Federation of Tax Administrators showed that at least eight states used collection goals in evaluating staff. In our survey, two states said that they use individual collection performance

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measurements in compensating and rewarding staff. In one of these states, bonuses were not permitted, but collectors were rated on the basis of measures such as number of closed cases and contacts made. These measures were one factor used in promoting employees. The other state had merit pay for field agents with above-average collection performance.

As we have stated in the past, IRS should be able to use collection performance as a criterion in determining compensation and rewards for individual collectors.<sup>7</sup> We believe that information such as taxes collected is a reasonable basis on which to judge the performance of employees whose job it is to collect taxes as long as other criteria, such as fair and courteous treatment of taxpayers, are also evaluated.

Current tax law prohibits IRS from using collection performance statistics to evaluate, compensate, or reward employees.<sup>8</sup> Congress, long concerned that collection performance might be interpreted as quotas that might induce IRS staff to mistreat taxpayers, added this provision in 1988 to protect taxpayers from such actions. However, the provision might be changed to specify prohibited behaviors that would be grounds for employee dismissal or other forms of discipline, rather than prohibiting the use of performance statistics as a management tool.

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### Supplement IRS' Collection Programs With Private Collection Companies' Services

Over 6,000 companies specialize in collecting debts on behalf of others and offer an array of accounts receivable management services tailored to client needs. In addition to basic collection services such as telephone calls and letters, private collection companies can provide debtor location assistance, asset searches, litigation services, and management of accounts receivable.

Many businesses and state tax departments use private collection companies because of their vast collection experience. States and businesses also use collection companies to gain state-of-the-art computer technology for managing receivables, to avoid the expense of hiring permanent staff, or to supplement their own collection staff during peak periods. In addition, states use private companies to collect tax debts from persons who reside outside their states.

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<sup>7</sup>Tax Administration: IRS' Implementation of the 1988 Taxpayer Bill of Rights (GAO/GGD-92-23, Dec. 10, 1991), and U.S. General Accounting Office Views and Observations on Various Taxpayer Bill of Rights Issues (B-229147, Oct. 8, 1987).

<sup>8</sup>See footnote 1.

Many states that use private collection companies regard this approach as successful in increasing collections and reducing the volume of unresolved accounts receivable. Thirty-three of the states that responded to our survey had an individual income tax,<sup>9</sup> and all but five of these states used private collection companies in collecting this tax. Of the 28 states that referred individual income tax cases to companies for collection, 27 had an opinion on their effectiveness. Only 6 states believed that collection companies had been ineffective while 13 believed they had been effective. The remaining eight states were neutral about the effectiveness of collection companies.

In December 1991, IRS completed an internal study that addressed legal, financial, policy, and design considerations involved in contracting out collections. The study concluded that IRS should test the use of private collection companies provided that legal issues regarding the activities that IRS could contract out and funding sources were resolved.

In September 1992, OMB issued a policy letter on inherently governmental functions that must be performed by government employees. According to OMB's guidance, the actual collection of taxes is considered an inherently governmental function because it is so closely related to the public interest that it requires performance by government employees. However, private companies can do such collection-related functions as locating taxpayers, making telephone calls to remind taxpayers of tax delinquencies, mailing tax notices, and providing lock boxes (secure depositories for temporary storage) for receipt of payments.

In December 1992, the IRS Chief Counsel's office issued guidance for IRS' use in contracting with private collection companies. The Chief Counsel's guidance, which concurs with the OMB policy letter, also states that IRS needs to address such additional issues as disclosure, liability, funding, and labor matters. In discussing disclosure issues, the Chief Counsel stated that if IRS has the authority to contract out certain collection related activities, then tax information may be disclosed to contractors performing such services for IRS pursuant to I.R.C. 6103(n) and its implementing regulations. Although I.R.C. 6103(n) was added to the tax code to enable IRS to disclose tax information to persons providing services such as expert witnesses, IRS' Chief Counsel believes it provides sufficient legal basis for IRS to make disclosure to collection contractors. The Chief Counsel cautioned that IRS should take care to ensure that the

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<sup>9</sup>These 33 states represent 79 percent of the states with an individual income tax.

types of activities contracted out will not lead to the perception that IRS has exceeded the disclosure authority granted by the statute.

The disclosure provisions of I.R.C. 6103 incorporate measures to protect taxpayers' privacy rights. These provisions were added after enactment of the Privacy Act to address the particular problems associated with disclosure of tax return information.<sup>10</sup> Before IRS can make disclosures of tax information to contractors under I.R.C. 6103, it must comply with Treasury Regulation 301.6103(n)-1. This regulation provides general rules for IRS to follow when it discloses tax information to contractors and guidelines for contractors to use in determining whether they can further disclose tax information in the performance of their contracts. It also requires contractors to maintain, to the satisfaction of IRS, safeguards to protect the confidentiality of the tax information and guard against unauthorized disclosures. The regulations state that contractors are subject to criminal penalties and civil suits for disclosure violations.

The states we contacted that use collection companies said they required their contractors to follow guidelines similar to the guidelines for state employees to protect the confidentiality of taxpayer information and to prevent unauthorized disclosures. Several states referred a delinquency case to a private company for collection only if the state has filed a tax lien against the taxpayer. The lien essentially makes the tax debt public.

Despite the privacy safeguards in I.R.C. 6103, an additional area of concern for IRS is how the use of private collection companies would be perceived by the public. IRS may need to assure the public that their rights and privacy would not be compromised if IRS were to contract with collection companies and give them access to taxpayers' records. This assurance may be difficult for IRS unless it improves its agencywide efforts to protect the privacy of taxpayer information. We previously reported that the three key organizations responsible for privacy protection were not as effective as they could be because they did little to interact and coordinate among themselves.<sup>11</sup>

IRS officials are currently moving forward with plans to conduct a test using private collection companies. Pending funding and final approvals

<sup>10</sup>The Privacy Act of 1974 (P.L. 93-579) regulates what information an agency maintains about an individual, how it uses the information, and when and to whom the information may be disclosed. In the regulation of disclosures of tax information, the Privacy Act has been largely superseded by the more specific provisions of I.R.C. 6103.

<sup>11</sup>Tax Systems Modernization: Concerns Over Security and Privacy Elements of the Systems Architecture (GAO/IMTEC-92-63, Sept. 21, 1992).

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within IRS, a pilot program that will use private collection companies to contact delinquent taxpayers about their tax debts may start as early as October 1993. IRS' long-range plans include further study of using private collection companies. IRS may propose legislation to permit certain accounts, such as accounts deferred at the end of the billing cycle, to be worked by private collection companies.

Since IRS does not work all its delinquency cases and many of the cases that are eventually worked are delayed because collection staff work higher priority cases first, we believe that private collection companies should be allowed to supplement IRS' collection resources at least as a short-term strategy. If private collection companies are used, IRS should develop mechanisms to measure the companies' effectiveness in order to determine whether to continue their use on a longer-term basis.

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### Increase Cooperation With State Governments to Collect Delinquent Taxes

IRS and state tax departments cooperate in many tax administration efforts. According to information published by IRS' federal and state relations division, more than 150 projects were ongoing between IRS and states during fiscal year 1991. These projects covered many facets of tax administration, including joint federal-state electronic filing, joint audits and criminal investigations, and sharing information about taxpayers who had not filed federal and state tax returns. Fifteen projects directly facilitated IRS' collection of delinquent federal taxes. Projects such as the offsetting of state income tax refunds for federal tax delinquencies involve 27 states and the District of Columbia, and other projects are limited to only one state.

Congress passed legislation in 1992 that contained provisions to increase joint tax administration projects between IRS and states. This legislation, which was vetoed by the President for other reasons, would have allowed states to be reimbursed for expenses associated with their participation in tax administration projects with IRS.

Based on preliminary results from our survey of states, we believe that state tax collection officials are amenable to assisting IRS in collecting delinquent federal taxes if they are compensated for doing so. Of the 25 states that gave an opinion, 14 said that they probably would consider collecting delinquent federal taxes if they were paid to do so. Seven states were uncertain about participating in this type of joint project. The remaining four states said that they would not consider this type of cooperative project because they and the federal government were

competing for the same dollars and they did not have the resources for additional collection efforts. We believe IRS should explore ways of increasing such projects, especially with states expressing a willingness to pursue them.

Thirty-eight states have tax enforcement programs with their state agencies that can deny, revoke, or suspend various types of licenses and permits of taxpayers with delinquencies. State officials said these programs have been successful because of the value of the licenses and permits. Hawaii also requires that federal tax delinquencies as well as state tax delinquencies be resolved in order for businesses to obtain or renew a state liquor license. IRS may have opportunities to increase its collection of delinquent taxes if similar arrangements could be made with other states' tax enforcement programs.

Since the inception of the Hawaii project in the late 1980s, IRS officials estimated that they have collected between \$500,000 to \$2 million annually in delinquent federal taxes. An IRS official attributed the program with greatly reducing the need for revenue officers to visit taxpayers to work delinquency cases. Through cooperative projects such as the one with Hawaii, IRS is able to collect delinquent taxes with the assistance of the enforcement powers of states.

## Conclusions

IRS should treat delinquent tax collections as a competitive business and explore alternative ways of pursuing delinquent tax debts. Collection methods used by private firms and states offer IRS opportunities to increase collections from delinquent accounts, streamline the collection process, and perhaps ultimately reduce the overall cost of collecting delinquent taxes. We recognize that some collection techniques that work for private sector firms or states may not be appropriate for IRS. However, we believe that many of the collection methods being used by private companies and states offer IRS a reasonable opportunity to enhance its approach to delinquency collections and that IRS should try them. We also believe that increased cooperation between IRS and state governments could result in more collections.

For IRS to realize the potential offered by these opportunities, certain external and internal changes have to occur. Tax law has to be changed to allow IRS to use collection results in evaluating individual collection employees. In addition, IRS needs to change its collection process and organization to provide for earlier telephone contact with delinquent

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taxpayers. IRS also needs to develop more information about the characteristics of delinquent taxpayers and use that information to customize its handling of delinquencies. Further, IRS has an opportunity to increase additional cooperative efforts with state governments and test the use of private collection companies to supplement its collection resources.

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## Agency Comments

We discussed the contents of this report with IRS officials and have included their comments where appropriate. National Office collection officials did not necessarily agree with reallocating field collection staff to the earlier collection stages but said that the matter needs consideration as IRS reviews its deployment of collection staff. The officials agreed to consider how information on taxpayer characteristics could be used to customize collection procedures.

National Office collection officials also said that they do not support a change in the law on rewarding collection staff with incentives based on individual collection performance because of concerns about the potential mistreatment of taxpayers by collectors. We believe that if collectors were evaluated on the basis of collection performance and other criteria that specified desired behaviors, the potential for taxpayer mistreatment would be minimized. IRS officials support exploring opportunities to increase cooperation with states.

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## Matter for Congressional Consideration

We believe Congress should consider revising current tax law to allow IRS to use collection performance in determining compensation and rewards for its collection staff as long as other criteria, such as fair and courteous treatment of taxpayers, are also considered.

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## Recommendations to the Commissioner of Internal Revenue

We recommend that the Commissioner of Internal Revenue

- restructure IRS' collection organization to support earlier telephone contact with delinquent taxpayers and determine how to use current collection staff in earlier, more productive phases of the collection cycle;
- develop detailed information on delinquent taxpayers and use it to customize collection procedures; and
- identify and implement ways to increase cooperation with state governments in collecting delinquent taxes.

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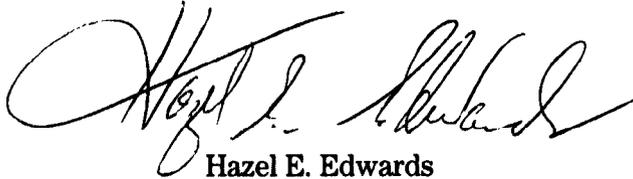
We also recommend that the Commissioner test the use of private collection companies to support IRS' collection efforts as permitted by current law.

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As arranged with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Commissioner of Internal Revenue and other interested parties. We will also make copies available to others upon request.

The major contributors to this report are listed in appendix II. If you have any questions about this report, please call me on (202) 272-7904.

Sincerely yours,



Hazel E. Edwards  
Associate Director, Tax Policy and  
Administration Issues

# Credit Card Tax Payment Issues

Congress has proposed credit card tax payments on several occasions. Congress passed legislation last year that contained such provisions but was vetoed by the President for other reasons. Most recently, the Tax Simplification Act of 1993 (H.R. 13), introduced in January, contains a provision for IRS to accept tax payments by credit cards.

Even if legislation were enacted to authorize federal tax payment by credit card, IRS would need to resolve important issues before accepting such payments. It is likely that authorization for credit card federal tax payments would be extended to debit cards as well. IRS staff have been working on policy issues surrounding credit and debit card payments and ways to implement a credit and debit card tax payment program once legislation is enacted.

For Visa and MasterCard—the companies with the two most widely used credit cards in the nation—the treatment of federal taxes paid with a credit card in bankruptcy proceedings is the single most important unresolved issue. Under current law, federal taxes are generally not dischargeable in bankruptcy. However, consumer indebtedness owed on credit cards is subject to discharge in bankruptcy proceedings. According to data we obtained from Visa, bankruptcy losses are one of their largest write-offs annually.

Officials representing Visa and MasterCard have expressed reservations to IRS about allowing credit card tax payments unless federal tax debts paid with a credit or debit card remain a nondischargeable item in bankruptcy. Their position is that a program allowing federal taxes to be paid using credit and debit cards should not create new risk for either IRS or the credit card system. It is important to note that taxpayers can currently pay their taxes with credit cards if they obtain cash advances or use the convenience checks associated with some credit cards.

IRS must address some additional issues to administer a credit card tax payment program. One issue is treatment of the discount fees typically incurred on traditional charge transactions. A merchant accepting a credit card pays a discount fee, which reduces the amount of the proceeds from sales made by credit card. The potential problem is that credit card issuers prohibit merchants from passing the discount fees on to customers and IRS typically does not discount taxes (other than in circumstances involving an offer in compromise), which it would be doing if it paid the discount fee.

Several states currently allow taxpayers to pay taxes by credit card. Generally, to avoid discounting taxes owed the states, the states have contracted with an intermediary company that actually accepts the credit card payment from the taxpayer. The state is paid the full amount of the tax, and the taxpayer pays to the intermediary a transaction fee over and above the amount of taxes owed the state. Because of the transaction fee, these types of credit card transactions are under review by Visa and MasterCard.

One solution for IRS in dealing with discount and transaction fee issues would be to join the FMS' Credit Card Collection Network.<sup>1</sup> FMS has made arrangements with banks that allow federal agencies to accept credit cards for sales without discounting them. Under FMS' arrangement, the federal government maintains noninterest-bearing accounts at the banks instead of paying discount fees. IRS officials told us they believe the prior legislative proposals did not require that they use the FMS arrangement.

Another matter for IRS to consider involves the resolution of credit and debit card billing errors. Credit card billing errors are governed by the Truth in Lending Act (15 U.S.C. 1666) and similar state laws. Debit card billing error resolution guidelines are covered by the Electronic Funds Transfer Act (15 U.S.C. 1693f). Additional guidance would be needed to clarify when and how IRS should be involved in resolving billing disputes associated with taxes paid with credit and debit cards.

There are benefits to IRS accepting credit cards directly for paying federal taxes. It would offer taxpayers an easy payment option and might possibly facilitate tax payment under IRS' electronic filing program. Currently, taxpayers who file returns electronically and owe additional taxes must send their payments to IRS separately. Any benefits, however, should be weighed against other concerns. For example, Bankcard Holders of America is concerned about taxpayers' privacy and suggests that tax preparers and others be prohibited from marketing information obtained as a result of taxpayers paying taxes with credit cards. There has also been some opposition to the credit card tax payment proposal because of concerns about encouraging more consumer indebtedness.

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<sup>1</sup>The FMS, an agency of the U.S. Department of the Treasury, is responsible for operating and maintaining systems for collecting government funds.

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