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Updated February 6, 2020

The Internal Revenue Service's Private Tax Debt Collection Program

For the third time in its history, the Internal Revenue Service (IRS) is managing a program to hire private debt collection agencies (PCAs) to collect delinquent individual income taxes. Section 32102 of the Fixing America's Surface Transportation (FAST) Act (P.L. 114-94) requires the IRS to revive the private tax debt collection program it managed from 2006 to 2009, with several notable changes.

IRS's Previous Experiences with Private Debt Collectors

Before the enactment of the FAST Act, the IRS twice experimented with the use of PCAs to collect delinquent individual income tax debt. In both cases, the agency sought the authority to establish and manage the programs, and Congress granted it.

1996 to 1997

The first experiment was a pilot program (known as the Contracting Out Collection Agencies Project) that was created by the Treasury, Postal Service, and General Government Appropriations Act, 1996 (P.L. 104-52). Although the project was authorized to last two fiscal years, the IRS ended it after one year, owing to disappointing results and mounting opposition from Congress and the Clinton Administration. According to the findings of a 1997 assessment of the program by the (then-named) General Accounting Office, the five PCAs hired for the project had collected $3.1 million in delinquent taxes through January 1997, whereas the total cost for the program (i.e., the fees paid to the PCAs, the project's opportunity cost, and its design, start-up, and administration expenses) during the same period was $21.1 million, or nearly seven times greater than the revenue gain.

2006 to 2009

The second experiment was more ambitious in scope. It resulted from the addition of Section 6306 to the federal tax code by the American Jobs Creation Act of 2004 (AJCA; P.L. 108-357). Section 6306 authorized the IRS to enter into contracts with qualified PCAs to collect delinquent individual income tax debt that the IRS was not pursuing because of a lack of resources. The Treasury Department had asked Congress in its FY2004 budget request for the statutory authority to hire PCAs for this purpose.

Under the act, the IRS was required to use PCAs in a manner that protected taxpayer rights, prevented the use of abusive collection practices, and was consistent with federal regulations and laws governing the outsourcing of activities deemed inherently governmental, such as tax collection.

In addition, the IRS could use PCAs for two purposes only: (1) to locate and contact individuals with overdue income tax liabilities who are not contesting the amount owed, and (2) to arrange for the payment of the back taxes.

Payments went into a revolving fund established under the AJCA. The IRS could use up to 25% of the money in the fund to compensate the PCAs for their services and another 25% of the money to fund its enforcement activities.

In early 2005, the IRS began a PCA program based on Section 6306. After several court challenges to the IRS's initial solicitation of bids for collection contracts, the agency signed one-year contracts with three PCAs in March 2006. Collection activities commenced the following September. In February 2007, the IRS extended the contracts with two of the companies through March 2008; the contracts were further extended through March 2009.

In February 2009, the IRS notified the two contractors that it was evaluating the cost-effectiveness of the collection program, and would let them know by March 6 whether their contracts would be extended for another year. The study found that between the first quarter of FY2004 and the first quarter of FY2009, the total cost to the IRS of designing, implementing, and managing the collection program was $82.9 million, or $0.4 million more than the $82.5 million in gross revenue collected by the PCAs in that period. A subsequent IRS analysis found that the program produced a net loss of $4.5 million.

By contrast, the Joint Committee on Taxation (JCT) estimated in 2004 that the program (as specified in the AJCA) would raise $1.36 billion over 10 years, including $621 million between FY2005 and FY2009.

On March 5, 2009, the IRS informed the two remaining PCAs that their contracts would not be extended (IR-2009-019). Then-IRS Commissioner Doug Shulman cited three reasons for terminating the program. First, the total cost of the private tax debt collection program (including start-up expenses going back to FY2004 but excluding opportunity costs) exceeded the revenue it collected. Second, as a 2009 study by the IRS and an independent reviewer showed, IRS employees were more cost-effective than PCAs in handling the same inventory of delinquent tax cases. Third, the collection work "was best done by IRS employees who have more flexibility in handling cases," especially those involving taxpayers facing financial difficulties.

FAST Act and the New Private Tax Debt Collection Program

The enactment of the FAST Act required the IRS to revive the 2006-2009 PCA program, but with a few modifications.

According to an estimate by the JCT, the new program was expected to raise $2.4 billion from FY2016 to FY2025.

Under the act, the IRS was required to enter into "one or more qualified collection contracts for the collection of all outstanding inactive tax receivables" within three months of the enactment of the act.

Such a receivable is defined in the act as any tax assessment in the IRS's inventory of potentially collectible taxes that meets at least one of the following four criteria: (1) the assessment has been removed from the active inventory because the IRS lacks the resources to collect it or cannot locate the taxpayer; (2) more than one-third of the statute of limitation has lapsed; (3) the assessment has not been assigned to an IRS employee for collection; and (4) if an assessment has been assigned to an IRS employee for collection, more than 365 days have passed since the last communication between the IRS and the taxpayer for the purpose of collecting the tax owed.

The FAST Act required the IRS to enter into "one or more qualified collection contracts for the collection of all outstanding inactive tax receivables" within three months of its enactment.

A PCA may not collect delinquent taxes from cases involving a deceased person, someone under the age of 18, someone serving in a combat zone, or someone who is the victim of tax refund fraud related to identity theft. Nor is a PCA permitted to collect taxes from taxpayers who have a pending or active "offer in compromise" or installment agreement with the IRS; are classified as an innocent spouse case; or are the focus of an active examination, litigation, criminal investigation, levy, or appeal.

Contrary to the operating procedures for the PCAs hired for the 2006-2009 collection effort, the employees of PCAs participating in the new program may identify themselves as contractors of the IRS when contacting taxpayers by phone and disclose the reason for the call.

Taxpayers residing in presidentially declared disaster areas are eligible for an immediate cessation of PCA collection activities against them and a return of their cases to the inventory of active cases worked on by IRS employees.

Like the 2006-2009 PCA program, the IRS is allowed to keep up to 25% of the amount collected under the new program. But unlike that program, the funds will be placed in a new account (set up under newly added Section 6307) for the hiring and training of "special compliance personnel." These employees will work as field collection officers or representatives of the IRS's Automated Collection System, collecting delinquent tax debt.

In March of each year, the IRS Commissioner must report to the House Ways and Means and the Senate Finance Committees on the cost of the program and the amount of revenue it raised in the previous fiscal year and the expected cost and tax collection for the current year. In a separate report, the agency must provide details on the total amount collected by each contractor, the collection costs incurred by the IRS, the total amount of fees retained by the IRS, and the agency's use of the funds.

Four debt collection companies have signed contracts with the IRS to collect eligible debt: CBE Group, Pioneer Credit Recovery, ConServe, and Performant.

The IRS began referring cases to the firms for collection on April 10, 2017. The companies receive a commission for the tax debt they collect equal to as much as 25% of that amount. When the program began, the debt eligible for collection totaled nearly $138 billion from about 14 million taxpayer accounts.

From the start of private collection activity through September 30, 2019, the four companies collected a total of $301.8 million in revenue. The total cost of the program came to $131.7 million, leaving a net balance of $170.0 million, which was transferred to the Treasury general fund. Among the costs were $54.6 million in commissions paid to the PCAs and $11.5 million in retained revenue for a fund used by the IRS to hire and train special compliance agents.

Proponents of the new PCA program contend that without the use of private debt collectors, little or none of the billions of dollars in the IRS's inventory of inactive but collectible individual tax debt would be collected. They claim that the IRS lacks the resources to collect this tax debt on its own and thus assigns a low priority to doing so. Some argue that private firms would be more efficient than the IRS in collecting delinquent tax debt.

Critics of the third PCA program say that it fails to serve the public interest or the interest of affected taxpayers. They contend that hiring new IRS personnel to collect the targeted tax debt would be more cost-effective than using PCAs. Critics also note that unlike PCAs, the IRS has the flexibility to reach installment agreements with, or extend offers in compromise to, taxpayers who cannot afford to pay off their entire debt all at once.

Some charge that the PCA program imposes economic hardships on low-income taxpayers and makes them vulnerable to aggressive targeting by PCAs.

The Taxpayer First Act (TFA, P.L. 116-25) addressed these concerns in several ways. First, the IRS is barred from assigning eligible tax debt for collection by PCAs for taxpayers who receive "substantially all" of their income from Supplemental Social Security benefits or Social Security Disability Insurance benefits, or whose adjusted gross income is 200% or less of the federal poverty level. Second, the act redefines tax debt eligible for collection by a PCA as debt for which two or more years have passed since the tax liability was assessed; under previous law, tax debt became eligible for PCA collection one or more years after assessment. Third, the act requires PCAs to allow taxpayers up to seven years to pay off their tax debt through an installment agreement, rather than the five years allowed under previous law. Each of these changes applies only to tax debt referred to PCAs for collection after December 31, 2020.

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IF10339

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