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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 collect certain delinquent individual income tax debt using private debt collection agencies (PCAs). Section 32102 of the Fixing America's Surface Transportation (FAST) Act (P.L. 114-94) directed the IRS to revive the private tax debt collection program it operated from 2006 to 2009, but with several 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 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. It was funded under the Treasury, Postal Service, and General Government Appropriations Act, 1996 (P.L. 104-52). Although the project was authorized to last two years, the IRS ended it after one year, owing to disappointing results and 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 (GAO), the five PCAs hired for the project collected $3.1 million in delinquent taxes through January 1997, but 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 Internal Revenue Code (IRC) by the American Jobs Creation Act of 2004 (AJCA; P.L. 108-357). IRC 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 statutory authority to hire PCAs for this purpose.

Under IRC Section 6306, 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 back taxes.

Payments went into a revolving fund. The IRS could use up to 25% of the money in the fund to compensate 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 the guidelines laid down in IRC Section 6306. After a series of court challenges of 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 in September 2006. In February 2007, the IRS extended the contracts with two of the companies through March 2008, and those contracts were further extended through March 2009.

The IRS notified the two contractors in February 2007 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 cost to the IRS of designing, implementing, and managing the collection program totaled $82.9 million, or $0.4 million more than the $82.5 million in gross revenue collected by PCAs. A subsequent IRS analysis found that the program had produced a net loss of $4.5 million.

This finding was inconsistent with a 2004 estimate by the Joint Committee on Taxation (JCT) 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 Third Private Tax Debt Collection Program

The FAST Act required the IRS to revive the 2006-2009 PCA program, but with a few modifications. According to a JCT revenue estimate, the new program is expected to raise $2.4 billion in delinquent individual income tax debt from FY2016 to FY2025.

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

Such a receivable is defined as any tax assessment in the IRS's inventory of potentially collectible taxes that satisfies at least one of four criteria: (1) the assessment has been removed from the active inventory because the IRS lacks the resources to collect it or could not locate the taxpayer; (2) more than one-third of the 10-year statute of limitation has lapsed; (3) the assessment has not been assigned to an IRS employee for collection; and (4) more than 365 days have passed since the last communication between the IRS and the taxpayer about collecting the tax owed.

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A PCA may not collect delinquent taxes from 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. In addition, a PCA may not collect delinquent 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 involved in an active examination, litigation, criminal investigation, levy, or appeal.

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

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, as well as the expected cost and revenue collected for the current year. In a separate report, the IRS is required to 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 are working with the IRS to collect tax 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 taxes 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 cost of the program totaled $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 to hire and train special compliance agents.

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

Critics say that the current PCA program fails to serve the public interest. They contend that mandating that the IRS hire people to collect the targeted tax debt would be more cost-effective than using PCAs. Another concern is that unlike PCAs, the IRS has the flexibility to reach installment agreements with or extend offers in compromise to taxpayers who cannot pay off their debt all at once. Some argue that the PCA program imposes economic hardships on low-income taxpayers.

Taxpayer First Act

The Taxpayer First Act (TFA, P.L. 116-25) addressed some concerns about the current PCA program.

First, the act bars the IRS from assigning tax debt for PCA collection held by 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 up to 200% of the federal poverty level.

Second, the act redefines tax debt eligible for PCA collection 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 year after assessment.

Third, the act allows taxpayers up to seven years to pay off tax debt assigned to a PCA for collection through an installment agreement, rather than the five years allowed under previous law.

Each of these changes applies to tax debt referred to PCAs for collection after December 31, 2020.

Gary Guenther, Analyst in Public Finance

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