USE OF PRIVATE COLLECTION AGENCIES TO IMPROVE IRS DEBT COLLECTION

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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TUESDAY, MAY 13, 2003

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

The Subcommittee met, pursuant to notice, at 2:03 p.m., in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

CONTACT: (202) 225–7601

FOR IMMEDIATE RELEASE
May 06, 2003
OV–4

Houghton Announces Hearing on the Use of Private Collection Agencies to Improve IRS Debt Collection

Congressman Amo Houghton (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on private collection agencies. **The hearing will take place on Tuesday, May 13, 2003, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include the Honorable Mark Everson, Commissioner of the Internal Revenue Service (IRS), and Nina Olson, the National Taxpayer Advocate.

BACKGROUND:

Each year, the IRS collects over $2 trillion in tax revenue from all sources. A small percentage of this amount is assessed, but not collected. The IRS has 10 years to collect newly assessed taxes. Over the past decade, the total inventory of unpaid tax assessments has more than doubled. It has grown from $130 billion in 1992 to over $280 billion in March 2003.

Much of this amount represents tax debts that cannot be collected, due to death or bankruptcy, but the IRS estimates that about $78 billion is collectible. The amount judged to be collectible has grown by 12 percent during the past 2 years, and the inactive portion that the IRS is not currently pursuing has grown by 38 percent. As of March, the IRS had identified over $13 billion in tax debts that can only be collected if the IRS has more resources.

The Bush Administration is highly concerned about the growth in the inventory of uncollected taxes, and the IRS issued a Request for Information that appeared in the Federal Register in January 2002 to seek input from private collection agencies (PCAs) on how PCAs could assist the IRS with its collection efforts, while preserving important taxpayer protections in existing law. Using this information, the Administration developed a proposal that appeared in the fiscal year 2004 budget request for the IRS. Chairman Houghton introduced legislation (H.R. 1169) that would implement the Administration's proposal.

In announcing the hearing, Chairman Houghton stated, "We all know that it is a duty of citizenship to abide by the rules and pay our taxes. Yet, in the event that the rules are not followed, the IRS is unfortunately not able to adequately enforce this obligation due to a lack of funds. Enforcement is inconsistent at best. The Administration is looking for innovative solutions to this problem, and I applaud them for it."

FOCUS OF THE HEARING:

The hearing will focus on the Administration's proposal to use private collection agencies to support the IRS's collection efforts and Chairman Houghton's bill to implement the proposal.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to hearingclerks.waysandmeans@mail.house.gov, along with a fax copy to (202) 225–2610, by the close of business, Tuesday, May 27, 2003. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing should deliver their 200 copies to the Subcommittee on Oversight in room 1136 Longworth House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol Police will refuse sealed-packaged deliveries to all House Office Buildings.

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. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to hearingclerks.waysandmeans@mail.house.gov, along with a fax copy to (202) 225–2610, in Word Perfect or MS Word format and MUST NOT exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

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. Any statements must include a list of all clients, persons, or organizations on whose behalf the witness appears. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman HOUGHTON. Good afternoon, ladies and gentlemen. Thank you very much for coming to this hearing. We are delighted to have the new Commissioner with us. I am going to make an initial statement. Then, Mr. Pomeroy, who is the Ranking Member, will make one, and if anybody else comes in and wants to do that, that is okay, too. Then we will get to you, Commissioner. So, thank you.

As I had indicated, really this is the first time we have had you as the new Internal Revenue Service (IRS) Commissioner, and we are delighted and honored that you are here. The President, as many of you know, has shown great faith in Mr. Everson by en-

trusting him with the critically important job of managing the IRS, and I am sure he is up to the challenge.

Now, we are all familiar with the annual tax filing ritual, but thankfully few Americans are familiar with the IRS collections process. Of the $2 trillion per year that the IRS collects through self-assessment, a small percentage, but a large amount in real terms, approximately $60 billion—$60 billion—remains unpaid at the end of the year. Now, ideally, the IRS would collect every individual tax debt owed to the Treasury Department, but that has not occurred in recent years.

It may never have occurred, but certainly the proportion has not been in recent years. The backlog of unpaid assessments has grown substantially since 2000, and the IRS estimates that $78 billion of the total inventory of outstanding tax liabilities is potentially collectible.

The IRS has determined also that it lacks the resources, however, to pursue much of the unpaid taxes. This means that it is inevitable without a change in the status quo that the tax collection system will be conducted selectively. Some taxpayers will experience the full weight of the IRS enforcement powers, including liens, levies, wage garnishment and even bankruptcy, while other taxpayers will be able to walk away from their tax liabilities.

This is an unconscionable situation that must be remedied, but we must also do this in a way that preserves taxpayer rights in the confidentiality of tax return information.

Now, the solution proposed by the administration, and the topic of our hearing today, is the proposal for the limited use of private sector collection agencies (PCAs) consistent with taxpayer rights so they can assist the IRS in its collection efforts. The Administration has developed a detailed proposal that will allow the IRS to benefit from the knowledge and skills of private sector companies and also will allow IRS revenue officers to focus on higher priority tasks.

Today, we are going to hear from a variety of experts on this subject. I should note that 40 States already use private debt collectors to assist in collecting unpaid tax debt, and the Federal Government uses private companies to collect student loan debt.

Our hearing today will review these efforts, and we will hear how the IRS plans to address the challenge of implementing this proposal while at the same time protecting taxpayer rights and the confidentiality of return information.

I would now like to yield to a good friend of mine, the Subcommittee's Ranking Member, Mr. Pomeroy from North Dakota.

[The opening statement of Chairman Houghton follows:]

Opening Statement of The Honorable Amo Houghton, Chairman, and a Representative in Congress from the State of New York

Good afternoon. Before us today, for the first time, is the newly confirmed Commissioner of the Internal Revenue Service, Mark Everson. The President has shown great faith in Mr. Everson by entrusting him with the critically important job of managing the Internal Revenue Service, and I have no doubt that he is up to the challenge.

We are all familiar with the annual tax filing ritual, but, thankfully, few Americans are familiar with the IRS collections process. Of the $2 trillion per year that the IRS collects through self-assessment, a small percentage—but a large amount in real terms, approximately $60 billion, remains unpaid at the end of the year.

Ideally, the IRS would collect every individual tax debt owed to the Treasury, but that has not occurred in recent years. The backlog of unpaid assessments has grown substantially since the year 2000, and the IRS estimates that $78 billion of the total inventory of outstanding tax liabilities is potentially collectible. The IRS has determined that it lacks the resources, however, to pursue much of the unpaid taxes.

This means that it is inevitable—without a change in the status quo—that the tax collection will be conducted selectively. Some taxpayers will experience the full weight of the IRS's enforcement powers, including liens, levies, wage garnishment, and even bankruptcy, while other taxpayers will be able to walk away from their tax liabilities. This is an unconscionable situation that must be remedied, but we must do so in a way that preserves taxpayer rights and the confidentiality of tax return information.

The solution proposed by the Administration, and the topic of our hearing today, is the proposal for the limited use of private sector collection agencies—consistent with taxpayer rights—to assist the IRS in its collection efforts. The Administration has developed a detailed proposal that will allow the IRS to benefit from the knowledge and skills of private sector companies and will allow IRS revenue officers to focus on higher priority tasks.

Today we will hear from a variety of experts on this subject. I should note that 40 states already use private debt collectors to assist in collecting unpaid tax debt and the Federal Government uses private companies to collect student loan debt. Our hearing today will review these prior efforts, and we will hear how the IRS plans to address the challenge of implementing this proposal, while at the same time, protecting taxpayer rights and the confidentiality of return information.

I would now like to yield to a good friend of mine, the Subcommittee's ranking member, Mr. Pomeroy from North Dakota.

Mr. POMEROY. Thank you, Mr. Chairman, and thank you for holding this hearing. I do think this is a proposal that needs our thorough evaluation. I want to begin by commending the Commissioner. It is good to have a Commissioner again, and as we mentioned in our meeting before the hearing, I have high confidence in the newly confirmed Commissioner and look forward to your new leadership on this critical government agency.

Mr. EVERSON. Thank you.

Mr. POMEROY. My concerns on the idea of suddenly enlisting significant private bill collectors to help the Federal Government collect back taxes is that it is an idea that frankly is not ready for prime time. I think we need to look at a lot of issues, and this hearing is going to be really the best public forum to date for Congress to evaluate the idea.

I think you can start with the notion of collecting taxes. Now, if there is ever an inherently governmental function, it would seem like that really is to the core what would be a governmental function: collecting the revenues it is owed for purposes of running the government.

I also believe that further investigation in this shows this is something the Federal Government has been doing a long time, it does it very well, very efficiently, and has now an operating environment where the Congress working with the IRS over the years has put in place a number of taxpayer protections very important to the rights of our taxpayers.

From an efficiency standpoint, the average IRS collection employee brings in $900,000 in taxes each year. I think that that is very impressive. It would seem to me that we could expand collection, get at the uncollected debt this proposal would address through private collectors by simply funding more IRS collectors.

When we have to give private collectors enlisted in the cause of collecting taxes a significant cut of the action by way of their compensation, be it up to 25 percent, we are diverting money that otherwise could be used to retire the deficit or fund critical programs like the military, and we are devoting it to compensation of private sector partners when this could be much more cost effectively performed simply by hiring and adding to the existing IRS collection system in place.

Another very fundamental question I hope we can explore today is what kind of cases are going to be sent out for private collection? We have got a range of uncollected debt including individuals armed with accountants and lawyers and hiding behind the most elaborate yet phony tax avoidance schemes ever devised, and we have got a lot of middle class taxpayers that one reason or another have not paid what they owed.

While it certainly would not seem fair to me if suddenly this barrage of private debt collectors singled on the middle-income, modest-income household, leaving the more elaborate tax shelters for another day, a day that will not ever come in light of the existing staffing for the IRS. So, we need to learn more about how fairly this new private sector initiative is going to be applied.

It certainly should not be just applied to your basic middle-income household that is behind on their tax obligation.

We also need finally to explore whether the protections that taxpayers have when they are subject to IRS debt collection also exist when you have got a private bill collector coming after them.

In 1998, and I believe the Chairman was very involved in this legislation, we no longer allowed IRS employees to be compensated based on percentage of what they bring in. There were some horrific examples brought forward in the hearings that we all recall of IRS overreaching in its debt collection, individuals that were usurping their authority and basically misapplying the authority of the Federal Government in collecting debt, driven in part by the fact that they were paid on a percentage basis: the more they brought in, the more they made, and they overreached.

We prohibit that in public law, but will this same prohibition attach to private collection efforts? Actually the proposal looks as though that protection will not be in place. That compensation could be up to 25 percent of revenues collected, pure percentage based compensation, again putting in place in the private sector the potential that you are going to have the kind of abuse that we have moved to prohibit in the public sector.

Will it happen? We do not know. These are questions that we certainly have to thoroughly plumb before we rush this proposal forward. So, in conclusion, Mr. Chairman, I just want to commend you. This is the right hearing on an important topic, and I think we all should pause before we go down this road and fully evaluate the wide-ranging consequences that suddenly enlisting private debt collectors could bring upon our taxpayers. Thank you, Mr. Chairman.

[The opening statement of Mr. Pomeroy follows:]

Opening Statement of The Honorable Earl Pomeroy, a Representative in Congress from the State of North Dakota

The Ways and Means Oversight Subcommittee is always interested in exploring innovative ways to better administer our federal tax system. One new proposal that merits our thorough review is the Administration's plan to allow private debt collection companies to begin contacting taxpayers for payment of taxes due.

Based on what I know going into this hearing, I would say that the program is "not yet ready for prime time." Fortunately, even the Administration's proposal does not anticipate implementation of private debt collectors until 2005. I would urge Committee Members to move slowly and carefully on this matter.

The fundamental issue before the Subcommittee is whether "privatizing" IRS debt collection is a good or bad idea. I believe that the public considers federal tax collections to be the job of the IRS and Department of Treasury—an inherently governmental function. I do not think that the public believes that federal tax collections should be profitable business transactions for parts of corporate America looking to expand their market share. The very notion of unleashing a small army of bill collectors on the taxpayers of this Nation should give us all major pause.

Clearly, the IRS could do more collection work if they had more resources. An IRS collection employee averages about $900,000 in taxes collected each year. This is quite impressive. It would seem to me that the IRS could efficiently and effectively collect the next batch of tax-owed cases "in the queue." The notice and letter machines, the telephone lines, the know-how, the entire process is there and ready to go at the IRS. All that is needed are people and resources to work the existing system. Why would we pay someone 25% of a $500 tax bill for making a phone call or sending a letter to a taxpayer, when the IRS could send that same letter or make that same phone call at little cost? It seems silly to intentionally deny the IRS needed collection funds and staffing, then say the IRS is ignoring many collection cases, and thus we must turn to private collectors.

Putting this basic question aside, there are many unanswered questions about how the Administration's privatization plan would work:

What types of cases will the IRS send to private collectors? Will they be large dollar uncollected tax cases owed by the "big boys," or small amounts owed by working families? Will the cases be truly old and delinquent, or will they be new taxes-due found on recently-filed returns which the taxpayers fully intend to pay?

How will the private contractors be rewarded? The IRS Reform Act of 1998 specifically prohibits IRS employees from being evaluated based on collection results in order to eliminate incentives to use overly aggressive tax collection techniques. The private debt collector approach goes in the exact opposite direction. It specifically rewards collectors up to 25% of amounts collected. Why would we want to give people who are not directly accountable to the Treasury Department Secretary and IRS Commissioner a bounty for getting money from taxpayers?

How can strong taxpayer protections be effective when dealing with private collectors? IRS employees are subject to job termination by the IRS Commissioner for harassing a taxpayer, destroying documents, violating IRS rules, etc. How would "bad" contractors be identified and would they too get fired? Further, the proposal explicitly prevents taxpayers from seeking relief or damages from the IRS if a contractor misuses confidential taxpayer information. Why would we want to reduce taxpayers' protections in dealing with IRS collection agents after fighting so hard for them in 1998?

So, in conclusion, I want to thank Subcommittee Chairman Houghton for scheduling a hearing on this important issue. I share his view that hearings, such as today's, are critical to our understanding and evaluation of how to improve our administration and enforcement of the tax laws.

Thank you.

Chairman HOUGHTON. Okay. Well, thank you very much, Mr. Pomeroy, and Mr. Everson, we are delighted to have you here, and you follow an extraordinary man in Charles Rossotti, and I know you are going to equal him and do it even better. So, thank you, and we look forward to your testimony.

STATEMENT OF THE HONORABLE MARK W. EVERSON, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. EVERSON. Thank you. Mr. Chairman, Mr. Pomeroy, thank you for this opportunity to testify today. As you know, this is my first hearing before the Subcommittee since assuming office just last week. Mr. Chairman, I look forward to a productive working relationship with you, Mr. Pomeroy, and the entire Subcommittee and your staff.

During my tenure as Commissioner, I expect to focus on three areas. One, we must continue the reorganization begun by Commissioner Rossotti in order to improve customer service. We must stay the course; employees and managers at all levels of the organization must fully embrace the changes he launched.

Two, we must continue the information technology modernization program. Its success is critical to establishing a more efficient and effective IRS.

Three, we must strengthen the integrity of our Nation's tax system through enhanced enforcement efforts. The IRS must deter those who might be inclined to evade their legal tax obligations and appropriately pursue those who actually do. It is as simple as this: people should pay what they owe.

The President's budget requests a real increase in resources targeted toward enforcement, new money to expand enforcement efforts with a sharper focus on high income/high risk taxpayers and businesses. However, in order to attack systemic problems such as uncollected debt, we must use all, and I repeat all, available tools but, of course, with appropriate controls.

In this regard, the budget contains an important legislative proposal that would authorize the IRS to contract with PCAs, to supplement current tax collection efforts for a targeted category of debt.

I would like to emphasize that this proposal is totally distinct from competitive sourcing and will not result in the loss of a single job at the IRS. While Federal employees could do this work, as you know, appropriated resources are scarce, and I would like to point out that for 8 out of the last 10 fiscal years, the IRS has actually received less than its full budget request.

The proposed use of PCAs is a realistic approach. As the National Taxpayer Advocate states, quote: "PCAs appear a limited but reasonable option."

For the purposes of this initiative, the Treasury Department and the IRS identified over $13 billion in individual tax debt designated as currently non-collectible. The cases the IRS would refer to PCAs are those where the taxpayer would likely pay the outstanding tax liability if contacted by telephone.

These include situations where a taxpayer filed a return indicating an amount of tax due but did not also send in payment for that full amount. These cases also would include situations where the taxpayer has made three or more voluntary payments of tax that was assessed by the IRS.

The IRS would not refer to PCAs cases for which there is any indication that enforcement action would be required to collect the tax liabilities. The IRS will avoid referring cases that would require IRS expertise or the exercise of discretion.

I want to stress in the strongest possible terms that PCAs would be prohibited from threatening or intimidating taxpayers. Indeed, the PCAs would be governed by all of the same rules by which IRS employees are held accountable. The taxpayer protections woven throughout this proposal have also been thoroughly reviewed by the National Taxpayer Advocate who will be testifying this afternoon.

From my previous perch as Deputy Director for Management at the Office of Management and Budget (OMB), I am also acutely sensitive to the need for proper supervision of outside contractors. I want to assure the Subcommittee that PCAs and PCA employees will receive close supervision by the IRS to ensure compliance with taxpayer protections and applicable policies and procedures. The National Taxpayer Advocate will continue to be involved in this process.

Mr. Chairman, I want to make one final point. The President's initiative builds on a record of success at both the State and Federal level. The PCAs are common across more than 40 States including those represented on this Subcommittee. We will work to take the best from these different approaches, and we will also benefit from their lessons learned.

In the Federal arena, I would like to point out that PCAs are being successfully used by both the Financial Management Service, within the Treasury Department and the Education Department. Under the Debt Collection Improvement Act of 1996 (P.L. 104–134), non-tax debts of a certain age owed to Federal agencies such as defaulted loans must be referred to the Finance Management Service (FMS). The collection of the debt is the responsibility of PCAs and this system is working very well.

In addition, I have confirmed with the Deputy Secretary of Education that that Department's experience with PCAs is also very positive. Thank you. That concludes my oral statement. I would be happy to take any questions.

[The prepared statement of Mr. Everson follows:]

Statement of The Honorable Mark W. Everson, Commissioner, Internal Revenue Service

Mr. Chairman and Members of the Subcommittee, there is a significant and growing backlog of cases involving individual taxpayers who are aware of their tax liabilities but have not paid them. We believe that many of these taxpayers have simply chosen not to pay, even though they have the means to do so. This is unfair to every hard-working taxpayer who has paid his or her fair share of taxes. Indeed, nothing undermines the confidence of honest taxpayers in the tax system more than the perception that other taxpayers who can pay their liabilities are able to get away with not paying.

The Administration's FY 2004 budget proposes to support the IRS's collection efforts with private collection agencies (PCAs) that will engage in carefully defined and limited collection activities. PCAs would be used to address two groups of taxpayers. The first group consists of taxpayers who have filed a tax return showing an amount of tax due, but who have failed to pay the tax. The second consists of taxpayers who have been assessed additional tax by the IRS and have made three or more voluntary payments to satisfy that additional tax, but who then have stopped making payments. These taxpayers clearly are aware of their liabilities. In many cases, however, they are taking advantage of the fact that the IRS cannot continually pursue each taxpayer who fails to pay an outstanding tax liability. We believe that PCAs could efficiently and effectively address these liabilities.

PCAs would allow the IRS to focus its enforcement efforts on more complex cases and issues. Significantly, because PCAs would work the simplest and most straightforward collection cases they would enable the IRS to handle more collection cases

at an earlier stage in the process—before those accounts become stale and harder to collect.

Over 40 states have used private collection agencies successfully as part of their tax collection efforts, and other federal agencies have used private collection agencies for a number of years to collect a significant amount of delinquent federal nontax debt. Once the required authorizing and funding legislation are enacted, the IRS would be able to begin placing outstanding tax liabilities with PCAs by as early as a year later.

At the present time more than $13 billion in individual income tax debt has been designated as uncollectible due to IRS collection and resource priorities. Less than three years ago, this amount was only $7 billion. PCAs could be used to address many of these cases, and the IRS is working to identify other appropriate cases that may be eligible for referral if the necessary legislation is enacted.

Taxpayer protections will be fully maintained under this proposal. The Treasury Department and the IRS determined early on that no proposal to engage PCAs would ever be feasible unless and until those developing the proposal could assure themselves and others that taxpayer rights would not be weakened in any way. A taxpayer contacted by a PCA would enjoy the same rights and protections as a taxpayer contacted by an IRS employee. The taxpayer protections incorporated in the Administration's proposal have been reviewed thoroughly in consultations with the National Taxpayer Advocate (NTA). The NTA and her organization would have a continuing role in ensuring that taxpayer protections are maintained under any program using PCAs to support the IRS's collection efforts.

Present Law

Under present law, the IRS must collect tax liabilities; they cannot be referred to a PCA for collection. This stands in stark contrast to other federal agencies that may, and often do, enter into contracts with non-governmental parties for the collection of debts owed to the United States.

Section 6301 of the Internal Revenue Code (Code) directs that "[t]he Secretary shall collect the taxes imposed by the internal revenue laws," and the Code defines the "Secretary" to mean officers, employees, or agencies of the Treasury Department. The reservation of tax collection authority to Treasury officers and employees also is reflected in the Debt Collection Improvement Act of 1996 (DCIA), Public Law 104–34. The DCIA expressly permits federal agencies to enter into contracts with private contractors for the collection of debts owed to the United States. This authorization, however, specifically excludes Federal tax debts.

The Treasury Department's Financial Management Service (FMS) currently uses private collection agencies as part of its implementation of the DCIA. Under the DCIA, nontax debts of a certain age that are owed to most federal agencies must be referred by the agency to FMS. FMS then may refer those debts to private collection agencies for collection. Since 1998, FMS has collected $109 million in nontax debts through the use of private collection agencies, with $43 million of this amount being collected in FY 2002. The amount being collected through the use of private collection agencies has been growing at a rate of at least 22 percent since 1999.

Section 7809(a) of the Code provides that collections received or collected by authority of the internal revenue laws shall be paid daily into the United States Treasury, without any deduction for compensation, fees, costs, charges, expenses, or claims of any description. The existing statutory exceptions do not cover potential fees or compensation earned by a PCA. Therefore, unless modified, section 7809 would require fees or compensation due to a PCA to be paid only from funds already appropriated to the IRS. In contrast, under the DCIA federal agencies that enter into contracts with private collection agencies for the collection of public nontax debts are allowed to deduct the fees owed to private collection agencies directly from the amounts recovered.

Reasons For Change

Our tax system has a simple time-honored premise: each person who is voluntarily meeting his or her tax obligations must have confidence that his or her neighbor also is complying. While most taxpayers do their best to comply with our tax laws, some do not. In those cases, the IRS must exercise its enforcement powers to achieve compliance.

In recent years, the increased demands on the IRS's collection resources have resulted, as of March 2003, in over $13 billion in individual income tax debt being designated as uncollectible due to collection and resource priorities. Not all of these delinquent tax liabilities, however, are truly uncollectible. Rather, we believe that many of these accounts could be collected relatively easily with minimal follow-up efforts.

More troubling is the fact that this backlog of cases will only grow over time. The total accounts receivable dollar inventory is growing at an annual rate of 3–4%. Thus, without a significant change in business practice, the pool of uncollected, but potentially collectible, tax liabilities will continue to plague us. This not only will result in billions of dollars of lost revenue but also will undermine voluntary compliance by allowing some taxpayers to pay less than their fair share.

PCAs would allow the IRS to address efficiently a significant portion of currently inactive inventory. The cases the IRS would refer to PCAs are those where the taxpayer would likely pay the outstanding tax liability if contacted by telephone. These cases would include situations where a taxpayer filed a return indicating an amount of tax due but did not also send in payment for that full amount. These cases also would include situations where the taxpayer has made three or more voluntary payments of tax that was assessed by the IRS.

The IRS would not refer to PCAs cases for which there is any indication that enforcement action would be required to collect the tax liabilities. The IRS also would not refer any case that likely would require IRS expertise or the exercise of discretion. Discretion is required, for example, in determining how to best obtain payment of a delinquent tax liability, including the use of enforcement tools such as a lien or levy, where the taxpayer will not voluntarily enter into repayment terms.

A Description Of The Administration's Proposal

The Administration's proposal has three components: (1) the activities PCAs would undertake in support of the IRS's overall collection efforts; (2) the taxpayer protections that would apply with respect to actions taken by PCAs; and (3) the compensation of PCAs.

Statutory authorization is required for the IRS to use PCAs and the revolving fund mechanism for compensating PCAs. In addition, certain statutory changes would be required to ensure that all taxpayer rights and protections would continue to apply. A number of the items discussed below, however, would be addressed through the IRS's administration of the program and its contracts with the PCAs. This would provide the IRS with the flexibility needed to ensure that the PCAs are used in a manner that best serves the proposal's objectives.

PCA Activities

Under the Administration's proposal, PCAs would focus on taxpayers who are likely to pay their outstanding tax liabilities, either in full or in installments, if they were located and contacted. These are functions that would not require the exercise of discretion or involve enforcement action. PCAs may be provided by the IRS with a specific statement that can either be sent or delivered verbally to taxpayers regarding the benefits of paying an outstanding tax liability, and the potential consequences of failing to do so. This statement would not be taxpayer specific, but rather would be a more general description of the collection process that would serve an important taxpayer education purpose.

Mr. Chairman, I want to stress in the strongest possible terms that PCAs would be prohibited from threatening or intimidating taxpayers, or otherwise suggesting, beyond the specific statement discussed above, that enforcement action will or may be taken if a taxpayer does not pay the liability. Decisions regarding enforcement actions will always remain with the IRS. In no case would a PCA be permitted to take enforcement action against a taxpayer.

After thoughtful consideration, we came up with the following process that the PCAs would carefully employ to assist the IRS in collecting delinquent taxes.

1. **Selection of Accounts to be Referred to PCAs—**The IRS would select those cases likely to be the simplest to collect, based on factors indicating that the taxpayer would likely pay the outstanding tax liability if contacted by telephone. The initial identification of referable accounts would target taxpayers who have indicated an amount of tax due on a return but who have not paid that amount (so-called "balance-due" taxpayers). This initial identification also would target taxpayers who have been assessed tax by the IRS (e.g., after having failed to file a return or report all income received) and who have made three or more voluntary payments of assessed tax. Again, the IRS would not refer cases for which there is an indication that enforcement action may be necessary or that IRS discretion would be required to resolve the liability.
2. **Notification by Mail—**A PCA would send to each assigned taxpayer's last known address a written notice informing the taxpayer that the PCA is attempting to collect a debt owed to the IRS. (For taxpayers who have filed a power-of-attorney with the IRS, the PCA would contact the designated representative.) The notice would comply with the requirements imposed by the

Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. § 1692 et seq., and the requirements applicable to comparable notices issued by the IRS. Each notice would be accompanied by a copy of IRS Publication 1 ("Your Rights as a Taxpayer"), which provides a brief overview of the collection process, including a taxpayer's right to seek assistance from the Taxpayer Advocate Service.

3. **Location of Taxpayers—**In cases where the FDCPA notice is returned as undeliverable, and for purposes of verifying a taxpayer's telephone number, PCAs would obtain current contact information by using automated database matching (e.g., running a name against an on-line or electronic "white pages") and, if necessary, contacting information sources, such as directory assistance. PCAs, however, would not contact individuals (such as relatives and neighbors) or employers in order to locate a taxpayer.
4. **Telephone Contact with Taxpayers—**After a FDCPA notice has been sent to a taxpayer, the PCA would contact the taxpayer by telephone to discuss the tax liability. The purposes of this call is to respond to questions that the taxpayer may have, based on specific information provided by the IRS to the PCA; request that the taxpayer pay the amount due in full; and, if the taxpayer is unable to do so, offer the taxpayer the ability to pay the full amount due pursuant to an installment agreement providing for full payment of the liability over a period of up to three years (a "3-year installment agreement"). A 3-year installment agreement, like all installment agreements under section 6159 of the Code, would be between the taxpayer and the IRS and would be subject to all of the protections provided for under the Code, including the restriction on levy under section 6331(k).
5. **Questions Regarding an Outstanding Liability—**PCAs would have access to specific information regarding an outstanding tax liability (e.g., type of tax, tax years affected, dates of assessment, whether the assessment is based on a taxpayer's own balance due return or an IRS notice, prior payments, and application of prior payments) in order to answer basic, but important questions that a taxpayer may have regarding the liability.

   The taxpayer information provided to PCAs would be strictly limited to the information required for the collection of the specific tax liability at issue. PCAs would not receive, for instance, information regarding a taxpayer's total or adjusted income, sources of income, IRS examination results, delinquency history for liabilities not being handled by the PCA, or employer information.

   Let me stress here too that PCAs would be trained with respect to the information that they can, and cannot, provide in response to a taxpayer question. PCAs would not be permitted to address questions as to the validity of the liability, or the basis for the liability, beyond providing the taxpayer with the basic account information to which the IRS gives the PCA access.
6. **Full Payment Of Outstanding Liability—**PCAs would request that a taxpayer pay the outstanding tax liability in full and provide directions for doing so. PCAs would be provided with a specific statement that they can make to taxpayers regarding the benefits of paying the liability (including the stopping of interest and penalties, and the release of any tax liens). All taxpayer payments, whether in full satisfaction of an outstanding liability or an installment payment, would be made directly to the IRS. PCAs would not actually collect any amount.

   Mr. Chairman, in no case would a PCA be permitted to provide advice to the taxpayer regarding the legality of, or proper way to challenge the outstanding tax liability or the consequences of paying, or failing to pay, that liability beyond the specific statement provided by the IRS and the explanations in IRS Publication 1. Taxpayers with further questions would be directed to consult with their own advisor, with IRS personnel overseeing the PCA, or with the Taxpayer Advocate Service.
7. **Payment Pursuant To A 3-Year Installment Agreement—**If a taxpayer is unable to pay immediately the full amount of the outstanding tax liability, the PCA would request that the taxpayer enter into an installment agreement (i.e., full payment over time, not to exceed 3 years).

   A PCA would be responsible for monitoring installment agreements that are facilitated by the PCA. Specifically, a PCA would monitor whether a taxpayer was making payments in accordance with the terms of the installment agreement and, if payments stopped, would contact the taxpayer in an effort to bring the taxpayer current with the installment agreement. A PCA would be prohibited, however, from threatening or intimidating taxpayers, or suggesting that enforcement action will or may be taken if a taxpayer does not continue making payments.

A PCA would notify the IRS if a taxpayer remained in breach of the installment agreement for nonpayment, and any decision to terminate the installment agreement would have to be made by the IRS. Any termination decision by the IRS would be subject to the notice of proposed termination required by section 6159(b)(5), an independent administrative review by the IRS Office of Appeals under section 6159(d), and the prohibition on levy under section 6331(k) until any such review has been resolved.

8. **Cases Where a Taxpayer Cannot Pay in Full or Enter into a 3-Year Installment Agreement—**The Treasury Department and the IRS expect that in certain cases, a taxpayer either may request to pay the outstanding tax liability over more than three years or may indicate that he or she is unable to pay the liability in full even over time. In these cases, the PCA would attempt to obtain from the taxpayer financial information in the same manner that the IRS does through its Automated Collection System (ACS). Generally, this would involve the PCA eliciting information from the taxpayer in response to specific questions. The IRS would provide PCAs with specific training regarding this process, and the information received would be forwarded to the IRS.

   The IRS would evaluate the financial information collected by the PCA for further action, as well as any offer by a taxpayer to enter into an installment agreement other than a 3-year installment agreement. Although the IRS would be responsible for reaching resolution of the liability with the taxpayer (e.g., the execution of an installment agreement other than a 3-year installment agreement), PCAs would be permitted to monitor installment agreements reached between the IRS and taxpayers who were contacted originally by the PCAs. As with 3-year installment agreements, PCAs would monitor whether a taxpayer was making payments in accordance with the terms of the installment agreement and, if payments stopped, would contact the taxpayer in an effort to bring the taxpayer current with the installment agreement.

   Again, a PCA would be prohibited from threatening or intimidating taxpayers, or suggesting that enforcement action will or may be taken if a taxpayer does not continue making payments. A PCA would notify the IRS if a taxpayer remained in breach of the installment agreement for nonpayment, and any decision to terminate the installment agreement would have to be made by the IRS. Any termination decision by the IRS would be subject to the notice of proposed termination required by section 6159(b)(5), an independent administrative review by the IRS Office of Appeals under section 6159(d), and the prohibition on levy under section 6331(k) until any such review has been resolved.

9. **Death, Bankruptcy, Incarceration, and Other Special Situations—**We would make every effort to refer only those cases where a taxpayer is likely to agree to pay an outstanding tax liability if contacted by a PCA. In some cases, however, the taxpayer will be unable to do so because of a special circumstance. For these cases, the IRS may develop specific procedures to permit a PCA to gather information that would enable the IRS to resolve the account administratively. These procedures, for instance, may permit the PCA to contact an official representative of the taxpayer or taxpayer's estate (e.g., a trustee in case of bankruptcy, or executor in case of death) as well as access other publicly available sources such as court records.

An IRS support unit and PCA oversight team would work with each PCA to ensure proper controls, protection of taxpayer rights, and segregation of activities considered inherently governmental. PCAs would be evaluated based on a balanced measure scorecard that would reflect quality of service, taxpayer satisfaction, PCA employee satisfaction, and case resolution, in addition to collection results. Scorecard results would impact the number of taxpayer accounts that a PCA would receive.

Taxpayer Protections

Under this proposal, taxpayer protections would be preserved under existing law and through a combination of statutory amendments, explicit contractual provisions, and detailed oversight by the IRS over PCAs. This proposal, however, has been designed to minimize the possibility that any PCA would be engaged in an activity that may violate a taxpayer right or protection in the first place.

More generally, our experience with the 1996/97 IRS pilot and FMS' more recent experience using PCAs to collect nontax debts indicate that, properly structured, the use of PCAs to support the IRS's overall collection effort would not threaten taxpayer rights or protections.

PCAs and PCA employees would be subject to extensive quality-control monitoring by the IRS to ensure compliance with taxpayer protections and applicable policies and procedures. This monitoring would include "live" monitoring of telephone communications between PCA employees and taxpayers, review of recorded conversations, taxpayer-satisfaction surveys, audits of PCA records, and periodic reviews of PCA performance. In addition, the IRS would specifically monitor PCA compliance with taxpayer confidentiality requirements and the restrictions contained in section 1203 of RRA 1998.

Mr. Chairman, the following are the specific safeguards that will protect the taxpayer:

- **Protections Provided by the Fair Debt Collection Practices Act (15 U.S.C. § 1692 et. seq.)—**PCAs would be required to adhere to all applicable requirements and restrictions contained in the Fair Debt Collection Practices Act (FDCPA). (Certain provisions of the FDCPA have been incorporated into the Code in section 6304 so that they apply to IRS employees.) PCAs, for instance, would be prohibited from communicating with taxpayers at an unusual or inconvenient time or place, or engaging in conduct that is harassing, oppressive or abusive.
- **Protections Against Unauthorized Disclosure (I.R.C. § 6103)—**Sections 6103(n) and 7431(a)(2) of the Code currently permit a taxpayer to pursue legal action against any person who is permitted to receive tax returns and return information for purposes of assisting in tax administration, but who unlawfully inspects or discloses that information. Criminal penalties also may be imposed. I.R.C. §§ 7213, 7213A. These provisions would apply to PCAs. The Administration's proposal would require annual reports outlining the safeguards in place at the PCAs to protect taxpayer confidentiality and PCA compliance with the taxpayer confidentiality provisions.
- **Assistance from the National Taxpayer Advocate (I.R.C. §§ 7803(c) and 7811)—**The office of the National Taxpayer Advocate provides assistance to taxpayers seeking help in resolving their problems with the IRS. Any taxpayer experiencing a significant hardship (as defined in section 7811 of the Code and the Taxpayer Advocate Service manual procedures) relating to the manner in which the internal revenue laws are being administered may seek assistance from the office of the NTA. Under this proposal, PCAs would be required to inform taxpayers of their right to obtain assistance from the office of the NTA and to immediately refer any case where such assistance is requested to the local Taxpayer Advocate office. All efforts by the PCA to collect would be suspended until the office of the NTA decides whether to act upon the taxpayer's request for assistance.
- **Protections with Respect to Third-Party Contacts (I.R.C. § 7602(c))—**As explained above, PCAs would not, except in highly unusual circumstances, communicate with third parties in a manner that would constitute third-party contacts for purposes of the notification and reporting requirements of section 7602(c) of the Code. A PCA would be required to notify the IRS if the PCA intends to make a communication governed by section 7602(c), and must receive specific, written authorization from the IRS before the communication could be made.
- **Protections with Respect to Installment Agreements—**Any installment agreement between the IRS and a taxpayer who is contacted by a PCA (including 3-year installment agreements) would be treated like any other installment agreement pursuant to section 6159 and, therefore, would be subject to the protections provided by the Code. These protections include the prohibition on levy during the consideration and term of the installment agreement, as well as immediately after a proposed rejection or termination of an installment agreement. I.R.C. § 6331(k). In addition, a taxpayer has a right to a hearing with the IRS Office of Appeals following the termination or rejection of an installment agreement. I.R.C. §§ 6159(d), 7122(d).
- **Protections with Respect to Communications—**PCAs would be required to comply with Code provisions governing notices reflecting balances due, penalties, and interest. I.R.C. §§ 6631 and 6751(a) (currently suspended until July 1, 2003) and I.R.C. § 7522. In addition, PCAs also would be required to follow Internal Revenue Manual provisions governing taxpayer interviews by IRS employees.
- **Protections against Conduct that Violates Minimum Standards—**Section 1203 of RRA 1998 prohibits certain specified conduct by IRS employees, including conduct in connection with the collection of any unpaid tax. IRS employees, for example, are prohibited from violating any constitutional or civil right of,

or retaliating against, a taxpayer or taxpayer representative. PCAs would be required to comply fully with the provisions of section 1203, including, to the extent permissible under applicable law, the removal or termination of PCA employees who violate the requirements of this provision. The Administration's proposal would require annual reports outlining compliance by PCAs with the restrictions contained in section 1203 of RRA 1998.

This proposal would amend section 7433, which generally permits civil actions by taxpayers for unauthorized collection actions, to extend this provision to actions by employees of a PCA. Taxpayers therefore could bring actions for damages against a PCA employee if the employee violated a protection provided by the Internal Revenue Code. The amendment, however, would permit the government to intervene in any action brought by a taxpayer against an employee of a PCA (whether under section 7431 or section 7433), although in no case would the government be liable for a wrongful act of a PCA.

PCA Compensation

Under the Administration's proposal, section 7809 of the Code would be amended to create a revolving fund from the tax revenue collected by PCAs, and the amounts in this fund would be used to compensate the PCAs. IRS's administrative costs would be paid for from appropriated funds. This proposed revolving fund mechanism is a critical component of this proposal for two important reasons.

First, the revolving fund mechanism would allow the IRS to preserve its existing collection resources for complex cases and issues. *Second*, the revolving fund mechanism, in conjunction with the IRS's ability to control the number of cases that are referred to PCAs, provides flexibility with respect to the extent to which PCAs would support the IRS's overall collection effort.

Revenue Estimates

In January 2002, the IRS issued a Request for Information regarding the potential use of PCAs to support the IRS's overall collection effort. Twenty-three firms responded. Several of the requests for information concerned the average collection rates and fees for contracts similar to the ones contemplated under this proposal. The IRS also obtained average collection rates and fee information for state and local government receivables.

Based on this information, the IRS's current inventory of outstanding tax liabilities closed for workload balancing purposes, and the IRS's expected future inventory of tax liabilities with similar classification, the proposal is expected to return an incremental $1.008 billion to the Treasury over 10 years. The Treasury Department and the IRS are continuing their review of this estimate.

Conclusion

Mr. Chairman, in conclusion, the Administration's proposal to permit the IRS to use PCAs could be an important tool to support our overall compliance program. Taxpayer rights will be protected to the fullest and the real beneficiaries of this program will be the overwhelming majority of America's taxpayers who play by the rules and expect everyone else to do the same.

Chairman HOUGHTON. Well, thank you very much. I have a question, and then I will turn it over to you, Earl, and then we can go back and forth. Now, you have only been on the job—what—a week?

Mr. EVERSON. A week. It seems a little longer, but——

Chairman HOUGHTON. All right. You will never be more objective than you are now. Let me ask you a personal question here. If you had been on the job 2 years ago, would you have initiated this type of program, knowing what you knew then?

Mr. EVERSON. Let me say this because that sounds like it is trying to look back at what happened under the previous Commissioner.

Chairman HOUGHTON. Oh, I do not mean to——

Mr. EVERSON. Maybe that is not the——

Chairman HOUGHTON. No, no. I do not mean to throw any cold water on former Commissioner Rossotti because he did an absolutely great job.

Mr. EVERSON. You mean you think there should have been——

Chairman HOUGHTON. All of a sudden you are thrust into this thing.

Mr. EVERSON. Right.

Chairman HOUGHTON. Would you have done this thing this way and now?

Mr. EVERSON. I do not think that there is any question that it makes sense to do this initiative. Appropriate resources are scarce. After Commissioner Rossotti got in, he had to redirect the IRS very clearly toward the service side of the business. That involved to a certain degree a poaching from the enforcement side.

He has talked about that. He laid it all out in his end-of-term report, which I know you have seen, and so that does go back into the period you talk about. What this initiative does is it enables you to get to a piece, and only a piece, of this whole enforcement question. The Ranking Member, Mr. Pomeroy, is quite correct in stating we need to be working on high-end taxpayers, the tax shelter schemes, all these areas.

This is another piece of it, and we can get to this piece of it without the appropriated resources, and we can do it with the proper controls. So, my answer is, yes, this is a tool that the IRS should have available to it, and I think it is a good tool now, 2 years ago, 10 years ago, as with the Education Department when they began using PCAs, or in the future.

Chairman HOUGHTON. So, in effect, just to follow this up very briefly, you feel that control, and you just mentioned this, is adequate to sidestep some of the problems which they had with the original IRS agents in trying to get an incentive to bring people into court just for their own financial benefit? You think that is controllable with these outside agencies?

Mr. EVERSON. I think it is, sir. We have worked very closely with the Taxpayer Advocate and the proposal that has been developed. It builds off of a balanced scorecard concept that looks at issues like customer satisfaction, employee satisfaction, a whole number of areas. It is not as simple as just saying maximize your return by the dollars you brought in. That will not necessarily generate additional casework for the various firms that will be involved.

There will be a whole series of factors which will be carefully weighted to make sure that private collections are not judged solely on the amount of dollars coming in. I think we can handle that.

Chairman HOUGHTON. Okay. Thank you very much. Mr. Pomeroy.

Mr. POMEROY. Commissioner, following up on the Chairman's line of questioning, I look at this really as Plan B for the IRS, Plan A being staff up, staff up so that the IRS can do its work. If in 8 of the last 10 years, the IRS has been able to get through the OMB and into the President's budget a request for resources that Congress has reduced, again in 8 of 10 years, clearly you were seeking a greater measure of internal capacity to address this debt question than you presently have. Is that correct?

Mr. EVERSON. I think we are looking broadly to increase all the enforcement efforts along the lines of what you said. We need a balanced program. I am not interested at all in going after middle-income taxpayers or low-income taxpayers, and just leaving the people who have more and owe more on their own. Of course not. This is a relatively clear way to supplement that whole program, and again I am going to, as I made the statement last week before the Members of the House Committee on Appropriations—I am going to take a fresh look, and if we believe we need more resources on the enforcement side, we will bring forward proposals.

This is a way of making sure that we can actually get to the inventory that is already out there and we will not need to actually even make that request. So, I think it is a pretty clean way of doing it.

Mr. POMEROY. Although, Commissioner, I just think under the circumstances of its implementation, it is not going to be comprehensive in its reach. You do not propose that you will be freeing up institutional resources by these private debt collectors to have them applied to other work. They are going to be doing the same thing. These just go to pots of unrecovered debt that are sitting there unintended to; is that correct?

Mr. EVERSON. That is absolutely correct, sir.

Mr. POMEROY. Reclaiming my time to make my point, you talk about going after not those that involve some discretionary call or elaborate review of the legitimacy of the tax shelter, but rather debt where they have made some payments and then fallen off, or they have filed a return, and the check does not match what they owe. So, they indicate they are trying but they do not quite get there, but they need a little prod. They need a little kick in the backside to pay what they owe, and you and I are absolutely in accord on that. People need to pay what they owe and the IRS has to establish its absolute credibility and seriousness that it is going to demand enforcement.

You are going to be required to pay what you owe or there will be consequences. I do not know how we run a tax program without that deeply imbedded in our institutional framework——

Mr. EVERSON. Right, yes.

Mr. POMEROY. The people's understanding of government. The only things certain are death and taxes.

Mr. EVERSON. Yes.

Mr. POMEROY. Tax collection is part of taxes.

Mr. EVERSON. It should be, yes.

Mr. POMEROY. If we get to this situation where the only people we are getting are those people that are filing a little bit and are paying a little bit and then not, it would seem to me that inherently that new effort is geared to middle and moderate income households. I would expect most of these would be in the $75,000 and below category. Wouldn't you, fairly?

Mr. EVERSON. That may very well be the case, but again in the budget request that the President has put forth, he has asked for additional moneys to attack these other problems that you are referencing, and that I am very sensitive to as well. Honestly, I think we cannot afford to say that we are going to ignore any area. We have to have a feeling that there is an obligation to comply across

the spectrum of the taxpaying public, and clearly we are going to target and work very heavily in coming months on the corporate abuses, the tax shelters, the offshore schemes, all of these areas. That is where we are going to put the appropriate resources.

Mr. POMEROY. Commissioner, I think that the public is going to look at this with somewhat of a jaundiced eye if, for example, the Senate has proposed this in a pay-for as part of their tax bill. Now, I do not know what their bill is by way of breakdown, but the bill that came out of this Committee had about 75 percent of the tax relief going to the top 5 percent in terms of income of U.S. households over the next 10 years.

If connected with that, we have a new collection initiative using private bill collectors sent out across the land targeted at those under $75,000 as part of the same package, that is going to seem viciously unfair to people.

On the one hand, if you are $75,000 and below, you do not get much under the tax bill, and by the way expect a call because we are going to send some private bill collectors after you to collect the debt you owe. I think that maybe Congress will want to think long and hard about whether we want to cobble both of those elements in the same package if this is a legitimate endeavor, and I certainly respect the seriousness and professionalism of your approach in trying to collect what is owed to the IRS.

This would be a bad way to start it, I think. I think there would be a lot of cynicism out there about this. Anyway, that is not a IRS issue. That is a political issue, but I very much appreciate your testifying today. I yield back, Mr. Chairman. Thank you.

Chairman HOUGHTON. Just to pick up on that a little bit, maybe I misunderstood, but I do not think you were thinking of picking on any one particular group. There is a whole variety of people who are fudging on their taxes willfully or just out of ignorance. You are trying to do that, and then in terms of the 5 percent figure, you know the whole concept is when you put a tax bill in, you ask people in the higher categories to pay more of the tax, and when you take a tax off, they are in necessity of relief that they would not have gotten under ordinary circumstances.

So, I think what you are trying to do, if I understand it—I do not mean to be answering your question—but to try to even this thing out.

Let me ask you another question. You plan to require companies to comply with this so-called Fair Dept Collection Practices Act (FDCPA), which is a tough consumer law that regulates the private debt collection industry. Can you explain what this means and why it is important?

Mr. EVERSON. Well, yes, Mr. Chairman. There will be a very rigorous procurement process to make sure we get qualified effective organizations but also those that will act responsibly in the conduct of this matter. My understanding of that act is that it governs issues such as PCAs' conduct relative to harassing people at certain hours, odd hours of the day or night, and the FDCPA very much controls what kind of contact they can or cannot make with the individual that owes the money. So, we will be following that.

It is my understanding that this process is being practiced by the Education Department. It is not a statutory requirement, but it is

one they impose on their collectors, so it is not as if new ground is being broken here, sir. I think this is well understood out in the industry as to how that applies. We will absolutely assure that standards regarding contact with individuals are applied. We will go beyond that, in fact.

I would note, again, that in the Education Department, the PCAs actually have some authority to settle and negotiate some of these issues. We are not giving that authority to the PCAs. Under our proposal, the PCAs would be limited to call up and say, Mr. Pomeroy, you have a balance due of $10,000; would you like to pay that? Would you like to pay that all at once? Would you like to pay that over a period of up to 3 years?

Mr. POMEROY. This is a hypothetical example, Mr. Everson?

Mr. EVERSON. I am not allowed to disclose any individual taxpayer information.

Chairman HOUGHTON. He says he is going to refer it to Mr. Houghton who has got to pay even more.

[Laughter.]

Mr. EVERSON. Anyway, that is how it would work and, yes, we would adhere to that.

Chairman HOUGHTON. I have another. We have spent a lot of time and money in terms of the computer system and the methods of managing cases. We assume that that is going to go hand-in-hand with this other program. We are just not going to stop.

Mr. EVERSON. No, Mr. Chairman, you are absolutely right. My understanding is that this would require an additional incremental investment now, something $10 to $15 million, to develop a system, because we have to work very carefully with the PCAs in terms of the data they would gather. It would be very limited. Once you establish a program where somebody agreed to pay over a 3 year period, you have to make sure you are able to track it, and that information is fed into the IRS.

So, we will have to find some money and we will do this. The IRS spends $2 billion a year on Information Technology (IT), so I would like to believe that we will be able to find money to get this system going and there will be overall work on collection systems as part of the bigger modernization effort as well.

Chairman HOUGHTON. Well, I do not have any other questions. Do you, Earl?

Mr. POMEROY. No, I think we have covered it.

Chairman HOUGHTON. All right. Good. Listen, thank you very much. I certainly appreciate your coming in. We look forward to working with you.

Mr. EVERSON. Thank you.

Chairman HOUGHTON. Now the second panel is Ms. Nina Olson, National Taxpayer Advocate of the IRS; Ms. Pam Gardiner, Acting Treasury Inspector General for Tax Administration (TIGTA), in the Treasury Department; Ms. Colleen Kelley, President of the National Treasury Employees Union (NTEU); and Mr. Alan Felton, who is the Assistant Secretary for Examinations and Collections in North Carolina Department of Revenue.

Ladies, gentlemen, we are delighted to have you here, and do not forget that there is a 5 minute rule, and if you can do it any short-

er than that, that would be okay also, whatever you want, but watch that red light.

So, why don't we start, Ms. Olson, with you, if you are ready. If not, we will wait for you.

STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE

Ms. OLSON. Thank you, Mr. Chairman.

Chairman HOUGHTON. Okay. Thank you.

Ms. OLSON. This past year I have, in fact, worked closely with the IRS and Treasury Department so that taxpayer rights and confidentiality are protected in contract collection arrangements. As you know, the Federal Government cannot constitutionally delegate to private parties any power inherently governmental, as evidenced by the exercise of judgment and discretion. The government can contract out ministerial acts, but it must retain sufficient control over the private contractors to ensure against arbitrary or self-serving use of government power.

This oversight and control is particularly important where Federal tax debt is concerned because our tax system relies on the willingness of taxpayers to voluntarily report, file, and pay their taxes. That willingness will be eroded if taxpayers believe that the government or its contractors are acting capriciously in collecting the tax.

There is no question that the IRS must augment its current efforts to collect outstanding tax debts. It may be true that IRS employees are the best qualified and most efficient tax collectors. However, in the absence of funding to hire additional employees to work this inventory, PCAs could be used for the collection of those tax debts which by definition and careful selection are easily resolvable and not subject to dispute.

Of course, any such arrangement must meet constitutional requirements. Here are some of my major concerns for this type of arrangement. First, IRS employees and PCA employees must work on a level playing field. The PCA employees must be subject to the same restrictions and penalties for overreaching as are IRS employees. Otherwise, the IRS could get around taxpayer protections Congress enacted by simply contracting out tax collection.

The PCA employees should not be permitted to work on accounts other than IRS cases and information obtained from working an IRS account regardless of source cannot be used for a non-IRS account that the PCA has involving that taxpayer.

Consumer groups and tax professionals have raised several issues including the IRS's ability to conduct live as well as taped monitoring of taxpayer calls, the application of FDCPA to the PCAs without exception or exemption, and limits on the use of subcontractors.

Using subcontractors increases the IRS's oversight burden and could have the effect of weakening taxpayer protections including confidentiality of tax return information. We recommend that PCAs be prohibited from using subcontractors or leased employees in any activity that involves direct taxpayer contact or direct contact with or handling of taxpayer information in activities other than skip tracing.

The legislation should clarify that subcontract employees be subject to the same restrictions and liabilities as PCA employees. When a subcontractor violates a contract provision, it may be appropriate to impose a penalty on the contractor as well.

Today, IRS employee performance evaluation is based on balanced measures: employee satisfaction, customer satisfaction, and business results. The proper balance between these three aspects of tax administration creates good customer service and prevents abuses. Compensation arrangements with PCAs must reflect a similar approach.

If we do not structure compensation incentives properly, PCA employees may place taxpayers into inappropriate payment arrangements or fail to refer cases back to the IRS or the Taxpayer Advocate Service (TAS).

Proper case selection is essential for success of this program. If the IRS does not select cases carefully, PCA employees will send these cases back to the IRS to be worked. We will have a new backlog of cases, having resurrected the taxpayer from one queue only to be placed into the black hole of yet another queue.

Finally, taxpayers must have access to the TAS. The PCA employees must advise taxpayers that if they are experiencing a significant hardship, TAS may be able to help. Moreover, the National Taxpayer Advocate should have the same statutory authority to intervene in a PCA case and over PCA employees as she has over other IRS employees. She must also have the authority to issue a taxpayer assistance order to remove the case from the PCA to the IRS for consideration.

When I was in private practice representing taxpayers in State tax collections by PCAs, I witnessed first-hand many of the abuses that the IRS proposal tries hard to avoid. Because of these experiences and the concerns expressed by many others, I have worked with the IRS and Treasury Department to structure a proposal that if authorized will be a model for protection of taxpayer rights. Although I would prefer that we not contract out collection of tax debts, I believe that this proposal can meet constitutional requirements, create a level playing field, protect taxpayer rights and confidential information and actually result in fair and accurate tax collections.

Should Congress authorize the use of PCAs to collect Federal tax debt, my office will actively monitor its implementation. Thank you for the opportunity to speak today.

[The prepared statement of Ms. Olson follows:]

Statement of Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service

Mr. Chairman and members of the committee, thank you for inviting me here today to testify about the proposal to contract out the collection of certain categories of tax debt to private collection agencies. I must state at the outset that I have a level of discomfort with the concept of using private collection agencies (PCAs) based on my earlier professional experiences representing taxpayers in states that utilize PCAs.[1] Much to their credit, both the Department of Treasury and the Internal

[1] Internal Revenue Service: The Commissioner's Final Report: Hearing before the House Comm. On Gov't. Reform, Subcomm. on Gov't. Efficiency, Financial Management and Intergov-

Continued

Revenue Service have included the Office of the Taxpayer Advocate in the development of this proposal and have sought to accommodate my office's concerns wherever and whenever possible. In my testimony today, I will outline some of those concerns and the proposal's attempts to address them.

The Inherently Governmental Nature of Tax Collection

As early as 1819, the United States Supreme Court recognized that the Federal Government's taxing power is ancillary to its sovereignty.[2] In McCulloch v. Maryland, Chief Justice Marshall stated that the power to tax "is an incident of sovereignty, and is coextensive with that to which it is incident." Thus, that power—to assess and collect taxes—is "inherently governmental." The hallmark of an inherently governmental function is one that requires the exercise of discretion in interpreting and executing the law. It is a function that is recognized as "so intimately related to the public interest as to mandate performance by Government employees. . . ."[3] An inherently governmental function cannot be delegated by the government to private parties.[4] A ministerial function, however, may be delegated to private parties.[5]

Within these constitutional parameters, Congress has broad authority to delegate such governmental powers. Such delegations must establish clear standards that detail how and when private parties may exercise government power. The delegating governmental body must conduct sufficient oversight, including the establishment of procedural safeguards, and retain sufficient control over private delegates to ensure against arbitrary or self-serving use of government power. Under such delegations of government authority, private parties are essentially limited to advising the government and performing ministerial acts. Functions involving the exercise of discretion are reserved to the government itself.

Where the Federal Government seeks to delegate the collection of federal tax debt to private parties, the activities must be limited to those that do not involve the exercise of discretion. The Federal Government must structure the terms of the contract and its implementation so that the government has close oversight and control. The head of the delegating agency must retain the authority to resolve disputes, compromise claims or terminate the collection action.[6] Finally, the Federal Government cannot dilute the rights and protections taxpayers otherwise enjoy merely by contracting out certain functions to private parties.

The Unique Nature of Tax Debt

I believe that taxes are fundamentally different from other types of debt owed to the Federal Government for several reasons. First, unlike other federal obligations, taxes are the "lifeblood" of the government.[7] Second, because our tax system relies on the willingness of taxpayers to voluntarily report, file, and pay their taxes, there is the potential for an erosion of that willingness, if taxpayers believe that the government or its contractors are acting capriciously in collecting the tax. Third, the correct tax liability often cannot be determined from the "four corners" of the taxpayer's own return or even an IRS notice, thus, taxpayers are allowed to dispute the correctness of a tax assessment, including their *own* original assessment on a return. Taxpayers, the IRS and the courts are often called upon to interpret the Internal Revenue Code and regulations to determine the actual tax debt, and taxpayers can challenge the amount of actual liability up to two years after their last payment. These qualitative differences between tax debts and other government accounts raise, in turn, serious practical challenges for contracting out the collection of federal tax debt.

The Current Tax Gap and Potentially Collectible Inventory

Today, the Internal Revenue Service has a known $78 billion inventory of potentially collectible debt, up from $68 billion in September, 2000. Of the $78 billion potentially collectible inventory (PCI), approximately 38 percent is in inactive status. This is debt that the taxpayer has either agreed is due and owing and/or on which

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ernmental Relations, 107th Cong. 107–169 (2002) (Statement of Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service).

[2] Marshall v. McColloch, 17 U.S. 316, 429 (1819).

[3] OMB Circular No. A–76, § 6(e) (1999). The proposed revision of OMB Circular No. A–76 states at (E)(1) that "[a]n inherently governmental activity is an activity that is so intimately related to the public interest as to mandate performance by governmental personnel." (November 14, 2002.)

[4] Carter v. Carter Coal Co., 298 U.S. 238 (1936).

[5] In the context of interest abatement, the IRS defines a ministerial act as one that does not involve the exercise of judgment or discretion. Treas. Reg. § 301.6404–2(b)(1).

[6] 31 U.S.C. § 3718(a).

[7] Bull v. United States, 295 U.S. 247, 259 (1935).

the taxpayer has made at least three payments, yet the IRS is unable to collect because it cannot locate the taxpayer or does not have sufficient resources.

Most commentators, practitioners, and IRS employees believe that the IRS can collect federal tax debt more efficiently than private contractors. The IRS possesses many powerful tools with which to collect debt. The application of liens, levies, other seizures, compromises of tax, abatements of penalties and interest, the determination of allowable expenses for purposes of an installment agreement or "currently not collectible" hardship status—all of these procedures involve the exercise of discretion. Issues arise in the course of tax collection that may require the IRS to revisit the underlying tax liability. Any attempt to collect tax is also an opportunity to educate the taxpayer about his or her rights and obligations under the Internal Revenue Code. As government employees, IRS employees are trained in aspects of these procedures and are, to various degrees, authorized to exercise discretion, where appropriate, in the collection of federal tax debts.

However, Congress can reasonably conclude that it would make sense for these valuable IRS resources to be applied to those aspects of tax enforcement, including collection of intractable or elusive tax accounts, that absolutely require the unique skills IRS employees possess. Within constitutional boundaries, private contractors could reasonably be used for the collection of those tax debts which, by definition and careful selection, are easily resolvable and not subject to dispute.

The Level Playing Field

Particularly with respect to the collection of federal tax debt, Congress has seen fit to provide taxpayers with significant due process protections and to place restrictions or requirements on IRS employees whose function is to collect federal taxes.[8] Any delegation of even ministerial authority must not dilute those rights but rather must ensure that IRS employees and contract employees operate on a level playing field. Otherwise, the IRS could subvert existing taxpayer protections by simply contracting out the collection of federal tax debt.

Therefore, any proposal for contracting out the collection of federal tax debt must, at a minimum, incorporate the following protections:

- Provisions similar to those under section 1203 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)[9] that protect the taxpayer from harassment, threats, retaliation, and that provide for similar sanctions (including termination of employment) against any PCA employee who, after investigation, has been found to have committed one or more of the prohibited acts.
- Contractor liability for PCA employees' negligent collection actions, to the same extent as is applicable to the IRS under IRC section 7433.
- Restrictions on taxpayer information shared with PCAs to that which is necessary for the PCA to locate the taxpayer and to collect the tax. Generally, this would only include the taxpayer's name, last known address, tax year, type and amount of tax liability, amount and date of payments made toward the tax debt, and the portion of the tax liability attributable to tax, penalty and interest.
- A prohibition that bars Private Collection Agency employees working on IRS accounts from working on any other PCA account. Similarly, any information obtained in the course of working an IRS account, whether from the IRS, from the taxpayer, or from some third source, cannot "migrate" to a non-IRS account that the PCA has involving that taxpayer.

Implementation Issues

There are, of course, significant practical concerns regarding the implementation of this proposal which would not only limit its success in terms of tax collection but also impose undue burdens on taxpayers. During the months I worked with Treasury and the IRS to ensure that taxpayer rights were protected, I heard from many tax practitioners, low income taxpayer clinics, and consumer groups. Here are some of the practical concerns raised by my office and others about this proposal.

Selection of Appropriate Cases. The IRS has stated that it will only send to PCAs those cases that meet the following criteria:

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[8] These procedures include the lien and levy collection due process hearings under IRC §§ 6320 and 6330; the right to appeal an offer in compromise or installment agreement determination under section 7122(d); the taxpayer protections under RRA 98 section 1203; and a right of action against the IRS for its employees' negligent collection activity under IRC § 7433.

[9] Pub. L. No. 105–206 (1998).

(1) the taxpayer has either agreed to the tax debt and/or has made three or more payments toward that debt; *and*

(2) the taxpayer appears to have the ability to pay this debt in full immediately or within 36 months.

It is vital to the success of this proposal that only those cases that fit these parameters are selected and referred to the PCAs. If PCA employees receive cases and make contacts with taxpayers, only to find that taxpayers frequently cannot full pay the tax debt either immediately or within 36 months; or they request penalty or interest abatements; or they are candidates for offers-in-compromise or currently-not-collectible status; or they challenge the underlying liability, then these cases, which must be referred back to the IRS for resolution because they require the exercise of discretion, will create a backlog and be counterproductive. We will have resurrected the taxpayer's account from the "black hole" of inactive potentially collectible inventory and contacted the taxpayer, only to have the account fall into another queue for the collection of unpaid taxes—albeit a specific, dedicated queue.

Thus, the Service's initiatives for case analysis and selection must be carefully planned, scrutinized, and funded. Systems must be in place to identify trends in case selection on an ongoing basis and to quickly alter the selection algorithms when problems arise.

Access to and Authority of the Office of the Taxpayer Advocate. IRS Publication 1, "Your Rights as a Taxpayer," describes the role of the Office of the Taxpayer Advocate and will be enclosed in each PCA contact letter. However, as a safeguard against any overreaching on the part of PCAs, PCA employees should advise taxpayers that if they are experiencing a significant hardship, the Taxpayer Advocate Service may be able to assist them. The Taxpayer Advocate Service must have the opportunity to provide training to PCA employees about how to recognize a significant hardship situation under IRC section 7811, so that if a PCA employee discovers a situation in his later dealings with the taxpayer, he can remind the taxpayer about access to the Taxpayer Advocate Service.

Finally, the National Taxpayer Advocate and her employees should have the same statutory and delegated authority to intervene in a PCA case and over PCA employees as they have over IRS employees, including the authority to issue a Taxpayer Assistance Order to the IRS to have the case removed from the PCA to the IRS for consideration. We do not have this authority today.

Compensation and Balanced Performance Measures. IRS employees are prohibited from being evaluated based on Records of Tax Enforcement Results.[10] Today, IRS employee performance evaluation is based on balanced measures—employee satisfaction, customer satisfaction, and business results. The proper balance between these three aspects of tax administration creates good customer service and prevents abuses. The compensation arrangements with the PCAs must reflect a similar approach. PCAs must be measured not only by the tax that they collect or the accounts they bring to resolution but also by the appropriate referrals they make back to the IRS or to the Taxpayer Advocate Service. Moreover, while it may be too much to expect that taxpayers contacted by the PCA will be happy that they are having to pay an aged tax debt, they can at least feel that they were treated professionally and courteously, that they received clear and helpful explanations about the debt, that their rights and recourse were clearly explained, and that their concerns were listened to and addressed. Thus, customer satisfaction should be prominently factored into PCA compensation.

In response to these concerns, the IRS plans to issue each PCA a monthly scorecard that will cover the three aspects of balanced measures, including customer satisfaction. Compensation will be tied to the scorecard results. Further, the IRS plans to tie the placement of future work (and future PCA revenue) to that score, such that it will place additional cases with those companies having the highest score. I do not know if this approach strikes the right balance to compensation; I believe this is an issue that Congress should review very carefully.

I am keenly aware that PCA compensation must be structured so that we do not create incentives for PCA employees to encourage taxpayers to enter into payment arrangements that they will not be able to keep or disincentives for PCA employees to refer cases back to the IRS or to the Taxpayer Advocate Service. If Congress authorizes the Secretary to contract out the collection of federal tax debt, my office will be closely monitoring the performance, evaluation, and compensation of PCAs.

Monitoring and Supervision of PCAs. During the development of this proposal, the IRS team (which included a representative of the Taxpayer Advocate Service) studied and visited several private collection agencies, including those that collected

[10] RRA 98 section 1204.

state tax debts and other federal agency debts. I, too, discussed this issue with tax professionals and advocates who represented individuals before private collection agencies. The IRS learned a great deal from all of these contacts and has designed what I think is a commendable approach to monitoring and supervising the PCAs.

Unlike many other agencies, the IRS intends to conduct live call monitoring in addition to taping calls to ensure that taxpayers are treated appropriately. The IRS will also have an on-site presence at each private collection agency. Cases referred from a PCA to the IRS for resolution will go to a dedicated unit, so that the IRS can monitor the effectiveness of referrals and quickly resolve open issues.

The Office of the Taxpayer Advocate will actively monitor the implementation of this initiative. Referrals from PCAs to the Taxpayer Advocate Service will go to one or two locations so that my office can quickly analyze and identify trends. My office will independently review all of this information and make recommendations for improvement of protections, oversight, training and other issues. An analyst from my office will work routinely and directly with the IRS to discuss and share any suggestions and trends. Finally, I will include regular reports on this initiative in my annual reports to Congress under IRC section 7803.

Fair Debt Collection Practices Act. It is my understanding that the Fair Debt Collection Practices Act[11] will apply, without exemption or exception, to all private collection agencies under this proposal. I believe that this is an important distinguishing feature between the IRS proposal and other federal or state agencies' use of private debt collectors. That is, other government agencies either do not apply the provisions of the FDCPA to their private collection contractors or exempt these contractors from some provisions of the Act.

PCA Use of Subcontractors. The use of subcontractors or leased employees by private collection agencies in the course of collecting federal taxes raises several difficult issues. Since protecting the confidentiality of taxpayer information is paramount, the use of subcontractors to collect taxes, or to process taxpayer correspondence, or even to prepare and mail notices to taxpayers will impose additional oversight burdens on the IRS, essentially forcing it to monitor two entities for conformity with taxpayer protections. The use of a subcontractor may be thought to be a means to dilute the liability of a contractor for violation of taxpayer rights or other provisions. On the other hand, it may be industry practice to contract out certain activities, such as skip-tracing.

In light of these concerns, my office recommends that PCAs be prohibited from using subcontractors or leased employees in any activities that involve (1) direct taxpayer contact or (2) direct contact with or handling of taxpayer information in activities other than skip-tracing. The legislation should specifically address this issue, and should clarify that employees of permitted subcontractors are subject to the same restrictions and to the same liability as PCA employees with respect to federal tax collection. In fact, where a subcontractor has violated one of the contract provisions, it may be appropriate to impose a penalty on the contractor as well. This penalty regime would reinforce the need for serious oversight of subcontractor activities.

Correspondence with Taxpayers. The reporting, filing and payment of taxes is the primary contact most taxpayers have with the Federal Government on a routine basis. Since our tax system depends on the willingness of taxpayers to come forward and voluntarily report, file and pay taxes, the IRS must take every step necessary to reassure taxpayers that their rights and their tax information are secure. I believe that taxpayers may be alarmed if they receive a letter, direct from a PCA, requesting payment of their federal tax debt. I believe this is true even where those same taxpayers are accustomed to dealing with PCAs for collection of student loans or state taxes. I attribute this to the unique nature of federal tax debt, discussed above, and to the fact that Congress has afforded federal taxpayers with rights and protections that exceed those available with respect to other federal agency or state tax debts.

Thus I believe that the first communication with a taxpayer whose account will be handled by a PCA should come from the IRS. This letter should clearly inform the taxpayer that a PCA will be contacting the taxpayer; it should outline what the taxpayer has the right to expect of the PCA, both in terms of PCA conduct and case resolution, and it should provide the taxpayer with a toll-free number for reporting PCA misconduct or grievances. The IRS letter would then be followed by the PCA's initial contact letter, which would include Publication 1. This sequence of letters would clearly inform the taxpayer of this new program and his or her rights thereunder (a communication that should come directly from the tax agency itself) while minimizing the possibility that the taxpayer will call the IRS directly to resolve the debt.

[11] 15 USC § 1692.

Conclusion

The use of private collection agencies to collect federal tax debt is a complex issue. There is a clear need to work the tax debt that is languishing in our inactive but potentially collectible inventory—a need not just based on revenue but also on fairness to all other taxpayers who are dutifully paying their tax debts. Moreover, the IRS has many other demands on its use of limited resources and personnel; indeed, some of these demands, such as stemming various abusive tax schemes, threaten to undermine the very confidence in the tax system we are seeking to protect. In light of these competing concerns, PCAs appear a limited but reasonable option.

However, I represented taxpayers in state tax collections by PCAs when I was in private practice. I witnessed first-hand many of the abuses that the IRS proposal tries hard to avoid. Because of these experiences, and the concerns expressed by many practitioners, IRS employees, consumer groups, and taxpayers, I have worked with the IRS and Treasury to structure a proposal that, if Congress so authorizes, will be a model for federal debt collection in terms of the protection of taxpayer rights. My office will be watching closely to ensure that, if authorized and implemented, this initiative succeeds in meeting its constitutional requirements, creates a level playing field between IRS and PCA employees, protects taxpayer rights and confidential information, and actually collects the correct amount of tax due.

Chairman HOUGHTON. Thank you very much. Now, Ms. Gardiner.

STATEMENT OF PAMELA J. GARDINER, ACTING TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, U.S. DEPARTMENT OF THE TREASURY

Ms. GARDINER. Mr. Chairman, Ranking Member Pomeroy, I appreciate the opportunity to appear before you today to discuss the IRS's progress regarding the use of collection agencies and my office's work in assessing this progress.

The use of collection agencies to assist in the collection of Federal tax debt is not a new concept. In 1996, the IRS piloted the use of collection agencies and after a detailed internal evaluation concluded that their use was not economically viable.

The IRS's current approach, however, differs significantly from the prior methodology. Most importantly, in 1996, the collection companies were compensated with moneys from the IRS's appropriated funds. In contrast, as part of its 2004 budget submission, the IRS has requested authority to fund the use of collection companies directly from the moneys collected by those companies from taxpayers.

The IRS plans to eventually place 2.6 million cases annually with collection companies. The Treasury Department projects that this initiative will produce revenue of as much as $1 billion through 2013. While this amount is significant, it represents a small portion of the $280 billion accounts receivable that were due at the end of fiscal year 2002.

In a recent audit report, TIGTA identified that the IRS's preliminary planning efforts for using collection companies were extensive. The IRS carefully evaluated similar programs at other Federal and State government entities such as the Education Department and the State of Virginia, contacted subject matter experts regarding industry best practices, issued a draft request for quotation on February 14, 2003, and subsequently held an informational conference to solicit feedback and answer questions from potential contractors regarding the IRS's requirements.

Although these efforts were good, TIGTA identified several areas where IRS planning could be enhanced: additional focus on the development of management information to improve the IRS's ability to oversee the program; better development of detailed requirements to help ensure taxpayer rights and privacy are protected; and a more measured initial release of cases to collection companies to provide IRS more data to determine staffing needed to effectively support this initiative.

The IRS management agreed with all of these recommendations and indicated that they have already implemented corrective actions to address the findings in our report.

One issue warranting future attention which is critical to the success of the program is the process of selecting which cases are given to the contractors. In the 1996 IRS pilot, most of the cases delivered to the collection agencies were small dollar delinquencies normally collected by the IRS at a minimal cost.

However, the case selection process has changed over time at the IRS. In fact, the IRS has recently changed the methods used to determine which cases it works internally. These changes will affect the types of cases that the contractors receive, but the IRS has not yet officially finalized the method for selecting cases for this new initiative.

We are also concerned generally with IRS's contract administration and oversight of contractors. The TIGTA has issued several audit reports and conducted investigations of alleged criminal or civil misconduct in the procurement area in the last 3 years, finding such things as:

Employees at one lockbox bank lost or destroyed more than 70,000 taxpayer remittances worth more than $1.2 billion, and another 71 investigations identified 14 instances of thefts of receipts valued at close to $2 million; an IRS employee ensured certain companies received contracts in exchange for illegal payments; and, a contractor was not in compliance with the terms of its contract resulting in increased security risk at some IRS locations.

The IRS proposal to contract out the collection of delinquent accounts to private collection companies has the potential to recover a significant amount of IRS accounts receivable. Nonetheless, we will want to watch the effort closely to ensure the dual risks of protecting taxpayer rights and effective contract administration are addressed. This concludes my statement.

[The prepared statement of Ms. Gardiner follows:]

Statement of Pamela J. Gardiner, Acting Treasury Inspector General for Tax Administration, U.S. Department of the Treasury

Mr. Chairman, Ranking Member Pomeroy, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the IRS's progress regarding the use of collection agencies and my office's work in assessing this progress.

The use of collection agencies to assist in the collection of federal tax debt is not a new concept. In 1996 the IRS piloted the use of collection agencies, and after a detailed internal evaluation, concluded that their use was not economically viable. The IRS' current approach, however, differs significantly from the prior methodology. Most importantly, in 1996 the collection companies were compensated with monies from the IRS's appropriated funds. In contrast, as part of its 2004 budget submission, the IRS has requested authority to fund the use of collection companies directly from the revenues collected by those companies.

The IRS plans to eventually place 2.6 million cases annually with collection companies. Treasury projects that this initiative will produce revenue of as much as $1 billion through 2013. While this amount is significant, it represents a small portion of the $280 billion in accounts receivable that were due at the end of FY 2002.

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Although these efforts were good, TIGTA identified several areas where IRS planning could be enhanced:

- Additional focus on the development of management information to improve the IRS's ability to oversee the program.
- Better development of detailed requirements to help ensure taxpayer rights and privacy are protected.
- A more measured initial release of cases to collection companies to provide IRS more data to determine staffing needed to effectively support this initiative.

IRS management agreed with all of these recommendations and indicated that they have already implemented corrective actions to address the findings in our report.

One issue warranting future attention, which is critical to the success of the program, is the process of selecting which cases are given to the contractors. In the 1996 IRS pilot, most of the cases delivered to the collection agencies were small dollar delinquencies normally collected by the IRS at a minimal cost. However, the collection case selection process has changed over time at the IRS. In fact, the IRS has recently changed the methods used to determine which cases it works internally. These changes will affect the types of cases that the contractors receive, but the IRS has not yet officially finalized the method for selecting cases for this new initiative.

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- Employees at one lockbox bank lost or destroyed more than 70,000 taxpayer remittances worth more than $1.2 billion, and another 71 investigations identified 14 instances of thefts of receipts valued at close to $2 million.
- An IRS employee ensured certain companies received contracts in exchange for illegal payments.
- A contractor was not in compliance with the terms of its contract resulting in increased security risk at some IRS locations.

The IRS's proposal to contract out the collection of delinquent accounts to private collection companies has the potential to recover a significant amount of IRS accounts receivable. Nonetheless, we will want to watch the effort closely to ensure the dual risks of protecting taxpayer rights and effective contract administration are addressed. This concludes my statement. For further information on the Treasury Inspector General for Tax Administration's (TIGTA) work related to the use of debt collection agencies, see:

Management Advisory Report:
Additional Options to Collect Tax Debts Need To Be Explored
July 2001
Reference Number: 2001–40–122
http://www.treas.gov/tigta/2001reports/200140122fr.pdf

Efforts to Develop a Successful Collection Contract Support Program Could Be Enhanced
March 2003
Reference Number: 2003–30–075
http://web.tigta.treas.gov/aci-ia/03–AuditProgram/03–AuditReports/FY03AuditReports/06Mar03/200330075fr.html

Chairman HOUGHTON. All right. Well, thank you very much. Ms. Kelley.

STATEMENT OF COLLEEN M. KELLEY, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Ms. KELLEY. Chairman Houghton, Ranking Member Pomeroy, I very much appreciate the opportunity to share the view of frontline IRS employees on turning over IRS tax collection responsibilities to private debt collectors.

The NTEU strongly opposes hiring private tax collection agencies on a commission basis to collect tax debt. This proposal will cost the taxpayers more money than having this work done by IRS employees, and it will jeopardize the rights and the privacy of thousands of taxpayers by putting private taxpayer files in the hands of private companies.

I urge the Subcommittee to reject this. If given the appropriate resources, IRS employees could collect outstanding tax debt at significantly less cost than contractors and avoid subjecting taxpayers to the unknown impact of providing their confidential tax information to private collection companies.

In a report submitted to the IRS Oversight Board last September, former Commissioner Charles Rossotti made clear that with more resources to increase IRS staffing, the IRS would be able to close the compliance gap. Commissioner Rossotti stated that the IRS is simply outnumbered when it comes to dealing with the compliance risks.

The Rossotti report found that while workload had increased 16 percent over the last 10 years, the number of full-time employees dropped from 115,000 in 1992 to 95,000 in 2001. A disproportionate reduction occurred in field compliance personnel falling 28 percent from 29,000 in 1992 to 21,000 in fiscal year 2002.

The Rossotti report quantified the workload gap noting that the majority of the workload gap is in compliance. It found that if Congress were to appropriate an additional $296 million to hire additional IRS compliance employees to focus on field and phone accounts receivable, the IRS could collect an additional $9.47 billion in known tax debts per year.

In other words, for every dollar spent on implementing Commissioner Rossotti's plan, a net of $31 will be collected. Compare that to the administration's 25 percent commission scheme, $3.25 billion to collect $13 billion, that under the best case scenario nets only $3 for every taxpayer dollar spent versus the $31 if IRS employees were doing this work.

According to the Joint Committee on Taxation, the administration's tax collection privatization proposal would bring in less than $1 billion over 10 years. The IRS could bring in that amount in 1 year with the appropriate resources. Steadily increasing compliance staffing levels at the IRS will give the taxpayers a return on their tax dollar that is 10 times better than the privatization initiative being proposed.

I would note that in a report issued just last week on May 7 by the U.S. General Accounting Office (GAO), they noted that the IRS has not done a cost analysis on implementing the PCA initiative versus expanding the traditional use of IRS collection activities, and GAO noted we have not seen any plans to do so in the future.

Tax collection has historically been defined as an inherently governmental function. As a result, legislation is necessary to allow

contractors to perform this function. Two pilot projects were authorized by Congress to test the private collection of tax debt in 1996 and 1997.

The 1996 pilot was so unsuccessful that the 1997 project was canceled. Contractors violated the FDCPA and did not protect the security of sensitive taxpayer information. An IRS internal audit report found that contractors made hundreds of calls to taxpayers outside of the time restrictions of the FDCPA, and calls were placed as early as 4:19 a.m.

In addition, the contractors did not bring in anywhere near the dollars they projected and millions were spent by the IRS to train the contractors instead of doing their IRS work.

The IRS has said that it has learned from the 1996 project and can now address the problems. The IRS has not shown, however, that it has contractor oversight systems or personnel in place to ensure that contractors comply with the laws and regulations that are in place to protect the taxpayers.

The Mellon Bank lockbox program has already been mentioned as an example of the failure of contractor oversight by the IRS on this project.

Section 1204 of the IRS Restructuring and Reform Act (RRA) 1998 (P.L. 105–206) also specifically prevents IRS employees or supervisors from being evaluated on the amount of tax collections they bring in. This was done to eliminate incentives for overly aggressive tax collection techniques.

Paying a contractor a percentage of what they collect clearly flies in the face of this policy and ensures that the employees of the contractors will do what they need to do to produce, knowing that they won't have a job if they do not.

The NTEU is not alone in opposition to this proposal. Earlier this month, the National Association of Enrolled Agents testified about the risk of taxpayer information being released, and the Tax Section of the American Bar Association pointed out paying vendors a percentage of collections is inconsistent with RRA 1998.

The risk of paying contractors commissions to collect taxes are great. Instead, the IRS should increase compliance staffing levels at the IRS so that the IRS employees can do the work that they do very well, and if funded to do so, there is no one who could do this work better on behalf of America's taxpayers. Thank you.

[The prepared statement of Ms. Kelley follows:]

Statement of Colleen M. Kelley, National President, National Treasury Employees Union

Chairman Houghton, Ranking Member Pomeroy, and other distinguished Members of this subcommittee, my name is Colleen Kelley and I am the National President of the National Treasury Employees Union (NTEU). NTEU represents 150,000 federal employees in 28 federal agencies and departments, including the men and women who work at the Internal Revenue Service (IRS). I appreciate you giving me the opportunity to share the views of frontline IRS employees on turning over IRS tax collection responsibilities to private debt collectors.

Let me be very clear: NTEU strongly opposes hiring private tax collection agencies on a commission basis to collect tax debt. This proposal will cost the taxpayers more money than having this work done by IRS employees, and will jeopardize the rights and privacy of thousands of taxpayers by putting millions of taxpayer files in the hands of private companies. There are also serious questions regarding the government's liability and taxpayer remedies should such information be misused and whether the IRS has the needed technology to select appropriate cases. This

scheme is costly, risky, and would lead to a gross invasion of the privacy of American taxpayers. I urge this subcommittee to reject it.

Spending Taxpayer Dollars Wisely

Even the IRS will acknowledge that if given the appropriate resources, IRS employees could collect outstanding tax debt at significantly less cost than contractors and avoid subjecting taxpayers to the unknown impact of providing their confidential tax information to private collection companies. In a report submitted to the IRS Oversight Board last September, titled "Assessment of the IRS and the Tax System," former Commissioner Charles Rossotti made clear that with more resources to increase IRS staffing, the IRS will be able to close the compliance gap. Commissioner Rossotti stated that "the IRS is simply out-numbered when it comes to dealing with the compliance risks."

The Rossotti report found that while workload had increased 16% the number of full time employees dropped from 115,205 in FY 1992 to 95,511 in FY 2001. A disproportionate reduction occurred in Field Compliance personnel, falling 28% from 29,730 in FY 1992 to 21,421 in FY 2002. From 1997 through 2002 the IRS has lost an additional 2,952 employees.

The Rossotti report quantified the workload gap, noting "the majority of the workload gap is in compliance." (See attached charts.) It found that if Congress were to appropriate an additional $296 million to hire more IRS compliance employees to focus on Field and Phone Accounts Receivable, the IRS could collect an additional $9.47 billion in known tax debts per year. This would be a $31 dollar return for every dollar spent. Compare that to the Administration's 25% commission scheme—$3.25 billion to collect $13 billion or a $3 dollar return for every dollar spent. According to the Joint Committee on Taxation, the Administration's tax collection privatization proposal would bring in less than $1 billion over ten years. The IRS could bring in that amount in one year with just over $30 million in additional in-house enforcement resources.

Plain and simple, we can avoid putting taxpayer information in the hands of private collectors by steadily increasing compliance staffing levels at the IRS and, in the process, give the taxpayers a return on their tax dollar that is ten times better than the privatization initiative being proposed. Yes, I am a certified public accountant, but this is math my six year old nephew understands.

Privatization of Tax Collection Was Tried and It Failed

Tax collection has historically been defined as an inherently governmental function, and therefore private contractors have been prevented from bidding for this work. As a result, legislation is necessary to allow contractors to perform this inherently governmental function. Two pilot projects were authorized by Congress to test private collection of tax debt for 1996 and 1997. The 1996 pilot was so unsuccessful that the 1997 project was cancelled. Contractors violated the Fair Debt Collection Practices Act (FDCPA) and did not protect the security of sensitive taxpayer information and the IRS officials charged with oversight of the contracts were ill-informed of the law and lax in their duties, failing to cancel the contracts of those in violation even though they had the authority to do so.

An IRS Internal Audit Report (Reference No. 080805, 12/19/97) found that reviews of only a small number (18 to 40 days) of telephone records for three contractors found 294 instances of completed calls placed before 8 a.m. or after 9 p.m., the times prohibited by the act. Calls were placed as early as 4:19 a.m. (p. 15). The audit found that IRS "Collection officials were unaware that phone calls to third parties to locate debtor taxpayers were subject to the time frames of the FDCPA." (p. 15). It found that required weekly reviews of contractor telephone reports were not being done. (p. 16). And the audit found that contractors did not adequately protect sensitive taxpayer information. "System security at some contractor sites did not meet contractual requirements or did not provide adequate protection over sensitive taxpayer data." (p. 20)

In addition to using prohibited collection techniques and not safeguarding confidential taxpayer information, the contractors did not bring in anywhere near the dollars they projected, and millions were spent by the IRS to train the contractors and millions were not collected by IRS employees because they were training the contractors instead of doing their jobs. (See GAO/GGD–97–129R and IRS Private Debt Collection Pilot Project, Final Report, Oct. 1997)

Some supporters of private tax collection say the pilot was flawed due to the kind of cases given to the contractors. But technology to do the kind of analysis of what kind of cases might be successful, as both the GAO and the Taxpayer Advocate have

said would be necessary, is not in place and, in fact, such proposals were dropped from the President's FY '04 budget submission.

The Inability of the IRS to Manage its Contractors

The IRS has said that it has learned from the 1996 project and can now address the problems raised. However, even very recent evidence is to the contrary. As this subcommittee is well aware, the contractor-led IRS Business System Modernization continues to have cost overruns and delivery delays. For example, A Treasury Inspector General for Tax Administration (TIGTA) report issued in September 2002 (Ref. #2002–20–189) criticized the PRIME contractor, stating, "progress has been slower and more costly than expected. Project dates were delayed from 4 to 9 months, while cost increases ranged from nearly $700,000 to over $13 million from original estimates."

Another example of poor IRS management of contractors came to light recently when an IRS contractor who provided bomb detection dogs and services to patrol the perimeters at the IRS Service Center in Fresno was indicted on 28 charges after he lied about the qualifications of his dogs, then faked the dogs' certifications to keep his business with the IRS and other federal agencies.

And members of this subcommittee may be familiar with the troubling case of Mellon Bank, a contractor hired by the IRS as part of its "lockbox program." Mellon Bank lost 78,000 taxpayer checks worth more than $1.2 billion in revenues for the U.S. Treasury. In response to the Mellon Bank contracting fiasco, GAO issued a report in January 2003 on the IRS lockbox program titled, "IRS Lockbox Banks: More Effective Oversight, Stronger Controls, and Further Study of Costs and Benefits Are Needed" (GAO–03–299). The report highlighted a number of deficiencies of the lockbox program that are very relevant to the proposal to privatize tax collection. Here is a sampling of some of the report's findings:

1. "Oversight of lockbox banks was not fully effective for fiscal year 2002 to ensure that taxpayer data and receipts were adequately safeguarded and properly processed. The weaknesses in oversight resulted largely from key oversight functions not being performed" (p. 3)
2. "Tax receipts and data were unnecessarily exposed to an increased risk of theft." (p. 21)
3. There were "deficiencies in processing controls designed to account for or protect tax data and receipts." (p. 27)
4. Contract "employees were given access to taxpayer data and receipts before bank management received results of their FBI fingerprint checks." (p. 29)

The IRS will likely testify that lessons have been learned from cleaning up after the Mellon contracting mess, and that contracts with tax collection contractors will be written in a way to protect the taxpayers. Yet even though the GAO found all of these flaws in the poor oversight and management of the lockbox contracts, GAO "found nothing inherent in the new 2002 lockbox bank contractual agreements or the prior agreements that would necessarily contribute to mishandling of taxpayer receipts" (p. 12). So in other words, thousands of privacy and security provisions designed to protect the taxpayers can be written into each and every one of these contracts with private collection agencies, but the bottom line is that the IRS cannot and will not be able to ensure taxpayers are protected. The IRS simply does not have the staffing or systems in place to monitor the work of contractors.

Failure to Safeguard Confidential Taxpayer Information From Criminals

Another problem that continues to threaten taxpayer confidentiality and will pose an even greater threat under this privatization proposal is the inability of the IRS to conduct background checks on contractors. A February 2003 report from the Treasury Inspector General for Taxpayer Administration (TIGTA) found that the IRS failed to conduct background checks on its contract employees. The report found that the IRS did not perform required background checks on more than 2,100 contract employees working in IRS offices in New Carrolton, Maryland who have access to sensitive taxpayer information.

Additionally, background checks that have been conducted on IRS contract employees are incomplete at best. Employees who work for the IRS must be U.S. citizens. However, there is no such requirement that government contractors hire only U.S. citizens, even if they will be reviewing sensitive private taxpayer information. While the IRS has indicated all employees working for the tax collection contractors will undergo background checks, GAO's January report on the lockbox program found criminal investigation controls to be inadequate. "This hiring practice may pose unnecessary risks to IRS materials because the FBI fingerprint check, which

is national in scope, may have very little information to disclose if these individuals lived in this country for only a short period of time." GAO raised concerns that lockbox contractors could hire "individuals with criminal histories which, in turn, increases the risk of theft of receipts or misuse of tax data." How much can even the FBI learn about an individual who has only lived in the U.S. for less than two years? The arrangement for the tax collection privatization initiative is even more suspect than the lockbox initiative, especially since some of the companies bidding for the work are not even based here in the United States.

Incentives for Private Debt Collectors to Harass Taxpayers

Allowing private collection agencies to collect tax debt on a commission basis flies in the face of the tenets of the IRS Restructuring and Reform Act of 1998 (RRA 98). Section 1204 of RRA 98 specifically prevents employees or supervisors at the IRS from being evaluated on the amount of collections they bring in. Yet despite RRA 98's clear mandate to ensure fair enforcement of the tax laws, the Administration is now proposing incentives for contractors to use aggressive collection techniques. Even if individual contract employees were not to be evaluated on the basis of their individual collection amounts, surely they will know that if they do not produce, they will not have a job. Paying a contractor out of its tax collection proceeds clearly encourages overly aggressive tax collection techniques, the exact dynamic RRA 98 sought to avoid.

Additionally, RRA 98 allows a taxpayer to recover damages from the Federal Government if an IRS employee is found to have inappropriately accessed or misused confidential taxpayer information. However, under H.R. 1169, such a taxpayer could only seek damages against the collection company, so if a contractor cannot pay a judgment the taxpayer is out of luck.

Poor Experience with Private Debt Collectors

The contractors will say that state and non-tax federal efforts have been wildly successful, but independent sources have a different view. On April 15, 2002, at a hearing before the House Government Reform Committee, National Taxpayer Advocate Nina Olson testified on private tax collection. She said "Few state and private creditors are subject to the significant due process protections enjoyed by Federal taxpayers in the post RRA 98 era. My own personal experience with private contractors attempting to collect State tax debt has not been positive. In my former tax practice, which included a large number of collection cases, I continually struggled with private collection employees of different skill levels and expertise. It was difficult to get a case out of the hands of the collection agency and back into the tax authority for issue resolution." She went on further to state "Contractors resisted revising inappropriate collection terms and agreements."

And the Department of Education's experience with using contractors to help prevent and collect defaulted student loans has been heavily criticized. A GAO report (GAO–03–531T) dated March 12, 2003, found that "neither Congress nor the public can determine whether FSA's (Office of Federal Student Aid) default management goals have been met." And a Department Inspector General Report (ED–OIG/A07–B0008) issued in November 2002, focused on FSA's Modernization Partner Agreement with its contractor. This IG report found that the performance measures to review the work of the contractor "did not provide sufficient quantifiable or qualitative information to determine if the contractor's performance was in accordance with the terms of the contract." The IG also criticized the Department for using inaccurate baseline information used to calculate payments to the contractor, which resulted in larger payments to the contractor than what should have been actually earned. No wonder contractors think this is a great program.

Widespread Opposition to Privatization of Tax Collection

NTEU is not alone in its opposition to this proposal. At a hearing on April 8, 2003 before this subcommittee, the Tax Executives Institute, an association of business tax professionals, testified that "using outside, for-profit contractors could impede taxpayer privacy and undermine the perception of fairness. Such concerns are even more acute if the companies are compensated on a contingency basis, which raises significant due process issues."

At that same hearing, the National Association of Enrolled Agents, testified in opposition to the tax collection privatization initiative, stating that "the opportunities for disclosure of taxpayer information combined with the potential for aggressive collection approaches inherent in a bounty-incentive approach runs counter to the protection of taxpayer rights."

And a representative of the Tax Section of the American Bar Association at the April 8th hearing urged caution, and pointed out that "paying vendors a percentage of collections appears to be inconsistent with the prohibition of collection statistics in the 1998 Revenue Reconciliation Act."

IRS employees were demoralized by the 1997 Congressional hearings and have worked hard to repair the damage to their image, much of which was due to inaccurate information. However, the American public rating of the IRS is significantly higher than what it was in 1997. Now, the Administration is going to turn around and tell the IRS workforce that private collection agencies will be let loose to recover unpaid tax debt? And if the contractors are overly aggressive and it turns out to be a repeat of the 1996 pilot project disaster, it will be the IRS employees labeled again as the jack booted thugs when the contractors are long gone.

The risks of privatizing tax collection are enormous. It is a disservice to the taxpayers, and a disservice to IRS employees to pay contractors a bounty to collect taxes. Instead of rushing to privatize, the IRS should make the necessary investments today in increased agency staffing, resources, and better training, so that the compliance gap can be closed without compromising taxpayer rights. When supported with the tools and resources they need to do their jobs, there is no one who is more reliable and who can do the work of the IRS better than IRS employees.

Thank you for giving me the opportunity to testify today.

Chairman HOUGHTON. Thank you very much, Ms. Kelley. Mr. Felton.

STATEMENT OF ALAN FELTON, ASSISTANT SECRETARY FOR EXAMINATION AND COLLECTION, NORTH CAROLINA DEPARTMENT OF REVENUE, RALEIGH, NORTH CAROLINA

Mr. FELTON. North Carolina began outsourcing collection cases to private contractors in late 2000. Currently, we have four collection agencies on contract, but only actively use two of the four—National Coordination Office Financial Services and Open Source Initiative outsourcing. We consider use of the contractors one strategy in a multifaceted collection program.

North Carolina uses PCAs to work lower value but high volume collection accounts. At the time we began the outsourcing program, we found that accounts with a $500 balance or less comprised two-thirds of our caseload, but only 10 percent of the value of our receivable inventory.

Outsourcing these low-yield cases and other low priority accounts allows the Department of Revenue to focus our internal resources on the remaining one-third of our cases that comprise 90 percent of the value of our receivable inventory.

By employing a comprehensive collection program, including the use of collection contractors, we have been able to increase delinquent tax collections by nearly $150 million between July 1, 2001 and April 30, 2003. This represents more than a 40-percent increase over previous years.

From our experience with PCAs, there are several lessons learned that may be helpful to keep in mind. Administration of the collection outsourcing program should be as simple as possible. Simplicity allows taxing agency administrators more time to focus on ensuring quality service and productivity and less time performing unnecessary administrative tasks.

North Carolina places its accounts on a contingency basis and only owes fees to the contractor after collections are processed and posted to the Department of Revenue system. This contingency ar-

rangement creates a real partnership between the Department of Revenue and the collection contractors.

We also recommend resisting the urge to micromanage the contractors' collection process. Providing clear goals and objectives, then allowing the contractor to determine the best way of accomplishing them seems to have been the best way to do this business.

Evaluation of contractor performance is essential. The evaluation methods should be consistent, simple and tough. Since December 2002, North Carolina has issued a scorecard that evaluates collection agency performance using both objective collection criteria and more subjective ratings for quality of service including the level of taxpayer complaints.

This month, we will begin changing account placement ratios for the two collection agencies the State uses based on the performance rating on these scorecards.

Last, our contract with private agencies allows the Department of Revenue to pull a single case or every case assigned to the contractors at any time and for any reason. Pulling cases and returning them to our internal case inventory is as simple as making a telephone call. We believe this ensures that the contractor does business in a way that guarantees taxpayer rights and privacy while at the same time ensures maximum quality effort is exerted from the collection agency.

The use of contract collection agencies has been of great benefit to the Department of Revenue, and more importantly to the citizens of North Carolina. The program has received no significant opposition from the State Legislature, the tax practitioner community, the departmental staff, or the general public. A solid comprehensive collection program that includes PCAs is an effective way to do business.

Again, I appreciate this opportunity to share information on North Carolina's collection outsourcing program with the Committee. This concludes my remarks.

[The prepared statement of Mr. Felton follows:]

Statement of Alan Felton, Assistant Secretary for Examination and Collection, North Carolina Department of Revenue, Raleigh, North Carolina

Mr. Chairman and Members of the Committee:

Thank you for inviting me to present the North Carolina Department of Revenue's experience with outsourcing delinquent tax accounts to private collection agencies. I am Alan Felton and I serve as the Assistant Secretary of Revenue for Examination and Collection. Accompanying me is Charlie Helms, Assistant Director of the Collection Division and contract administrator of our collection-outsourcing program.

North Carolina began outsourcing collection cases to private contractors in late 2000. Currently, we have four collection agencies on contract, but only actively use two of the four—NCO Financial Services and OSI Outsourcing. We consider use of the contractors one strategy in a multifaceted collection program. North Carolina uses private collection agencies to work lower value, but high volume, collection accounts. At the time we began the outsourcing program, we found that accounts with a $500 balance or less comprised two-thirds of our case load but only 10% of the value of our receivable inventory. Outsourcing these low yield cases and other low priority accounts allows the Department to focus our internal resources on the remaining one-third of our cases that comprise 90% of the value of our receivable inventory. By employing a comprehensive collection program, including the use of collection contractors, we have been able to increase delinquent tax collections by nearly $150 million between July 1, 2001 and April 30, 2003. This represents more than a 40% increase over previous years.

From our experience with private collection agencies, there are several lessons learned that may be helpful to keep in mind.

Administration of the collection-outsourcing program should be as simple as possible. Simplicity allows taxing agency administrators more time to focus on ensuring quality service and productivity and less time performing unnecessary administrative tasks.

North Carolina places its accounts on a contingency basis and only owes fees to the contractor after collections are processed and posted to NCDOR's system. This contingency arrangement creates a real partnership between NCDOR and the collection contractors. We also recommend that you resist the urge to micromanage the contractors' collection process. Provide clear goals and objectives then allow the contractor to determine the best way of accomplishing them.

Evaluation of contractor performance is essential. The evaluation methods should be consistent, simple, and tough. Since December 2002, North Carolina has issued a "scorecard" that evaluates collection agency performance using both objective collection criteria and more subjective ratings for quality of service, including the level of taxpayer complaints. This month we will begin changing account placement ratios for the two collection agencies the state uses based on the performance rating of their scorecards.

Lastly, our contract with the private agencies allows the Department to pull a single case or every case assigned to the contractors at any time and for any reason. Pulling cases and returning them to our internal case inventory is as simple as making a telephone call. We believe this ensures the contractor does business in a way that guarantees taxpayer rights and privacy while at the same time ensures maximum, quality effort is exerted from the collection agency.

The use of contract collection agencies has been of great benefit to the NC Department of Revenue and, more importantly, to the citizens of North Carolina. The program has received no significant opposition from the state legislature, the tax practitioner community, or the general public. A solid, comprehensive collection program that includes private collection agencies is an effective way to do business.

Again, I appreciate the opportunity to share information on North Carolina's collection outsourcing program with the Committee.

Chairman HOUGHTON. All right. Thank you very much. I will have a question for each one of you, but let me just briefly go over them. First of all, we are interested in protection of taxpayer rights and the safeguarding. Ms. Olson, you could talk about that.

Ms. Gardiner, I would like to talk a little bit about the program in 1996, and what is different now. Ms. Kelley, I would like to ask you a little bit about the Education Department's program, and then, Mr. Felton, I would like to ask you about the reaction of State employees and their representatives to the proposal, and why you started this at $500?

So, maybe we could talk, Ms. Olson, on the safeguarding, the protection of taxpayers.

Ms. OLSON. Well, I am concerned about the spread of information from the contract agency from one side of it to another, to other accounts. I am concerned that the agencies will pressure taxpayers into accepting arrangements in order to get a fee. The IRS employees are going to be paid regardless of whether they literally collect taxes. They may get a poor evaluation if they don't do their job correctly, but they will still get their paycheck.

I am concerned that we won't have what I call a level playing field between the contractors and the IRS, and so, I have made some proposals about how you could structure that. Certainly the section 1203 restrictions that are against the IRS employees which can result in termination and actually are supposed to result in termination unless the Commissioner mitigates that effect, there needs to be an identical arrangement with the PCA employees, so they are operating with the same kind of brakes that IRS employees have on them.

The balanced measures—I cannot emphasize how important that is. I know we talk about the contingency fee arrangement. The IRS has looked at this very carefully. They may not have come to the level that I am as comfortable about. I would like to see more emphasis placed on customer satisfaction in the actual compensation arrangement, not just in a bonus pool or giving out cases in advance. Those are all brakes, as I would think about it, that would protect taxpayers.

Chairman HOUGHTON. Okay. Thank you very much. Ms. Gardiner, compared to the program started in 1996, do you think the IRS has taken better steps to plan for the proposed use of private debt collectors?

Ms. GARDINER. Yes, sir, I do. Some of the differences are in the 1996 pilot, they did not do any kind of benchmarking like the Education Department or other States. This time they did extensive benchmarking to find out the good things, the bad things, the things to be aware of, so they are entering into the project knowing a whole lot more, and what to be cautious about.

Other things such as the age of the cases, in the original 1996 pilot, they selected cases to give to the contractors that were 9 years or less in terms of age. This time they know that they want to give them cases that are 6 years or less. Six years still sounds like a long time but it is still better than 9.

The way they would compensate the contractors as Nina had mentioned, in some cases they might just determine that the taxpayer is deceased or there might be some other outcome besides just the collection of taxes and they would still get a payment for that, so it is not based solely on a flat rate of how much they would collect.

The other way that the contractor would solicit payment, they are thinking that they would use some kind of voucher that was scannable that the taxpayer could send in to the IRS. So, IRS would still be collecting the tax, but it would be in a more efficient manner than the way they had done it in the 1996 pilot.

So, those are some of the differences. There is still a lot to be cautious of, but at least this time I think they have a better idea of what they need to be cautious of.

Chairman HOUGHTON. Right. Well, thank you very much. Now, I would like to ask the following question of Ms. Kelley. I think in an ideal world, we would like all these things to be done in-house, in the government. The problem, of course, is money. The IRS has had tremendous demands on it to bring the IRS up to speed. It was woefully behind speed, and so what happens is that the collection process and the hiring and recruiting of good young people go by the boards every single time. That is really too bad.

I do not know why it is not possible, at least on a temporary, maybe permanent, but at least on a temporary basis, to be able to trust outside agencies to try to fill in the gap while this whole modernization program comes along. Now, for example, with the Education Department program, don't you think they have done pretty well there?

Ms. KELLEY. My only knowledge of that is what I have read about it, Mr. Chairman. I believe there are some on the panel behind me who may report on some failures and abuses and problems

with that program. I do not have any firsthand information on that, but what I can say is that I see a distinction between the Education Department student loan program and IRS taxes.

There is probably nothing that taxpayers hold more confidential than their tax information. Even if it is a single number like the balance due on a tax return and the amount of taxes owed, they do not have a choice in releasing that information. Well, they do, if they want to be subject to criminal action.

The law requires them to submit that information to the IRS. Those who submit and deal with the Education Department on student loans have a choice to make as to whether they want to voluntarily provide the information in an effort to get a loan and then, of course, whatever the process is for the collection of that, but I see those as very, very different issues, and I do believe that you will hear on a subsequent panel of some first-hand abuses and problems with the Education Department.

Chairman HOUGHTON. Of course the requirement of being discrete is not selective here. It is for everyone whether you have a private or a PCA, and I would imagine, according to what Ms. Olson says and others, that there is rather rigorous determination on who should be that PCA and the people in it, and if they do not fulfill their obligations, the wheels go under them pretty fast.

So, it is really, you see, if you look at it from the standpoint of the Federal Government, we are trying to solve a problem. We do not have enough money to do it right now with the accounting system being what it is.

Ms. KELLEY. I would suggest if there is money to pay contractors to do this work, then a way should be found to find the money to give the IRS to do it, especially when the cost to do it produces so many better benefits for taxpayers as $31 for every dollar spent as set out in the numbers that we have from Commissioner Rossotti's report.

Chairman HOUGHTON. The difference, I think, there is that the IRS is doing a whole range of income, and from what I understand, and I think I was wrong when I made that comment with you, Earl, that the whole focus is on the lower-income people. So, that when you get the payback, you are talking about a different universe of taxpayers.

Ms. KELLEY. Well, I think those are some of the things that the IRS has said about the kind of work that will be given to the PCAs. However, there has not been a model yet developed by the IRS to identify those cases. I believe the IRS will acknowledge that and GAO's report, again, just issued last week says that the IRS realizes identifying appropriate cases for referral to PCAs is a key issue. The GAO report says: "While IRS proposes using 'case selection analytics' to identify appropriate cases. That model has not yet been developed."

So, I would question the specificity with which they think they can possibly do this in a manner that will be successful. There are many trained committed, career IRS employees, who are not just committed to doing this work as a part of their job. They are committed to the mission of the agency which is collecting the appropriate tax and respecting taxpayers' rights.

Chairman HOUGHTON. Sure. Well, now let us move for a moment on to Mr. Felton. Mr. Felton, what has been the reaction of State employees and the representatives to the proposal?

Mr. FELTON. The reaction, Mr. Chairman, has been quite positive. We have received no negative comments or complaints from our employees. There has been no resulting job reductions from the use of PCAs at the Department of Revenue in North Carolina.

Chairman HOUGHTON. Thank you very much. Sir.

Mr. POMEROY. Mr. Chairman, it is a delight to be your Ranking Member. I have been in Congress now I am going on 11 years, and I have never heard a Chairman ever self-correct himself before.

[Laughter.]

Mr. POMEROY. You are so refreshing in your leadership. Let me begin by following up on this point of who is going to be the universe targeted with this new initiative. Ms. Olson, we are talking about people that have made some payments and then dropped off a payment, have not fulfilled the payment reflected on their tax return. Just based on your own expertise as the Nation's taxpayer advocate, what proportion in this category would have over $200,000 adjusted gross income compared to those that would have under $75,000 adjusted gross income?

Ms. OLSON. Congressman Pomeroy, it varies all over the United States. I think when we talk about the $278 billion that is in the known tax gap, and we narrow it down to $78 billion in what we call potentially collectible inventory, and my understanding is that 38 percent of that is cases that we are not working because we can't find the taxpayer, we don't have the resources to work them, et cetera.

Some of them are people who do have high adjusted gross incomes. It may be over $100,000 or $200,000. They are out perhaps in a queue in the field. They are in line to be worked by a revenue officer. A classic story that I have sort of held in my mind as I have gone through this process is a husband and wife and they were married and they have a joint tax debt, and they split. The wife is the wage earner. Well, we have got her in the system.

We can do all sorts of things by computer with her without sending collections of the account out to a human being. We can identify her wages, we can garnish her wages, whereas her ex-husband may be a small businessman and files a Schedule C and makes over $100,000. He is in a queue somewhere. So, as every week we are collecting out of that one person's paycheck, but we are not doing a thing to that other person's because we do not have the resources.

It is entirely possible that that person, if we actually made our presence known, would get nervous, because we could shut down his business. We could levy his business accounts and things like that, and he would start talking to us. As long as we are not there there is the ostrich effect. If I stick my head in the sand, they will not see me. That happens a lot.

I do not know what is going to be in this population of cases. I know that eventually the IRS intends to select from all different categories of taxpayers, and so the way they described it is——

Mr. POMEROY. Although, reclaiming my time, basically I did not hear the Commissioner saying about any effort to make certain

this kind of evenly fell across income distribution points. It was a matter of what was the activity on behalf of the taxpayer that lent itself to collectibility. So, it was this kind of partial performance and then falling off, which I believe—in fact, I think the Commissioner gave us some evidence—is going to fall disproportionately on middle and moderate.

I think if cobbled with the tax bill, you could have the ironic situation where $200,000 and up get a tax break; under $75,000, get a tax collector. It is just not fair, fundamentally not fair.

I agree that student loan collection has been done very efficiently in the private sector, and I used to be very familiar with the program run by the State of North Dakota through the Bank of North Dakota, where they had a collection function. I do think that there are some things to distinguish student loan debt and that whole genre of activity versus tax collection, although in raising my doubts, I certainly do not mean to discredit either the Bank of North Dakota's efforts or Sallie Mae's efforts or any other student loan collector's effort. I do think that has been done pretty effectively.

What I think we need to do is be sensitive and raise to the public's attention the relative cost of using private vendors to collect taxes. The whole outcry about the $600 toilet seat or whatever it was in U.S. Department of Defense procurement was because we were getting a bad deal. We were spending dollars that we otherwise would not have had to spend. Same thing here.

We staff this internally and collect, we get a whole different measure of return than if we outsource it and pay a significant margin to the private collector. This is the $600 toilet seat of tax collection. I would like your reflection on that, Ms. Olson, if you would.

Ms. OLSON. I viewed my role in this as certainly not the person making the decision about whether this initiative was going to go forward or not. I have expressed my preference that we not contract out debt for the reasons in my testimony, one of which is that Federal tax debts are different from student loan debts, and taxes are the life blood of our government, and it is a contract between the taxpayer and the government how we manage this.

Once the decision has been made, at least internally, that we might think to use this and look at it, then my job becomes to look at this proposal and make sure that taxpayers are protected in that contract, and that is how I have approached it.

Mr. POMEROY. I understand that. I guess I am somewhat——

Ms. OLSON. It is difficult.

Mr. POMEROY. We are not too far apart in our analysis. If left with the choice, Earl, you get this or you get nothing, well, then I would have to think long and hard about it. I do not think we have fully exhausted the staffing model. In North Dakota, when I was in the State Legislature in 1993, Tax Commissioner Kent Conrad, now Senator Kent Conrad, brought forth an initiative titled "Catch the Tax Cheater" program, cleverly named. It was to basically bolster tax collection efforts, and he promised the legislature $10 dollars for every $1 spent, and he delivered, and his successor delivered, and for 10 years in North Dakota, tax collection

efforts of this "Catch the Tax Cheater" program produced about a 10 to 1 return.

Is it your evaluation that if Congress was really concerned about collecting back tax debt and doing so in a way that would yield the highest return to the Treasury Department, that staffing it up internally would produce better value in terms of ultimate collections?

Ms. OLSON. Yes.

Mr. POMEROY. Thank you. I yield back, Mr. Chairman.

Chairman HOUGHTON. Of course that gets into the bigger issue than dynamic scoring, return on your investment, which I agree with you. If you do that, you take a look if you spend $1 here, do you get $10 dollars back, or do you spend a dollar here and only record it as a dollar of expense?

Well, listen, thank you very much. You have been very, very helpful, and we will take your comments under advisement.

Chairman HOUGHTON. I would like to call the next panel which is Rozanne Andersen, General Counsel, Association of Credit and Collection Professionals, who comes from Minneapolis; Dexter Smith, Senior Vice President, Government Services Division, Allied International Credit Corporation in Smyrna, Georgia; Jon Shaver, Chief Operating Officer, Diversified Collection Services (DCS), Incorporated, in San Leandro, California; and Chi Chi Wu, attorney, National Consumer Law Center in Boston, Massachusetts.

Okay. Are we ready? Thank you very much for being here. We appreciate your time, and Ms. Andersen, would you start?

STATEMENT OF ROZANNE M. ANDERSEN, GENERAL COUNSEL AND SENIOR VICE PRESIDENT, LEGAL AND GOVERNMENT AFFAIRS, ACA INTERNATIONAL, MINNEAPOLIS, MINNESOTA

Ms. ANDERSEN. Chairman Houghton, Congressman Pomeroy, I am Rozanne Andersen, General Counsel and Senior Vice President for Legal and Government Affairs for the Association ACA International.

Thank you for the opportunity to testify on behalf of the industry this afternoon. The ACA International is a 64-year-old trade association composed of 5,300 credit and collection——

Chairman HOUGHTON. Please speak right into the mike. As Chairman Thomas is fond of pointing out, it is a very unidirectional, and he is going to get a new sound system, but he has not yet. So, just have it right up there.

Ms. ANDERSEN. How does this work? Okay. All right. Shall I begin again? All right. Thank you. Chairman Houghton, Congressman Pomeroy, I am Rozanne Andersen, General Counsel and Senior Vice President for Legal and Government Affairs for ACA International.

Thank you for the opportunity to allow me to testify this afternoon on behalf of the industry. ACA International is a 64-year-old trade association composed of 5,300 credit and collection professionals, headquartered in Minneapolis, Minnesota. The ACA's membership spans all 50 States. Our agencies range in size from three-person operations to publicly held corporations that employ between 5,000 and 15,000 individuals.

The ACA strongly supports H.R. 1169, Mr. Chairman, and the framework of the IRS outsourcing proposal. This legislation provides that the power to make decisions that impact the rights of individual taxpayers would remain solely with the IRS. Under the program, private collection agents, PCAs, would be imbedded in the IRS collection scheme, not working outside or independent of it.

The PCAs would have neither enforcement authority nor discretion to determine tax liability. They would operate under the supervision and control of the IRS to perform a strictly limited function collection activity.

There are a number of Federal agencies that contract with PCAs for debt collection services with documented success. You have heard from at least one this afternoon: the Education Department has used PCAs to collect on delinquent student loans since the mid-eighties. The Treasury Department began to contract with PCAs for non-tax collection services in 1998. The Security and Exchange Commission (SEC) recently revealed that it too is contemplating a plan to contract with PCAs to enhance its collection activities.

Yet opponents say that debt collectors will abuse citizens and that the privacy of taxpayer information will not be protected. Such talk indicates a lack of understanding of the many Federal and State laws that strictly regulate the activities of private debt collectors.

The primary Federal laws governing the practices of debt collectors include the FDCPA, the Fair Credit Reporting Act (P.L. 104–208), the Federal Trade Commission Act (1914, Ch. 311, 38 Stat. 717), the Gramm-Leach-Bliley Act (P.L. 106–102) in certain instances, and the Health Insurance Portability and Accountability Act (HIPAA) (P.L. 104–191), as well as numerous State and local statutes.

Collectors winning a contract under the draft Request for Information (RFI) would also be subject to the Taxpayer Bill of Rights (P.L. 100–647), the Federal Claims Collection Act (P.L. 89–508), and the Privacy Act 1974 (P.L. 93–579).

A number of these laws impose duties and restrictions on private sector debt collectors that do not currently apply to IRS employees. The IRS intends that all Federal tax debt collection activities performed by the PCAs be subject to the FDCPA. This is to afford taxpayers additional consumer protections in addition to those currently governing the IRS employees.

The ACA suggests H.R. 1169 should clarify that the FDCPA applies to PCAs collecting on behalf of the IRS. In addition to the statutory and regulatory framework, ACA members must also adhere to rigorous ethical standards and guidelines established by our association.

Collectors have long understood the need to protect consumer privacy and to maintain rigorous controls to ensure that private consumer information indeed remains private. In fact, the Federal Trade Commission's (FTC) 2002 and 2003 annual reports to Congress made it clear that the number of complaints against debt collectors is de minimis when compared to the billions of contacts between debt collectors and consumers that occur annually.

Health information is arguably as sensitive and as private of information as any information retained by the IRS for tax purposes,

and in fact medical debts comprise approximately 65 percent of the total number of accounts currently transferred to third-party debt collectors.

Recent regulations under HIPAA only allow collection agents access to that information which is minimally necessary to perform collection functions. These regulations could certainly serve as a blueprint for resolving taxpayer data privacy concerns as proposed by H.R. 1169.

Some question the ability of the IRS to ensure that private debt collectors are operating properly when actually contacting taxpayers. Advanced technology systems allow the IRS to monitor phone conversations while they are happening to see how the collectors are updating their collection records during the calls.

In addition, the IRS can send staff to audit the collection activity of any PCAs at any time. Most importantly, through membership in ACA International, collection agencies receive training, access to written electronic and web-based collection training modules, direct access to 5 compliance attorneys, access to 50 State compliance chairs, agency certification opportunities as well.

Currently, 34 States have licensing, registration or bond requirements for debt collectors. Under the IRS proposal, State attorneys general and the FTC would monitor activities of the IRS's contracted private debt collectors adding another layer of protection, as these agencies currently have no role in IRS collections.

Finally, if H.R. 1169 is properly drafted, the enabling legislation would also afford private citizens with even greater protections under the law. I urge the Committee to ensure that this outsourcing contract is available to small, minority, persons with disabilities, and women-owned collection agencies.

The number of contractors contemplated by the IRS is very limited in scope: 10 agencies with 2 additional contracts set aside for small business. Available technology affords the IRS with the ability to expand this number of contractors to as many as one per State. In order to accomplish such a distribution of accounts, H.R. 1169 may need to be modified to specifically authorize the Secretary to enter into both direct and indirect qualified tax collection contracts.

In keeping with the President's policy of encouraging more participation by small business in the Federal procurement process, I suggest the Committee consider this modification to H.R. 1169.

Mr. Chairman, Congressman Pomeroy, the collection industry has a great deal to offer the Federal Government and the taxpayers that support it. H.R. 1169 would bring needed Federal revenue into the Treasury Department and would make progress in eliminating the huge backlog of collections on overdue tax debt.

The ACA is the premier trade association representing the collection industry with the experience, knowledge, training and certification credentials to ensure the success of the IRS outsourcing program. If given the opportunity, our members will perform exemplary collection services in partnership with the IRS, while at all times exhibiting great sensitivity toward the privacy rights of taxpayers. I urge the Subcommittee's support of this important measure.

[The prepared statement of Ms. Andersen follows:]

Statement of Rozanne M. Andersen, General Counsel and Senior Vice President, Legal and Governmental Affairs, ACA International, Minneapolis, Minnesota

Chairman Houghton, Ranking Member Pomeroy, and members of the Subcommittee, I am Rozanne Andersen, General Counsel and Senior Vice President for Legal and Government Affairs for ACA International. It is a pleasure and a privilege for me to present testimony today on behalf of the nation's premier trade association representing the credit and collection industry.

ACA International is a 64 year-old trade association composed of 5,300 credit and collection professionals who provide a wide variety of accounts receivable management services to credit grantors. Headquartered in Minneapolis, Minnesota, ACA's membership spans all fifty states and includes 3,400 third-party collection agencies, 750 attorneys, 1,200 credit grantors, and 140 vendors. The third-party collection agencies that belong to ACA range in size from small 3 person operations to huge, publicly held corporations that employ between 5,000–15,000 individuals. In short, ACA's membership represents both the very smallest of businesses that operate within a very limited geographic radius within a state, and the very largest of multinational collection agency corporations that operate in all fifty states.

ACA strongly supports H.R. 1169, Mr. Chairman, and the framework of the proposal put forward by the Internal Revenue Service, to outsource the collection of past due federal income taxes to private collection agencies. We commend the leadership you have shown in introducing the enabling legislation that would allow this worthy and necessary proposal to move forward, and for holding this hearing today.

I apologize if my testimony sounds a little like 'déjà vu' all over again. In 1996, ACA presented testimony before this Subcommittee on the subject of outsourcing IRS collections. Today we are considering, once again, a proposal that will allow the IRS to partner with private collections agencies to bring uncollected federal tax revenue into the Treasury. The arguments about why this is a good idea—for the Treasury, for the IRS, for the economy, and most importantly, for the vast majority of American taxpayers that dutifully pay their fair share of federal income taxes each year—remain the same. In my observation what *has* changed is the Administration's and the IRS's commitment to this program, with success being the only acceptable outcome. Commissioner Everson, I commend you for being here today as evidence of the IRS's commitment to moving this proposal from concept to reality.

Debt Collection and the U.S. Economy

If I may, I'd like to take a moment to talk about the collection industry, and it's impact on the U.S. economy. As one of our members said to me recently, "One of the quickest ways to kill a conversation at a social gathering is to tell someone you're a debt collector." Perhaps IRS employees can relate to this experience. A better way to explain who we are is to say that this industry really serves as an extension of your community's businesses, such as the hardware store, the retailer down the street, or the local hospital. The collection industry works with these businesses to try to get payment for those goods and services that have been delivered to the consumer. Unless someone tries to collect what is owed, the existence of these businesses may be threatened. Furthermore, the rest of us pay a higher price for the goods and services we need, to compensate for uncollected bad debt.

According to the Federal Reserve Board and the U.S. Census Bureau, total consumer bad debt costs every adult in the United States $683 annually. This translates into a cost for the average non-supervisory worker of nearly 54 hours (before taxes) in lost salary every year to pay for the bad debt of other consumers. Collection services, such as those offered by ACA members, are an essential part of the U.S. economy. In 1999, more than $216 billion in past due accounts were referred to collection agencies. Collection on those accounts recovered approximately $30.4 billion—a massive infusion of money into our economy.

IRS Compliance Concerns

Mr. Chairman, I cite these statistics to emphasize the importance of debt collection in our economy. The amount of federal income taxes owed the government and not paid each year is staggering. The IRS estimates that $249 billion in federal tax debt is currently past due. Although estimates vary, between $76 and $112 billion of this delinquent amount has some collection potential. However, when considering the topic of today's hearing, much more is at stake than bringing in much-needed funds to the Treasury. This is really an issue of fairness. Our tax system is a voluntary one, in which we rely upon individual citizens to dutifully file their returns and pay their taxes every year. Nonetheless, I don't believe that the millions of citizens who file their taxes and pay their fair share view their compliance as "vol-

untary," anymore than they would consider the decision of some not to pay the federal taxes they owe an acceptable choice.

As the Government Accounting Office (GAO) noted in it's report to the Subcommittee in May, 2002, "Taxpayers' willingness to voluntarily comply with tax laws depends in part on their confidence that friends, neighbors and business competitors are paying their fair share of taxes." Law-abiding citizens need to be assured that their government, which created our federal tax system, will effectively enforce its requirements. It is a matter of taxpayer equity.

Mr. Chairman, there is a crises in the collection of past due federal income tax. This crises is well documented in the IRS's own assessments, and by independent studies by the GAO. In GAO testimony presented last week before an Appropriations Subcommittee, the IRS's collection programs were shown to have significant declines in workload coverage, cases closed, direct staff time used, productivity and dollars of unpaid taxes collected. This same report cites the IRS's deferral policy, which had been in place for three and one-half years, as part of the collection backlog. By the end of FY 2002, the IRS had deferred taking action—i.e. not pursued—collection on $15 billion in unpaid taxes, interest, and penalties. In one out of every three cases requiring collection activity, the IRS has deferred action. The GAO cites an average of 1.6 years elapsing between the time past due taxes are established and collections activity is initiated by the IRS. As staff has been shifted to other priority functions, a 60 percent gap has grown between the collection workload and work completed. The IRS staff needs and deserves relief from this overwhelming situation.

Using the Private Sector to Collect Past Due Federal Income Taxes

The former IRS Commissioner reported in September 2002 that 5,450 new full time employees at a cost of $296.4 million would be required to close this gap.

Alternatively, the IRS collection-related contract support initiative is a proposal to leverage the resources of private collection agencies with minimal investment of taxpayer dollars, while providing maximum protection of taxpayers' rights. It is an important piece of a comprehensive effort to reorganize, streamline and improve collection outcomes. Since 1998, the IRS has worked with experts, including ACA and ACA member companies, to study and design the best method to implement the program. Under the proposal, private collection agencies would perform supplemental collection activities, subject to the oversight and control of the IRS, and in compliance with all applicable laws and regulations.

Let me be clear, as I know there are those skeptical of the concept of using private businesses to perform a function that has been reserved for IRS employees. However, the passage of enabling legislation, such as H.R. 1169, will not permit the IRS to abdicate its responsibilities. The power to make decisions that impact the rights of individual taxpayers shall remain solely with the IRS. Under the program, private collection agents (PCAs) will be embedded in the IRS collection scheme, not working outside or independent from it. PCAs will have neither enforcement authority nor discretion to determine tax liability. They will operate under the supervision and control of the IRS to perform a strictly limited function—collection activity, which is not intimately related to the public interest in a manner that mandates the use of federal employees.

Mr. Chairman, there are a number of federal agencies that contract with PCAs for debt collection services, and with documented success. The Department of Education has utilized PCAs to collect on delinquent student loans in the mid-1980's. Gary Hopkins, Director of Collections for Federal Student Aid at the Department of Education stated that, "From outsourcing we gain expertise and the ability to have continuous improvement and stay current with technology." More recently, the Department of the Treasury, as part of it's own debt program, began to contract with PCAs for non-tax collection services. Since the program's inception in 1998, PCAs have collected $109 million, more than half of it during the last two years. Richard L. Gregg, Commissioner for Financial Management Services at the Department of Treasury, recently testified to Congress that the "Treasury's debt program is one that is both robust and effective, one that has consistently met or exceeded its performance measures." The Securities and Exchange Commission recently revealed that it, too, is contemplating a plan to contract with PCAs to enhance its collection activities.

Myths Regarding the Outsourcing of Tax Collections

Given the successful track record many federal agencies have had contracting with professional debt collectors from the private sector, one would hope that support for the IRS outsourcing initiative would be unanimous. However, there seem to be a few myths surrounding the privatization of federal tax collection that need

to be dispelled. One argument I've heard raised against allowing the IRS to contract with private sector debt collectors stems from concern that debt collectors will abuse citizens, or that the privacy of taxpayer information will not be protected. Such assertions indicate a lack of understanding of the many federal and state laws that strictly regulate the activities of private debt collectors.

The primary federal laws governing the practices of debt collectors include the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, the Federal Trade Commission Act, the Gramm-Leach-Bliley Act, and the Health Insurance Portability and Accountability Act, as well as numerous state and local statutes. Collectors winning a contract under the draft RFI would also be subject to the Taxpayer Bill of Rights, the Federal Claims Collection Act, and the Privacy Act of 1974. In addition to this statutory and regulatory framework of consumer protection laws, ACA collection agency members must also adhere to rigorous ethical standards and guidelines established by our association. A copy of ACA's Code of Ethics is attached to my testimony for your review. A number of these laws, and specifically, the Fair Debt Collection Practices Act, impose duties and restrictions on private sector debt collectors that do not apply to IRS employees. It is the intention of the IRS that all federal tax debt collections activities performed by private contractors be subject to the Fair Debt Collection Practices Act, to afford taxpayers consumer protections in addition to those currently governing the collection efforts of IRS staff.

With regard to the privacy of taxpayer information, I can state confidently that no other topic has received as much attention by the IRS in drafting the parameters of an outsourcing project. In addition to extending the Fair Debt Collection Practices Act to those contractors who work with the IRS on this project, there are very stringent contractual requirements pertaining to the contractors' operations in performing IRS collections. The outsourcing proposal, as crafted by the IRS, requires that all facilities and data and corporate systems meet threshold requirements for capacity, encryption, record retention, and data transfer. Other security requirements include: registration with the Department of Defense central database; onsite security measures, including the maintenance of restricted areas and limited access; background investigations; and reporting and auditing requirements.

Debt collectors deal responsibly with sensitive information requiring the utmost care to protect consumer privacy all the time. Perhaps one of the best examples I can point to right now is the significant amount of collection of medical debts being done by private debt collectors. This is because health care providers are among the very small minority of businesses that offer services on credit, other than through credit cards. One's health information is arguably as sensitive and private as that information retained by the IRS for tax purposes. Recent regulations pursuant to the Health Insurance Portability and Accountability Act (HIPAA), may serve as a model to the IRS in finalizing its outsourcing proposal. The HIPAA privacy, security and electronic transaction rules safeguard confidential medical information to facilitate the collection of medical debts while protecting highly sensitive information. As a result of their compliance with HIPAA, most collection agencies have the type of safeguards in place to ensure compliance with the proposed privacy standards for this outsourcing project. In short, the requirement under HIPAA of only allowing collection agencies access to that information minimally necessary to perform collection functions could serve as a blueprint for resolving taxpayer data privacy concerns.

In recent years, privacy requirements for financial information have also been put into place under the Gramm-Leach-Bliley Act. Debt collectors are intimately familiar with these requirements because they service banks and credit card issuers, as well as other entities governed by Gramm-Leach-Bliley. Even without these regulations, collectors have long understood the need to protect consumer privacy and to maintain rigorous controls to ensure that private consumer information remains private.

Another concern that has been raised is doubt over the ability of the IRS to ensure that private debt collectors are operating properly when contacting taxpayers. In these days of advanced technology, it will be possible for the IRS to monitor most debt collectors in real time. Most debt collectors who service large clients allow those clients to monitor phone conversations while they are happening and to see how collectors are updating computer records during the calls. This can be accomplished through the telephone and computer technology that is available today. In addition, the IRS can send auditors to audit collection activity at any time.

Buttressing the IRS's monitoring will be the panoply of watchdogs that keep an eye on debt collectors. For example, approximately 34 states have licensing and/or registration requirements for debt collectors. These state agencies monitor debt collectors to varying degrees. Some states send examiners to ensure that debt collectors comply with their laws. Others require debt collectors to provide consumers

with contact information for the state regulatory agency to make it easier for consumers to file complaints about collectors. Under the new proposal, State Attorneys General and the Federal Trade Commission, would be included in the list of those monitoring the activities of the IRS's contracted private debt collectors. This would be an added layer of protection as these agencies currently have no power over IRS collections. Properly drafted, the enabling legislation would afford private citizens with individual enforcement power currently unavailable.

Mr. Chairman, I hope this information has helped to persuade those doubting the wisdom of granting the IRS outsourcing authority for collections that their concerns are unfounded. Assuming my narrative has been successful, I would like to end my testimony with a few thoughts for your consideration.

The IRS has done a commendable job in researching the strengths and capabilities of the private sector collection industry, and shaping a proposal whereby the IRS could partner with the private sector for certain collection activities. Certainly, all possible measures for protecting taxpayer privacy have been incorporated in the draft RFI. However, I would remind you that in order for this project to be successful, the collection agencies must have an opportunity to make money. The IRS must give collectors accounts for which there is a reasonable chance for recovery. While collectors can do much to locate taxpayers for whom there is no current address or phone number, they should not only be given accounts where the IRS has been unable to locate the tax debtors. Similarly, collectors should be given newer accounts in addition to those that have been outstanding for years. Proper identification of cases that should be placed with the PCAs for collection will be key to this program's success. The Government Accounting Office made a similar assessment in its May 7, 2003 testimony before the Appropriations Committee when citing a shortcoming from the 1996 outsourcing pilot project.

Secondly, I would strongly urge the IRS to take steps to make some of this outsourcing contract available to small, minority and women-owned collection agencies. The number of contractors contemplated by the IRS is very limited in scope—10 agencies with 2 additional contracts set-aside for small businesses. With the large volume of collection files needing attention, and the technology available to aid the IRS in monitoring it's contractors, they should consider expanding the number of contractors. At the very least, the IRS should reconsider or clarify its prohibition on subcontracting any "core functions." It is very common in the private collection industry for certain specific services, such as the provision of forms and correspondence mailing services, dialer software, and skiptracing, to be subcontracted to another business. This subcontracting is routinely done by PCAs, large and small, without compromising the security of the information shared with third-party subcontractors.

Prohibiting the subcontracting of any such activities as a "core function" of the contract would be particularly deleterious to small businesses. Businesses frequently outsource functions such as letter mailing. This allows them to focus on other aspects of the collection process and provides cost-effective alternatives to purchasing or leasing expensive hardware and software. Subcontracting agreements contain provisions to account for the protection and security of information shared with third party subcontractors. With some minor modifications to the RFI, I believe the IRS could satisfy its concern with diminished control or oversight associated with subcontracting core functions, without prohibiting the use of subcontractors.

Mr. Chairman, the collection industry has a great deal to offer the Federal Government and the taxpayers that support it. That fact is well documented as the expertise of the professional collection industry has been tapped to enhance federal collections' activities in numerous agencies. Adoption of H.R. 1169 would be an important next step in allowing the IRS to similarly harness the debt collection industry's technology and expertise. While this role would be of a very limited scope in comparison to the vast responsibilities borne by the IRS and its dedicated employees, it would assist the IRS in managing their human resources to increase activity in those areas that can only be performed by IRS employees. Bringing needed federal revenue into the Treasury, and making progress in the huge backlog of collections on overdue tax debt would serve to reinvigorate the IRS. I urge the Subcommittee's support of this important measure, H.R. 1169, and I would be happy to answer any questions the members may have at the appropriate time. Thank you, Mr. Chairman.

Chairman HOUGHTON. Well, thank you very much. Just as a note, we have just been joined by a very distinguished Member of

our Committee, Mr. Foley of Florida. We are delighted to have you here, and we will proceed with the questions, and then you can chime in when you want. Okay. Now, Mr. Smith.

STATEMENT OF DEXTER SMITH, SENIOR VICE PRESIDENT, ALLIED INTERNATIONAL CREDIT CORPORATION, ATLANTA, GEORGIA

Mr. SMITH. Mr. Chairman, Congressman Pomeroy, Mr. Foley, thank you for this opportunity to testify before the Subcommittee on Oversight. I am Dexter Smith, Senior Vice President at Allied International Credit Corporation (US), with our U.S. headquarters in Atlanta, Georgia. As our name implies, we are an international company with experience collecting Federal debt in the United States, Canada, and the United Kingdom.

In 2002, we handled more than 1.6 million collection accounts valued at over $11.5 billion. Currently, we partner with the Education Department in collecting defaulted student loans which is considered to be more similar to the IRS proposal than any other collections contract in the industry.

Allied International Credit endorses the proposal before the Subcommittee. We believe it protects taxpayer rights and privacy, preserves the jobs of current IRS employees, and most importantly strengthens citizens' faith in the integrity and fairness of the tax system.

We believe that the substantial resources and private sector best practices brought to the table by the debt collection companies will help the IRS advance its goal of providing top quality service to each taxpayer by bringing additional resources to bear in each individual case and ensuring fairness and shortening the resolution time.

The proposal will provide top quality service to all taxpayers by increasing the number of successfully closed cases which will increase the level of overall compliance. We believe that the proposal will support a quality workforce and ultimately increase employee morale because it will allow IRS employees to focus on accounts more suited to their training and tools.

A program that successfully shrinks accounts receivable will give employees a sense that the agency is better accomplishing its mission. Under the proposal, in addition to all the taxpayer rights provisions in the Internal Revenue Code, the private companies would be subject to all the requirements of the FDCPA. Failure to comply with these stringent requirements subjects our company to legal liabilities and ultimately bankruptcy.

In order to ensure full compliance, the IRS plans to put in place a strenuous performance measurement program that will monitor all telephone contacts with taxpayers, conduct taxpayer surveys, and audit company records. In protecting taxpayer privacy, the proposal would deputize participating companies under section 6103, placing a great responsibility on us to maintain the privacy of taxpayer information.

The private sector companies would not have access to return information. While the information shared with the companies would be limited to the name, Social Security Number, amount of debt, penalties, interest and payment history, unauthorized disclosure

would bear the same dire consequences as disclosing return information.

All private sector staff working on this contract would be fingerprinted and undergo a thorough Federal background check. At Allied International Credit, we ensure a quality work staff by focusing our recruiting efforts at local colleges, churches and the military.

It is important to state that under the proposal, not a single job currently performed by IRS employees would be lost due to the program. In fact, the business case provides that the program would result in an additional 70 full-time employees at the IRS and should be seen as supplementation of the current IRS resources, not a replacement of current employees.

On a similar issue, some commentators have stated that simply hiring additional IRS employees would be cheaper. In the very narrow field of finding debtors, skip tracing, contacting them and counseling them through payment procedures, the private sector brings state-of-the-art practices and tools to the table. This is our core business and we do it as efficiently and effectively as anyone. Otherwise, we could not stay in business very long.

In closing, our recommendation for the Committee is to provide the IRS guidance and enough flexibility to resolve any issue arising down the road without mandating a one-size-fits-all solution.

We would like to state our strong belief that passage of the proposal allowing private debt collection companies to partner with the IRS will not only raise billions of dollars in a fair and equitable manner, but will restore people's confidence that all taxpayers are paying their fair share.

Thank you once again for affording me this opportunity to testify before the Subcommittee today.

[The prepared statement of Mr. Smith follows:]

Statement of Dexter Smith, Senior Vice President, Allied International Credit Corporation, Atlanta, Georgia

Thank you for this opportunity to testify before the Committee on Ways and Means Subcommittee on Oversight. Over the past few months, I have appreciated the opportunity to work with the members of this committee and your staffs to enact legislation clarifying the ability of the IRS to partner with the private sector to collect debts owed to the people of this country.

I am Dexter Smith, Senior Vice President at Allied International Credit Corp. (US) (Allied International Credit) with our U.S. headquarters in Atlanta, Georgia. As our name implies, we are an international company with experience collecting debt in the US, Canada and the United Kingdom. In 2002, we handled more than 1.6 million collection accounts, valued at over $11.5 billion. Currently, we partner with the Department of Education in collecting student loan debts.

If this legislation is enacted, we believe we could bring internationally recognized business processes, state-of-the-art technology, and most importantly highly trained and professionally qualified people to the job of shrinking the currently ballooning accounts receivable at the Internal Revenue Service.

Allied International Credit endorses the proposal before the Subcommittee today and believes that the proposal strongly supports the mission and strategic goals of the Internal Revenue Service as directed by Congress under the Internal Revenue Service Restructuring and Reform Act of 1998; while at the same time protecting taxpayer rights and privacy, preserving the jobs of current IRS employees, and most importantly strengthening citizen's faith in the integrity and fairness of the tax system.

Top quality service to each taxpayer—The proposal will support IRS efforts to provide prompt, professional, and helpful treatment to each taxpayer, even in cases where additional taxes may be due. We feel that the substantial resources and

private sector best practices brought to the table by the debt collection companies will help the IRS advance this important goal by increasing the number of cases resolved and shortening the resolution time of each case. Further, because the added resources of the private companies will substantially shorten the cycle for collecting outstanding debts, penalties and interest will be reduced in the long run. Finally, because the program will promote a greater reliance on case management, rather than on harsh collection activities such as seizures, levies, and garnishments the program will make the tax compliance system fairer and more tolerable to taxpayers.

Top quality service to all taxpayers—The IRS strives to increase fairness of compliance and increase overall compliance. We believe strongly that with this proposal will come a substantial increase in the number of successfully closed cases, which will increase the fairness, and level of overall compliance. There will be a strong message that if you owe, you will not be ignored, increasing the incentive for taxpayers to meet their obligations sooner rather than later.

Productivity through a quality work environment—The IRS endeavors constantly to increase employee job satisfaction. We believe that the proposal will increase employee morale because it will allow IRS employees to focus on accounts more suited to their training and technology tools. The skip tracing skills of the private companies such as Allied International Credit will present IRS employees with new contact information that will allow them to focus on cases requiring their expertise and enforcement powers such as law enforcement and actions against property. Elimination or a significant reduction of case backlogs will provide a greater sense of accomplishment. In short, if every employee along the IRS tax pipeline knows that their efforts are more effectively resulting in taxpayers meeting their obligations, they will have a better overall satisfaction in their work.

Protecting Taxpayer Rights—Under the proposal the rules governing taxpayer rights would provide for the proverbial belt and suspenders. The private sector employees would be subject to all rules applicable to IRS employees, plus more. In addition to mandating that all private sector employees would be subject to rules governing automatic firing and the taxpayer bill of rights, the private companies would be subject to all the requirements of the Fair Debt Collection Practices Act (FDCPA). For instance, under current law, FDCPA prohibits collection agencies from communications with taxpayers at an unusual or inconvenient time or place, or any conduct that is harassing, oppressive or abusive. Failure to comply with these stringent requirements subjects our company to legal liabilities, and ultimately bankruptcy if we fail to comply.

In order to ensure full compliance with taxpayer rights protections, the Internal Revenue Service plans to put in place a strenuous performance measurement program that will monitor all contacts with taxpayers, including live monitoring of telephone contacts, review recorded conversations, taxpayer surveys, audits of company records and periodic reviews of collection performance.

At Allied International Credit, as with many in the industry, we consider these requirements to be just a starting point. Our management objectives go one-step further: we strive to treat the people we contact like customers. We are deeply aware of the sensitivity of "public debt" and have established a solid background and experience in delivering respectful collections services to taxpayer debtors. We know that there are many reasons people are unable to meet their obligations, none of them easy. Our employees are measured and rewarded for their fair and equitable treatment of everyone we contact in the course of our business. Each one is well versed in the latest thinking on debt management and counseling. As just one example of our emphasis and forward thinking in this area, we have created a special web site, www.payandrelax.com.

Protecting Taxpayer Privacy—Equally important is the priority the program places on protecting taxpayer privacy. Confidentiality of taxpayer data is at the heart of our voluntary system of self-assessment. In short if people do not believe that the financial information they provide the IRS is going to be kept from prying eyes, taxpayers may not be as forthcoming with the data they provide to the agency.

Once again, we believe the industry is up to the job. The proposal would deputize participating companies under section 6103, placing a great responsibility on us to maintain the integrity of taxpayer information. While the information shared with the companies would be limited to the name, social security number, amount of debt, penalties and interest and past history of payment, disclosure would bear the same dire consequences as disclosing return information. Namely, Allied International Credit and any company contracting to provide these services would be subject to private law suits, criminal fines, and even imprisonment. I can assure you that the shareholders of my company would take the requirements of section 6103 with the utmost seriousness.

How do we propose to maintain the strictest compliance with the spirit as well as the letter of this essential law? Once again, we start with the quality of our workforce. We focus our recruiting efforts at local colleges, churches and military bases. People working this account would undergo a completed and certified background check, including finger printing. Our training on all statutory and contract requirements is focused, strenuous and continuous. Finally, we use a balanced matrix of measurements to reward and advance our employees similar to the system established under Commissioner Rossotti for all IRS employees.

Partnering with the current IRS workforce—Allied International Credit has experience partnering with governmental union and non-union employees throughout the world. Initially, these workforces have been understandably reticent about contracting out debt collection. Our experience shows that in a short time, strong partnerships are formed that provide greater job satisfaction for all employees involved. Part of that process is educating employees on the details of the program and working with their representatives to foster a collaborative, win-win environment.

It is important to state upfront that under the proposal no jobs currently performed by IRS employees will be outsourced. Not a single job would be lost due to the program. In fact, the business case provides that the program would result in an additional 70 FTEs at the agency. The program should be seen as a supplementation of current IRS resources, not a replacement of current employees. In fact, the Administration's budget provides for 887 additional FTEs to augment current enforcement and taxpayer service resources. Once the program is successfully implemented as proposed, all indications from the IRS are the program should substantially increase the need for additional revenue officers. Additional revenue officers will be required to work those cases where, the private collection company has found the taxpayer and identified his or her assets, had to remit the case back to the IRS for enforcement actions because the taxpayer refuses to pay voluntarily.

On a similar issue, some commentators have stated that simply hiring additional IRS employees would be cheaper. First, it is important to compare apples to apples and oranges to oranges. The private sector brings state-of-the-art practices and tools to the table in the very narrow field of finding debtors (skip tracing), contacting them and counseling them through payment procedures. This is one of our core businesses. In this narrow, but very important aspect of debt collection, the private sector brings the best efficiencies and practices existing today. The IRS currently employs professionally trained Revenue Officers with the authority to contact taxpayers and, if necessary, to seize assets and contact third parties for collection of the debt. Some could argue that these harsher measures are "more efficient" than entering into payment agreements, but we believe that it is better policy to provide debt counseling and help taxpayers voluntarily meet their obligations, saving the harsher property and wage seizures to only uncooperative debtors.

Finally, this proposal would provide the agency with the resources of as many as 12 private companies in as short a time as three months. Even if the funds were available, the IRS would be hard-pressed to hire, train and provide tools for equivalent number of employees over many numbers of years. In short, the program will provide the agency with the maximum flexibility to hire and, frankly, dismiss immense resources as needed.

Use of Enforcement Results—Opponents of this proposal have pointed out that the Restructuring and Reform Act prohibits the use of "enforcement results" to evaluate employees or the use of production quotas or goals. It also requires that the Commissioner establish Balanced Performance Measurements in line with a new IRS Mission statement. The Conference report states, "In no case should measures be used which rank employees or groups of employees based solely on enforcement results."

The first level focus of the Restructuring and Reform Act was on the strong police powers exercised by the IRS to seize property, levy on bank accounts, and enforce third party garnishments of wages. These powers, which received the highest scrutiny by Congress, will not be passed to private collection companies. The private collection companies under the contract would have no enforcement powers or ability to contact 3rd parties for payment. The second level focus of the Act was on how the IRS interacts with all taxpayers on a daily basis. Clearly, Congress intended all employees, and consequently any outside contractors of the agency, to treat taxpayers as customers, with courtesy and respect. They recognized that, while the employees of the agency respond strongly to how they are measured on the job, proper measurements would in most cases result in proper treatment of taxpayers

With this in mind, former Commissioner Charles Rossotti invested a substantial amount of time and resources developing, with input from Congress, a very sophisti-

cated measurement system that properly balanced efficiency and productivity with fair treatment of taxpayers.

The Draft Request for Quote (RFQ) also sets out very specific balanced performance measurements that are almost identical to the measurements developed and used for IRS employees. The performance measurements in the RFQ would dictate how much the private companies would make and whether or not their contracts could be terminated for inadequate performance. The metrics would include overall amounts collected, customer satisfaction as measured by independent surveys, and overall quality as measured by phone monitoring. In all regards, the private debt collection companies would be measured in a similar fashion to IRS employees not engaged in enforcement actions.

Issue for Review—While we substantially support HR 1169 as introduced, there are a number of issues that should be reviewed by the committee and resolved with guidance in either the statutory language or the committee's report. First, most if not all private debt collection companies focus on their core business of finding, contacting and counseling people owing debt. A number of the more collateral elements of the business are outsourced to other private companies. These important services include letter and notice writing and the maintaining of data banks for skip tracing. It is our understanding based on public meetings with the Internal Revenue Service that they interpret section 6103(n)—the law governing disclosure to contractors—as not allowing them the ability to disclose to a second tier of contractors. They have also voiced concerns about being able to manage additional layers of contractors even if the law did allow for a second tier of contractors. We are afraid that not resolving this issue could add significantly to the cost by eliminating many able companies from being able to compete for the contract.

In the case of businesses providing letters or notice writing services, they are often small, many times minority owned, family businesses. While many companies could bring this activity internally, most would prefer to continue to concentrate on their core business, while at the same time supporting local small businesses. This would have a significant negative impact on the amount of revenue collected.

On the issue of using outside data banks, it would be much more problematic bringing these services internally. As you can imagine, in order to keep these data sources updated they must be continuously refreshed with new information. It would add significantly to the cost and decrease the efficiency of our business to manage the various data banks necessary for doing our business.

Our recommendation for the Committee is to provide the IRS with guidance and enough flexibility to resolve this issue down the road without mandating a one-size-fits-all solution. For instance, in the case of letter services, the IRS may want to contract directly with companies to provide these services to the debt collection companies. By doing so, they would solve their second-tier contracting problem and would be able to manage privacy issues directly. On the other hand, the data bank problem would probably best be resolved by certifying anonymity of the data run through the systems, similar to what must occur with data banks used currently by the IRS. Mostly, I raise this issue for public discussion because ignoring it will only result in increasing the cost and slowing down implementation of the program.

Finally, many of the private companies interested in working with the IRS on this project are concerned that the IRS may not be given enough flexibility to grow and evolve the program over time. While it is important to focus initially on the collection of a smaller batch of financial accounts receivable, after a number of years of experience under their belt the agency may want to expand what they define as financial receivables. It may want the companies to focus on older, harder to collect debt. Or, it may choose to have the companies focus their attention on the newest accounts. My point is that any restrictions on amounts to be paid or on the type of debt to be collected will only tie the hands of the agency down the line to shape the program in the best interest of taxpayers. We urge the Committee to provide guidance to the Department of Treasury and the IRS to create a robust program—we believe that $30 billion in the first few years is quite doable—but also that Congress refrain from placing too many restrictions on how the "experts" at IRS run the program.

After all, the intent of the proposal is to establish an effective legislative and management framework to support maximum recovery of outstanding tax debt.

Help Restore faith in the Tax System—In closing, we would like to state our strong belief that passage of the proposal allowing private debt collection companies to partner with the IRS, will not only raise billions of dollars in a fair and equitable manner, but will help contribute to restoring taxpayers' faith in the integrity of the tax system. According to the latest annual report of the IRS Oversight Board, currently 60 percent of identified tax debts are not being pursued. By collecting these debts in the most humane fashion possible, while at the same time visibly shrinking

the accounts receivable at the IRS for the first time in history, citizens will have more confidence in the fairness of the tax system. It will restore people's confidence that all taxpayers are paying their fair share. Thank you once again for affording me with this opportunity to testify before the Subcommittee today.

Chairman HOUGHTON. Thank you, Mr. Smith. Now, Mr. Shaver.

STATEMENT OF JON D. SHAVER, CHIEF OPERATING OFFICER, DIVERSIFIED COLLECTION SERVICES, INC., SAN LEANDRO, CALIFORNIA

Mr. SHAVER. Mr. Chairman, Mr. Pomeroy, Mr. Foley, thank you for the opportunity to be here today. My name is Jon Shaver, and I am Chief Operating Officer at DCS, headquartered in San Leandro, California. We have offices in Grants Pass, Oregon; Lathrop, California; and San Angelo, Texas.

I would like to make a few comments in the time I have available today. I have submitted more extensive comments in writing for the record.

The DCS is a debt collection firm that specializes exclusively in the collection of Federal and State debt. We are recognized in our industry as the benchmarking standard, consistently producing the best results for our clients. Our performance superiority is the result of our state-of-the-art technology, the professionalism of our staff, and knowledge gained from a quarter of a century practicing in the government debt arena.

We served following evaluation and selection in a national competitive process as a subject matter expert to advise the IRS with regard to its prospective contact collection services project.

In our experience, no government agency has ever conducted such a thorough and comprehensive planning and development process prior to implementation of a contract collection services project. The IRS deserves recognition and commendation for its process, and the results which are reflected in its draft plan.

We are a Member of a national industry coalition whose members include the major firms working for Federal and State governments in recovery of defaulted and delinquent government debt, including taxes.

We strongly support H.R. 1169. The experience of the Federal Government in planning and implementing supplemental contract collection services contracts has been excellent. Since 1990, for example, we have contracted with the Education Department for collection of defaulted student loans.

Today, the Education Department oversees a portfolio of nearly $13 billion and its contractors return hundreds of millions of dollars to the government each year. Many of the accounts in this portfolio, by the way, were previously designated as uncollectible.

The Treasury Department, pursuant to the Debt Collection Improvement Act (P.L. 104–134), is currently placing about $4.5 billion in non-tax Federal debt with contractors, again with outstanding results.

Performance-based contracting, strict standards, public accountability, and a blending of the best capabilities of the government

and private sectors in a partnership pursuing the public interest is a recipe for success, one which we endorse for application in the case of the IRS problem with delinquent tax accounts receivable.

Forty-two States now contact for supplemental collection services in the collection of delinquent individual and corporate income taxes. Those conducting well-planned professional programs are achieving excellent recoveries while ensuring fair treatment of all taxpayers through careful attention to privacy protection and due process.

The States have shown that use of contractors in tax collection, while the States retain the unique enforcement powers of government, is an effective and useful arrangement.

The private sector specializes in finding and contacting delinquent taxpayers and debtors, then working out voluntary repayment arrangements. It has no enforcement power of any kind nor would it under the provisions of this bill. It is precisely because of the lack of governmental powers that we are so successful. We have had to learn to find and work with taxpayers absent any direct threat of lien, levy, seizure or other adverse sanction.

Enactment of H.R. 1169 will produce positive results for the Federal Government. Delinquent taxes will be collected from individuals and corporations and otherwise unrealized revenue returned to the government.

A sense of fair play will be restored to the tax system. Voluntary compliance will likely increase as attention is paid to delinquent tax accounts receivable.

Thousands of private sector tax-paying jobs will be created without eliminating any IRS collection jobs. Taxpayer privacy will be protected. Taxpayer due process will be ensured, indeed may well be improved, as unresolved, unattended to accounts are acted upon and resolved either through payment, administrative resolution or appropriate action taken by IRS.

Working together, the Federal Government and private sector can truly partner again, as it has for many years in the Education Department and the Treasury Department, producing jobs, additional needed revenue, greater fairness in and compliance with the tax collection and administration system and confidence by the public that their government is paying attention to its and their business. We urge the Committee to act favorably on H.R. 1169. Thank you.

[The prepared statement of Mr. Shaver follows:]

Statement of Jon D. Shaver, Chief Operating Officer, Diversified Collection Services, Inc., San Leandro, California

Mr. Chairman and Members, good afternoon. My name is Jon Shaver. I am Chief Operating Officer at Diversified Collection Services, Inc. (DCS) headquartered in San Leandro, California. We have offices in Grants Pass, Oregon; Lathrop, California; and San Angelo, Texas.

DIVERSIFIED COLLECTION SERVICES BACKGROUND INFORMATION

DCS specializes in assisting federal and state government agencies in recovery of delinquent and defaulted debt, both tax and non-tax. In our industry, we are recognized for producing the best results for our clients and are considered the benchmarking standard against which the performance of other firms is measured. Our performance superiority is a result of our state of the art technology, the professionalism of our staff, and the knowledge gained from over a quarter century of practice in the government debt collection arena. For the Federal Government, we

have been effectively collecting defaulted student loans since 1990 pursuant to several contracts managed by the U.S. Department of Education. Additionally, we are now in our second contract with the U.S. Department of the Treasury, where our work focuses on recovering non-tax debts owed the Federal Government.

In addition to our work with the Federal Government, we also provide collection services for numerous federally chartered state student loan guarantee agencies. Lastly, we contract with numerous states to provide supplemental collection services for the recovery of delinquent tax accounts receivable.

HOW THE PRIVATE COLLECTION INDUSTRY WORKS

The private collection industry, almost exclusively, provides its services to clients—whether government or private sector—on a contingent fee basis. That is, we receive payment generally only in those instances where we produce a successful resolution result. In most instances, resolutions are in the form of payments but, in the government debt arena, we are also often compensated for administrative resolutions as well. An administrative resolution is one that closes a case without a payment—examples include for reasons of death, permanent disability, eligible bankruptcy, defunct corporations, and so on.

FEDERAL CONTRACT COLLECTIONS EXPERIENCE HAS BEEN EXCELLENT

The experience of the Federal Government with contract collection services has been outstanding. Today, the U.S. Department of Education, pursuant to the requirements of the Higher Education Act, manages a nearly $13 billion dollar defaulted student loan portfolio—many of these loans being previously designated as uncollectible—and is recovering hundreds of millions of dollars per year from it. The U.S. Department of the Treasury, pursuant to the Debt Collection Improvement Act, is currently placing more than $4.5 billion in non-tax federal debts for collection with outstanding results. These programs encompass all debt—with some special international exceptions—except delinquent taxes, owed to the government of the United States. The government's experience has been positive as these contracted efforts embody best industry and government collection and contract oversight practices, along with a very public accounting and accountability process. Strict standards, performance based contracting, public accountability, and a blending of the best capabilities of government and the private sector in a partnership pursuing the public interest is a recipe for success—one which we endorse for application in the case of the IRS's major problem with delinquent tax accounts receivable.

WE RESPECT THE DEBTORS AND TAXPAYERS WITH WHOM WE WORK

We are aware that, because of taxpayer abuses by IRS in the past, there is concern about the application of the industry standard of contingent fee compensation. We make careful effort here to point out that private industry has no reputation for taxpayer abuse. We do not have power to threaten, intimidate, or harass as a result of enforcement powers. We do not determine debts owed. We are legally required to work with and assist taxpayers who dispute their tax debts. Taxpayers with whom we deal have immediate access to remedies that can strongly sanction improper conduct. The private debt collection industry has decades of experience in consumer protection and respecting due process.

TWENTY-FIVE YEARS OF CONSUMER PROTECTION

This year marks the twenty-fifth anniversary of the landmark Fair Debt Collection Practices Act, the template for today's consumer protection standards. The private consumer sector has a mature and robust body of consumer debt protection law in place that the private collection industry conforms to lock-step. If we were to fail to honor these laws, we would lose contracts, be subject to civil penalties, lose our reputations, and ultimately go out of existence. Actual experience shows that our behavior is just the opposite of the stereotypical view. Our industry makes literally millions of contacts per year, with only an occasional compliance problem.

Finally, while many people would prefer that we not contact them and remind them of their obligations, there are many that have thanked us for our professionalism and for relieving them of the worry and adverse effects of having unpaid government obligations hanging over them.

We are an industry that relies on providing information, communication, and assistance in the decision-making relating to debt resolution for both individuals and corporations. We have no power of any kind, neither to harass or intimidate anyone nor to take any enforcement action resulting in involuntary surrender of property or assets. Our effectiveness is achieved because we are better at finding missing people and corporations than is the government and in communicating with them in an effort to find ways to assist them in voluntarily resolving their obligations.

SERVICE AS A SUBJECT MATTER EXPERT TO THE IRS

Because the depth and breadth of our experience, we were selected through a national competitive review process to consult with the Internal Revenue Service, along with two other national collection services firms, regarding its prospective supplemental contract collection services project. This project, which would require the authority and provisions contained in H.R. 1169, would involve the IRS's use of private collection firms to supplement the collection function of the IRS. More specifically, it would involve limited collection activities by private firms to recover delinquent tax accounts receivable in business and corporate cases where the delinquent tax obligation is undisputed by the taxpayer.

With more than twenty-five years of experience in federal and state contracting for collection services as context, we can say unequivocally that the planning and program development process employed by the IRS staff in developing the contract collections support program is the best, most thorough, and complete process ever conducted. Examination of industry and other government best practices, consultation with industry as to the practicality of certain concepts, an overarching concern for taxpayer privacy protection, assurance of taxpayer due process, and a strongly focused sense of fairness and equity toward all taxpayers are among the highlights of the exemplary effort of the IRS relating to this project. IRS's preparation and dissemination for public review and comment of a comprehensive and detailed draft Request for Information should give Congress and the public comfort that the IRS has been careful and deliberate in its planning. The scope and intent of the project is clear and is intended to use the private sector only on a limited basis to do what it does best—find and contact delinquent individual and corporate taxpayers and provide them with information and assistance on how to best voluntarily resolve their tax delinquencies.

DCS IS A MEMBER OF A NATIONAL INDUSTRY COALITION

DCS is a member of a broad-based national coalition of private sector collection and debt recovery firms that strongly support the idea of supplemental contract collection services for the IRS and that, accordingly, supports H.R. 1169. We in industry have had ample time to publicly discuss the IRS draft Request For Information, the process by which it was developed, the effects of placing the volume of delinquent federal tax accounts receivable on the capacity of the private sector, and other related issues.

WHAT WILL BE ACCOMPLISHED IF H.R. 1169 IS PASSED?

DCS, consistent with the opinion of others in our industry, believes firmly that the supplemental contract collection services program envisioned by the IRS and as reflected in the language of H.R. 1169 will do several things:

- Restore a sense of fairness to the tax system—although some may not like paying taxes, all will be treated fairly and consistently.
- Improve voluntary compliance and disincentivize the waiting game. No individual or corporation will be rewarded by simply "outwaiting" an overburdened IRS until the statute of limitations runs its course.
- Find missing taxpayers—by bringing the technological superiority and flexibility of the private sector to bear on the problems of finding and contacting "skipped" taxpayers; that is, those who have moved and are unlocatable by the IRS. Simply put, the private sector's proprietary tools for finding and working with such individuals and corporations are unparalleled.
- Enhance IRS's level of customer service to all taxpayers—private contractors will locate and contact each delinquent individual and corporation and work through the process of achieving a voluntary financial or administrative resolution where possible. Additionally, private firms will be readily accessible to taxpayers and will maintain a continuous relationship with those in repayment arrangements, assisting them as needed throughout the repayment process. IRS staff will be able to focus on complex cases requiring their special training and expertise using tools uniquely available to them.
- Produce revenue for the government, very likely in excess of the government's current estimates of recovery.
- Create needed jobs—thousands of private sector tax-paying jobs will be created without transferring or eliminating existing or authorized federal tax collector positions—our private sector effort will be limited to resolving the backlog of delinquent tax receivables and will in no way be involved with current year receivables. Moreover, the private sector will only have authority to work out voluntary arrangements with taxpayers as no enforcement authority will be conveyed whatsoever.

KEY ASPECTS OF TAX COLLECTION ARE NOT INHERENTLY GOVERNMENTAL

We have occasionally encountered, during our many discussions with members of Congress concerning H.R. 1169, the notion that tax collection is an "inherently governmental" function that ought not be contracted for. While we would agree that seizing an individual's or corporation's assets, implementing a lien or levy, or conducting a criminal investigation are clearly functions that ought to be limited to the role of government, we are unconvinced that finding and talking to taxpayers about tax debt owed the government is the exclusive domain of government. Our view in this regard is held by forty-states in the United States, all of whom contract for supplemental collection services in the recovery of delinquent individual and corporate tax debt.

THE EXPERIENCE OF FORTY-TWO STATES IS INSTRUCTIVE

The states recognize, from long experience, that the private sector has an important and useful contribution to make in the recovery of delinquent tax debt, even though the scope of engagement of private collection firms in the service of the states is limited to the same role that the IRS envisions for its program—that is, finding and contacting delinquent taxpayers and working through voluntary repayment plans with them or referring back to the IRS for an appropriate administrative resolution (hardship, death, disability, innocent spouse, etc.) or other action. The experiences of the states vary based on what type of supplemental collection support program they conduct and depending on the extent to which best practices are embedded in their programs. Those conducting well-planned, professional programs are achieving excellent recoveries and ensuring that all taxpayers are treated fairly, with intense focus on ensuring taxpayer privacy and due process protection. Nearly all of the states have in place well-developed Taxpayer Bills of Rights and additionally, the fundamental consumer protections embedded in the federal Fair Debt Collection Practices Act are made applicable to states' taxpayers by means of contractual provision.

TAXPAYER PRIVACY, DUE PROCESS RIGHTS, AND CONFIDENTIALITY WILL BE PROTECTED

A fundamental concern of Congress with regard to IRS contract collection services has been and continues to be taxpayer privacy, due process protection, and data security and confidentiality. These issues are also of concern to the IRS, as reflected in its draft Request For Information document, and to the private sector that would be responsible for compliance. We are confident that the data security and confidentiality safeguard provisions that the IRS envisions are readily implementable, auditable, and practical. We are certain that abiding by the requirements for due process and professional treatment of all taxpayers is readily achievable. How do we know? We know because we have been providing similar levels of protection for our other state and federal customers and their taxpayers, borrowers, and debtors for many years. While we are particularly sensitive to the issues of taxpayer abuse that Congress has periodically addressed through the Taxpayer Bills of Rights and the Restructuring and Reform Act of 1998, we are nonetheless confident that we can meet the strict standards that Congress and the IRS will impose through the provisions of H.R. 1169 and contracts issued pursuant to it. Moreover, we will continue to apply the consumer protection standards that other applicable federal statutes require while performing tax collection services for the Federal Government.

THE IRS CONTRACT COLLECTION SUPPORT PROGRAM IS FEASIBLE

Finally, we would offer our view that the supplemental contract collection support activity envisioned in the bill is practical and feasible. As noted earlier, the private sector stands ready to assist the government in this undertaking, having in place the technical and people capability and capacity as well as the means to quickly expand both in service to the IRS. The program that H.R. 1169 would authorize and that is reflected in IRS's publicly vetted plan document is one that reflects learning from past incomplete efforts, as well as the very best practices reflected in other successful federal and state public debt collection work.

RECOMMENDATIONS TO IMPROVE THE CURRENT BILL

While the fundamental provisions of H.R. 1169 are solid, we would suggest that the Committee consider amending the bill to expand the scope of the value of tax accounts that would be placed for collection. The IRS, in its draft Request For Information, has identified at least $30 billion in receivables that would benefit from the efforts of the private sector. Extending the scope from $13 to $30 billion would ensure that a more balanced portfolio, including mid-balance and high-balance accounts would be placed for collection. Moreover, the government would receive sig-

nificantly greater revenues. Our industry has been consistent on this recommendation and we make it again here, subject to the provision that implementation would be administratively feasible and that the implementation would be within a three year period from date of enactment of H.R. 1169.

We have also suggested some technical changes to ensure that there is greater clarity with respect to ensuring that existing laws not be in conflict as a result of contracting procedures or requirements and that there be an administrative process available to taxpayers, similar to that in place for the IRS, to resolve disputes quickly and without litigation. We would note quickly that no taxpayer would be precluded from litigation under existing federal law; rather, this provision would simply standardize and harmonize remedies for complaint resolution.

Our recommended language has been submitted to staff for your consideration.

H.R. 1169 IS A GOOD GOVERNMENT MEASURE

Good government opportunities may be many, according to some observers. However, few are as clear as this one. Working together, the government and private sector can truly partner and produce jobs, additional revenue, greater fairness in the tax collection and administration system, and confidence by the public that their government is paying attention to its business.

Thank you for this opportunity to hear our views on this matter. I would welcome any questions that you may have.

Chairman HOUGHTON. Thank you, Mr. Shaver, very much. Ms. Wu.

STATEMENT OF CHI CHI WU, ATTORNEY, NATIONAL CONSUMER LAW CENTER, BOSTON, MASSACHUSETTS

Ms. WU. Mr. Chairman, Representative Pomeroy and Representative Foley, the National Consumer Law Center thanks you for inviting us today to testify regarding the proposal to employ private debt collectors to collect IRS tax debts.

As consumer law specialists, we have over 30 years of experience in debt collection matters, and it is from that perspective that we raise grave concerns about this proposal.

The debt collection industry has a record of aggressive members who abuse and harass consumers. While there are many debt collectors who obey the law, there is a significant minority who do not. Don't just take our word for it. A FTC report said the debt collection industry is the FTC's single-most complained about industry for 4 years running. Over 25,000 complaints in 2002 and the FTC says this is the tip of the iceberg.

What kind of complaints are we talking about? Threats of violence, obscenities, racial slurs, midnight calls, lewd language, threats of immediate arrest and imprisonment and debt collectors posing as government officials.

Now, we have heard it said that the Education Department's use of private collectors is a success story and a model for the IRS. I am sorry to tell you from the consumer perspective this is not true. There certainly have been abuses in the student loan context. Private collectors have misrepresented themselves as the Education Department. They have overcharged consumers for collection fees, used misleading telegrams, browbeat borrowers into unaffordable payment plans despite the protections of the Higher Education Act (P.L. 89–329), and threatened to offset Supplemental Security Income (SSI) benefits even though SSI benefits are protected from offset.

Now, some of the abuses in the student loan context have specifically arisen because of the fact that a Federal Government program is involved. Student loan borrowers have many rights such as discharges, exemptions and deferrals, creating a complex scheme, but many private collector employees don't know enough about the scheme, resulting in consumers being deprived of important options that they are entitled to.

Based on this experience, we believe that IRS collection of its own debts will not only be more cost effective, but it will ensure that taxpayer rights are better protected. The IRS employees understand tax law, tax procedure, and taxpayer rights.

Now, if you insist on going forward with this proposal, it must be significantly revised to include strict taxpayer protections in the statutory authorization. I will mention a few.

First, private collectors cannot be compensated on the basis of contingency alone, because it creates too potent a motivation for collectors to engage in aggressive tactics while ignoring taxpayer rights. That protection must be in the statute. Financially distressed and low income tax payers eligible for special IRS protection should not be targeted by private tax collectors. Studies have shown that many consumers fall behind on their debts not because they are deadbeats, but because something unexpected and catastrophic has happened: a serious illness, a death in the family, the loss of a job. To sic private collectors on these already vulnerable families is simply unconscionable.

Let us not be under any illusion that the private collectors are going to go after the high-flying tax cheats. It is not the modus operandi of private collectors to handle complex tax shelters, fraudulent property transfers, or discover hidden assets.

Private collectors must not be permitted to use the powerful administrative remedies of levies, liens, and garnishments. Such protections must be in the statute and there must be prohibitions against any threats of such administrative remedies.

Private collectors must be covered by all of the protections in the FDCPA. H.R. 1169 currently does not do that. It applies the fair tax collection rights at section 6304 of the IRS code. This is not adequate because certain critical protections are missing from the IRS version, and currently the FDCPA does not apply to tax debts. They are not considered consumer debts under that act.

Private collectors must be required to return a case to the IRS if there is contested liability or if the taxpayer seeks a settlement or a payment plan. That last point is very important because payment plans involve the exercise of discretion. We have heard too many horror stories in the student loan context of borrowers being browbeat into payment plans they cannot afford, the payment plans fail, and it creates more financial distress for the taxpayer.

Taxpayers must be given adequate disclosures of their rights, remedies, and there should be a prominent disclosure that the collector is not the IRS but a private contractor and is not entitled to use IRS special administrative remedies.

There must be a strict and meaningful oversight system over private collections including a toll-free complaint line, privacy rights of taxpayers must be stringently protected, and last but not least, there should be a private right of action for taxpayers to sue pri-

vate tax collectors who violate their rights with significant penalties for violations. This will complement limited IRS resources and oversight.

Use of section 7433 of the IRS code as currently proposed is inadequate because that provides only for actual damages which alone will not be enough to deter abuse. Private collectors will shrug off lawsuits as a slap on the wrist. Only when we have strong private attorney general enforcement with public oversight can we even attempt to have a private debt collection scheme that balances collections with fairness to taxpayers. Thank you for the opportunity to testify today.

[The prepared statement of Ms. Wu follows:]

Statement of Chi Chi Wu, Attorney, National Consumer Law Center, Boston, Massachusetts

Mr. Chairman, Representative Pomeroy, and Members of the Subcommittee, the **National Consumer Law Center** thanks you for inviting us to testify today regarding the proposal to employ private debt collectors to collect IRS tax debts. We offer our testimony here on behalf of our low income clients, as well as the **Consumer Federation of America.**[1]

The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen many examples of harsh and abusive debt collection practices against low-income people in almost every state in the union. It is from this vantage point—many years of observing the harassment against the less sophisticated and less powerful in our communities—that we supply these comments.[2]

The use of private debt collectors to collect tax debt raises a number of serious concerns. We believe the IRS should not use private debt collectors, for a number of reasons:

- The debt collection industry has a record of aggressive members who abuse and harass consumers. The potential of exposing millions of taxpayers to collector abuse in the name of the United States will undermine the sense of faith and fairness in our government and tax administration.
- IRS collection of its own debts will be more cost efficient, and it will ensure that taxpayers rights are better protected. IRS employees understand tax law, tax procedure, available payment options, and taxpayer rights and remedies.

If this proposal does go forward and private collectors are used, the proposal must be significantly revised to include strict taxpayers protections, such as:

- Private tax collectors cannot be compensated on the basis of contingency or commission alone. Financially distressed taxpayers eligible for special IRS protections should not be targeted by private tax collectors.
- Private tax collectors must not be permitted to use the powerful array of special administrative remedies that Congress has granted the IRS.
- Private tax collectors must be covered by all of the protections in the federal Fair Debt Collection Practices Act, including the requirement to stop contacting a consumer if a cease communication letter is sent.
- Private collectors must be required to return a case to the IRS if there is contested liability or the taxpayer seeks a settlement or payment plan.
- Taxpayers who are subjected to private tax collection must be informed of all of their rights, remedies, and available options.
- The privacy rights of taxpayers must be stringently protected.
- The IRS must institute a strict and meaningful oversight system over private collections, including a toll-free complaint line.

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[1] The **Consumer Federation of America** is a nonprofit association of almost 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

[2] In addition, NCLC publishes and annually supplements sixteen practice treatises which describe the law currently applicable to all types of consumer transactions, including Fair Debt Collection (4th ed. 2000 and Supp.) and Student Loan Law (2d ed. 2002).

- There must be a private right of action for taxpayers to sue private tax collectors who violate their rights, with significant penalties for violations.

Debt Collection Industry's Record of Abuse

While there are many debt collectors who obey the law, there is a significant minority who do not. These collectors pound away at Americans who've fallen behind on their debts with tactics that can be both frightening and illegal. In addition to the horror stories we at the National Consumer Law Center know about, statistics from the Federal Trade Commission tell a similar story. In 2001, the latest year available, the FTC received 15,819 consumer complaints about debt collection agencies—giving debt collectors the impressive title of the FTC's most complained-about industry for the third year running.[3] Furthermore, the FTC report characterizes this the tip of the iceberg, stating: "The Commission continues to believe that the number of consumers who complain to the agency represents a relatively small percentage of the total number of consumers who actually encounter problems with debt collectors."

What kind of misconduct has been documented in the debt collection industry? The FTC report cites harassment, threats of violence, racial slurs, calling consumers' work places, revealing alleged debts to third parties and demanding excessive payments. At the National Consumer Law Center, we hear about midnight calls, obscene and lewd language, threats of immediate arrest and imprisonment, bogus threats to seize property without judicial process, and debt collectors posing as government officials.[4]

History of Collection Abuses for Student Loans

Some have said that the Department of Education's privatization of collections is a success story and should be a model for the IRS. I'm sorry to tell you that from the consumer perspective, this is not true. Many of the debt collection abuses I speak of have occurred in the student loan context. Private collectors of student loans have repeatedly deliberately deceived consumers by misrepresenting themselves as the Department of Education. They've overcharged consumers for collection fees, used misleading telegrams to trick borrowers, browbeaten borrowers into unaffordable payment plans, threatened them with actions that collectors can't take, and pressured consumers to borrow from relatives.

Moreover, one of the three collection agencies that IRS has chosen to ask for advice on privatizing tax collections has been the subject of repeated lawsuits over its student loan collections.[5] Another company expected to bid on this proposal has been known to misrepresent itself to consumers by using the Department of Education's name on its stationary and to intimidate and confuse consumers with its claim of affiliation with the IRS.[6]

Some of the abuses in the student loan context have specifically arisen because of the fact a Federal Government program is involved. Student loan borrowers have many important rights, such as discharges, deferments, different payment options, and exemptions, creating a complex scheme for collections. Yet many private collectors do not have enough knowledge about these schemes, which results in consumers being deprived of important options to which they are legally entitled. Even worse, some private collectors misrepresent these rights or steer consumers into options more profitable for the collector. For example, collectors have been known to strong-arm student loan borrowers into agreeing to payment plans that the borrowers could not afford and did not want, despite the consumer's rights under the Higher Education Act to a reasonable and affordable payment plan.[7] Collectors have threatened to offset federal benefits for SSI recipients, even though SSI benefits are protected. They steer consumers into loan refinancing options which may not be appropriate for the consumers. Some collectors aggressively threaten wage garnishments, failing to inform or misrepresenting the rights of consumers to hearings

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[3] Federal Trade Commission, Annual Report: Fair Debt Collection Practices Act (June 2002)

[4] See, e.g. Jean Chatzy, Stop Calling Me!, Time Magazine, March 10, 2003, at 68; Andrea Coombes, Debtor Abuse, CBS Marketwatch.com, February 20, 2003, available at www.CBSmarketwatch.com.

[5] See Romine v. Diversified Collection Services, 155 F.3d 1142 (9th Cir. 1998); Kort v. Diversified Collection Services, 2001 WL 881449 (N.D. Ill. August 2, 2001); Farley v. Diversified Collection Services, 1999 WL 965496 (N.D. Ill. September 30, 1999).

[6] See Peter v. GC Services, 310 F.3d 344 (5th Cir. 2002); Gammon v. GC Services, 27 F.3d 1254 (7th Cir. 1994) (debt collector used its status as IRS software vendor to imply to credit card debtors that it had special access to IRS).

[7] See, e.g., Arroyo v. Solomon and Solomon, 2001 WL 1590520 (E.D.N.Y. Nov. 16, 2001).

and exemptions. Others charge collection fees that exceed the amounts authorized by Department of Education regulations.[8]

Tax Debts Will Be Collected More Efficiently and Fairly by IRS Employees

The administrative scheme and rights of taxpayers under tax law is just as complicated as that under student loan law, if not more so. The potential for collectors to misunderstand or misrepresent these rights or steer taxpayers away from options that do not as richly compensate the collector is even more worrisome. Of course, the complexity of the tax scheme raises the simple question—why not give the IRS adequate resources to do its job. The IRS is uniquely qualified to collect taxes—its employees understand tax law, tax procedure, available payment options, and taxpayer rights and remedies. If IRS is not being given by the Congress the resources it needs to do additional collections, Congress should provide adequate resources to the IRS, and not give up precious tax dollars and the well-being of taxpayers to an aggressive industry well-known for abuses amongst its ranks.

Furthermore, this proposal will not provide more money to Treasury, or it will do so on the backs of those least able to defend themselves. Collection agencies will want the easiest, freshest, least complicated cases. These are the same cases, however, that IRS could easily handle. Such "cherry picking" will ultimately mean fewer, not more, tax dollars in the coffers of Treasury.

As for those high flying tax cheats, the public should not be under the illusion that private collectors will solve that problem. It is not the modus operandi of private collectors to handle complex tax shelters, fraudulent property transfers, or discover hidden assets. They will not want to deal with millionaire tax dodgers with phalanxes of high-priced lawyers. Private debt collectors will want cases involving middle and working class wage earners, whose salaries are easily garnishable and who are unable to afford legal representation.

Collector Compensation Should Not Be Based on Contingency Alone

While not perfect, another reason IRS employees are preferable to private debt collectors is that IRS employees do not have the powerful incentives that encourage them to pursue measures that are not in the best interests of both taxpayers and the tax system. The current proposal to pay collectors 25% is a recipe for abuse and harassment. Even though the collectors' fees are not added on top of the tax debt, a 25% contingency system provides a potent motivation to collectors to engage in aggressive tactics, while ignoring taxpayer rights. After all, every dollar collected from a taxpayer means 25 cents for the collector, which inevitably will spur certain collectors to push the envelope and the law. In addition, collectors will steer taxpayers away from less profitable options to which the taxpayer is entitled. One simply cannot have a proposal to use private debt collectors that is fair to taxpayers if the compensation structure is based on contingency alone.

Financially Distressed Taxpayers Should Not Be Targeted by Private Tax Collectors

Many taxpayers who owe tax debts are not deadbeats. Studies have shown that overwhelmingly consumers fall behind on their debts because something unexpected and catastrophic happened—a serious illness, a death in the family, the loss of a job. Very few consumers deliberately avoid their debts when they have the ability to pay them. The majority of debtors are your friends, relatives, and neighbors—good people who want to pay their debts but simply can't and still stay afloat, and who have every intention of paying once they get back on their feet. To let loose private hired guns on these already vulnerable families will only cause increased family distress and social costs that can be substantial.

Thus, if IRS is permitted to farm out its collections to private debt collectors, a critical issue will be the selection of which taxpayers will be subject to that collection. Currently, there are significant protections for low-income and financially-distressed taxpayers, including the availability of "currently not collectible" status. It would undermine the fundamental fairness of tax administration to permit private debt collectors to target families that qualify for taxpayer protections based on their sheer poverty. Without clear safeguards keeping private collectors targeted at higher income tax delinquents, private collectors will have few scruples about using strong pressure for payments from financially distressed households. IRS employees are reputed to be strong collectors but most will work with families that have fallen on hard times.

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[8] See, e.g., Padilla v. Payco General American Credits, 161 F.Supp.2d 264 (S.D.N.Y. 2001).

Taxpayer's Rights Must Be Protected

Other strict protections must be included in any legislation permitting private tax collection, to avoid the abuses we've seen in the student loan area. First, taxpayers must unequivocally, clearly and conspicuously be informed of all their rights and the types of relief available to them. As mentioned earlier, student loan private collectors have an abysmal record of according consumer loan rights, such as fraudulent school discharges to fraud victims, loan deferments to returning students. Thus private debt collectors must be required to provide a copy of IRS Publication 1 (Your Rights as a Taxpayer) and Publication 594 (The IRS Collection Process) with the first written communication or within 5 days of the first oral communication.

Private collectors cannot be permitted to use IRS administrative remedies, such as non-judicial levies, liens, and garnishment. In the student loan context, the use of administrative garnishments has given collectors an overwhelming weapon with which to wring submission from borrowers, using threats to bully those who are entitled to discharges or other remedies. Imagine what private debt collectors, some of whom are already known for making bogus threats to seize homes to frighten consumers, will do if they actually have the power to place non-judicial liens on a taxpayer's home. Not only should collectors not have special administrative remedies, there must be strict prohibitions against collectors representing or implying that they have the right to use such remedies, with significant penalties for violation. A false threat is just as devastating for unsophisticated taxpayers.

Private Tax Collectors Must be Covered By ALL of the Protections Under Federal Debt Collection Law

Private collectors of IRS debt must be covered by Fair Debt Collection Practices Act (FDCPA).[9] The FDCPA provides the most important protection for consumers from abusive or unfair actions by debt collectors. While a few states have adopted similar statutes, in the overwhelming majority of states, the FDCPA remains the primary law specifically delineating the permissible activities of debt collectors. The finding articulated by Congress in 1978 remains valid today, in that "[e]xisting laws and procedures [other than the FDCPA] for redressing these injuries are inadequate to protect consumers" 15 U.S.C. § 1692(b).

The FDCPA establishes general standards of proscribed conduct, defines and restricts abusive collection acts, and provides specific rights for consumers.

The standards protect a consumer from invasion of privacy, harassment, abuse, false or deceptive representations, and unfair or unconscionable collection methods.

- Specific acts that are prohibited include late night or repetitive phone calls and false threats of legal action.
- The Act gives a consumer the right to require a collector to stop all collection contacts.
- It requires a collector to deal with a consumer's attorney when the consumer has one.
- It gives a consumer the right to require a collector to verify the existence, legality, or amount of a disputed debt it is attempting to collect.
- The courts require strict adherence to the Act's explicit terms to accomplish the remedial and preventative goals of Congress.

In fact, the FDCPA was the model for the fair tax collection rights at 26 U.S.C. § 6304. However, certain critical FDCPA protections are missing from section 6304, and mere application of that section as currently proposed is not enough to protect consumers.[10] In particular, private collectors must be subject to section 1692c(c) of the FDCPA, which requires that they cease contacting a consumer, with certain exceptions, if the consumer sends a written notification stating that the consumer wishes the debt collector to cease further communication with the consumer. This is the single most important "release valve" for distressed families to avoid harassment and get an aggressive collection agency off their backs immediately, without need to resort to a lawsuit or a cumbersome complaint process. When a consumer is being harassed by a debt collector, even a few weeks delay can cause unbelievable stress and anxiety on his or her family. Of course, the IRS will have the option of

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[9] Private collectors of tax debts are currently mostly likely not covered under the FDCPA because tax arrears are not considered consumer "debts" under that Act. See Pollice v. National Tax Funding, 225 F.3d 379 (3rd Cir. 2000); Beggs v. Rossi, 145 F.3d 511 (2nd Cir. 1998).

[10] The omission of certain requirements in 26 U.S.C. § 6304 is not surprising since that section was intended to apply to IRS collectors, i.e., the original creditor. Original creditors are usually subject to fewer requirements than third party collectors. However, since the IRS is proposing to use third party collectors, all of the requirements of the FDCPA must apply to those entities.

taking the case back or pursuing administrative or legal remedies if the consumer has sent a cease communication letter.

Private Tax Collectors Should Not Be Permitted to Handle Contested Liability, Offers-in-Compromise, or Payment Plan Negotiation

Another important right not present in 26 U.S.C. § 6304 is the right to validation of a debt. Section 1692g of the FDCPA gives the consumers the right to dispute a debt or its amount, and requires the debt collector to go back to the creditor to verify the debt. For tax debts, we believe there should be a special validation requirement, in that if the consumer disputes liability or amount, the case must be returned back to IRS. Private debt collectors cannot be permitted to handle issues of contested tax liability. Unsophisticated taxpayers must be protected from paying amounts that are not actually owed—an accurate determination of tax liability is beyond the ability of most consumers and will not be in the interest or within the skills of the private tax collector.

Furthermore, the case must be returned to IRS if the taxpayer wants a payment plan or settlement—these options cannot be negotiated by collector. As discussed earlier, private collectors have a history of browbeating consumers into payment plans they cannot afford. Not only will an unrealistic payment plan result in more taxpayer distress and ultimately prove a failure, but it will undermine the ability of the taxpayer to ensure that she can pay this year's tax obligation, thus subverting current tax compliance to line the private collector's pockets.

Under the FDCPA, consumers must be given certain notices, including information about the right to have the debt validated. Because of the unique nature of tax debts and the options available to taxpayers, taxpayers must be given additional information in plain language so that they are informed of their taxpayer rights. This notice must inform taxpayers of the right to return the case to IRS if the consumer: 1) disputes liability or amount of liability; 2) wants to apply for an Offer-in-Compromise; or 3) wants a payment plan. In addition, the written communication should include notice of the taxpayer's FDCPA rights, including the right to send a cease communication letter. It should include a prominent disclosure that the collector is not the IRS, but a private contractor and is not entitled to use special IRS administrative remedies. Finally, as discussed above, copies of IRS Publication 1 and 594 should accompany the written communication.

Taxpayer Privacy Must Be Protected

Another concern is the privacy rights of taxpayers. The IRS treats personal tax information as confidential and private. There must be strict prohibitions against use or sharing of IRS data for purposes other than collection of federal tax debt. This prohibition must include sharing of information internally within a private collection agency and with affiliates or credit bureaus. The current proposal would impose on private collectors the same restrictions against dissemination of taxpayer information as IRS employees are currently subject to. However, even when privacy protections exist, private contractors have an abysmal record of protecting the confidentiality of taxpayer information.[11] It is not difficult to posit that taxpayer privacy will be compromised as tax returns are shared with increasing number of collectors, many of whom may have other debts they are pursuing against the taxpayer, such as state tax debts[12] or consumer credit debts. After all, if a taxpayer is unable to pay his federal tax debts, it is likely he cannot pay his state tax debts or his credit cards debts—and the information in the IRS database will be temptingly available for the private collector to use to collect those debts as well.

The IRS Must Establish a Strict Oversight Program and a Meaningful Complaint Process

Private debt collectors have never been completely successful with clamping down on the bullying culture within their ranks. If there are those debt collectors who have no compunction against violating the FDCPA and other laws, even official IRS prohibitions may not be adequate. This is a risky experiment, at best, that the IRS is proposing. Thus, the IRS must establish a stringent oversight and monitoring program for its private collection program. There must be frequent audits and compliance reviews with real penalties for poor performance in respecting taxpayer rights. Employees of private debt collectors must be required to give out their real names and some sort of identifying information, so that rogue employees can be identified.

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[11] See, e.g., Office of the Inspector General, Social Security Administration, Federal Agencies' Control over the Access, Disclosure and Use of Social Security Numbers by External Entities, February 2003.

[12] An unanswered issue is how federal-state information sharing agreements on tax collection will play out when private debt collectors are involved.

One tactic used in the debt collection industry is that employees will refuse to give their names or will give false names so that consumers and their attorneys cannot track down the employee who actually perpetrated abuse. This permits the debt collection agency to disclaim responsibility for and knowledge of abusive employees.

There must be a toll-free complaint line and staff assigned specifically to deal with complaints. Furthermore, taxpayer complaints must be weighted seriously against a private collector. Many debt collection complaints are based on oral communications. The IRS must not be permitted to discount taxpayer complaints on the basis that "it's just your word against theirs."

Taxpayers Must Have the Right to Take Legal Action Against Private Collectors Who Violate Their Rights

In conjunction with a stringent IRS oversight program, there must be a private right of action for private collector violations, with significant penalties. To use the current scheme under IRC, 26 U.S.C. § 7433 is inadequate. Section 7433 only provides for actual damages; it does not provide for any statutory damages or the right to file class actions. The primary "actual damages" suffered by most victims of abusive debt collectors are those that flow from mental distress. Loss of sleep, anxiety, stress, and worry may be very hard to prove months and years later, and are always difficult to place a monetary value on. Also the cost and discomfort to the injured consumer of getting on the witness stand and reliving the collector's abuse during a former period of financial distress in order to prove actual damages deters many consumers. Without statutory damages or class actions, actual damages will not be adequate to deter abuse. Private collectors will shrug off lawsuits as a slap on the wrist or a cost of business. Only strong public oversight with private enforcement can ensure that we will have a private debt collection scheme that balances collections with fairness to taxpayers.

Conclusion

Based upon over 30 years of experience on behalf of consumers in debt collection matters, we at NCLC have grave concerns about the current proposal to permit IRS use of private debt collectors. The experience in the student loan context would predict, not a shining success as some have promised, but a legacy of taxpayers being harassed, deprived of their lawful rights and options, and mislead. Taxpayer abuse by private tax debt collectors will not reflect well on the IRS, our tax administration, or our government.

If this proposal is to go forward, it must be significantly revised to include strict taxpayers protections and a meaningful oversight system. Private debt collectors must not be permitted to use the special collection powers of the IRS, negotiate payment plans or settlements, deal with contested liability, or even hint that they can do any of the above. Private debt collectors should never be sicced on financially distressed low-income taxpayers. Private debt collectors must be bound by ALL of the requirements of the federal Fair Debt Collection Practices Act. Taxpayers must be informed of all of their rights and options in dealing with tax debt. Taxpayer privacy must be respected. Private tax collectors who violate the law must be subject to both meaningful sanctions by IRS as well as private enforcement. Only with all of these protections will we have a chance of avoiding the abuses that have plagued student loan collections as well as debt collection in the private sector.

Thank you for the opportunity to testify today.

Chairman HOUGHTON. Well, thank you very much, Ms. Wu. I have just got a couple of questions, one really to the three people, the head of the association and Mr. Smith and Mr. Shaver, and then I would like to ask one of you, Ms. Wu.

When you embark on a program like this, you are looking at three things. You are looking at costs, you are looking at return, and you are looking at service. So, really what abilities do your agencies have that the IRS does not have in this particular process of collections?

Mr. SMITH. Are you addressing that to me, sir?

Chairman HOUGHTON. Sure. Anybody, because you are representing the industry.

Mr. SHAVER. Mr. Chairman, the private sector has, as I commented, at least in my oral remarks, superiority in the technological field. Our primary capability that separates us from government in the arena of collection and specifically those accounts that are difficult to find and collect is our ability to locate individuals. That is number one.

Number two, I also commented that we have no enforcement capability. We have no ability to threaten people into submission. We do not adjudicate the tax determination. We do not initiate any enforcement activities, and so consequently whether it is in the area of tax collection or student loan or in any other area of debt collection, we have had to learn how to talk to people, communicate with them about their options, and our success only comes about when there is a voluntary plan to either make a payment in full or partial payment, an installment program or something of that sort. Those I think are two exceptional hallmarks of the private debt collection sector.

Chairman HOUGHTON. Okay. Thank you. Do you have any comments, Mr. Smith or Ms. Andersen?

Mr. SMITH. I would like to add that in the private sector, the collection agencies create a culture of success amongst its employees by beyond just the fact of compensation from a commission structure, and that in and of itself helps to create a more superior product when it comes to servicing our customers.

For example, we have employees share option plans that we bring to bear in respect to rewarding employees in the overall good of the performance of the agency under the particular contracting question. So, for example, we do not believe that there would be an issue, as Ms. Wu has already touched on, in respect to just being paid commission. This is a balanced matrix approach, and that is very important that we keep that in mind, and we think that the PCAs could do a superior job because of that balanced matrix performance measurement.

Chairman HOUGHTON. Good. Well, I assume that you agree with that; is that right, Ms. Andersen?

Ms. ANDERSEN. I certainly agree with their testimony. I would also like to add that there are several other motivators for collection agencies in terms of compliance with the law. One obvious one, I suppose, is the desire to perform adequately on any contract for any creditor. It also is to decrease any potential litigation against the agency.

My point is that an optimally run collection agency will have weekly appraisals performed internally where they literally look at any complaints, any disputes, any nonconformities with their collection activities, and what this results in is immediate remedial action in terms of correcting any problems with the messages left on machines, with the communications shared with consumers, with the collectors' tactics, with any actual communication deficiencies, whether it's in the written communication or the oral communication.

I would like to underscore that, in the modern collection agency, the goal is to understand the needs of the consumer and to collect debt based on that understanding—as opposed to a more tradi-

tional approach as has been suggested, where collection is done under threat.

Chairman HOUGHTON. All right. Well, thank you very much. Just very quickly, because my time has run out, Ms. Wu, you are worried about collectors being compensated solely on the basis of the amount they collect. If I understand it, there is a process there which sort of insulates that type of individual impetus to try to collect more and more and more and hurt the taxpayer, this thing called a balanced scorecard.

Also, when the results come in and the collections are made, they go directly to the IRS and then come back to the company. They don't go to the individual. The company decides what portion the individual will get.

Now, you can say that if somebody is very effective, he will get a different bonus, or he might get opportunities for advancement in the company, but basically my impression is there is a pretty good immunization that goes on here.

Ms. WU. Well, from what I understood from the National Taxpayer Advocate's comments, and I may be wrong, I just heard them for the first time, is that there would be this balanced scorecard, but compensation would be on the basis of contingency. So, that there might be incentives for customer service, but when it comes down to the bottom line, it is contingency and contingency only, and that is risky for consumer, for taxpayer rights. That really creates incentives.

It creates incentives not just for the agency but for the individual employees, because the individual employees are paid on the basis of commissions, and so they have the incentive to be as aggressive as possible. So, you may have an agency where not every single employee is engaged in aggressive tactics but some are, and the issue is if you have enough of those, if you have thousands out of the millions of taxpayers being contacted who have horror stories about aggressive tactics, that will undermine the sense of fairness in our government and our tax administration.

Also, even with a balanced scorecard approach to compensation, I believe it should be in the statute. The statutory formulation right now is contingency.

Chairman HOUGHTON. All right. Thank you very much. Mr. Pomeroy.

Mr. POMEROY. I congratulate the panel. It has been very interesting. Let me begin by just affirming for you my own support of your industry. Now whether or not your industry ought to be doing public debt collection, that is the question before us. Whether your industry ought to be doing private debt collection, I believe you play a critical part in the marketplace. People ought to pay what they owe.

Specialized techniques and infrastructure of developing debt collections obviously is a very important part of making the whole commercial world work, and so make no mistake about where I am coming from. I think you are an integral part of the marketplace. I commend you for what you do.

The question before us: should the IRS start just taking over debt over here? First, let us talk about student loan debt just for a minute as whether it offers any precedential value or not. To me

it's not as surprising that the Federal Government has enlisted private collectors for student loan debt as it is that the Federal Government is writing student loans in the first place. The Federal Government is basically discharging a private function: loans and loan administration.

So, the fact that in the exercise of that function, it would outsource debt collection seems to me entirely reasonable. Basically it's a private life function the Federal Government is doing in the first place, as opposed to tax collection.

Let us talk for a minute about that. I am not very familiar with this industry. Mr. Smith, you indicate that you are have operations in three countries with your company.

Mr. SMITH. Yes, Congressman.

Mr. POMEROY. Is it a U.S. domiciled company?

Mr. SMITH. We are a Toronto-based company from a global perspective. However, 100 percent of all of our business for the Federal Government student loan contract is operated out of the United States, and we are incorporated in the State of Delaware, and 100 percent of all the employees staffed are U.S. citizens.

Mr. POMEROY. How about other debt? Do you get across border, outsourced, you know you locate call centers wherever, within the United States, outside the United States?

Mr. SMITH. Yes, many organizations within our industry have multiple sites throughout the country as well as the world. As you know, of course, we are becoming more of a global economy, and it is just best practices to do so. In respect to the United States, we have Atlanta and Phoenix.

Mr. POMEROY. Things we might want to keep an eye on is this might not just involve then discharging debt collection or tax collection over to the private sector, but U.S. tax collection to outside of the border, other nationalities, other countries, could be, unless we tighten it up within the contract.

Mr. SMITH. No, that is not what we would include in our proposal, Congressman, and that is not the tact that we have taken with the Education Department, as well we have been awarded the contract by the Education Department with full understanding that we are a global organization.

Mr. POMEROY. These things have a——

Mr. SMITH. As well as approved by the U.S. General Services Administration.

Mr. POMEROY. The public perception matters. I hate the thought of a town meeting back in Bismarck where I am talking about this Canadian firm that we have hired to collect U.S. taxpayer debt. It just doesn't sit well with me somehow.

These techniques are quite interesting, and Mr. Shaver, you indicate that the lack of government powers is why you are so successful. I suppose you mean you have had to become more creative. How would you exercise your authority on behalf of the Federal Government? How would your firm in collecting debt? Would you have your private employees identify themselves as private employees or would there be an inference that they are working for the Federal Government or the IRS in their collection calls?

Mr. SHAVER. Typically we identify that we are a private firm under contract to whoever the client may be. We are contacting

whoever the individual is with respect to either a specific student loan obligation or a Treasury Department obligation, tax debt, this type of thing.

Mr. POMEROY. Would there be mailings that you would incorporate as part of your collection effort?

Mr. SHAVER. I would think so, yes.

Mr. POMEROY. Would they be also similarly identified making it very clear that it was a private contracting entity, or would this private firm be providing mailing that appeared to be public?

Mr. SHAVER. Our understanding is clear at this point that it is the intent of the IRS to provide us with a specific language that would be conveyed to taxpayers, but it would be on our letterhead as a contractor in the service of government.

Mr. POMEROY. My early days as an insurance regulator, I was often cracking down on agents that would send things looking like they were a Medicare offer.

Mr. SHAVER. I understand. We do not do that, and do not misrepresent our position.

Mr. POMEROY. You also indicate, Mr. Shaver, and this is a point that really my gripe is not with you on this, but you indicate this is going to restore a sense of fair play to the U.S taxpayer. I don't think so if basically the only new enforcement effort that we are talking about is this private outsourced activity involving that pool of taxpayer debt that is not fully collected but has been partially paid.

Again, not the difficult tax collection issues, not the tax shelters, not these other things. In my opinion, this is going to whack the middle-income taxpayer disproportionately to any other income segments of the taxpaying public.

Mr. SHAVER. I absolutely understand your concern, and let me say this about complex cases. We resolve some fairly complex commercial debt cases for the Treasury Department on a regular basis, and we are prepared to take on the caseload that IRS is given authority to assign to us to resolve.

My comments with regard to restoring a sense of tax fairness may just simply be the opinion of me and several other people with whom I work and discuss these matters. I pay my taxes. It may be impolitic in this house to say I don't always like to do that, but nonetheless I pay my taxes.

I want my neighbors to pay their share of the taxes and in cases where there are economic hardships, innocent spouse issues, those kinds of things, those matters ought to be resolved and not left lingering. There are resolution means administratively available for those kinds of cases to be resolved.

Mr. POMEROY. I totally agree with you. I really do. I think your industry helps people deal with that which they must do: pay what they owe. In the end they sleep better at night for it. It is the right thing to do.

Now, again, whether or not that effort by the Federal Government through its IRS ought to be given to others or whether we ought to staff up and do it, that is the question before us. I believe we ought to staff up and do it, as you obviously have been able to gauge from my comments today. I understand, however, your sig-

nificant contribution and helping people accept their accountability for their responsibilities.

Ms. Wu, I don't have a question for you. My time is up, but I think that you play a very important role as well, because in the tension that is in the marketplace in terms of collection activities, we need to have a pushback to make sure we are doing this within the bounds of acceptable play, so I commend you for your efforts as well.

Ms. WU. Thank you, sir.

Mr. POMEROY. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much. Mr. Foley.

Mr. FOLEY. Thank you, Mr. Chairman. I am very encouraged about the conversations. There are some obvious levels of concern. I have had my identity stolen, and credit run up on my account, and despite my best efforts with a collection agency—I repeatedly told them the story that I wasn't the person that they were trying to pursue. Each time they said fill out forms and send in the information; 3 or 4 days later, I would get someone else calling who was new to the case, and so I was browbeat day after day after day for a $786 charge that was made out in my name from Target.

So, I am somewhat sensitive to Ms. Wu's concerns, because I want to make certain as we are establishing a system by which we can forcefully get people to comply with the laws, but in cases like mine where I consistently was able to advocate the person who applied for this credit is not me, they stole my Social Security, they have a different address in Pompano, I have never lived there, and yet I went through probably a year and a half of what I unconsidered unmitigated harassment, calling the house, calling different and sundry people.

So, there are points in time when you start getting concerned are overzealous people trying to collect their wages or their debts when they have the wrong person? Will they ever give into the fact that they have made a mistake or somebody has made a mistake, there is fraud?

After a year and a half, I finally got it off my record, but I thought to myself, here I am a Member of Congress, I have the capabilities of calling people, I have the capabilities of talking. I could not imagine if I was a poor guy working all day, trying to raise a family, coming home at night, having to deal with this now, considering it is the fraudulent start.

So, I think we have got to establish that those provisions are, in fact, in this documentation. I would not mind if you would submit for the record your employment applications as to what you consider important when you hire somebody for debt collection, if you would supply that for us, criteria for employment, the actual application, educational requirements. Things of that nature I think would be helpful to see exactly how you pursue employees.

I assume we are not talking Wharton grads here that are going to be on the phone?

Ms. ANDERSEN. Might you also be interested in written testimony in response to your question about some characteristics of an optimum collection agency?

Mr. FOLEY. Yes.

Ms. ANDERSEN. Factors that may be considered?

Mr. FOLEY. Yes.

Ms. ANDERSEN. Okay.

[The information is being retained in the Committee files.]

Mr. FOLEY. These are important because the IRS, as you will remember, in Philadelphia recently had a firm that they had retained who was supposed to be processing IRS tax returns, and they apparently stuck them in a drawer and never quite got to them. So, in addition to collecting, we obviously ought to be processing these things. So, we are very, very cognizant of the fact.

Ms. Wu, you raised some questions, too, and I understood those, but they are part of the bill. Many of the concerns that you laid out are part of the bill, but you seem to be strenuously opposing the measure even with the safeguards that you ask be in here. They are here, so I am curious whether you like the proposal at all?

Ms. WU. Well, first of all, I would like to say that not all the safeguard I have proposed are in the bill. As I mentioned, there are some distinctions between application of the fair tax rights at 6403 of the IRS code and application of the FDCPA itself. There are some critical distinctions, as there should be, because the FDCPA applies to third-party debt collectors, whereas section 6403 applies to the IRS.

The IRS is the original creditor. Original creditors are subject to fewer requirements than third-party debt collectors, but when you are talking about third-party debt collectors, you need all of the protections of the FDCPA. You need all of the remedies in the FDCPA including statutory damages and class actions.

Right now the proposal is to impose the remedies of section 7433 of the IRS code which only provide for actual damages. There are other points, too. I think, contingency based compensation alone, it should not exist, and it should be prohibited in the statute.

Even with those protections, I have grave concerns about the use of private tax collectors to collect tax debts. Even with all of the protections of Federal laws, there are collection agencies and collection employees that engage in abusive tactics and as I said before, if you start getting those, even if it just a percentage of the actual collections that go on, it will undermine the sense of fairness in our government if a collector in the name of the United States starts screaming obscenities or calls at 4 a.m. in the morning, that reflects on the Federal Government.

So, yes, I have serious doubts about the bill even if everything that I suggest in my testimony were to be in place.

Mr. FOLEY. You do agree that those of us who pay our taxes should expect others to pay them as well?

Ms. WU. I agree, of course, everyone should pay their taxes. I think collection is best done by IRS employees who understand the collection process. They understand tax law. They understand tax procedure. They understand the different rights and remedies available to taxpayers. This has been one of the big problems in the student loan area, where folks who are entitled to special remedies, because, for example, they have been the victim of some sort of fraud. In this case, it would be trade school fraud schools that open up, don't really provide an education, and shut down, and the borrowers are left holding the bag. You know Congress recognized

this; the department recognized this. There are discharges available.

These students or these borrowers don't always get informed of their rights to a discharge. Instead, they get steered into private loan consolidations because the private loan consolidations frankly benefit the collector, and so, that borrower who had certain rights didn't know about their rights, was not informed of their rights, and ended up paying money that they should not have.

Mr. FOLEY. Let me ask you, though, a fundamental question. Would you assume, though, then if we had a government employee, an IRS employee making the phone call for collection purpose, you are assuming though that that IRS person, that employee, would understand the full complexities of the Tax Code.

Ms. WU. Well, they would have a better chance of it. The IRS is in the shoes of the original creditor. Original creditors certainly have been known to commit abuses, too, but it does not mean the situation is going to get better placed in the hands of a third-party debt collector.

Mr. FOLEY. Well, just to dispel the notion, one of our colleagues on the Committee, Clay Shaw, is a Certified Public Accountant and a lawyer, and he has somebody else do his taxes. That is pretty much what is happening in the complexities of the Code, so I am not sure the employees of the IRS are more capable of defining or understanding. That is why I am not so reluctant to look at a private vendor for purposes of collecting.

Ms. WU. I think an IRS employee has a better chance of understanding all the complexities or at least they will have more training and experience. One of the things I might suggest that you ask for is not only the employment qualifications for employees, but also their salaries and the turnover rate, because from what I understand some agencies have a fair amount of turnover and so even with training when you have a lot of turnover, you lose experience and especially with something as complicated as tax laws and procedures, losing that experience will mean less knowledge, and that will ultimately not be to the benefit of the taxpayer.

Mr. FOLEY. Mr. Chairman, could you indulge me one further?

Chairman HOUGHTON. Go ahead.

Mr. FOLEY. Thank you. In regards to the accusation of somebody swearing on the phone, yelling and harassing, that is something of interest to me having gone through this. I almost now wish I would have paid the person's bill, the $785, because it may have been far cheaper than putting up with the harassment that I received.

How do you screen people and how do you monitor their calling activities? If a person obviously is arrear in their payments, I guess you automatically assume to some degree they are a bad person. So, if they call and complain about harassment, would you accept that as a fact or would you assume that it is just this person once again trying to skirt their responsibilities? How do you determine your employees?

Ms. ANDERSEN. First of all, I am with the trade association so I do not actually perform debt collection services. I am the general counsel of the association that really provides training opportunities for companies.

Mr. FOLEY. If Mr. Shaver would like, whoever would like?

Ms. ANDERSEN. No, but I would not like to lose my chance to respond because it is absolutely critical for you to understand that in the training that we do provide, there is a script, which includes a strong message to the debt collectors that there is not a presumption that consumers are deadbeats. There is, in fact, an understanding that many people are literally strapped with resources. I would say that if I can offer nothing else to this testimony; I do want to dispel the notion that debt collectors come to work, licensed in as many as 34 States thinking that the people they are going to communicate with are either bad people or deadbeats or any of the stereotypes that you would like to overlay on those individuals, because that is not the current formula for success, if you will, in terms of collecting debts.

I would say that it is because of the beauty of the FDCPA that Ms. Wu is able to talk about certain abuses that have come to light. I would suggest that that is because there is a complaint resolution process for consumers to access, and there is a private cause of action under the FDCPA afforded to consumers. When you take those opportunities/protections away, perhaps we will not know about those abuses, and to me that would be the real loss for the American public.

Mr. FOLEY. Mr. Shaver.

Mr. SHAVER. We have an extensive training program that begins the day a person comes in the door and is hired and continues for the first 2 years of their employment. Quite literally every single day that that person is on the job in the first 2 years is structured.

We have supervisors who routinely and regularly and daily monitor the performance and the dialog that collectors have with debtors and taxpayers. In our particular company, I can tell you, the behavior that you described that was directed to you would result in an immediate termination, period. We do not tolerate that behavior in our agency.

I would suggest if there were a contractor and there were repeated incidents, meaning it was a cultural problem with the contractor, that they should not work for the government, they should not be in this business. This is not a business where people are threatened, intimidated, harassed, and abused into repaying their obligations.

Mr. FOLEY. They have to have some script like that? It cannot be, hey, how are you doing, hope you are well.

Mr. SHAVER. Mr. Foley, I invite you and the Members of the Committee, your staff, to come and visit any of our locations at any time unannounced, walk in and see what these folks do. They are professional. They are more in what I would call a sales kind of approach or counseling approach where information is provided. I do not want to dismiss the experiences that Ms. Wu has reported to you.

What I do want to say is that I think she made the distinction between a minority of collection agencies that behave that way. They should not be tolerated. We have no tolerance for that behavior in our industry.

Mr. FOLEY. I think that is what we need to get at. We have to make certain as we pursue this thought process.

Mr. SHAVER. Absolutely.

Mr. FOLEY. It is the minority that always gets us in trouble. It is that one or two outside the norm that causes everyone to have a blemish. As we are bringing this bill forward, I want these things to be mindful, because if you are one of the 5 or 10 percent that have had a horrific experience, then you are somewhat loathe to place this opportunity on someone else because it does sting and it is painful and it is argumentative and it is debilitating, and particularly when it is not your fault, it is even more of this.

You are thinking to yourself that poor person who really went and charged on my Target or—not even on my Target—they went and charged and got the merchandise. They are scot free. They are enjoying the goods that they have stolen virtually from Target and nobody is chasing them. The police do not have time for it. There is no opportunity to go after those bad people.

The poor person in my end of the world who is wrongly used as the victim ends up having to deal with it. So, I guess my caveat is I am willing to pursue and proceed, but Ms. Wu brings some very important cogent points to bear, and I hope we all use those as we move this legislation forward.

Chairman HOUGHTON. Okay. Thanks, Mr. Foley. Mr. Pomeroy.

Mr. POMEROY. Mr. Shaver, I am aware of some prior litigation involving some of your business practices, specifically involving Western Union. I believe the practice would be people would get a Western Union telegram, they call back in, because the message was to respond by calling, and then that would provide a telephone number for the individual, otherwise unlisted telephone number, and that your firm provided these numbers to other debt collection services, and there was some litigation about that practice. Is that a fair or grossly unfair characterization of what occurred?

Mr. SHAVER. I think it is a characterization that is more or less accurate. Let me say two things. We like every business in America today are litigated and I literally know of no business acquaintance in a private firm that does not deal with litigation as a means of dispute resolution. Having said that——

Mr. POMEROY. I agree with you, and I would expect that your business is inherently at highest risk for this kind of litigation.

Mr. SHAVER. Well, we do, as you can imagine, deal with people that would rather that we do not talk to them, and occasionally they will use a variety of means to discourage us from doing so including litigating.

There are a couple kinds of problems that occur under FDCPA protections. There are errors of commission where someone does something wrong and it is a violation of a specific requirement, and it is done by an individual, and there are errors that are systemic, meaning that every collection business today relies and has to rely on some form of technology.

There can be instances, not in our particular case, but there have been instances where technology failures lead to multiple letters being sent to someone, or a call being made outside of the scope of the time restrictions on making calls to individuals and so on.

Where we find that there are any violations or problems systemically with any aspect of FDCPA, we seek to correct those as quickly as possible, simply to avoid any future exposure and risk.

Mr. POMEROY. It is kind of like I think that you are an excellent panel, and that you are articulate representatives of a very legitimate, indeed an important industry. Whether or not we ought to enlist this industry for collecting taxes owed by U.S. taxpayers, the panel itself does I think give rise to some question.

Mr. Smith's company is Canadian owned. Your prior business practice involved eliciting telephone numbers under certainly less than disclosing if not misrepresenting circumstances, and then providing those to others.

Mr. SHAVER. Can I offer a clarification, Mr. Pomeroy?

Mr. POMEROY. Sure.

Mr. SHAVER. We were sued in that particular litigation as a customer of Western Union, buying a service that they offered. The matter was resolved and they neither offer the service nor do we participate in it.

Mr. POMEROY. Right. I do understand that. I am worried about misrepresentation of the Federal Government and the relationship with the Federal Government by private parties. I appreciate your clarification. It does allay a bit of the concern that I had from just looking at the case. It does go to show you if we go down this road, we had better write in protections that make it very clear with our private partners what the safeguards must be.

We need to oversee it vigorously. I believe it was Mr. Smith that mentioned additional 70 IRS people might be required to do this. Well, if they are on average collecting $900 million, close to a billion dollars each if we put those 70 people to collecting debt, we would maybe get the best return for the value for the taxpayer.

Well, it is not a discussion we are going to conclude today, but I think that we have had a fair opportunity to raise the questions that I have had. Thank you, Mr. Chairman. Thank you, panel.

Chairman HOUGHTON. Okay. Thanks, Mr. Pomeroy. Thanks very much for coming.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of COLLECTCORP, Inc.

Company Background

COLLECTCORP, Inc. has been in the business of debt collection since 1978, specifically with respect to accounts receivable outsourcing, early-out programs, and third party collection recoveries. The company has enjoyed the respect of those in the industry for a number of years as a result of its long history, reputation, and management style. We hold to a philosophy of working with the largest debt grantors in North America, which affords us a unique opportunity to maximize collectible debt while keeping our client base small. This mind-set has proven to be tremendously successful. With fewer than 30 clients, we have accepted over $2.5 billion for collection in the past 12 months. Our work is exclusively limited to the banking and finance industry, as well we work with government agencies throughout North America. In fact, 41% of our collections work over the past 12 months was derived from government clients, making government collections and banking/finance collections our largest areas of business activity. COLLECTCORP has established itself to be an undisputed leader with respect to third party collection recoveries for both the private and public sector.

The IRS and Debt Collection

The IRS knows how lengthy and difficult the collection process can be. It is estimated that within the past three years, the amount of uncollected individual IRS tax revenue has risen from $7 billion to approximately $13 billion. The IRS is not able to recover this amount without additional resources and new approaches to collections.

While the outstanding tax money comes from taxpayers of all income brackets, the majority of the backlogged cases account for a small percentage of revenue outstanding. It is estimated that approximately ⅔ of the backlogged cases account for 10% of the missing revenue while the remaining ⅓ account for 90% of outstanding revenue. The IRS needs to be able to focus on the ⅓ of their cases that account for most of the revenue, which requires an amount of time and effort that the IRS does not have when it is saddled with the other ⅔. Furthermore, the number of backlogged cases and uncollected revenue is continuing to increase at an alarming rate.

Private Collection Agencies

Private collection agencies can be used to support the IRS's collection efforts. The IRS has an opportunity to free up resources through outsourcing to focus the remaining resources on the most important backlogged cases. The private collection agencies would focus their resources on collecting the debts that reap the smallest returns, which would allow the IRS to aggressively pursue the smaller number of cases that yield much higher returns. In other words, the IRS would direct its attention to the more high profile cases, such as tax shelters, while leaving the agencies to the lower profile cases, such as people who just chose not to pay their taxes. COLLECTCORP fully supports the Administration's initiative and believes that the use of private collection companies is a reasonable addition to the IRS's collection efforts.

Our main concern, however, lies in the selection process: the IRS needs to closely scrutinize those agencies it is considering for collection work. Each collection agency employs different collection strategies for individual client needs and utilizes different approaches to maximize net collections with differing cost structures and commission rates. Consequently, in order to better assess the ultimate performance of an agency, a greater emphasis in the evaluation criteria should be placed on "how the work will be done" rather than "how much it will cost". The criteria for selection must be rigid in order to maintain a sense of stability, increase consumer confidence, and allay fears of privacy invasion. Particular to privacy, all employees should be made to sign both a Confidentiality Agreement and a Notice and Acknowledgement of Federal Tax Information and Confidentiality of Child Support Information. COLLECTCORP has a full time Security Officer that ensures full compliance on all security matters including licensing, security clearances, facilities, and database. The application of these security requirements is verified by our Quality Assurance Department prior to the commencement of the contract. The Project Manager then signs off on the project after having reviewed a report from the Security Officer and verification from the Quality Assurance team. Such privacy measures need to be considered when choosing a private collection agency.

Moreover, there is always a danger of putting one's eggs in too few baskets. COLLECTCORP believes that the key to the success of the IRS collection outsourcing initiative is to spread the case load amongst a large enough pool to be diverse. It has been our experience in working with government clients that fiscal and operational objectives can be more readily achieved when more than one agency is employed. The benefit achieved by using a multiple number of agencies is enhanced competition. With more competition, greater returns are realized as each agency strives to outperform its competitor. Furthermore, the IRS can maximize results by assigning more accounts to those firms that perform well and fewer accounts to those that perform poorly. In the end, the IRS would benefit from the use of the maximum number of agencies your system could administer.

Conclusion

Many states and other government agencies have used private collection companies in the past with much success. The use of such agencies would allow the IRS to focus its resources where they are most needed while making valuable progress in increasing debt collection and decreasing IRS case workloads. If implemented properly through the use of multiple agencies that are selected based on how they plan to achieve the IRS's objectives and not based on cost, private collection agencies would be a practical and efficient addition to the IRS's current collection process.

Statement of U.S. Army Brigadier General Ret. Robert S. Young, GC Services, LP, Houston, Texas

Good morning, Mr. Chairman. My name is General Robert Young. I served in the United States Army from 1943 to 1982, the last seven years of that time as a Brigadier General. Currently, as Senior Vice President of GC Services LP, I run the Washington, DC operations of one of the largest private collection companies in the United States. I have been associated with GC since 1982.

Chairman Houghton, I want to thank you for introducing H.R. 1169. This legislation addresses an important and growing problem in the United States—the increasing backlog of taxes that have not been paid to the U.S. Internal Revenue Service.

GC has a long history with the IRS and its collection of taxes. GC has worked with the IRS for more than twenty years. In fact, GC was the general contractor for IRS's Automated Collection System, was the principal subcontractor for the IRS Integrated Collection System, and was one of five collection companies hired by the IRS to participate in its outsourcing pilot project in 1996–1997. GC has a history of completing projects for the IRS on time and within budget—a rarity among IRS contractors. GC also has an extensive history collecting state taxes since the mid-1980s and currently collects taxes for the states of: Colorado, Illinois, Kansas, Louisiana, Massachusetts, Michigan, Missouri, Oklahoma, Ohio, South Carolina, Utah, and Virginia.

The use of private collection companies to collect delinquent tax debts would be a sound addition to the IRS's current collection efforts. The IRS needs private collectors. Since 1999, the IRS has not even attempted to collect approximately $13 billion per year in delinquent taxes. The General Accounting Office reported last year that the IRS has had "dramatic" declines in collection programs since 1996. For example, coverage by telephone and field collection programs declined by 15% and 45% between 1996 and 2001. By 2001, according to GAO, the IRS was deferring collection action on 1 out of 3 assigned delinquencies.

Other government agencies have had success using private collection companies. Numerous states use private collectors. My company alone collects taxes for twelve states. One of our longest-running tax collection contracts is with the State of Michigan and that effort has been tremendously successful from day one. In fact, Michigan recovered its initial development cost on the Michigan Automated Collection System in 1986 within the first four months of the system's operation. Since then, GC has collected a total of $1.7 billion for Michigan.

We also perform collection work for other state debts and for municipalities. One of the areas in which private collectors have shown particularly good results is in the area of child support collections. GAO reviewed private child support collection efforts in 1996 and found that for all eleven private contracts it reviewed (covering nine states), the states had net revenues from their privatized child support collection efforts. In fact, in every state GAO studied that fully privatized child support collections, privatized offices performed as well as, or better than, public offices in locating noncustodial parents, establishing paternity and support orders, and collecting support owed.

One issue that is raised when states consider using private companies to collect taxes is privacy. Taxpayer privacy is important and we take it very seriously. Private collectors can and do protect taxpayer privacy. For example, the IRS will require private collectors to adhere to the same privacy protections as public collectors including all prohibitions against the disclosure of information in tax returns. Private collectors will be required to undergo background checks just like public employees and private collectors will be subject to penalties if they violate privacy provisions. I was the Project Manager for GC during the IRS outsourcing pilot in 1996–1997 and I can tell you that the IRS thoroughly and successfully tested its system of privacy protections during the pilot. It is important to protect privacy, but privacy concerns are not a reason to keep the IRS from using this necessary tool—private collectors—to address its backlog of delinquent taxes.

It should also be recognized that giving private collectors IRS information is not a novel concept. Private child support collectors in the states already have access to IRS information as authorized by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. The IRS also has employed other types of contractors over the years—such as computer and technical support people—who have the potential to access IRS data and have the responsibility to protect such data. Privately employed individuals have access to IRS information and protect it.

By allowing the backlog of delinquent taxes to grow, we not only lose the uncollected funds, but reduce the incentives for taxpayers to do the right thing and pay their taxes on time. Perceptions that other people get away with not paying taxes undermines our entire tax system. When that happens we all suffer because we have a larger and larger deficit to overcome. Private collectors also would take some of the workload off of current IRS employees allowing the IRS to focus on the most egregious cases of illegal tax avoidance such as off shore tax shelters and the like. Passing H.R. 1169 is a good way to help reverse the growing backlog of delinquent taxes and make sure everyone pays what they owe.

I thank the Committee for holding this hearing to consider this important issue and I urge you to support H.R. 1169.

Statement of Donald B. Kramer, Esq., Kramer & Frank, PC, Saint Louis, Missouri

I wish to call to the attention of the Committee that any legislation relating to the use of "private collectors" should include "collection law firms". There are more than 500 collection law firms in the United States who engage in the collection of delinquent accounts as a major part of their practice. These firms employ more than 3,500 skilled collectors. The law firms are controlled by the ethics and guidelines established by the Supreme Courts in their states, and by professional ethics. When a "pilot" program was conducted several years ago by the Justice Department, the private collection law firms were able to recover a greater percentage of the accounts than the U.S. Attorneys. Congress should not ignore this. These law firms should be given the leeway to collect accounts for the IRS as they do for the nation's largest lenders, on a contingent fee basis. There is an association of retail collection law firms, called the National Association of Retail Collection Attorneys, which enables Congress to communicate with the nation's finest collection law firms in an easy fashion. Thanks for your consideration of this information.

Statement of the National Society of Accountants, Alexandria, Virginia

The National Society of Accountants (NSA) is pleased to submit comments on the proposal to allow the Internal Revenue Service (IRS) to use private debt collection agencies (PCA) to collect outstanding tax debt. The outsourcing of federal tax debt collection represents a major change in federal tax administration policy. We congratulate Chairman Houghton for holding this hearing to facilitate an open dialog on the merits of the proposal.

NSA and its affiliated state organizations represent approximately 30,000 accountants, tax practitioners, business advisors and financial planners providing services to more than 19 million individuals and small businesses. Most NSA members are sole practitioners or partners in small- to mid-sized firms. NSA members agree to adhere to a strict code of ethics and professional conduct.

NSA recognizes the need for the IRS to improve its collection processes to reduce the mounting increase in delinquent tax debt. Fundamental fairness demands that all taxpayers who meet their tax obligations be confident that their neighbors are paying their fair share. While the Administration's proposal to use PCAs to collect a portion of this debt is innovative, we believe that implementation and management of such a program is fraught with danger and risk for all taxpayers. We prefer that Congress increase funding for IRS collection activities (including added staffing and adequate training) rather than outsource this vital activity.

First and foremost, we are concerned that the use of PCAs may erode taxpayer rights and protections. While it is true that H. R. 1169, as introduced, prohibits individuals while performing services under a qualified collection contract ". . . from committing any act or omission which employees of the Internal Revenue Service are prohibited from committing in the performance of similar services," much of the actual taxpayer protections would be addressed through IRS management of the program and in the contracts with the PCAs. Because the IRS record in contract negotiation and management leaves much to be desired, we fear that once again good intentions will not translate into sound contracts.

The testimony of Commissioner Everson and the National Taxpayer Advocate (NTA) details various steps that the IRS will undertake to protect taxpayer rights and to provide assurance that oversight of PCAs will be stringent. The NTA states

that this oversight will include live call monitoring in addition to taping of calls and that IRS will have an on-sight presence at each PCA.

We believe such safeguards are appropriate but question whether the IRS will have sufficient commitment and resources to maintain the level of oversight necessary to protect the public over the long-term. Often the IRS must divert resources from existing programs to fund emergency projects and to implement legislative changes (i.e. the generation of refund checks mandated by the Economic Growth and Tax Relief Reconciliation Act of 2001) not contemplated in the IRS annual appropriation. The proposed program must be shielded from any such reallocation of resources.

NSA feels strongly that to prevent confusion over taxpayer rights, many of the protections described by the IRS should be incorporated in the authorizing legislation. To address concerns over IRS contract negotiation skills, the IRS should be required to develop a model PCA contract and solicit comments from practitioners and other interested parties. The actual signed contract between the IRS and a PCA should be made available for public inspection.

H.R. 1169 absolves the Federal Government from liability for any act or omission of any person performing services under a qualified collection contract. We are concerned that this blanket absolution appears to give the IRS a very large escape hatch. By freeing the IRS from any responsibility for the program, it sends the wrong signal to taxpayers and undermines the IRS commitment to protect taxpayer rights. This provision may also cause harm to low-income taxpayers, and others, who may lack the resources to sue a PCA for damages caused by improper collection activities. We believe this provision should be deleted from the bill.

In an ideal world, the IRS would have the staffing and the funding to properly manage the collection of outstanding federal tax debt without resorting to third party collection agencies. Should Congress decide to allow the use of PCAs, continuing close oversight of this program by this Committee is vital.

NSA thanks the Chairman for the opportunity to provide our comments.