COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 5, 2009

The Honorable Charles E. Grassley
United States Senate
Washington, DC 20510

Dear Senator Grassley:

Please find enclosed the information that you requested in your letter of last week.

I hope that you find it responsive. Should you have any questions, please feel free to contact me, or have your staff contact Floyd Williams, Director, Office of Legislative Affairs, at 202-622-3720.

Sincerely,

Douglas H. Shulman

Enclosure

cc: The Honorable Timothy F. Geithner

**Question 1**: *The primary argument for terminating the IRS PDC program is that it is not cost effective. In order to better understand the program's revenues and costs, we would like a monthly accounting of all funds expended on the program since its inception, including a breakdown of all costs for IRS personnel involved in administering the program (salary levels, position descriptions, etc.), as well as costs associated with technology and travel.*

**Program Costs** – Private Debt Collection (PDC) Program costs include IRS personnel devoted to this initiative as well as the cost of operating the IT infrastructure that selects and delivers cases to the private collection agencies. Infrastructure start–up and Project Milestone Release 1.1 and 1.2 costs are included in the annual expenses through FY 2007. IT costs associated with steady-state system operation are included beginning in FY 2008. While personnel costs associated with the program have been captured monthly in IRS financial systems since the program became operational, program cost data have historically been extracted and calculated on an annual basis. Therefore, we are unable at this time to provide monthly program cost summaries.

| | Non-IT Personnel | | | | |
|---|---|---|---|---|---|
| | Labor & Benefits | Training, Travel, Rent, Furniture, etc. | IT Costs (Hardware, Software, & Support) | Other Costs (Services & Supplies) | Total |
| **FY 2004-2005** | $2.4 M | $.1 M | $36.3 M | n/a | $38.8 M |
| **FY 2006*** | $4.3 M | $.2 M | $10.7 M | $1.4 M | $16.6 M |
| **FY 2007** | $3.4 M | $.8 M | $7.9 M | $1.7 M | $13.8 M |
| **FY 2008**** | $5.4 M | $.9 M | $3.4 M | $1.5 M | $11.2 M |
| **FY 2009 (Q1)** | $1.2 M | $.2 M | (est.) $.9 M | $.2 M | $2.5 M |
| **Cumulative** | **$16.7 M** | **$2.2 M** | **$59.2 M** | **$4.8 M** | **$82.9 M** |

* The PDC Program became operational in September 2006.
** The increase in Labor & Benefits costs from FY 2007 to FY 2008 is primarily attributable to improved cost tracking.

**Program Staffing** – The Private Debt Collection Program is supported by full-time and part-time IRS staff in multiple offices across the country in different positions and at different pay grades. Costs range from the executive, senior manager, and tax analyst level in our headquarters office ($162,900 - $56,400) to frontline managers, taxpayer contact representatives, and a clerk in our campus locations ($78,100 - $33,800). These employees perform a variety of functions and support activities including inventory and taxpayer account management, contract administration and invoice validation, quality review, and general program support.

***Question 2:*** *We would also like to know the number of cases placed with the private agencies since the program began, including the number of cases for which the amount was collected in full, the number of resulting installment agreements, and the number of cases recalled and the reasons for the recall. We would also like an accounting of the commissions earned by the PCAs since the program started.*

**PCA Case Placement, Resolution, and Recalls** – The tables below show fiscal year data for cases placed from FY 2006 through January 2009 with the number of Full Payments, Installment Agreements, and Total Dispositions along with cases recalled since program inception.

| Time Period | Cases Placed (modules) | Full Payments | Installment Agreements | Total Dispositions* |
|---|---|---|---|---|
| FY 2006 (Sept. only) | 11,565 | 213 | 209 | 435 |
| FY 2007 | 107,019 | 7,094 | 2,639 | 11,218 |
| FY 2008 | 180,836 | 25,808 | 5,021 | 35,318 |
| FY 2009 (through Jan.) | 48,131 | 5,602 | 1,969 | 9,541 |
| **Cumulative** | **347,551** | **38,717** | **9,838** | **56,512** |

* Includes Full Payments, Installment Agreements, and 7,957 other dispositions that required cases to be returned to the IRS (e.g., Bankruptcy, Installment Agreements beyond 5 years, Deceased Taxpayers, etc.). Cases where an Installment Agreement (IA) later became a Full Payment have been removed from IA counts above to ensure total case dispositions do not double count these resolutions.

**Cases Recalled Since Program Inception**

| Taxpayer Cases | Recall Reason |
|---|---|
| 23,616 | Taxpayer resides in a designated Disaster Area. |
| 11,559 | Manual recalls that include TAS referrals, Opt Outs, unagreed new assessments, Installment Agreements beyond five years, PCA referrals resulting in a recall (CNC, Bankruptcy, Hardships, Innocent Spouse, Deceased, incarcerated). |
| 7,660 | Cases recalled from LGBS following contract expiration. |
| 4,347 | Ongoing systemic recall process for cases that have been in PCA inventory more than 26 months with no payment within the last 60 days. |
| 1,765 | Recalls that occurred before recall reason codes were included in system reports. |
| 1,260 | Taxpayer is in Bankruptcy/Litigation. |
| 914 | Recalls for cases with Innocent Spouse; Federal Payment Levy Program; injured spouse claims; whipsaw assessment; Collection due process, Offer in Compromise, Military, Foreign Address, IRS employee, etc. |
| 909 | Payment is received at the IRS and is coded as a Levy payment (DPC 05). |
| 640 | Case has a related liability that is not PCA assignable (e.g., BMF liability) |
| 572 | Case has been closed currently not collectible (CNC) based on financial information from the taxpayer. |
| 384 | Case has been identified as part of the IRS Withholding Compliance Program (ensures taxpayers with withholding issues are brought into compliance). |
| 350 | Case being worked by IRS Criminal Investigation Division. |
| **53,976** | **TOTAL** |

**PDC Program Revenue and Commissions** – The IRS tracks total payments received from taxpayer accounts placed with Private Collection Agencies (PCAs) by month. Below is a summary of revenue and commissions from program inception through January 2009. Commission figures are reported in the year earned, not in the year paid, and do not include $104,000 in administrative fees paid to the PCAs.

| Fiscal Year | Gross Taxpayer Payments Received | Commissionable Taxpayer Payments Received | PCA Commissions | Net Revenue | IRS Retained Earnings* |
|---|---|---|---|---|---|
| FY 2006 (Sept. only) | $ 1.1 M | $.50 M | $.11 M | $.95 M | $ 0 M |
| FY 2007 | $31.0 M | $24.7 M | $ 5.4 M | $25.6 M | $ 5.7 M |
| FY 2008 | $37.2 M | $27.7 M | $ 6.1 M | $31.2 M | $ 7.5 M |
| FY 2009 (through Jan.) | $13.2 M | $ 9.8 M | $ 2.1 M | $11.0 M | $ 2.7 M |
| **Cumulative** | **$82.5 M** | **$62.6 M** | **$13.7 M** | **$68.8 M** | **$15.9 M** |

* The IRS is permitted to retain 25% of the revenue collected to fund other enforcement efforts. Funds are transferred the month after commissionable payments are received.

**Question 3**: *Some taxpayers choose to ignore the IRS's many letters and respond to the IRS only after it notifies them that their cases will be referred to a PCA. In these cases, where the IRS benefits from the use of the PCA's names, we would like to know why the PCAs are not compensated when those taxpayers settle those debts.*

Based on the contractual relationship between the IRS and the PCAs, payments received on assigned accounts are commissionable 10 days following placement (PCA task order Section 3.1).

The ten-day non-commissionable period was established based on the schedule of activity that occurs on cases assigned to PCAs. The IRS sends an initial contact letter to the taxpayer once the case is assigned to a PCA. PCAs do not begin contacting the taxpayer by letter until seven days following case placement. Phone calls to the taxpayer do not begin until the ninth day after placement. The current procedure allows time for the IRS and PCA initial contact letters to be delivered and for the PCA initial telephone contact to be completed before the commissionable period begins.

**Question 4**: *We would like for you to describe how IRS's collection process and procedure differs from the process and procedure used by the PCAs in collecting IRS debts, including the IRS's ability to make outbound phone calls, negotiate or settle tax debts, and impose liens and levies.*

The IRS has the authority to use a variety of tools and procedures to collect unpaid tax debt. The law authorizing the IRS to enter into contracts with Private Collection Agencies, however, limits PCA authority. The Internal Revenue Code permits PCAs to:

- Locate and contact taxpayers,
- Request full payment from taxpayers, and if the taxpayer is unable to make full payment, to offer the taxpayer an installment agreement (IA) providing for full payment of unpaid taxes over a period not to exceed five years, and
- Obtain financial information from taxpayers.

The PCAs may contact taxpayers by telephone or mail in an attempt to collect full payment on taxes owed or to set up installment agreements. PCAs may also gather pertinent information from taxpayers and provide it to the IRS to resolve taxpayer accounts when necessary. Based on the law, PCAs may not use enforcement tools like liens, seizures, or levies. PCAs are not authorized to negotiate or settle tax debts, and therefore, may not work issues like Offers-In-Compromise or tax abatements.

**Question 5**: *Another criticism of the program is that the IRS has run out of cases that can be assigned to the current PCAs, which is why other PCAs have not been added. However, the exclusion list, which was not determined by statute but by the IRS, appears fairly extensive. In addition, as noted above, the GAO's June 2008 report indicates that, as of fiscal year 2007, there was at least $25.5 [billion] of potentially collectible inventory that IRS was not actively pursuing. We would like to know how each of the exclusion criteria was determined.*

Potentially Collectible Inventory (PCI) has two primary components: active and inactive. Active PCI includes taxpayer accounts that the IRS is actively working. Inactive PCI includes taxpayer accounts where the IRS has completed its initial work on the case but is not actively pursuing the case at the time. This inactive inventory is subject to systemic actions (e.g., refund offsets) and can be returned to active status if account circumstances change (e.g., subsequent taxpayer filing increases the balance due or new financial information becomes available.)

Every week IRS systems sweep all active and inactive collection inventories for cases eligible for placement with the PCAs. The exclusion criteria are applied systemically to all individual taxpayer accounts within the inventories. Eligible cases are placed with the PCAs based on total balance due, with the accounts having the highest dollar value being placed first.

The table below lists the exclusion criteria that IRS systems use to identify accounts eligible for PCA placement. The criteria are used to exclude cases that the IRS is actively working, should not be worked by any collection operation, are beyond PCA authority, or require specialized information or training.

| Explanation | Exclusion Criteria |
|---|---|
| These criteria ensure that cases the IRS is actively working or likely to pursue in the near future are excluded from PCA assignment. | • Been in deferral status, ACS status, or TDA queue for less than 61 days.<br>• A tax year in notice status.<br>• Open criminal investigation.<br>• Under Litigation.<br>• Open examination.<br>• Assigned to the Collection Field Function (Status 26.) |
| These criteria apply to both IRS collection operations and Private Collection Agencies. These exclusions prevent the IRS and PCAs from working cases where collection action would be inappropriate given the circumstances of the case. | • Taxpayer identified to be in a designated Combat Zone.<br>• A payment or credit is being researched.<br>• Frozen because of a duplicate return.<br>• A pending taxpayer claim (e.g., amended tax return releasing the tax liability.)<br>• An open Collection Due Process.<br>• A "collection-hold" (Signifies an IRS function is working the account or waiting for additional information/action by the taxpayer, e.g. additional substantiation on a return or a short-term extension of time to pay.)<br>• Taxpayer identified as living in a declared Disaster area (includes Presidential declarations.)<br>• An expired Collection Statute or the expiration date equals zero (indicates a military deferral).<br>• Already in Installment Agreement (Status 60.) |
| These criteria prevent cases where the taxpayer may dispute the tax debt from being assigned to the PCAs. The PCAs do not have the authority to negotiate or settle unpaid tax debts in dispute. | • All tax years considered to be unagreed where the taxpayer may dispute the tax liability. |
| These criteria ensure cases that require handling by specialized units within the IRS are not assigned to Private Collection Agencies. These exclusions require special skills given the circumstances of the case. | • An open Bankruptcy.<br>• Classified as Injured/Innocent Spouse.<br>• An Offer-in-Compromise with the IRS is pending or has been accepted.<br>• An IRS Employee.<br>• A Whipsaw, Abusive Tax Shelter, Equivalent (Due Process) Hearing, or Penalty Appeal Case identified. |
| These criteria identify sensitive and/or complex cases that are not appropriate to be assigned to the PCAs. | • Been classified as a Potentially Dangerous Taxpayer.<br>• Mix of tax years where some are non-payment on agreed assessments and others are unfiled returns. (TDA/TDI Combo cases would also require additional IT enhancements.)<br>• Taxpayers under the age of 18.<br>• Joint accounts with a third party representative. (Without the third party request form in hand, in many cases it cannot be determined if the representative is for the primary or the secondary taxpayer on the account.)<br>• Any MFT 31 module (e.g., Accepted Innocent Spouse Claim)<br>• An invalid Social Security Number or Individual Tax Identification Number (ITIN).<br>• Primary taxpayer identified as deceased.<br>• A civil penalty that is not part of the filed return—MFT 55 account (e.g. Trust Fund Recovery Penalty.)<br>• A levy that has been generated through the Federal Payment Levy Program (must be a current active levy).<br>• Taxpayers with an associated BMF liability.<br>• A current foreign address.<br>• Identified for the Withholding Compliance Program.<br>• Account located on the Non-Masterfile System. |

| Explanation | Exclusion Criteria |
|---|---|
| These criteria identify cases where there is insufficient time for the PCAs to establish installment agreements prior to the collection statute expiration date (CSED). PCAs have the authority to establish IAs with taxpayers up to 5-years in length. | • Fewer than 3.5 years remaining on the Collection Statute. (Provides taxpayers time to establish installment agreements, and as the statute ages, the ability to collect declines.) |

**Question 6**: *Tables 5, 6, and 7 of the GAO's June 2008 [report] provide a breakdown of the total delinquent debt for fiscal years 2002 through 2007. Please update these tables to add numbers for fiscal year 2008 and provide a breakdown of this amount by the exclusion criteria. We would also like to know why all potentially collectible inventory is not in active collection status and cannot be assigned to PCAs.*

As requested, Tables 5, 6, and 7 from GAO's June 2008 report have been updated with fiscal year 2008 values. We are unable to align the total inventory of Unpaid Tax Debt with the exclusion criteria since the data are extracted from different IRS systems. As discussed in the response to Question 5, every week the inventory of accounts for potential PCA placement is refreshed as IRS computer systems scan collection inventories, including inactive PCI, using program criteria.

**Table 5: Unpaid Tax Debt Inventory (as of the end of Fiscal Years 2002-2008)**

| Dollars in billions | FY 2002 | FY 2003 | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 |
|---|---|---|---|---|---|---|---|
| Total unpaid tax debt inventory | $ 279.8 | $ 278.1 | $ 284.8 | $ 257.9 | $ 270.4 | $ 290.1 | $ 304.3 |
| Assessed amount | $ 180.9 | $ 182.6 | $ 190.9 | $ 184.5 | $ 198.9 | $ 216.2 | $ 228.9 |
| Accrued interest and penalty | $ 98.8 | $ 95.5 | $ 93.9 | $ 73.4 | $ 71.5 | $ 73.4 | $ 75.3 |
| Percentage of assessed amount to total inventory | 64.7% | 65.7% | 67.0% | 71.5% | 73.6% | 74.5% | 75.2% |
| Percentage of accrued interest and penalty to total inventory | 35.3% | 34.3% | 33.0% | 28.5% | 26.4% | 25.3% | 24.8% |
| Total percentage | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 99.8% | 100.0% |

**Table 6: Potentially Collectible Inventory versus Non-Potentially Collectible Inventory of the Unpaid Assessments**

| Dollars in billions | FY 2002 | FY 2003 | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 |
|---|---|---|---|---|---|---|---|
| Total unpaid assessment inventory | $ 279.8 | $ 278.1 | $ 284.8 | $ 257.9 | $ 270.4 | $ 290.1 | $ 304.3 |
| Non-potentially collectible inventory | $ 203.1 | $ 198.9 | $ 203.5 | $ 170.9 | $ 174.8 | $ 184.8 | $ 191.0 |
| Potentially collectible inventory | $ 76.7 | $ 79.2 | $ 81.3 | $ 87.0 | $ 95.6 | $ 105.3 | $ 113.3 |
| Percentage of non-potentially collectible inventory to the unpaid assessment inventory | 72.6% | 71.5% | 71.5% | 66.3% | 64.5% | 63.7% | 62.8% |
| Percentage of potentially collectible inventory to the unpaid assessment inventory | 27.4% | 28.5% | 28.5% | 33.7% | 35.4% | 36.3% | 37.2% |
| Total percentage | 100.0% | 100.0% | 100.0% | 100.0% | 99.9% | 100.0% | 100.0% |

**Table 7: Potentially Collectible Inventory in Active Collection and Non-Active Collection Status**

| Dollars in billions | FY 2002 | FY 2003 | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 |
|---|---|---|---|---|---|---|---|
| **Total potentially collectible inventory** | $ 76.7 | $ 79.2 | $ 81.3 | $ 87.0 | $ 95.6 | $ 105.3 | $ 113.3 |
| **Potentially collectible inventory in active collection status:** | | | | | | | |
| **Notice** | $ 14.3 | $ 13.7 | $ 15.8 | $ 21.1 | $ 21.4 | $ 22.8 | $ 20.7 |
| **Telephone (Automated Collection System)** | $ 13.3 | $ 15.4 | $ 14.6 | $ 21.5 | $ 17.9 | $ 19.6 | $ 22.1 |
| **In-person contact (Collection Field Function)** | $ 20.1 | $ 21.5 | $ 23.4 | $ 24.5 | $ 32.7 | $ 36.9 | $ 38.2 |
| **Potentially collectible inventory dollars in active collection status** | $ 47.7 | $ 50.6 | $ 53.8 | $ 67.1 | $ 72.0 | $ 79.3 | $ 80.9 |
| **Percentage of potentially collectible inventory in active collection status** | 62.2% | 63.9% | 66.2% | 77.1% | 75.3% | 75.3% | 71.4% |
| **Potentially collectible inventory in a non-active collection status:** | | | | | | | |
| **Queue** | $ 21.5 | $ 21.3 | $ 20.8 | $ 15.0 | $ 19.5 | $ 22.0 | $ 27.8 |
| **Shelved due to lack of resources** | $ 7.6 | $ 7.3 | $ 6.7 | $ 4.9 | $ 4.0 | $ 3.5 | $ 3.6 |
| **Potentially collectible inventory dollars not in active collection status** | $ 29.1 | $ 28.6 | $ 27.5 | $ 19.9 | $ 23.5 | $ 25.5 | $ 31.4 |
| **Percentage of potentially collectible inventory in non-active collection status** | 37.9% | 36.1% | 33.8% | 22.9% | 24.6% | 24.2% | 27.7% |
| **Total percentage** | 100.1% | 100.0% | 100.0% | 100.0% | 99.9% | 99.5% | 99.2% |

**Question 7**: *We would also like to know whether Treasury or any other agency has studied the cost effectiveness of the use of PCAs by Treasury or other federal agencies. If such studies are available, we would like to see them.*

The IRS is not in possession of any formal cost effectiveness studies regarding the use of PCAs by Treasury or other federal agencies. In establishing the current PDC program, the IRS met with representatives from state revenue departments and other federal agencies that contracted with PCAs to solicit their insights into critical issues such as data security and the protection of taxpayer rights. The IRS also met with collection companies to gather industry feedback on case screening criteria, data sharing, security requirements, and potential compensation models. In its March 2003 report, the Treasury Inspector General for Tax Administration acknowledged the comprehensive planning and research the IRS conducted prior to establishing the current program.

> *"In summary, the IRS' preliminary planning related to the use of CCS companies was extensive and included a detailed evaluation of similar existing programs at other federal and state government entities. In addition, the IRS contacted subject matter experts for input regarding industry practices. These efforts should help leverage the use of existing best practices and aid in ensuring that the design of the IRS' CCS program fully uses the benefits of private collection services."* TIGTA report 2003-30-075, March 2003

Following program implementation, the IRS has continued to exchange best practice information with federal organizations that employ private collection agencies. The IRS has hosted roundtable discussions with Financial Management Service and the Department of Education. In these discussions, lessons learned are shared over a wide array of topics including data security, procurement requirements, and authentication process improvements.