Collection Actions Were Not Always Pursued on Cases Returned From the Private Debt Collection Program

September 27, 2011

Reference Number: 2011-30-114

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:
1 = Tax Return/Return Information

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COLLECTION ACTIONS WERE NOT ALWAYS PURSUED ON CASES RETURNED FROM THE PRIVATE DEBT COLLECTION PROGRAM

Highlights

Final Report issued on September 27, 2011

Highlights of Reference Number: 2011-30-114 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The Private Debt Collection (PDC) Program collected approximately $98.2 million from delinquent cases that were considered low yield and generally not worked by the IRS. In March 2009, the IRS Commissioner discontinued the PDC Program, and cases that were assigned to the private collection agencies were returned to the IRS. However, the IRS's collection policies and inventory assignment practices will prevent many of these delinquent accounts, and similar accounts in the IRS's current inventory, from being worked. Taxpayers who do not voluntarily pay their share of taxes create unfair burden on taxpayers who timely pay their taxes in full and can diminish the public's respect for the tax system.

WHY TIGTA DID THE AUDIT

This audit was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives. The overall objective was to determine the effectiveness of collection actions taken by the IRS on taxpayer accounts returned from the PDC Program.

WHAT TIGTA FOUND

The IRS took appropriate collection actions on cases returned from the PDC Program in Fiscal Year 2007. The Fiscal Year 2007 recall included procedures that required employees to work each case that was returned. However, many of the cases returned in a larger recall in Fiscal Year 2009 were not worked.

TIGTA reviewed a statistical sample of 62 cases returned in Fiscal Year 2009 and found that collection actions were not taken for 29 (47 percent) of the 62 cases. These cases were not selected for collection action due to Collection policies and inventory assignment practices. TIGTA estimates that potentially $30.7 million in collections will remain as outstanding liabilities. TIGTA also estimates the IRS may not collect an additional $103.2 million per year, or $516 million over the next five years, from similar cases in its inventory that would have been assigned to the PDC Program.

TIGTA also reviewed a statistical sample of installment agreement cases returned during Fiscal Year 2009 and determined no collection actions were taken for six (10 percent) of 61 cases reviewed. TIGTA estimates that potentially $58,000 in collections will remain as outstanding liabilities. Finally, the IRS did not capture or use PDC Program data and results to improve its own collection practices.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS 1) ensure Collection policy and procedures are reviewed for inventory assignment practices to determine if cases that would have been assigned to the PDC Program can be worked, or consider reinstituting the Program; and 2) evaluate private collection agency best practices and lessons learned for potential improvement of IRS collection processes.

In their response to the report, IRS officials partially agreed with the recommendations and stated they began taking steps to address TIGTA's concerns. The IRS implemented a process to improve balance due case prioritization and reviewed collection agency operations to identify potential best practices.

TIGTA is encouraged by the IRS's commitment to improving case selection and prioritization processes. However, it is still unclear how the IRS would actually work lower priority cases like those eligible for the Program.

IRS officials disagreed with the outcome measures. TIGTA maintains the outcome measures are reasonable and are based on actual PDC Program results.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 27, 2011

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Collection Actions Were Not Always Pursued on Cases Returned From the Private Debt Collection Program (Audit #201030016)

This report presents the results of our review to determine the effectiveness of collection actions taken by the Internal Revenue Service (IRS) on taxpayer accounts returned from the Private Debt Collection Program. This audit was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

In their response to the report, IRS management stated that our characterization of many of the cases returned from the Private Debt Collection Program as not worked is misleading. Management stated IRS systemic actions were often used while the cases were with the private collection agencies (PCA) and continued even after cases were returned from the PCAs into IRS inventory. However, systemic actions are mostly notices mailed to taxpayers, searches for Federal payments, and credits of current refunds against prior tax liabilities. Furthermore, these systemic actions are taken regardless of assignment to the PCAs. Therefore, for the purposes of this review, we compared the collection actions taken by PCA employees to those taken by IRS employees. We did not consider a case actually worked unless it was assigned to an employee and collection actions were taken by that employee. Cases have a higher probability of collection when taxpayers are contacted. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report recommendations.

Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

Table of Contents

Abbreviations

ACS	Automated Collection System
FY	Fiscal Year
IDRS	Integrated Data Retrieval System
IRS	Internal Revenue Service
PCA	Private Collection Agency
PDC	Private Debt Collection

Background

> ***In July 2004, the Department of the Treasury estimated that the IRS would collect $1.4 billion over the next 10 years by using PCAs.***

To help address the Internal Revenue Service's (IRS) gross accounts receivable[1] of over $300 billion, the Department of the Treasury proposed that Congress pass legislation authorizing the IRS to use private collection agencies (PCA) to help collect tax debts for simpler types of cases.[2]

On October 22, 2004, the President signed The American Jobs Creation Act[3] that created a new Internal Revenue Code Section 6306 (2004) to permit PCAs to help collect Federal tax debts. The law allows PCAs to locate and contact any taxpayer specified by the IRS, request from such taxpayer full payment of the amount of Federal tax due, and obtain financial information with respect to such taxpayer. The law allows the IRS to pay each PCA up to 25 percent of the amount they collect. The IRS is allowed to retain up to 25 percent of the amount collected for IRS collection enforcement activities. The IRS refers to this effort as the Private Debt Collection (PDC) Program (hereafter referred to as the PDC Program or the Program). In July 2004, the Department of the Treasury estimated the IRS would collect $1.4 billion over 10 years (Fiscal Years (FY) 2006–2015) by using PCAs.

The IRS established three main objectives for the Program:

- Help significantly reduce the growing number of uncollected tax liabilities.
- Help maintain taxpayer confidence in the fairness of the tax system by assisting the IRS in addressing more of its delinquent accounts.
- Assist the IRS in its continued focus to dedicate existing collection and enforcement resources on more difficult cases and issues.

The PCAs are assigned cases that the IRS would otherwise be unable to work because of its limited resources.

On September 7, 2006, the IRS placed an initial inventory of 11,562 balance due accounts with 3 PCAs. The IRS assigned two types of cases to the Program.

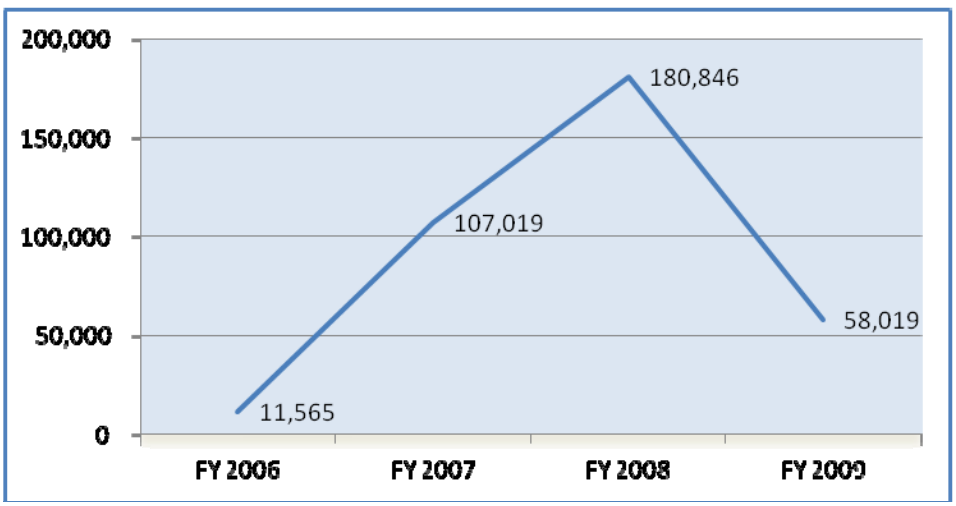
- From September to December 2006, the IRS assigned cases that involved an individual taxpayer with a balance due for one tax module and an amount due of $25,000 or less.

[1] See Appendix V for a glossary of terms.
[2] Simpler types of cases are those in which the taxpayer has filed all tax returns due.
[3] Pub. L. No. 108-357, 118 Stat. 1418 (2004).

- From January 2007 to February 2009, the IRS assigned cases that involved an individual taxpayer with a balance due for one or more tax periods and an amount due of $100,000 or less.

From September 2006 through February 2009, the IRS assigned 203,800 accounts with 357,449 tax modules and a total assessed balance of $1.6 billion to PCAs.[4] Fifty-one percent of the tax modules (180,846 modules) were assigned during FY 2008. Figure 1 shows the number of tax modules assigned each year. The IRS planned to increase assignment to 249,000 modules with a total assessed balance due of $1.1 billion to the Program each year beginning in FY 2010. As of September 2009, 79,916[5] (22 percent) of the 357,449 tax modules assigned to the Program were resolved as fully paid.

Figure 1: Number of Tax Modules Assigned to Program by FY[6]



Source: *Private Debt Collection Reports for FYs 2006–2009.*

One of the PCA's contracts ended in March 2007, but the IRS renewed the contracts for the other two PCAs twice. However, on March 5, 2009, when the two remaining contracts were about to end, the IRS Commissioner decided to discontinue the Program and announced that the contracts with the remaining two PCAs would not be renewed. The Commissioner cited the following reasons as the basis for his decision.

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[4] *Filing and Payment Compliance, Private Debt Collection Advisory Briefing*, dated April 20, 2009.
[5] Of the 79,916 tax modules resolved as full paid, the IRS reported 56,810 of the resolved tax modules were resolved while assigned to the PCAs, of which 14,113 were from commissionable payments.
[6] The Program was discontinued during FY 2009; cases were assigned to the Program from October 1 through March 5, 2009, prior to program discontinuation.

- A cost-effectiveness study of the Program,[7] conducted by the IRS and supported by an independent review, showed that it is reasonable to conclude that when working similar inventory, IRS employees are more cost effective than PCAs. (Notably, the Government Accountability Office recently reported that this IRS study was not soundly designed to support a decision about whether to continue the Program.)[8]

On March 5, 2009, the IRS Commissioner decided to discontinue the PDC Program.

- IRS employees have a wide range of options to resolve difficult collection cases that, by law, are not available to the PCAs. The IRS anticipated an increase in the number of tough collection situations in the months ahead, and believed its employees were in the best position to work with taxpayers and resolve their issues. (However, this belief assumes IRS employees will actually work the cases.)
- The IRS anticipated hiring more than 1,000 Collection function employees in FY 2009, which would give the IRS more flexibility to make assignments based on the areas of greatest need rather than filtering limited cases through PCAs. (The IRS hired over 1,500 new revenue officers between June 2009 and February 2010 and opened a new Automated Collection System (ACS) site with 120 employees in July 2010. However, based on current case selection and prioritization methods, it is unlikely that the new revenue officers or ACS site will be assigned the types of cases that were worked by the agencies. Revenue officers and ACS employees are generally assigned higher priority cases.)

Although the IRS discontinued the Program, the IRS is still authorized to enter into contracts with PCAs under the Internal Revenue Code. To remove this authority, legislation would need to be passed by Congress and signed by the President.

This review and data analyses were performed in the Small Business/Self-Employed Division Headquarters Office in New Carrollton, Maryland, during the period June 2010 through March 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[7] *IRS Employees More Flexible, More Cost Effective* (IR-2009-19, dated March 5, 2009).
[8] *IRS Could Improve Future Studies by Establishing Appropriate Guidance* (Government Accountability Office 10-963, dated September 2010).

Results of Review

The PDC Program collected millions in revenue from cases that were considered low yield and generally not worked by the IRS.[9] When the Commissioner discontinued the Program, accounts that were assigned to the PCAs were returned to the IRS. The IRS did not always pursue collection actions on cases returned from the PDC Program or analyze the best practices of the PCAs for possible improvement of IRS collection practices.

The Private Debt Collection Program Collected Millions in Revenue

The PDC Program collected $98.2 million[10] from cases that were considered low yield and generally not worked by the IRS. After paying $16.5 million in commissions and closeout costs to the PCAs, nearly $82 million was identified as net revenue, of which $18.3 million was retained by the IRS and approximately $63.4 million went to the U.S. Department of the Treasury. As of September 2009, 79,916 (22 percent) of the 357,449 tax modules assigned to the Program were resolved as fully paid.

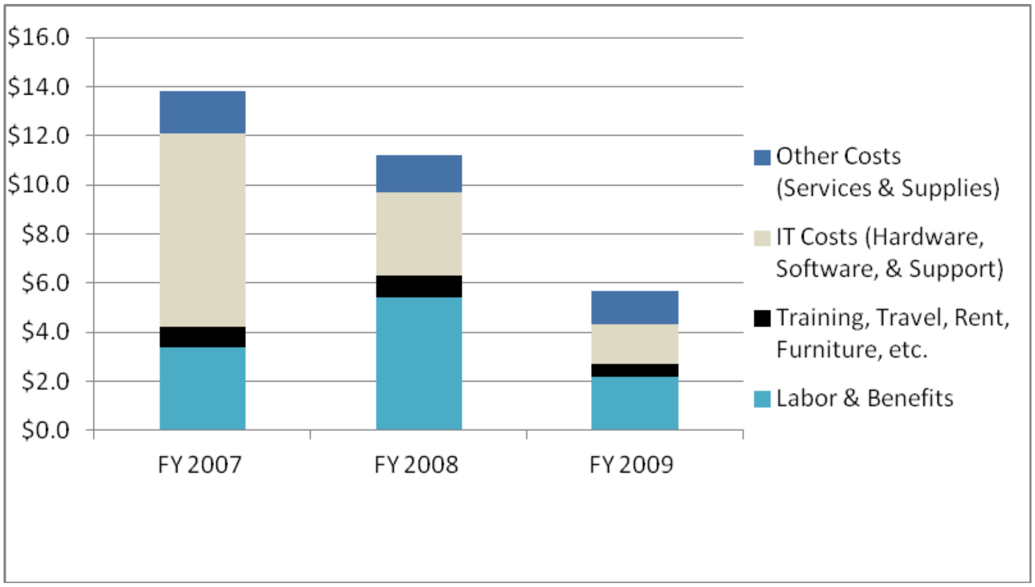
According to data provided by IRS management, the operating costs of the PDC Program were $47.2 million,[11] consisting of:

- IRS internal program costs of $30.7 million.
- Commissions paid to PCAs of $16.5 million.

The IRS internal program costs include IRS personnel assigned to this Program as well as the information technology infrastructure that selected and assigned the cases to the PCAs. Figure 2 shows the IRS internal costs ranged from $13.8 million in FY 2007 to $5.7 million in FY 2009.

[9] Some of the cases assigned went through the IRS notice process and search for levy sources.
[10] The PCAs were paid commissions on $70.1 million of the $98.2 million in collections.
[11] The $47.2 million is for FYs 2007 through 2009 and does not include IRS internal program startup costs of $55.4 million which occurred prior to FY 2007. The PDC program became operational in September 2006.

Figure 2: IRS Internal Operating Costs of Program by Category and FY[12]



Source: IRS management provided the cost data, which have not been validated by the Treasury Inspector General for Tax Administration.

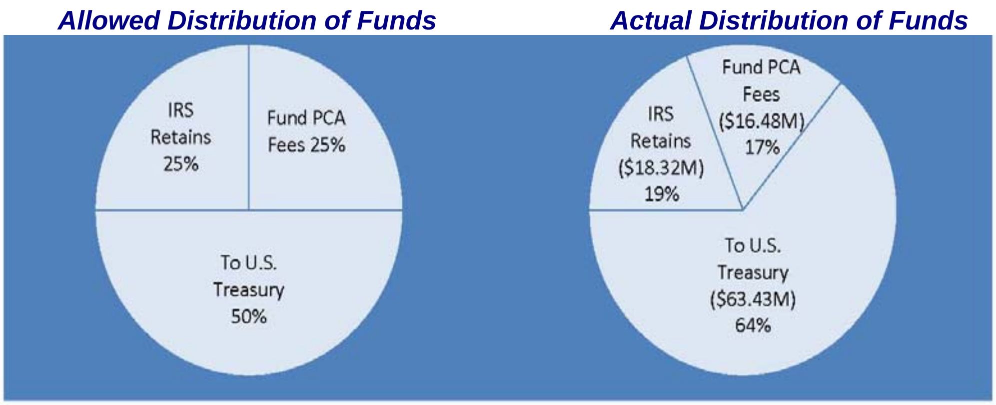
The expenses in FY 2007 included information technology infrastructure startup costs.[13] Internal program costs decreased during the Program as the need for information technology development and enhancements decreased.

The PDC Program was designed to eventually fund itself, while aiding the IRS in collecting a larger portion of the delinquent accounts. The law allowed the IRS to retain an amount not in excess of 25 percent of the amount collected for collection enforcement activities and to pay an amount not in excess of 25 percent of the amount collected by each PCA for the cost of services performed under a contract. The remaining 50 percent was to be paid to the U.S. Department of the Treasury. Figure 3 shows the percentage of revenue that was allowed to be distributed compared with the percentage actually distributed.

[12] The IRS internal costs were funded through appropriated funds through FY 2009. After the signing of the Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, 123 Stat. 524 (March 11, 2009), expenses associated with the PDC program were funded through user fees. However, for purposes of our review, they are included to determine if the Program was able to fund itself without IRS funds.

[13] Startup costs included program changes for the inventory selection process.

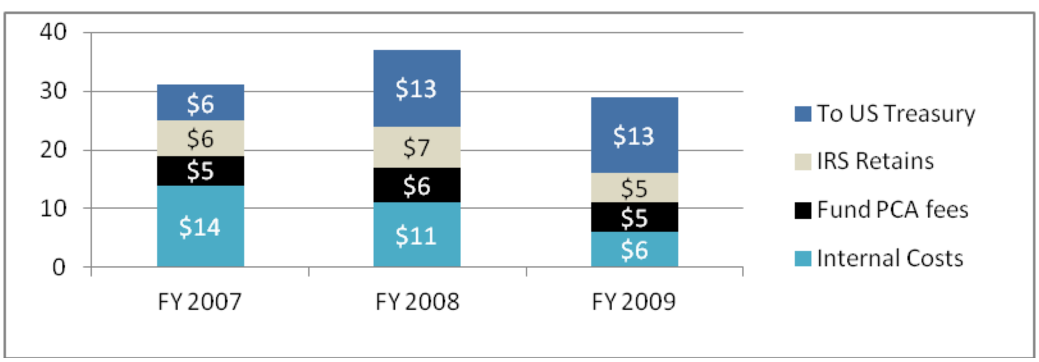
Figure 3: Allowed and Actual Distribution of Funds Collected by the Program[14]



Source: Private Debt Collection Initiative Briefing, September 8, 2006, and Filing and Payment Compliance, Private Debt Collection Advisory Council Briefing, October 19, 2009.

Notably, even though the IRS retained $18.3 million from PDC Program receipts, PDC Program internal costs were funded separately from the IRS's regular operating budget. However, if the internal costs were paid from PDC Program collections, the Program would have met the design objective of collecting enough revenue to fund itself in FYs 2007–2009. Figure 4 shows the funds that would have been available to the IRS and the Department of the Treasury if all operating costs were funded from Program collections.

Figure 4: Funds Available to the U.S. Treasury and the IRS if Internal Costs Were Funded by the Program (in millions)



Source: Private Debt Collection Reports for FYs 2007–2009 and cost data were obtained from IRS management and have not been validated by the Treasury Inspector General for Tax Administration.

[14] PCA fees are commissions paid for the cost of services performed under a contract.

The PDC Program collected $31 million, $37 million, and $29 million in FYs 2007, 2008, and 2009, respectively.[15] The net funds available to the U.S. Treasury would have been $6 million, $13 million, and $13 million for those same years.

Appropriate Collection Actions Were Taken on Cases Returned From the Private Debt Collection Program in Fiscal Year 2007

On March 7, 2007, the IRS discontinued one of the PCA contracts and performed a mass recall from the PCA of 8,395 tax modules with a total assessed balance of approximately $53.5 million. We reviewed a statistical sample of 110 tax modules from this population to determine what collection actions were taken by the IRS after the accounts were returned. We determined the IRS properly reviewed these cases and, when applicable, took appropriate collection action.

The FY 2007 recall process was well organized, with special procedures for processing the cases returned from the PDC Program. The IRS issued letters to taxpayers informing them that their cases had been transferred back to the IRS and providing them with a phone number to contact the IRS referral unit. The referral unit sorted the cases by type and taxpayer involvement. The PCA provided historical case information for all of the accounts returned. The recall process required the referral unit to review each case history and properly code, research, and work the cases as appropriate. This process also required IRS employees to review and/or work many cases that would not have been assigned with regular inventory assignment practices. As of September 2009, 2,701 (32 percent) of 8,395 tax modules returned were resolved as fully paid with collections of $12.5 million. These resolved tax modules are not included as part of the Program results because they were resolved while being worked by the IRS.

Several Cases Returned During Fiscal Year 2009 Were Not Selected for Collection Actions

When the PDC Program was discontinued in March 2009, the IRS recalled 192,713 tax modules with a total assessed balance of $848.5 million from the PCAs. Due to the volume of cases, the IRS did not use the same recall process it used in FY 2007, which required IRS employees to handle every case that was returned. The IRS conducted a phased recall process beginning March 19, 2009, in which a group of cases were returned each week through July 16, 2009. The PCAs were allowed to work the cases until recalled and were allowed to retain the installment agreement cases until the last 2 weeks of the phased recall process.

[15] An additional $1 million was collected in FY 2006, when the Program was only in operation for the last month of the year.

During this recall process, the PCAs classified the accounts into one of four categories:

- Suspended Accounts (Category 1) – A condition is present that requires the PCA to suspend collection activity, such as bankruptcies, disputes, and disasters.
- Installment Agreement Accounts (Category 2) – The account is currently in an active or pending installment agreement.
- Serviced Accounts (Category 3) – Current activity indicates contact is probable or taxpayer contact has occurred.
- Minimally Serviced Accounts (Category 4) – Minimal to no contact has been made with the taxpayer (for example, skip tracing efforts were not productive or mail was undeliverable).

The PCAs provided historical case information for suspended, installment agreement, and serviced accounts. No historical case information was provided for minimally serviced accounts. Approximately 72 percent of the cases returned from the Program were classified as minimally serviced accounts. Initially, the referral unit reviewed all cases returned from the Program for distribution. Subsequently, a systemic case distribution process was developed and used for the minimally serviced accounts.

We reviewed a statistical sample of 62 cases from a population of 192,713 cases returned in FY 2009. Overall, we determined that the IRS did not always pursue collection actions on cases returned from the Program. Specifically, our analysis showed:

- 30 (48 percent) of the 62 cases had some type of collection action[16] taken by the IRS. However:
  - 25 cases were unresolved and will require additional collection actions.
  - 5 cases were resolved, of which 4 were full paid and ********1**************
    **********1**********.
- 29 (47 percent) of the 62 cases had no collection action taken by the IRS.
  - 26 cases were not assigned to be worked based on inventory assignment practices and business rules. **************1******************************** and 4 were shelved due to lack of resources.
  - 3 cases were assigned to be worked; however, ACS processing did not select the cases for collection action. *****************1************************
    **************1*********************.

[16] Some of the cases assigned went through the IRS notice process and search for levy sources.

- 3 (5 percent) of the 62 cases required no further collection action by the IRS because the taxpayers took voluntary actions and fully paid the accounts.

The IRS applied its standard balance due account business rules to the accounts returned from the Program in FY 2009 to determine if a case should be assigned to the ACS to work. When cases are not assigned to be worked, they will likely not be resolved. However, cases assigned to the ACS are not automatically selected for collection actions. The ACS is designed for systemic next-case processing, which allows the system to select cases to be worked by priority.

The 29 cases with no collection action taken by the IRS had a total assessed balance of $105,412 ($1,700 per case). Based on our statistically valid sample and the actual collection rate of 9.38[17] percent, we project that approximately $30.7 million[18] of potential collections will remain as outstanding liabilities. We are 95 percent confident that the range of potential collections is between $14 million and $47 million.

The IRS planned to increase the tax modules assigned with the PCAs to 249,000 modules with a total assessed balance of $1.1 billion each year beginning in FY 2010. As of March 2011, the IRS tax debt inventory included approximately 1.5 million unassigned accounts, with a total outstanding balance of approximately $3.5 billion that are similar to the accounts that were assigned to the PDC Program. Approximately 349,000 of these unassigned accounts, with a total outstanding balance of approximately $1.2 billion, have already been shelved due to lack of IRS resources.

Projecting the actual collection rate of 9.38 percent to total assessed balance of $1.1 billion assigned to the PDC Program per year results in approximately $103.2 million[19] in potential collections of outstanding liabilities per year, or $516 million over the next 5 years. With the PDC Program discontinued, the IRS lacks the resources to actively work and collect the delinquent taxes associated with these cases.

Installment agreement cases were not always worked

The primary method the PCAs used for resolving balance due accounts was telephone contact with the taxpayers. When telephone contact was made, the PCAs were required to request full payment on the account. If the taxpayer could not fully pay the account, the PCAs were required to verify the taxpayer's filing compliance. If the taxpayer was not in filing compliance, the PCAs requested the taxpayer to file delinquent returns with the IRS. When the taxpayer was in filing compliance, the PCAs could work with the taxpayer to set up an installment agreement.

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[17] The PCAs were paid commissions on $70.1 million of the $98.2 million in collections.
[18] This projection is potential collections of outstanding liabilities and does not include the IRS's internal costs or collection agency commissions. See Appendix IV for details on the computation of the outcome measure.
[19] This projection is potential collections of outstanding liabilities and does not include the IRS's internal costs or collection agency commissions. See Appendix IV for details on the computation of the outcome measure.

The PCAs monitored installment agreements by sending the taxpayers monthly reminder notices and calling the taxpayer to remind them a payment was due.

The PCAs were allowed to retain and work installment agreement cases until these cases were recalled to the IRS the last 2 weeks of the phased recall process (weeks of July 9 and 16, 2009). The referral unit was required to review all installment agreement cases returned from the Program to determine if the installment agreements were current. If an agreement was current, the referral unit mailed a letter to the taxpayer with the terms of the installment agreement and updated an IRS computer system to send a monthly reminder notice. These cases were considered "active" installment agreements. If the taxpayer continued making payments, no other collection actions were required by the IRS.

If the referral unit determined an installment agreement was not current, it terminated the installment agreement and applied the same business rules for case distribution within the IRS. These cases were considered "inactive" installment agreements.

We selected a statistical sample of 61 tax modules from a population of 2,545 installment agreement tax modules to determine the collection actions taken by the IRS after the accounts were returned from the Program. We determined that the IRS did not take required collection actions on 6 (10 percent) of the 61 cases.

- Three active installment agreement cases did not have additional collection actions taken when the taxpayers stopped making payments. Specifically:
  - ******************************1*********************************
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- Three inactive installment agreement cases did not have additional collection actions taken. Specifically:
  - *******************************1*********************************
    *************************1*******************.
  - ********************************1********************************
    *************************1***********************************.

When cases are not assigned to be worked, they will likely not be resolved. For these 6 cases, the assessed balances totaled $14,968 (an average of $245 for 61 cases reviewed). Based on our statistically valid sample and the actual collection rate of 9.38 percent, we project that approximately $58,000[20] of potential collections will remain as outstanding liabilities, and we are 95 percent confident that the range is between $4,000 and $150,000.

It is clear that the Federal Government benefited from PCAs working these lower priority cases. Although IRS management believes its employees are more cost effective than the PCAs at collecting the outstanding balances on these accounts, this point is only valid if the IRS uses its resources to work these cases in addition to those that are already being worked as higher priority cases. However, as of the end of our fieldwork, our audit results show that the IRS has been unable to work many of these cases.

Recommendation

***Recommendation 1*:** The Director, Collection, Small Business/Self-Employed Division, should ensure collection policy and procedures are reviewed for inventory assignment practices to determine if cases that otherwise would have been assigned to the PDC Program can be worked. Alternatively, the IRS should consider reinstituting the PDC Program and funding all Program costs through Program collections.

> ***Management's Response*:** IRS management partially agreed with this recommendation. In FY 2011, the IRS implemented Consolidated Decision Analytics to improve balance due case selection and prioritization for the ACS. The Consolidated Decision Analytics system uses decision analytics and modeling to prioritize cases with the best potential for collection for ACS and Field Collection. The IRS will continually review the performance of the Consolidated Decision Analytics models and their output for potential improvement.
>
> IRS management did not agree with the outcome measures. They believe TIGTA's methodology inflates the potential future collection rate for accounts worked through the PDC program. IRS management stated that the methodology assumes future collection rates that are unsupported by actual results, and excludes potential revenue collections that may result from the IRS working these accounts in the future.
>
> ***Office of Audit Comment:*** We are encouraged with the IRS's commitment to reviewing and improving case selection and prioritization processes. However, while the Consolidated Decision Analytics may prioritize inventory that would have been eligible for the PDC Program, it is still unclear how the IRS would actually work those types of cases.
>
> The outcome measures were based on the actual PDC Program collection rate and the actual volume of cases the IRS planned to assign to the Program. The actual results of the PDC Program showed that the PCAs collected 9.38 percent of the liabilities worked.

[20] This projection is potential collections of outstanding liabilities and does not include the IRS's internal costs or collection agency commissions. See Appendix IV for details on the computation of the outcome measure.

IRS documentation showed that the Program was to be expanded to 249,000 cases with liabilities of $1.1 billion per year in FY 2010.

Industry Practices Were Not Used to Improve Internal Revenue Service Collection Efforts

The American Jobs Creation Act, which created the Internal Revenue Code to permit PCAs to help collect Federal tax debts, required the IRS to report on the collection contracts biennially (beginning in FY 2005) to the Committee on Finance of the Senate (Senate) and the Committee on Ways and Means of the House of Representatives (House). This report was to include a comparison of the best practices used by the PCAs with the IRS's own collection techniques and identification of successful collection techniques used by the PCAs which could be adopted by the IRS. However, the IRS did not capture or use PDC Program data and results to improve IRS collection practices. Instead, the IRS prepared briefing documents to the Senate and House to provide updates on the PDC Program. The briefing documents did not include the required comparison of PCA best practices to IRS operations.

Cases have a higher probability of collection when taxpayers are contacted. The PCAs' primary method of collection is focused on taxpayer contact. The PCAs had the resources available to make initial and follow-up taxpayer contacts. However, the IRS's primary collection method on these accounts is systemic.[21] The IRS does not have the resources for taxpayer contact on low-yield cases.

The IRS interviewed PCA and ACS employees, reviewed PCA operation plans and the Internal Revenue Manual, and reviewed IRS and PCA practices. IRS management stated that they did not find an opportunity to adopt a process similar to those used by the PCAs. However, the information the IRS obtained from the PCAs primarily focused on improving current PDC Program operations and determining training needs. This information did not include data to identify PCA best practices that could improve IRS collection practices. As a result, the IRS lost the opportunity to use the results and lessons learned from the PDC Program to make changes to its existing collection assignment practices and improve IRS operations. In addition, the IRS is not compliant with reporting requirements of the American Jobs Creation Act.

Recommendation

Recommendation 2: The Director, Collection, Small Business/Self-Employed Division, should evaluate PCA best practices and lessons learned, including the use of increased personal contact, to determine whether they can help improve IRS collection processes.

[21] The IRS sends notices to the taxpayer about the delinquency. After the notices are issued, the IRS searches for levy sources.

***Management's Response*:** IRS management agreed with this recommendation. The IRS reviewed the operations of two private collection agencies that supported the PDC Program to identify potential best practices that could be adopted to improve IRS collection practices. They interviewed PCA employees to understand their collection processes and to identify innovative practices. The IRS also reviewed PCA operational plans and guidance, which contained workflow diagrams and descriptions of their collection tools and techniques. The IRS will continue to study best practices in both the public and private sectors.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine the effectiveness of collection actions taken by the IRS on taxpayer accounts returned from the PDC Program. During the review, we relied on data provided by the IRS. We evaluated the reasonableness of the data through comparison to the Integrated Data Retrieval System (IDRS)[1] and a data extract obtained by the Treasury Inspector General for Tax Administration Information Services Team. To accomplish our objective, we:

I. Evaluated the PDC Program to determine the results of the Program.

   A. Interviewed management on the PDC Program to determine:

      1. The current status and plans, if any, for the PDC Program to be reinstated within the IRS.

      2. Research studies conducted on the PDC Program within and for the IRS, if any, and conclusions reached from these studies.

      3. The collection inventory assignment practices within the IRS and the criteria used (including whether these assignment practices include the types of cases assigned to PCAs).

      4. The collection actions taken on taxpayer accounts returned to the IRS from PCAs when the Program ended.

   B. Obtained PDC Program statistics and identified:

      1. The number of taxpayer modules and taxpayer entities assigned to the Program and related dollar amounts.

      2. The number of full paid modules and dollar amounts.

      3. The number of installment agreement modules and dollar amounts.

      4. The number of recalled modules and dollar amounts to exclude these accounts from further analysis.

      5. A collection rate for the Program.

      6. The installment agreement default rate for the Program.

      7. The costs charged to the Program.

[1] See Appendix V for a glossary of terms.

C. Based on results of Steps I.A and I.B, determined the overall results of the Program.

1. Determined whether the Program brought in more than it cost.

2. Determined whether the PDC Program was as productive as the IRS is or will be for similar cases.

II. Evaluated the collection actions taken by the IRS on taxpayer accounts returned from the PDC Program and determined the effectiveness of the collection actions.

A. Obtained statistics on taxpayer accounts returned and determined the current status of the accounts.

1. Obtained a listing of the taxpayer accounts returned to the IRS and determined the status of these accounts when returned to the IRS and the dollar amounts collected and outstanding when the PDC Program ended.

2. Ran a query on the listing obtained from the IRS and determined the current status for the taxpayer accounts returned to the IRS since the Program ended. We identified the number of returned taxpayer accounts:

a) Full paid and the related dollar amounts.

b) Under installment agreements and the related dollar amounts.

c) Closed as uncollectible and the related dollar amounts.

d) With subsequent modules with balance due accounts and the related dollar amounts.

B. Determined whether collection actions taken by the IRS were effective.

1. Selected statistical samples based on the population of taxpayer accounts returned from the PDC Program to review the collection history and determine the collection actions, if any, taken on the accounts by the IRS after they were returned. We validated the reliability of the data for each sample by comparing the data to the information available through research of the IDRS. We selected statistical samples to be able to quantify and project our results to the population.

a) <u>Sample 1 – Population of Recalled Accounts in March 2009</u> – Selected a statistically valid sample of 62 taxpayer modules that were assigned to the 2 remaining PCAs as of March 19, 2009. This sample was randomly selected from a population of 192,713 taxpayer modules returned from the Program during a phased recall from March 19 through July 16, 2009. The statistical sample was based on a 95 percent confidence level, a ± 10 percent precision level, and a 20 percent expected error rate.

b) Sample 2 – Population of Recalled Accounts in March 2007 – Selected a statistically valid sample of 62 taxpayer modules that were assigned to 1 PCA as of March 6, 2007 (the PCA whose contract was not renewed). This sample was randomly selected from a population of 8,395 taxpayer modules returned from the PDC Program during a mass recall on March 7, 2007. The statistical sample was based on a 95 percent confidence level, a ± 10 percent precision level, and a 20 percent expected error rate.

c) Sample 3 – Population of Installment Agreement Cases Recalled in July 2009 – Selected a statistically valid sample of 61 installment agreement taxpayer modules that were recalled during the weeks of July 9 and 16, 2009. This sample was randomly selected from a population of 2,545 taxpayer modules returned from the PDC Program in July 2009. The statistical sample was based on a 95 percent confidence level, a ± 10 percent precision level, and a 20 percent expected error rate.

d) Sample 4 – Population of Installment Agreement Cases Recalled in March 2007 – Selected a statistically valid sample of 48 installment agreement taxpayer modules that were recalled March 7, 2007. This sample was randomly selected from a population of 214 taxpayer modules returned from the PDC Program in March 2007. The statistical sample was based on a 95 percent confidence level, a ± 10 percent precision level, and a 20 percent expected error rate.

2. Determined whether the sample cases (Steps II.B.1.a and II.B.1.b) were within the PCA's authority to work by determining whether each sample case aggregate entity balance was $25,000 or less.

3. Determined if any collection actions taken by the IRS were limited to the collection actions as allowed by the PCAs (e.g., PCAs collection actions were limited to requesting full payment, setting up an installment agreement, or securing collection information statement data from taxpayers).

III. Determined whether the IRS captured and used PDC Program data and results to help improve IRS collection practices. We evaluated and conducted various analyses to identify trends, inventory available, lessons learned, and best practices from the Program.

A. Identified trends from the PDC Program and the taxpayer accounts returned to the IRS. We performed and conducted various analyses of the data provided from Step I to compare the PDC Program results to those the IRS achieved on taxpayer accounts returned to the IRS.

B. Analyzed the Queue to identify the accounts closed as not collectible due to a lack of resources and determined the amount of inventory available and dollar amounts that would have been assigned to the PDC Program if the Program had continued.

C. Interviewed IRS management to determine if the IRS identified any lessons learned or best practices from PCAs to use for other IRS programs. We obtained documentation of the lessons learned or best practices and:

   1. Reviewed it for completeness and usefulness.

   2. Determined who the lessons learned or best practices were communicated to and how they were used.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: IRS and ACS inventory assignment practices and business rules, and referral unit and PCA policy and procedure guides. We evaluated these controls by interviewing IRS management, reviewing source materials, and analyzing cases returned from the Program in a mass recall in March 2007 and a phased recall from March through July 2009.

Appendix II

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit, Compliance and Enforcement Operations
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Collection, Small Business/Self-Employed Division SE:S:C
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Calculation of Program Collection Rate:

During the life of the Program, the IRS reported $98,228,905 in program funds collected, of which $70,144,531 were commissionable payments. The IRS assigned to the Program $1.635 billion in balance due accounts and with contract cancellations recalled $887 million ($53.5 million in a mass recall in FY 2007 when one PCA contract ended and $848.5 million in a phased recall in FY 2009 when two PCA contracts ended, less $15 million resolved as full paid by the PCAs during the phased recall). This resulted in $748 million in balance due accounts worked by the PCAs ($1.635 billion less $887 million) and a collection rate of 9.38 percent ($70,144,531/$747,924,475) for the balance of the accounts.

During the life of the Program, the IRS reported it assigned 357,449 tax modules. With contract cancellations 199,419 tax modules were recalled (8,395 mass recall in FY 2007 when one PCA contract ended and 192,713 in a phased recall in FY 2009 when two PCA contracts ended less 1,689 resolved as full paid by the PCAs during the phased recall). This resulted in 158,030 tax modules worked by the PCAs (357,449 less 199,419). The program received commissionable payments of $70,144,531 on 14,113 tax modules (56,810 cases resolved less 42,697 refund offset cases which did not qualify for PCA commissions). This resulted in a collection rate of 8.93 percent (14,113/158,030) for the tax modules.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $30.7 million[1] of potential collections from 8,049 taxpayers will remain as outstanding liabilities (see page 7).

Methodology Used to Measure the Reported Benefit:

We identified 192,713 tax modules recalled from the PDC Program during a phased recall from March 19 through July 16, 2009, based on data provided by the IRS. From this population, we selected a statistical sample of 62 cases using a confidence level of 95 percent, a precision level of ± 10 percent, and an expected error rate of 20 percent.

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[1] This projection is potential collection of outstanding liabilities and does not include the IRS's internal costs or collection agency commissions.

We determined that for 29 cases, no collection actions have been taken since the cases were returned from the PDC Program. More specifically, 26 of the 29 cases were not assigned to be worked based on inventory assignment practices and business rules; 3 of the 29 cases have been assigned to be worked, however, ACS processing has not selected the cases for collection action. When cases are not assigned to be worked, accounts are potentially not resolved.

For these 29 cases, the assessed balances totaled $105,412. This results in an average of $1,700 per tax module ($105,412/62) and error rate of 46.8 percent (29/62). Projecting this average total assessed balance per tax module, error rate, and the actual collection rate of 9.38 percent over the population of 192,713 tax modules results in $30.7 million ($1,700 x 192,713 x 9.38 percent) or 8,049 tax modules (192,713 x .4677 x 8.93 percent) of potential collections that will remain as outstanding liabilities due to IRS inventory assignment practices and a lack of resources. We are 95 percent confident that the range of tax modules is between 6,000 and 10,000 and the dollars are between $14 million and $47 million.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $58,000[2] of potential collections for 22 taxpayers will remain as outstanding liabilities (see page 7).

Methodology Used to Measure the Reported Benefit:

We identified 2,545 installment agreement tax modules that were recalled from the PDC Program the weeks of July 9 and 16, 2009, based on data provided by the IRS. From this population, we selected a statistical sample of 61 installment agreement cases using a confidence level of 95 percent, a precision level of ± 10 percent, and an expected error rate of 20 percent. We determined that six cases required additional collection action.

For these 6 cases, the assessed balances totaled $14,968. This results in an average of $245 per tax module ($14,968/61) and error rate of 9.84 percent. Projecting this average total assessed balance per tax module, error rate, and actual collection rate of 9.38 percent over the population of 2,545 tax modules results in approximately $58,000 ($245 x 2,545 x 9.38) or 22 tax modules (2,545 x .0984 x 8.93 percent) of potential collections that will remain as outstanding liabilities due to IRS inventory assignment practices and a lack of resources. We are 95 percent confident that the range of tax modules is between 5 and 40 and the dollars are between $4,000 and $150,000.

Type and Value of Outcome Measure:

Increased Revenue – Potential; $103.2[3] million in potential collection of outstanding liabilities; $516 million over the next 5 years (see page 7).

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[2] This projection is potential collection of outstanding liabilities and does not include the IRS's internal costs or collection agency commissions. Historic PDC program costs are identified on Page 4 of the report.

Methodology Used to Measure the Reported Benefit:

As of September 2010, the IRS tax debt inventory included approximately 1.5 million unassigned accounts that are similar to those that were assigned to the PDC Program. These accounts have a total outstanding balance of approximately $3.5 billion, and 349,000 of these unassigned accounts with a total outstanding balance of $1.2 billion have already been shelved due to a lack of resources. We did not select a sample of this population.

The IRS's initial plans were to increase the tax modules assigned to the PCAs to 249,000 modules with a total assessed balance of $1.1 billion each year beginning FY 2010. The IRS assigned to the Program $1.635 billion in balance due accounts and with contract cancellations recalled $887 million ($53.5 million in a mass recall in FY 2007 when one PCA contract ended and $848.5 million in a phased recall in FY 2009 when two PCA contracts ended, less $15 million resolved as full paid by the PCAs during the phased recall). This resulted in $748 million in balance due accounts worked by the PCAs ($1.635 billion less $887 million) and a collection rate of 9.38 percent ($70,144,531/$747,924,475).

Projecting the collection rate to the planned balance due placements results in $103.2 million ($1,100,000,000 x .0938) in potential collection of outstanding liabilities per year, which is approximately $516 million over the next 5 years. With the PDC Program discontinued, the IRS lacks the resources to actively work and collect on these cases.

[3] This projection is potential collection of outstanding liabilities and does not include IRS's internal costs or collection agency commissions.

Appendix V

Glossary of Terms

Automated Collection System – A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

Business Rules – An activity based on the policies and practices of an organization that takes place during the course of an organization's business.

Gross Accounts Receivable – Includes all unpaid tax, with accrued penalties and interest, on taxpayers' delinquent accounts.

Installment Agreement – A method for taxpayers to pay tax liabilities by making regular payments to the IRS over time rather than all at once.

Integrated Data Retrieval System – An IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

PCA Operation Plan – A PCA document that describes how the contractor will carry out its duties under the Program contract.

Queue – An automated holding file for unassigned inventory of delinquent cases for which the Collection function does not have enough resources to immediately assign the cases for contact.

Recalled Accounts – An action taken by the IRS to direct the PCAs to close accounts and return them to the IRS in order to place them back into the flow of IRS processing.

Referral Unit – A unit of the PDC Program responsible for assigning cases to PCAs; maintaining cases; recalling cases; responding to inquiries from taxpayers, PCAs, and IRS staff; and handling taxpayer complaints.

Shelved Cases – Delinquent unpaid accounts or investigations of unfiled tax returns that have been taken out of the Collection function inventory because they are of lower priority than other available inventory.

Skip Tracing – The process to locate a new address whenever a taxpayer cannot be located at the address provided by the IRS.

Tax Module (or Period) – Refers to each tax return filed by the taxpayer for a specific period (year or quarter).

Appendix VI

Management's Response to the Draft Report

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

RECEIVED
SEP 15 2011

September 15, 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Collection Actions Were Not Always Pursued on Cases Returned From the Private Debt Collection Program (Audit No. 201030016)

Thank you for the opportunity to review TIGTA's draft report entitled, "Collection Actions Were Not Always Pursued on Cases Returned From the Private Debt Collection Program." We appreciate TIGTA's feedback on the process that the IRS ran to return cases from private collection agencies (PCAs), and that the report acknowledges the steps IRS took to analyze PCA practices to uncover any useful procedures.

However, the report states many of the cases returned from the PDC program were not worked. We believe this characterization is misleading. IRS systemic actions – such as levies and refund offsets – continued even after cases were returned from the PCAs into IRS inventory. In fact, systemic actions were undertaken even while the PDC program was fully operational and accounted for over 75% of the PDC program's full-paid modules. In addition, when taxpayer accounts were returned from the Program, the IRS conducted research for new levy sources. We then applied business rules and the cases were assigned to the appropriate collection strategy or inventory. Cases that remain unresolved are subject to refund offsets, systemic levy programs, and federal tax lien filing, and will receive written correspondence from the IRS on a regular basis. Cases may also be returned to active collection status if new information becomes available (e.g., updated levy source).

The IRS does not agree with the report's estimated benefits. We believe TIGTA's methodology inflates the potential future collection rate for accounts worked through the Private Debt Collection (PDC) program. The methodology assumes future collection rates that are unsupported by actual results and excludes potential revenue collections that may result from the IRS working these accounts in the future. In fact, while the

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highest annual revenue amount attributable to private collection agency (PCA) activities was only $28 million when the Program was operational, TIGTA estimates that the PDC program would have collected $103.2 million annually if it had continued.

Moreover, it is our view that the analysis should not rest on the distinction between Congressional actions to direct federal dollars directly to private contractors outside the appropriations process, versus directing funding to be managed by a federal agency through the normal funding process. If a comparative review of programs shows that more revenue would be generated if Congress were to provide funding to the agency, then we believe that it is our obligation to fully explain that point. From there, Congress can decide how best to direct resources to the agency.

The report provides recommendations for reviewing inventory assignment practices and for evaluating best practices to improve IRS collection processes. The IRS continually reviews and updates its collection practices and operations, including improving inventory selection. Attached is a detailed response outlining our corrective actions.

If you have any questions, please contact me, or a member of your staff may contact Brad Bouton, Director, Collection Strategy and Organizational Performance, Small Business/Self-Employed Division, at (202) 283-1574.

Attachment

Attachment

RECOMMENDATION 1:
The Director, Collection, Small Business/Self-Employed Division, should ensure collection policy and procedures are reviewed for inventory assignment practices to determine if cases that otherwise would have been assigned to the PDC Program can be worked. Alternatively, the IRS should consider reinstituting the PDC Program and funding all Program costs through Program collections.

CORRECTIVE ACTION:
The IRS partially agrees with this recommendation. In FY 2011, the IRS implemented Consolidated Decision Analytics (CDA) to improve balance due case selection and prioritization for the Automated Collection System (ACS); CDA was implemented for Field Collection in FY 2009. The CDA system uses decision analytics and modeling to prioritize cases with the best potential for collection for ACS and Field Collection. The IRS will continually review the performance of the CDA models and their output for potential improvement.

It should be noted that the CDA system models and prioritizes inventory that would have been eligible for the PDC program.

IMPLEMENTATION DATE:
Completed

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2:
The Director, Collection, Small Business/Self-Employed Division, should evaluate PCA best practices and lessons learned, including the use of increased personal contact, to determine whether they can help improve IRS collection processes.

CORRECTIVE ACTION:
The IRS agrees with this recommendation. The IRS reviewed the operations of two private collection agencies that supported the PDC program to identify potential best practices that could be adopted to improve IRS collection practices. We interviewed PCA employees to understand their collection processes and to identify innovative practices. We also reviewed PCA operational plans and guidance, which contained workflow diagrams and descriptions of their collection tools and techniques.

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During the PCA best practice review, the IRS determined that skip tracing (generally, the process of locating and contacting individuals through third-party information) was a significant driver of PCA collections. At the time of the review, the IRS already used skip tracing techniques to locate and contact taxpayers. Currently, the IRS uses a variety of information sources, including data maintained by state governments, to contact taxpayers and identify potential taxpayer assets. Privacy and disclosure regulations and policies determine the third-party data sources the IRS may use along with the manner in which it makes and records third-party contacts.

The IRS also studied how the PCAs used predictive dialer technology to assist in the resolution of unpaid debts. A predictive dialer is a computerized telephone system that makes automated outcalls. The IRS selectively uses predictive dialer, based on the characteristics of the account, to call taxpayers and their representatives. When the system makes contact with a taxpayer or representative, it directs the call to a customer service representative. If it reaches an answering machine, the system leaves an automated message. This approach is similar to the process that one of the PCAs used that the IRS reviewed.

In addition to the best practices detailed above, the IRS is always studying best practices in both the public and private sectors and will continue to do so in order to improve our programs.

IMPLEMENTATION DATE:
Completed

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A