

OUTSOURCING FEDERAL TAX COLLECTION

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I. INTRODUCTION

On October 22, 2004, President Bush signed into law the American Jobs Creation Act often referred to as the corporate tax-cut bill.¹ Buried in the 633 page American Jobs Creation Act are provisions that allow the IRS to use private debt collection companies (PCAs) and private law firms in the collection of delinquent taxes.² This follows a pilot program that was authorized by Congress and tested in 1996.³ After the initial pilot, the Clinton Administration opposed renewal of the program.⁴ However, the Bush administration has strongly supported the implementation of a permanent program for the collection of tax debts.⁵ For various reasons, there are many who strongly opposed such legislation.⁶ This article explores some of the areas of controversy. First, I will provide some background on the use of private debt collectors by the government in the context of historic use for tax collection and current use by other agencies. Next, I will examine the 1996 pilot program and discuss many of its problems. Then I will discuss considerations

1. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

2. *See id.*

3. Treasury, Postal Service, and General Government Appropriations Act of 1996, Pub. L. No. 104-52, 109 Stat. 468, 473-74; *Use of Private Collection Agencies by the IRS: Testimony Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 108th Cong. (May 13, 2003) (Testimony of Colleen M. Kelley, National President of National Treasury Employees Union), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=365> [hereinafter 2003 Kelley Testimony].

4. *Statement of Administration Policy on Treasury Funding Bill*, 96 TAX NOTES TODAY 179-45 (Sep. 12, 1996).

5. BUDGET OF THE UNITED STATES GOVERNMENT, OFFICE OF MANAGEMENT AND BUDGET, FISCAL YEAR 2004 (H. Doc. 108-3), ANALYTICAL PERSPECTIVES (Vol. III) at 76, available at <http://www.gpoaccess.gov/usbudget/fy04/pdf/spec.pdf>; see also SUMMARY TABLE S-9, available at <http://www.gpoaccess.gov/usbudget/fy04/pdf/budget/tables.pdf>.

6. *See generally NTEU Views on Investing in the IRS Workforce: IRS Oversight Board Hearing* (Jan. 26, 2004) (Testimony of Colleen M. Kelley, National President of National Treasury Employee's Union) [hereinafter 2004 Kelley Testimony], reprinted in NTEU's Kelley Testifies at IRS Oversight Board Hearing, Tax Notes Today, Jan. 29, 2004, LEXIS, 2004 TNT 19-40. Groups opposing the legislation include

Several taxpayer advocacy groups: the Tax Executives Institute; the National Association of Enrolled Agents; Citizens for Tax Justice; Consumer Federation of America; Consumers Union; National Consumer Law Center; National Consumers League; and large segments of the taxpaying public oppose the privatization of collection duties. Specifically, Global Strategy Group, Inc. conducted a poll last year that found 66% of respondents disapprove of allowing the IRS to hire private debt collection companies. When details of the IRS's plan were provided, the number in opposition rose to 79%. The results of this poll strongly indicate that Americans across all political, geographic and income lines oppose this proposal.

Id.

that must be taken into account before the implementation of any future program for outsourcing of tax collection activities. Finally, I will examine the recently passed legislation in light of those considerations and evaluate implementation of such a program.

II. THE USE OF PRIVATE DEBT COLLECTORS BY THE UNITED STATES GOVERNMENT

A. *Historically*

The use of private debt collectors to collect revenue, while novel in the modern era, is not entirely foreign to the United States. The early history of the United States includes the use of “collectors of internal revenue” to collect tariffs and excise taxes on distilled spirits.⁷ These collectors were a class of agents authorized in 1798 who received a percentage of the money collected.⁸ The first documented case of contracting out for tax collection occurred in 1872, “when the Secretary of the Treasury hired John Stanborn to collect excise taxes from thirty-nine whiskey manufactures and merchants.”⁹ Sanborn was compensated by half of the revenue collected.¹⁰ He continued to work until 1873 accumulating more than \$200,000 in personal gain.¹¹ Sanborn’s enterprise came to an end in 1873 with a Congressional investigation concluding that such contracts were improper.¹² Until the recent IRS pilot, this was the last instance of private collectors for tax debt in the United States.¹³

B. *Private Debt Collectors in Other Government Agencies*

The use of private debt collectors to collect government receivables is a practice applied in other government departments.¹⁴ In 1966, Congress passed the first legislation allowing for use of private debt collectors by the federal

7. Adam Melita, *Much Ado About \$26 Million: Implications of Privatizing the Collection of Delinquent Federal Taxes*, 16 Va. Tax Rev. 699, 703 (1997) (citing DEPARTMENT OF THE TREASURY AND INTERNAL REVENUE SERVICE, IRS HISTORICAL FACT BOOK: A CHRONOLOGY 12 (1993)).

8. *Id.* at 703-04.

9. *Id.* at 704.

10. *Id.*

11. *Id.*

12. *Id.* (citing DEPARTMENT OF THE TREASURY AND INTERNAL REVENUE SERVICE, IRS HISTORICAL FACT BOOK: A CHRONOLOGY 12 (1993)).

13. Melita, *supra* note 7, at 704.

14. *See id.* at 705-06.

government when it enacted the Federal Claims Collection Act.¹⁵ This legislation was first applied by the Department of Education in its efforts to collect on student loan debts.¹⁶

In 1982, Congress enacted the Debt Collection Act (DCA).¹⁷ This act gave federal and legislative agencies broad discretion to enter into collection contracts with collection agencies and law firms.¹⁸ However, the act specifically excluded collection of federal tax debts.¹⁹

The Justice Department initiated a limited pilot program in 1997 under the Federal Debt Recovery Act of 1986.²⁰ By 1990, the scheduled termination date of the initial three year program, the Justice Department had only implemented five collection districts.²¹ These pilot programs were renewed numerous times, and by 1995, at least twenty federal agencies were using private debt collectors.²²

In 1996, Congress enacted the Debt Collection Improvement Act (DCIA).²³ The DCIA made several amendments to the DCA.²⁴ The amendments included provisions designed to provide greater safeguards for debtors' due process rights.²⁵ The DCIA also included provisions designed to enhance debt collection including increased inter-agency information sharing through computer matching programs for purposes of offset, and to encourage use of inter-agency teams designed to integrate the debt collection process.²⁶

III. IRS PILOT PROGRAM

A. *Lost Revenue*

Each year, the federal government loses millions of dollars of potential revenue as a result of its failure to collect delinquent

15. Federal Claims Collection Act of 1966, Pub. L. No. 89-508, 80 Stat. 308.

16. Melita, *supra* note 7, at 705. This article provides a more in depth analysis of the history of debt collection acts employed by the federal government.

17. Debt Collection Act of 1982 (DCA), Pub. L. No. 97-365, 96 Stat. 1749; 31 U.S.C. § 3718(a) (2000).

18. Melita, *supra* note 7, at 704.

19. 31 U.S.C. § 3718(f).

20. Federal Debt Recovery Act of 1986, Pub. L. No. 99-578, 100 Stat. 3305, 3307.

21. Melita, *supra* note 7, at 705-706.

22. *Id.* at 706.

23. Debt Collection Improvement Act of 1996 (DCIA), Pub. L. No.104-134 § 31001, 110 Stat. 1321.

24. *See id.*

25. *See id.*

26. *See id.*; *see also* Metila, *supra* note 7, at 707-10.

taxes.²⁷ The IRS must forgo these delinquent taxes due to increasingly overly burdened IRS collection resources. As of March 2003, \$13 billion in individual income tax debt was designated as “uncollectible” due to a lack of IRS resources.²⁸ As of May 2003, the IRS had an inventory of potentially collectible debt of \$78 billion of which approximately 38% was in inactive status.²⁹ Potentially collectible debt is debt that the taxpayer has either agreed is due and owing or debt on which the taxpayer has made at least three payments but the IRS is unable to collect either due to insufficient resources or the inability to locate the taxpayer.³⁰ The total accounts receivable dollar inventory is growing at an annual rate of 3-4%.³¹

Numerous factors contribute to the escalating overburdening of IRS resources. Between 1992 and 2001, the IRS’ workload increased 16% while, during this same period, the number of federal tax employees decreased by 16%.³² A disproportionate reduction occurred in Field Compliance personnel which decreased by 28%.³³ From 1997-2002 alone, 12 million more tax returns were filed.³⁴ Another factor is the ever-changing tax code. During the 1997-2002 period there were nineteen tax bill changes affecting 292 code provisions and requiring 515 changes

27. I.R.S., 2003 IRS Data Book (March 2004), Table 16 Delinquent Collection Activities Fiscal Years 2000-03, available at <http://www.irs.gov/pu/irs-soi/03db16co.xls> (last visited Nov. 6, 2004).

28. NATIONAL TAXPAYER ADVOCATE’S REPORT TO CONGRESS, FISCAL YEAR 2004 OBJECTIVES 13 (June 30, 2003), available at http://www.irs.ustreas.gov/pub/irs-utl/nta_fy04_objrpt.pdf.

29. *Use of Private Collection Agencies by the IRS: Testimony Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 108th Cong. (2003) (statement of National Taxpayer Advocate Nina E. Olson, The Current Tax Gap and Potentially Collectible Inventory), available at 2003 WL 11717932 [hereinafter Olson Testimony]. As of September 30, 2003, the amount of potentially collectible debt had risen to \$89 billion, but the audit report containing that information does not indicate what percentage of that amount is in inactive status. U.S. GEN. ACCOUNTING OFFICE, GAO-04-126, FINANCIAL AUDIT: IRS’S FISCAL YEARS 2003 AND 2002 FINANCIAL STATEMENTS 79 (2003), available at <http://www.gao.gov/new.items/d04126.pdf> [hereinafter GAO Financial Audit].

30. *Use of Private Collection Agencies by the IRS: Testimony Before the Subcomm. on Oversight of the House Comm. on Ways and Means* (2003) (statement of Commissioner of IRS Hon. Mark W. Everson), available at 2003 WL 11717931 [hereinafter Everson Testimony].

31. GAO Financial Audit, *supra* note 29, at 79.

32. COMM’R CHARLES ROSOTTI, INTERNAL REVENUE SERVICE, REPORT TO THE IRS OVERSIGHT BOARD: ASSESSMENT OF THE IRS AND THE TAX SYSTEM 12 (2002), available at http://www.treas.gov/irsob/documents/commissioner_report.pdf [hereinafter 2002 Report to IRS Oversight Board]. Workload is calculated using the weighted average of returns filed, a measure of overall IRS workload. *Id.* The number of IRS employees decreased from 115,204 to 95,511 during this period. *Id.*

33. *Id.* at 12-13. Field Compliance personnel fell from 29,730 in FY 1992 to 21,421 in FY 2002. *Id.*

34. *Id.* at 13.

to IRS forms and instructions.³⁵ Additional factors include the recent massive Y2K compliance project undertaken by the IRS, September 11 related issues such as victims' relief, the IRS' security response, a money laundering task force, and the advance rate reduction credit requiring 126 million notices, which affected 91 million taxpayers.³⁶

The IRS' inability to enforce debt collection not only results in lost revenue from debt due but also increases lost revenue from future tax collection because voluntary compliance is undermined when taxpayers believe that they can get away with not paying their taxes.³⁷ This problem increases when taxpayers and tax professionals become increasingly aware of the IRS' inability to collect debt as the issue is reported in a wide range of publications including *The Wall Street Journal*, *New York Times*, *Fortune*, and *Forbes* and on national television.³⁸

B. *The Pilot Program*

On November 19, 1995, Congress earmarked \$13 million as part of the IRS' fiscal year 1996 appropriations legislation for a pilot program to test the use of private law firms and debt collection agencies to help collect delinquent tax debts.³⁹ An additional \$13 million was earmarked on September 30, 1996 as part of the IRS' 1997 budget as well as \$13 million for a second pilot program to be performed by the Treasury.⁴⁰

Many interested parties including the IRS Oversight Committee Board, the General Accounting Office (GAO), and the National Treasury Employees Union, considered the 1996 pilot a failure.⁴¹ In addition to the pilot's failure to reap any financial

35. *Id.*

36. *Id.* at 14.

37. Everson Testimony, *supra* note 30, *Reasons for Change*.

38. 2002 Report to IRS Oversight Board, *supra* note 32, at 17.

39. I.R.S INSPECTOR GENERAL FOR TAX ADMINISTRATION, MANAGEMENT ADVISORY REPORT NO. 2001-40-122: ADDITIONAL OPTIONS TO COLLECT TAX DEBTS NEED TO BE EXPLORED, REF. 2 (2001), available at <http://www.ustreas.gov/tigta/2001reports/200140122fr.pdf>; see also U.S. GEN. ACCOUNTING OFFICE, GAO/T-GGD-96-112, TAX ADMINISTRATION, IRS TAX COLLECTION PRACTICES: HEARING BEFORE SUBCOMM. ON OVERSIGHT, HOUSE WAYS AND MEANS COMM. 6-7 (1996) (prepared Statement of Lynda D. Willis, Director, Tax Policy and Admin. Issues, Gen. Gov't Div.), available at <http://www.gao.gov/archive/1996/gg96112t.pdf>.

40. U.S. GEN. ACCOUNTING OFFICE, GAO/T-GGD/AIMD-97-130, TAX ADMINISTRATION, I.R.S' FISCAL YEAR 1998 BUDGET REQUEST: HEARING BEFORE THE SUBCOMM. ON TREASURY AND GEN. GOV'T, S. COMM. ON APPROPRIATIONS 6 (statement of James R. White, Assoc. Director, Tax Policy and Admin. Issues, Gen. Gov't Div.), available at <http://www.gao.gov/archive/1997/g197130t.pdf> [hereinafter GAO/T-GGD/AIMD-97-130].

41. See, e.g., GAO/T-GGD/AIMD-97-130, *supra* note 40, at 6; 2003 Kelley

benefits for the IRS, the IRS cited lost-opportunity costs of about \$17 million because it had to move collection personnel off line to work on the pilot.⁴² Due to problems in the 1996 pilot program, the GAO recommended that the \$26 million allocated for 1997 not be spent until problems in the pilot were worked out, and the program was halted.⁴³

Specifically, the GAO identified three main problems with the pilot.⁴⁴ First, the IRS' legal interpretations prevented the pilot from being a true test of private contractors' ability to collect delinquent taxes.⁴⁵ Second, systems and operations problems made it difficult to identify, select, and transmit cases to the contractors.⁴⁶ The third problem involved a lack of performance measures whereby the IRS could learn from the collection practices and techniques used by the private collectors and apply them to the IRS' own collection practices.⁴⁷ These problems are discussed in more detail in the following sections of this article.

The IRS reported that through January 1997, private collectors contacted 14,000 taxpayers and had attributable total revenues collected of about \$3.1 million.⁴⁸ Performance payments to the private collectors during the pilot were \$1,049,648.⁴⁹ The IRS also reported that pilot design, startup, and administrative expenses through the same period were \$3.1 million.⁵⁰ While design and startup expenses will likely decrease after the initial implementation of a permanent program, administrative expenses for oversight of the private collectors as well as those associated with cases that require referral back to the IRS would be ongoing.

C. *Compensation for Private Debt Collectors*

One conflict in legal interpretations that hindered

Testimony, *supra* note 3, *Privatization of Tax Was Tried and It Failed*.

42. U.S. GEN. ACCOUNTING OFFICE, GEN. GOV'T DIV., GAO/GGD-97-129R, INTERNAL REVENUE SERVICE: ISSUES AFFECTING THE IRS' PRIVATE DEBT COLLECTION PILOT 2 (1997), available at <http://161.203.16.4/papr2pdf/159007.pdf> [hereinafter GAO/GGD-97-129R].

43. GAO/T-GGD/AIMD-97-130, *supra* note 40, at 6-7; GAO /GGD-97-129R, *supra* note 42, at 2.

44. GAO/T-GGD/AIMD-97-130, *supra* note 40, at 6.

45. *Id.*

46. *Id.*

47. *Id.*

48. GAO /GGD-97-129R, *supra* note 42, at 2.

49. *Id.*

50. *Id.*

implementation of the pilot regarded compensation of the private collectors.⁵¹ Many supporters of the pilot believed that private collectors should be compensated on a percentage basis for the debts collected.⁵² Detractors believed, however, that this would conflict with the intent of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA).⁵³

Congress enacted the RRA in an attempt to further protect taxpayer's rights. Section 1204 of the RRA prohibits evaluation of IRS employees based on "tax performance results."⁵⁴ "Tax performance results" include "a lien filed; a levy served; a seizure executed; the amount assessed; the amount collected; and a fraud referral."⁵⁵ Provisions such as this in the RRA were implemented in an attempt by Congress to facilitate more equitable treatment of taxpayers by the IRS.⁵⁶ Therefore, the IRS believed that compensating private collectors on a percentage basis would undermine the intent of the RRA by providing private collectors an incentive to collect as much as possible without any regard for taxpayers' rights, an incentive which is inappropriate when collection is conducted by IRS employees.⁵⁷

D. *Inherently Governmental Activities and the FAIR Act*

Another legal interpretation that limited implementation of the pilot program involved the definition of "inherently governmental activities." Both the IRS and the Office of Management and Budget consider the "collection of taxes" to be an inherently governmental activity that must be performed by government employees.⁵⁸ The Federal Activities Inventory Reform Act of 1998 (FAIR) prohibits executive agencies from contracting out inherently governmental activities.⁵⁹

Section 5 of the FAIR Act defines "inherently governmental activities."⁶⁰ Generally, an activity is inherently governmental if

51. *Id.*

52. Everson Testimony, *supra* note 30, *PCA Compensation*.

53. 2003 Kelley Testimony, *supra* note 3, *Incentives for Private Debt Collectors to Harass Taxpayers*.

54. Internal Revenue Service Restructuring and Reform Act of 1998 (RRA), Pub. L. No. 105-206, 112 Stat. 685 (codified at 26 U.S.C. § 7804, Notes).

55. 26 C.F.R. § 801.6(d)(i) (2004).

56. *See generally* 143 Cong. Rec. H10040-02 (daily ed. Nov. 5, 1997), available at 1997 WL 687037.

57. *Id.*

58. GAO/GGD-97-129R, *supra* note 42, at 2.

59. Federal Activities Inventory Reform Act of 1998 (FAIR), Pub. L. No. 105-270, 112 Stat. 2382 (codified at 31 U.S.C. 501, Notes).

60. *Id.*

“it is so intimately related to the public interest as to require performance by Federal Government employees.”⁶¹ These activities require either the “exercise of discretion” in applying governmental authority or the “making of value judgments relating to monetary transactions and entitlements.”⁶² The FAIR Act specifically lists some activities that are inherently governmental.⁶³ These activities include “the interpretation and execution of laws. . .such as: (1) “to bind the United States to take or not take some action;” (2) “to determine, protect and advance United States. . .interests;” and (3) “to significantly affect the. . .property of private persons.”⁶⁴ The FAIR Act also specifically excludes from the definition of “inherently governmental activities” the gathering of information for government officials.⁶⁵ Based on the FAIR Act and the Office of Management and Budget’s Circular A-76 issued pursuant to the FAIR Act, the IRS limited use of private collectors to assisting the IRS in locating and contacting taxpayers to remind them of their outstanding tax liability and to suggest various payment methods.⁶⁶ Application of the FAIR Act to PCA collection is discussed in greater detail in the next section of this article.

E. *IRS Computer Databases*

Another factor limiting the success of the pilot program involved the IRS’ reliance on computer systems, which made it difficult to identify, select, and transmit collection cases to private collectors.⁶⁷ One problem involved developing computer programs to filter out delinquent taxpayers that were appropriate for use in the pilot.⁶⁸ More importantly, the IRS had to develop computer programs to remove sensitive taxpayer information before transmittal to the PCAs.⁶⁹ Such computer related problems are startup in nature and, once resolved, would not likely be ongoing in any future program.

61. FAIR § 5(2)(A).

62. *Id.* § 5(2)(B).

63. *Id.*

64. *Id.*

65. *Id.* § 5(2)(C).

66. GAO/GGD-97-129R *supra* note 42, at 2.

67. *Id.*

68. *Id.*

69. *Id.* at 3.

IV. CONSIDERATIONS FOR FUTURE USE OF PRIVATE DEBT COLLECTORS

A. *Appropriate Cases*

An important consideration in any future program utilizing PCAs to collect tax debts involves the types of cases that are appropriate for PCA collection. There are two considerations in determining which cases are appropriate for delegation to private collectors. First, there are economic considerations that should be taken into account.⁷⁰ Cases need to be chosen for delegation to private collectors in a manner that brings about the greatest economic benefit to the IRS. Second, legal considerations need to be taken into account.⁷¹ The FAIR Act prohibits cases where any “inherently governmental” activity is required in the collection process from delegation to PCAs.⁷² In many instances these considerations are overlapping because any case that may require referral back to the IRS due to issues that arise requiring the exercise of inherently governmental activities will result in greater administrative costs than if the IRS handles the case from the start.⁷³

Often, it will not make sense from an economic standpoint to transfer cases with rather small balances due to PCAs for collection purposes. This is due to the fact that the IRS has a high success rate for collecting on cases with smaller balances with the exercise of minimal collection action.⁷⁴ In many instances, the IRS can collect on these cases merely by offsetting the balance due against refunds in future years.⁷⁵

The IRS places many of these cases in the “deferred” category.⁷⁶ The original design of the 1996 pilot called for a transfer of an inventory of cases to private collectors of which 6% would be from the “deferred” category.⁷⁷ In execution of the pilot, however, private collectors received 153,000 cases, of which about 53% were from the deferred category.⁷⁸ Any future use of private collectors should limit the percentage of cases transferred from

70. *Id.* at 2.

71. *Id.*

72. Federal Activities Inventory Reform Act of 1998, Pub. L. No. 105-270, 112 Stat. 2382 (codified at 31 U.S.C. § 501, Notes).

73. *See id.*

74. GAO/GGD-97-129R *supra* note 42, at 3.

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

the deferred category that can likely be collected by future offsets.

When an executive agency activity can be performed either by agency employees or by a source in the private sector, the FAIR Act encourages the agency to perform a comprehensive cost comparison analysis.⁷⁹ The FAIR Act specifically includes “the costs of quality assurance, technical monitoring of the performance of such function, liability insurance, employee retirement and disability benefits, and all other overhead costs.”⁸⁰ Therefore, in determining guidelines for determining which cases to place in the hands of private collectors, the IRS should take into all account all costs, including costs for oversight and potential costs if cases need to be referred back to the IRS. As a result, the cases contracted out to private collectors should require minimal oversight efforts and have a low risk of requiring referral back to the IRS.

The second consideration in selecting appropriate cases for placement with public collectors is whether the case will require the exercise of “inherently governmental” activities.⁸¹ As I mentioned above, one problem identified in the 1996 pilot program involved legal interpretations regarding the FAIR Act which prohibits executive agencies from contracting out inherently governmental activities.⁸² Inherently governmental activities include any activity that requires the exercise of discretion in applying governmental authority.⁸³ Due to the unique features of tax debt, application of the FAIR Act makes many delinquent cases inappropriate for placement with private collectors.

One complication arises from the fact that “correct tax liability often cannot be determined from the ‘four corners’ of the taxpayer’s own return or even an IRS notice, thus the taxpayer is allowed to dispute the correctness of a tax assessment. . . .”⁸⁴ Complicated cases involving disputes over interpretation of Internal Revenue Code (Code) sections clearly require the exercise of discretion and, therefore, are not suitable for placement with PCAs for collection purposes. In addition to these complicated cases, any case where a return was filed and the debt arose after the IRS disputed the taxpayer’s return will

79. FAIR § 2(e).

80. *Id.*

81. *Id.* § 5.

82. *Id.*

83. *Id.*

84. Olson Testimony, *supra* note 29, *Unique Nature of Tax Debt*.

involve the exercise of inherently governmental activities.⁸⁵ These cases would only be appropriate for placement with private collectors after review by an IRS employee and a clear determination that there is no viable basis for the dispute.

The IRS has developed proposals for any future use of private collectors.⁸⁶ The IRS proposes to select taxpayer accounts for referral to private collectors based on those debts that are the simplest to collect.⁸⁷ This would be based on factors indicating that the taxpayer will likely pay the liability if contacted by telephone.⁸⁸ 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 ("balance-due" taxpayers).⁸⁹ The initial identification would also target taxpayers who have been assessed tax by the IRS (such as where the taxpayer fails to file a return or report all of their income) and who have made three or more voluntary payments on the assessed tax.⁹⁰ The IRS would not refer accounts where there is an indication that enforcement action would be required to collect tax liabilities.⁹¹

B. *Taxpayers with Economic Hardships*

The Code provides taxpayers facing financial hardship many rights. These include the rights to enter into offers in compromise and installment agreements.⁹²

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA) expanded the use of offers in compromise under 26 U.S.C. § 7122 where there is doubt as to collectibility.⁹³ At a minimum, the IRS must accept offers where payment in full would not leave the taxpayer with sufficient amounts to cover basic living expenses.⁹⁴ Settling claims for less than the full amount is the type of inherently governmental activity that may not be outsourced under the FAIR Act.⁹⁵ Additionally, taxpayers

85. *Id.* at *The Inherently Governmental Nature of Tax Collection*.

86. Everson Testimony, *supra* note 30, *Introduction*.

87. *Id.*

88. *Id.* at *Reasons for Change*.

89. *Id.* at *Introduction*.

90. *Id.*

91. *Id.* at *Reasons for Change*.

92. 26 U.S.C. § 7122 (2000) (Offers in Compromise); *id.* § 6159 (Installment Agreements).

93. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified at 26 U.S.C. § 7804, Notes).

94. 26 U.S.C. § 7122(c)(2).

95. *See* 31 U.S.C. § 501, Notes (2000).

with significant economic hardship may be eligible for currently not collectible (CNC) status.⁹⁶ Therefore, cases in which the taxpayer seeks an offer in compromise or CNC status will require referral back to the IRS and should not be outsourced.

Under 26 U.S.C. § 6159, the IRS may enter into installment agreements with taxpayers for their outstanding tax liability.⁹⁷ Where the tax liability does not exceed \$10,000, the IRS may be required to enter into a three-year installment agreement with the taxpayer.⁹⁸ If the taxpayer is unable to make payment in full when the tax is due, the taxpayer is eligible for the three-year installment agreement if, during the previous five years, the taxpayer has paid all tax liabilities when due, filed all required returns, and not entered into a prior installment agreement.⁹⁹ While the discretion to determine which taxpayers are eligible for installment agreements is inherently governmental, offering a uniform installment agreement to all taxpayers does not involve the use of discretion and, therefore, is an appropriate activity for delegation to private collectors.

The IRS stated that it would not refer any cases requiring IRS expertise or the exercise of discretion.¹⁰⁰ The IRS proposes that private collectors first request taxpayers pay their outstanding tax liabilities in full.¹⁰¹ The private collectors would provide taxpayers with a specific statement regarding the benefits of payment in full including the stopping of interest and penalties, and the release of any tax liens.¹⁰² If the taxpayer is unable to make payment in full, the private collector would then be authorized to offer the taxpayer a three-year installment agreement for the full amount.¹⁰³ Since the public collectors would be required to offer the same three-year installment agreement to all taxpayers, this would not constitute an exercise of discretion in violation of the FAIR Act (assuming that all taxpayers qualify or there is a specific set of guidelines that do not allow for the exercise of discretion such as a schedule based on specified dollar amounts).¹⁰⁴

96. 26 U.S.C. § 6330(c).

97. *Id.* § 6159.

98. *Id.* § 6159(c)(1).

99. *Id.* § 6159.

100. Everson Testimony, *supra* note 30, *Introduction*.

101. *Id.* at *PCA Activities*.

102. *Id.*

103. *Id.*

104. *See, e.g.*, 31 U.S.C. § 501 (2000) (Definitions).

C. *Taxpayer Rights*

One of the most important considerations for any plan utilizing private collectors to collect taxpayer debts should be the protection of taxpayers' rights. Any future plan for the use of private collectors must supply measures to protect taxpayers from abuses by private debt collectors, ensure that taxpayers are adequately informed of their options and rights, and ensure that their privacy is adequately protected.¹⁰⁵

In recent years, Congress has passed legislation to protect the rights of taxpayers. This legislation includes the Taxpayer Bill of Rights,¹⁰⁶ the Taxpayer Bill of Rights 2,¹⁰⁷ and the RRA.¹⁰⁸ One important right is the right to be adequately informed by the IRS of rights and options.¹⁰⁹ The Taxpayer Bill of Rights provides that the IRS shall prepare a statement informing taxpayers in "simple and nontechnical terms" the rights of the taxpayer and the obligations of the IRS.¹¹⁰ The statement must also explain to the taxpayer the procedures by which the taxpayer may appeal any IRS decision, the procedures for filing taxpayer complaints, and the enforcement procedures available to the IRS.¹¹¹ Most of these rights are explained in IRS Publications 1, 5, 556, and 594.¹¹²

The Taxpayer Bill of Rights 2 created the position of the Taxpayer Advocate.¹¹³ Taxpayers have the right to enlist the Taxpayer Advocate's assistance in resolving problems with the IRS.¹¹⁴ In certain instances, the taxpayers have the right to apply to the Taxpayer Advocate for collection relief where the taxpayer would face significant hardship.¹¹⁵

105. Everson Testimony, *supra* note 30, *Introduction*.

106. Omnibus Taxpayer Bill of Rights, Title VI, Subtitle J, Pub. L. No. 100-647, 102 Stat. 3342 (1988).

107. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996).

108. Internal Restructuring Act and Reform Act of 1998 (RRA), Pub. L. No. 105-206, 112 Stat. 685.

109. See Technical and Miscellaneous Revenue Act of 1998, Pub. L. No. 100-647, 102 Stat. 3342.

110. *Id.* (relevant portion codified at 26 U.S.C. § 7801, notes).

111. *Id.*

112. IRS, PUBLICATION 1, YOUR RIGHTS AS A TAXPAYER (Rev. Aug. 2000); IRS, PUBLICATION 5, YOUR APPEAL RIGHTS AND HOW TO PREPARE A PROTEST IF YOU DON'T AGREE (Rev. Jan. 1999); IRS, PUBLICATION 556, EXAMINATION OF RETURNS, APPEAL RIGHTS, AND CLAIMS FOR REFUND (Rev. Jul. 2002); IRS, PUBLICATION 594, WHAT YOU SHOULD KNOW ABOUT THE IRS COLLECTION PROCESS (Rev. Feb. 2004), available at <http://www.irs.gov/formspubs/lists/0,,id=97796,00.html>.

113. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996).

114. 26 U.S.C. § 7803(c)(2)(A) (2000).

115. *Id.* § 7811(a).

It is crucial to rights of taxpayers that steps are taken to ensure that private collectors adequately inform taxpayers of these rights. Under IRS proposals for future use of private collectors, private collectors would initiate the collection process with a notice sent to the taxpayer's last known address informing the taxpayer that the collector is attempting to collect a debt owed to the IRS.¹¹⁶ A copy of IRS Publication 1 ("Your Rights as a Taxpayer") which provides a brief overview of the collection process, including the right to seek assistance from the Taxpayer Advocate, would accompany the notice.¹¹⁷ The notice would comply with the requirements applicable to comparable notices issued by the IRS, as well as the requirements imposed by the Fair Debt Collection Practices Act (FDCPA).¹¹⁸

Other government agencies either do not apply the FDCPA to PCAs or exempt them from some provisions.¹¹⁹ It is important that this not be the case with regard to the IRS. The FDCPA provides significant protections for debtors in the collection process.¹²⁰ Among other things, the FDCPA sets out requirements for collection related communications.¹²¹ Section 1692c of the FDCPA prohibits communications: (1) "at any unusual time or place or a time or place known or which should be known to be inconvenient to the consumer" (generally, communications may only be made between 8 a.m. and 9 p.m. local time)¹²² or (2) at the consumer's place of employment if the collector knows or has reason to know that such communications are prohibited by the consumer's employer.¹²³ Additionally, if the consumer is represented by an attorney, collectors may not communicate directly with the consumer where the collector knows or can easily ascertain the attorney's name and address.¹²⁴

Within five days after initial communication with a consumer, the FDCPA requires the collector to send a written notice to the consumer.¹²⁵ The notice must include the amount of the debt and the name of the creditor.¹²⁶ The notice must also

116. Everson Testimony, *supra* note 30, *Reasons for Change*.

117. *Id.*

118. *Id.*; Fair Debt Collection Practices Act, Pub. L. No. 104-208, 110 Stat. 3009 (1996) (codified at 15 U.S.C. § 1692).

119. Olson Testimony, *supra* note 29; Fair Debt Collection Act.

120. 15 U.S.C. § 1692(e) (2000).

121. *Id.* § 1692c.

122. *Id.* § 1692c(a)(1).

123. *Id.* § 1692c(a)(3).

124. *Id.* § 1692c(a)(2).

125. *Id.* § 1692g(a).

126. 15 U.S.C. § 1692g(a)(1)-(2).

include a statement that unless the consumer disputes validity of the debt within thirty days after receipt of the notice, the debt will be assumed to be valid.¹²⁷ If the consumer notifies the collector within the thirty-day period that the debt is disputed, the collector must cease collection activities until the collector obtains verification of the debt or a copy of the judgment.¹²⁸

The FDCPA also prohibits collectors from using false or misleading representations.¹²⁹ False or misleading communications include the false representation or implication that the collector is affiliated with the United States.¹³⁰ Among other prohibited activities, the FDCPA specifically prohibits the following: (1) misrepresenting the character, amount or legal status of any debt or any services rendered or compensation which may be lawfully received by any debt collector for the collection;¹³¹ (2) the false representation or implication that nonpayment of any debt will result in the arrest or imprisonment of any person or the seizure, garnishment, attachment, or sale of any property or wages of any person unless such action is lawful and the debt collector or creditor intends to take such action;¹³² (3) the threat to take any action that cannot legally be taken or that is not intended to be taken;¹³³ (4) the use or distribution of any written communication which simulates or is falsely represented to be a document authorized, issued, or approved by any court, official, or agency of the United States or any State, or which creates a false impression as to its source, authorization, or approval;¹³⁴ (5) the use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer;¹³⁵ (6) the failure to disclose that the debt collector is attempting to collect a debt and that any information obtained will be used for that purpose, and the failure to disclose in any communications that the communication is from a debt collector¹³⁶; and (7) the false representation or implication that documents are legal process.¹³⁷ Additionally, the FDCPA prohibits the use of “unfair or

127. *Id.* § 1692g(a)(3).

128. *Id.* § 1692g(b).

129. *Id.* § 1692e.

130. *Id.* § 1692e(1).

131. *Id.* § 1692e(2).

132. 15 U.S.C. § 1692e(4).

133. *Id.* § 1692e(5).

134. *Id.* § 1692e(9).

135. *Id.* § 1692e(10).

136. *Id.* § 1692e(11).

137. *Id.* § 1692e(13).

unconscionable means to collect” debt¹³⁸ and prohibits the furnishing of deceptive forms.¹³⁹ All of these provisions are relevant in the context of outsourcing tax collection.

The FDCPA also includes provisions that prohibit debt collectors from engaging in harassing behavior.¹⁴⁰ A debt collector may “not engage in any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt.”¹⁴¹ Harassing behavior includes the use or threat of violence, the use of obscene or profane language, the publication of consumers who allegedly refuse to pay debts, engaging in repeated phone communications with the intent to harass any person, and the placement of calls without meaningful disclosure of the debtor’s identity.¹⁴² The debt collector must also cease communications with the debtor upon receipt of a written request to do so.¹⁴³

The RRA enacted similar provisions with respect to the activities of IRS employees.¹⁴⁴ Section 6304 of the Code prohibits IRS employees from contacting taxpayers at unusual times and places as well as at the taxpayer’s place of employment where the IRS has reason to know that the taxpayer’s employer prohibits the taxpayer from receiving such communication.¹⁴⁵ Section 6304 also prohibits contact with the taxpayer when the taxpayer is represented by an attorney or other tax professional.¹⁴⁶ Additionally, this section contains other provisions preventing harassment and abuse of the taxpayer similar to those found in the FDCPA.¹⁴⁷

While the FDCPA provides strict guidance for the activities of debt collectors, it may not alone be sufficient to prevent harassment of taxpayers. For example, the results of the 1996

138. 15 U.S.C. § 1692f (prohibiting activities under this section include but are not limited to collection of amounts above the debt not authorized by law, depositing post-dated checks prior to the date on the instrument, and using language or other symbols, other than the collector’s name or address on an envelope).

139. *Id.* § 1692j.

140. *Id.* § 1692d.

141. *Id.*

142. *Id.*

143. *Id.* § 1692c (permitting collectors to advise the consumer that the debt collector’s further efforts are being terminated, to notify the consumer that the debt collector or creditor may invoke specified remedies which are ordinarily invoked by such debt collector or creditor; or where applicable, to notify the consumer that the debt collector or creditor intends to invoke a specified remedy).

144. *See generally* Internal Revenue Service Restructuring and Reform Act of 1998 (RRA), Pub. L. No. 105-206 § 3466, 112 Stat. 685.

145. 26 U.S.C. § 6304(a) (2000).

146. *Id.*

147. *Id.* § 6304(b).

pilot program found that “contractors made hundreds of calls to taxpayers before 8 a.m. or after 9 p.m. and some calls were placed as early as 4:19 a.m.”¹⁴⁸ During the course of the Department of Education’s program for outsourcing collection of student loans, private collectors have “deceived consumers by misrepresenting themselves as Department of Education employees, overcharged consumers for collection fees, used misleading communications, browbeaten consumers into unaffordable payment plans, threatened actions that collectors can’t take, and pressured consumers to borrow from relatives.”¹⁴⁹ Some collectors in the Department of Education program fail to inform consumers of their rights or, even worse, steer them into options more profitable for the collectors.¹⁵⁰ While taxpayers would be afforded legal remedies under the FDCPA that will be discussed later in this article, any future program for outsourcing collection activities should include oversight adequate to prevent repeat offenders from receiving future IRS business. Otherwise, the threat of litigation from the few taxpayers that actually take steps to follow through and seek legal remedies may not be sufficient to curb abusive behavior.

Other laws currently regulate treatment of taxpayers by IRS employees during the collection process.¹⁵¹ When IRS employees collect taxes, their performance evaluations are weighted heavily by their treatment of taxpayers.¹⁵² As is discussed above, the RRA prevents evaluation based on records of tax enforcement.¹⁵³ The RRA provides that the IRS shall use “fair and equitable treatment of taxpayers” as one of the standards for employee evaluation.¹⁵⁴ The regulations also provide that part of the performance measures for evaluating IRS employees shall be based on customer satisfaction.¹⁵⁵ When IRS work units are evaluated for customer satisfaction purposes, information is “gathered from a statistically valid sample of the customers served by that operating unit. . . .”¹⁵⁶ These statistics are used to measure, among other things, “whether those customers believe

148. 2003 Kelley Testimony, *supra* note 3, *Privatization of Tax Collection Was Tried and It Failed*.

149. *Federal Debt Management, Testimony Before Committee on House Government Reform* (Jun. 17, 2003) (Statement of Deanne Loonin, Staff Attorney, National Consumer Law Center), available at 2003 WL 56335387.

150. *Id.*

151. 26 U.S.C. § 7804; 26 C.F.R. § 801.2(b) (2004).

152. 26 U.S.C. § 7802(b)(5); 26 C.F.R. § 801.3(b).

153. 26 U.S.C. § 7804, notes; 26 C.F.R. § 801.1(b).

154. 26 C.F.R. § 801.3(b).

155. *Id.* §§ 801.3(a), 801.4.

156. *Id.* § 801.4.

that they received courteous, timely and professional treatment by the [IRS].”¹⁵⁷

Any future program for outsourcing collection should similarly evaluate the performance of private collectors based in part on their fair and equitable treatment of taxpayers and customer satisfaction. Otherwise, the intent of the RRA could be easily circumvented merely by outsourcing collection activities.

D. *Privacy and Security Concerns*

In the age of identity theft, any future program for outsourcing tax collection must take steps to protect both the security and privacy of taxpayers. First, legislation must prohibit private collectors from disclosing return information to third parties. Second, adequate background screening must be mandated for employees of private collectors handling sensitive taxpayer information.

Both the Privacy Act of 1974¹⁵⁸ and the Code limit the transmission of taxpayer information by IRS employees.¹⁵⁹ The Privacy Act provides that, except in limited situations, “no [government] agency shall disclose any record which is contained in a system of records by any means of communication to any person, or to another agency, except pursuant to a written request by, or with the prior written consent of, the individual to whom the record pertains. . . .”¹⁶⁰ The act does allow for transmission of records to “those officers and employees of the agency which maintains the record who have a need for the record in the performance of their duties[.]”¹⁶¹ When an agency contracts out to “accomplish an agency function,” the agency must take steps to ensure that the government contractor is bound by the provisions of the Privacy Act.¹⁶² Therefore, to ensure that private collectors are bound by the same standards as IRS employees with respect to the Privacy Act, it would not be necessary to include in future legislation specific provisions making the Privacy Act applicable to PCAs because the Privacy Act already requires the IRS to structure any contract agreements with private collectors to include provisions

157. *Id.*

158. Privacy Act of 1974, Pub. L. No. 93-579, 88 Stat. 1896 (codified as amended at 5 U.S.C. § 552a).

159. 5 U.S.C. § 552a(b) (2000).

160. *Id.*

161. 5 U.S.C. § 552a(b)(1).

162. 5 U.S.C. § 552a(m)(1).

subjecting the collectors to Privacy Act standards.¹⁶³

Section 6103 of the Code also places restrictions on IRS employees regarding the disclosure of taxpayer information.¹⁶⁴ Section 6103 provides that “returns and return information shall be confidential” and prevents disclosure of return information except as provided for in that section.¹⁶⁵ An internal revenue officer or employee may, in connection with any audit, collection activity, or civil or criminal tax investigation “disclose return information to the extent that such disclosure is necessary in obtaining information, which is not otherwise reasonably available, with respect to the correct determination of tax, liability for tax, or the amount to be collected or with respect to the enforcement of any other provision of [the Code].”¹⁶⁶ The current section 6103 would not allow private collectors to disclose any information since they are not internal revenue officers or employees.¹⁶⁷ If future legislation allows PCAs to disclose any information during the collection process such as for investigative purposes, the legislation should strictly regulate disclosures to protect taxpayers’ privacy and security.

Section 6103 would not require amendment in order to permit disclosure of taxpayer information by IRS employees to private collectors because section 6103 allows disclosure to any person providing services to the extent necessary for purposes of tax administration.¹⁶⁸ Under the IRS proposals, information provided to PCAs “would be strictly limited to the information required for the collection of the specific tax liability at issue.”¹⁶⁹ Under the proposal, PCAs would not receive information such as that “regarding a taxpayer’s total or adjusted income, sources of

163. Privacy Act of 1974 § 3.

164. 26 U.S.C. § 6103 (2000).

165. *Id.* § 6103(a). Return information includes:

a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense[.] *Id.*

Any agreements with or determinations regarding the taxpayer to the extent that they can be identified with the taxpayer are also included. *Id.* § 6103(b)(2)(A).

166. *See id.* § 6103(k)(6).

167. *Id.* § 6103(a).

168. 26 U.S.C. § 6103(a)(3), (n).

169. Everson Testimony, *supra* note 30, *PCA Activities*.

income, IRS examination results, delinquency history for liabilities not being handled by the PCA, or employer information.¹⁷⁰ The National Taxpayer Advocate proposes limiting information shared with PCAs to 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.¹⁷¹ These recommendations are prudent in creating an outsourcing plan that adequately protects taxpayer's privacy and security.

Additional safeguards are provided by the FDCPA, which limits communications between collectors and third parties.¹⁷² Without the prior consent of the consumer given directly to the debt collector, by judicial order, or for purposes of effectuating a postjudgment judicial remedy, a debt collector may not communicate "with any person other than a consumer, his attorney, the creditor, the attorney of the creditor, or the attorney of the debt collector."¹⁷³

The use of subcontractors must be considered in the context of these restrictions on disclosure of taxpayer information. The use of subcontractors by private collectors would likely result in greater costs to the IRS by creating additional oversight burdens.¹⁷⁴ The National Taxpayer Advocate recommends restricting use of subcontractors by private collectors in activities that involve either direct taxpayer contact or direct contact with or handling of taxpayer information in activities other than skip-tracing.¹⁷⁵ The National Taxpayer Advocate also recommends creating penalties for PCAs for violations committed by subcontractors.¹⁷⁶ This would create a strong incentive for PCAs to carefully select subcontractors and oversee their activities.

E. Penalties

The success of regulating the activities of private collectors will depend heavily on the penalties they face for infractions. Protecting taxpayer rights from the actions of private collectors will require taxpayer access to a wide range of remedies. Taxpayers have access to statutory remedies under the Code for

170. *Id.*

171. Olson Testimony, *supra* note 29, *Introduction*.

172. 15 U.S.C. § 1692c(b) (2000).

173. *Id.*

174. Olson Testimony, *supra* note 24, *PCA Use of Subcontractors*.

175. *Id.*

176. *Id.*

infractions of the IRS and its employees.¹⁷⁷ While private collectors are subject to statutory remedies for debtors under the FDCPA, they should also be subject to the same sanctions provided under the Code as the IRS and its employees for tax collection purposes.

Under the FDCPA, remedies available to individual debtors are limited in the absence of actual damages.¹⁷⁸ The FDCPA allows individuals to recover actual damages plus other damages up to \$1,000 and litigation costs.¹⁷⁹ In the case of a class action suit, the debt collector is subject to the same damages for class members, plus the lesser of \$500,000 or 1% of the collector's net worth for all other class members.¹⁸⁰

Section 7433 of the Code provides taxpayers with a cause of action against the IRS when an employee of the IRS recklessly, intentionally, or negligently disregards any provision of the code in connection with tax collection activities.¹⁸¹ In an action brought under section 7433, the taxpayer may recover the amount of actual damages as well as litigation costs.¹⁸² Damages for section 7433 actions are capped at \$100,000 for negligence and \$1,000,000 for reckless or intentional behavior.¹⁸³ In order to protect taxpayer rights, private collectors must be subject to causes of action under section 7433 for damages caused by the disregard of Code sections.

Under section 1203 of the RRA, employees of the IRS are subject to termination for violations of the Code and IRS policies committed for the purpose of "retaliating against, or harassing, a taxpayer."¹⁸⁴ In order to uphold the intent of the RRA, private collectors must similarly be required to terminate employees for such behavior.¹⁸⁵

Both the Privacy Act and the Code provide for legal remedies for unlawful disclosure of taxpayer information. Specifically, section 6103 already prevents government contractors from disclosing return information.¹⁸⁶

Under the Privacy Act, an unlawful disclosure by a private

177. 26 U.S.C. § 7433 (2000).

178. 15 U.S.C. § 1692k.

179. *Id.* § 1692k (1), (2)(A), (3).

180. *Id.* § 1692k(2)(B).

181. 26 U.S.C. § 7433(a).

182. *Id.* § 7433(b).

183. *Id.*

184. Internal Revenue Service Restructuring and Reform Act of 1998 (RRA), Pub. L. No. 105-206, 112 Stat. 685, § 1203 (codified at 26 U.S.C. § 7804, Notes).

185. *Id.*

186. 5 U.S.C. § 552a (2000); 26 U.S.C. § 6103(a).

collector would give rise to a cause of action for actual damages as well as attorney's fees.¹⁸⁷ In any such case where the plaintiff is successful, the plaintiff is entitled to a minimum of \$1,000, regardless of actual damages.¹⁸⁸ The individual actually responsible for the unlawful disclosure is also subject to misdemeanor charges and up to a \$5,000 fine if the violation is willful.¹⁸⁹

The penalties and fines for unlawful disclosure of taxpayer information are more severe under the Code. Section 7431 provides civil remedies for violations of section 6103.¹⁹⁰ Section 7431 applies to private collectors regardless of whether the disclosure is done knowingly or negligently.¹⁹¹ Significant damages can arise from a violation of section 6103.¹⁹² Under section 7431, the plaintiff is entitled to the greater of \$1,000 for each unlawful inspection or disclosure or the actual damages.¹⁹³ In either case, the plaintiff is also entitled to litigation costs and attorney's fees.¹⁹⁴ Willful violations of section 6103 carry more severe penalties.¹⁹⁵ In addition to actual damages, a plaintiff bringing suit under section 7431 may also receive punitive damages if the unlawful inspection or disclosure is done willfully.¹⁹⁶ Willful disclosures and inspections also carry criminal penalties.¹⁹⁷ Employees of private collectors committing willful disclosures in violation of section 6103 are subject to felony conviction punishable by up to \$5,000 plus litigation costs and five years in prison.¹⁹⁸ Unlawful inspections carry up to a \$1,000 fine and one year in prison.¹⁹⁹

The existence of the foregoing penalties is crucial to regulating the acts of private collectors and ensuring protection of taxpayer rights. Any future program for outsourcing tax collection activity should adequately inform taxpayers of their rights under the various laws. Well informed taxpayers would create a greater incentive for private collectors engaged in tax

187. 5 U.S.C. § 552a(g)(4).

188. *Id.*

189. *Id.* § 552a(i), (m)(1).

190. 26 U.S.C. § 7431.

191. *Id.* § 7431(a)(2).

192. *Id.* § 7431(c).

193. *Id.* § 7431(c)(1).

194. *Id.* § 7431(c)(2), (3).

195. *Id.* § 7431(c)(1)(B)(ii).

196. 26 U.S.C. § 7431(c)(1)(B)(ii).

197. *Id.* §§ 7213, 7213A.

198. *Id.* § 7213(a).

199. *Id.* § 7213A(b).

collection to respect the laws and regulations governing collection activities.

V. ANALYSIS OF LEGISLATION AS PASSED

A. *Proposed Bills*

The American Jobs Creation Act recently passed by Congress enacts provisions for use of private collectors to collect delinquent taxes.²⁰⁰ The legislation adds section 6306 to the Code and allows the IRS to enter into “qualified tax collection contracts.”²⁰¹ The legislation allows the IRS to retain up to 25% of the amount collected by a private collector for the costs of services performed under the contract.²⁰² The legislation applies many of the concepts previously discussed in this article.

Under the legislation, private collectors are allowed to locate and contact taxpayers, request full payment from taxpayers, and offer taxpayers three-year installment plans if they cannot pay in full.²⁰³ As is discussed above, authorizing PCAs to offer installment agreements does not constitute an inherently governmental activity where the installment plans are statutorily limited in duration and the PCA does not exercise discretion over which taxpayers are eligible.²⁰⁴ The legislation also authorizes PCAs to obtain financial information about the taxpayer when requested by the Secretary.²⁰⁵ Overall, the legislation does not allow the PCAs to conduct any activity that is inherently governmental in nature or that would violate the FAIR Act.²⁰⁶

Under the legislation, the use of subcontractors will be greatly limited.²⁰⁷ Subcontractors will not be allowed to contact taxpayers, provide quality assurance services, or compose collection notices.²⁰⁸ Other activities can only be conducted by subcontractors with approval of the Secretary.²⁰⁹ This measure lessens the burden on IRS employees charged with oversight of PCA activities. It also protects taxpayers by ensuring that only

200. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

201. *Id.* § 487 (to be codified at § 6306).

202. *Id.* (to be codified at § 6306(c)).

203. *Id.* (to be codified at § 6306(b)(1)(A), (B)).

204. *See supra* Part III.D.

205. American Jobs Creation Act § 487 (to be codified at § 6306 (b)(1)(C)).

206. *Id.* (to be codified at § 6306).

207. *Id.* (to be codified at § 6306 (b)(3))

208. *Id.*

209. *Id.*

those contractors selected by the IRS in the application process and who have accepted all the obligations imposed by such contracts will be in direct contact with taxpayers and sensitive taxpayer information.²¹⁰

The legislation prohibits private collectors from committing any act or omission that IRS employees are prohibited from committing during the course of tax collection.²¹¹ It also applies the FDCPA to private collectors, but where superseded by the fair debt collection provisions found in section 6304 of the Code, any cause of action will arise from the tax code.²¹² As a result, taxpayers will have all of the same rights and protections in PCA collection that they enjoy when collection is conducted by an IRS employee plus additional protections found in the FDCPA.

The legislation will exempt the IRS from liability for acts committed by private collectors.²¹³ § 801.1(b). The legislation adds section 7433A to the Code making remedies available to taxpayers under section 7433A for acts or omissions committed by IRS employees applicable to those committed by private collectors.²¹⁴ An action brought under section 7433A pursuant to section 7433A will not be a taxpayer's exclusive remedy against the private collector.²¹⁵ The monetary liability will likely provide PCAs an incentive to ensure that their employees are well trained and to take steps to prevent them from violating taxpayer rights. While insulating the IRS from liability may decrease the IRS' incentive to strictly regulate PCA activities, the fact that there is no joint liability with the IRS will likely increase incentives for PCAs to adhere to the law in collection activities. If joint liability existed, many PCAs might take comfort in the belief that any liability would be shared with a large government bureaucracy.

Employees of private collectors will cease to be permitted to perform work under a tax collection contract for willful retaliation against or harassment of taxpayers and their representatives to the same extent that IRS employees are subject to termination for such activities under section 1203.²¹⁶ Subjecting employees of private contractors to termination under

210. The IRS has already proposed an extensive PCA contract that includes extensive provisions designed to protect taxpayers and taxpayer security. See TIRNO-03-H-00001, available at <http://www.procurement.irs.treas.gov/collectionrelated/>.

211. American Jobs Creation Act § 487 (to be codified at § 6306 (b)(2)).

212. *Id.* (to be codified at § 6306 (e)).

213. *Id.* (to be codified at § 6306 (d)).

214. *Id.* (to be codified at § 7433A (a)).

215. *Id.* (to be codified at § 7433A (b)(3)).

216. *Id.* (to be codified at § 7433A (e)).

section 1203 for retaliation and harassment of taxpayers may not create the same level of incentive provided to IRS employees enjoying the benefits of a government job. However, as is discussed above, both the Privacy Act and section 6103, preventing unlawful disclosure of taxpayer information, already apply to private contractors.²¹⁷ Both would subject individual employees of PCAs to civil and criminal liability.²¹⁸ The IRS should prepare literature detailing the potential personal liabilities of PCA employees. PCA contracts should require all PCA employees to read and understand this literature. Notifying PCA employees of their potential liability would likely deter many from inappropriate behavior.

While the legislation allows for 25% of amounts collected to be set aside for PCA compensation, it does not specify how such money should be allocated. It is left to the IRS to implement a payment system consistent with the principles of the RRA. Therefore, the IRS should structure PCA contracts in such a way that incentives are not based solely on the amounts collected. A compensation plan based on a flat fee per return would not create incentives that conflict with the principles of the RRA, but such a plan would not create any incentive for PCAs to collect. It would also shift the costs associated with claims where the PCA is unable to collect to the IRS. Such a plan would likely result in huge costs to the IRS with little benefit.

It is difficult to design a system that provides both an incentive to collect and, at the same time, promotes fair and equitable treatment of taxpayers. The legislation provides that the IRS may “retain” the compensation amount.²¹⁹ Presumably, the use of “retain” implies that all taxes collected by PCAs will be first payable to the IRS, and PCA compensation will then be distributed from these funds.²²⁰ The dual task of compensating PCAs both on the basis of amounts collected and on the treatment of taxpayers might be achieved by first providing in

217. *See supra* Part III.D.

218. 5 U.S.C. § 552a (2000); 26 U.S.C. § 7431 (2000).

219. American Jobs Creation Act § 487 (to be codified at § 6306 (c)).

220. *Id.* Section 7809(a) of the Code provided 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, but section 487 of the legislation provides an exception for PCA compensation. *Compare* 26 U.S.C. § 7809(a), *with* American Jobs Creation Act § 487 (to be codified at § 6306 (c)). The current IRS proposal calls for PCA compensation to be made from a revolving fund. U.S. GEN. ACCOUNTING OFFICE, GAO-04-492, TAX DEBT COLLECTION: IRS IS ADDRESSING CRITICAL SUCCESS FACTORS FOR CONTRACTING OUT BUT WILL NEED TO STUDY THE BEST USE OF RESOURCES (May 2003) at 1, *available at* <http://www.gao.gov/new.items/d04492.pdf> [hereinafter GAO Tax Debt Collection].

contracts for compensation on a percentage of amounts collected and then allowing for deductions from that amount prior to distribution to PCAs for certain infractions. This objective could be furthered by reserving room in the percentage amount for bonuses that could be awarded to PCAs that receive positive feedback.²²¹ Such a system would rely heavily on informing taxpayers of both their rights and how to report infractions. IRS publications already contain much of this information,²²² but providing taxpayers subject to PCA collection with a specific publication outlining PCAs activities would be a prudent step. Well informed taxpayers are crucial to a system designed to protect taxpayer rights.

In addition to major infractions, PCAs should be subject to customer satisfaction evaluations. Providing taxpayers with a simple form evaluating PCA collection activities would aid in PCA oversight. If PCAs that performed poorly on such evaluations faced the possibility of losing lucrative government contracts, they would likely take additional steps to ensure fair and equitable treatment of taxpayers.

Many of the potential pitfalls in the legislation exist due to the fact that the legislation only provides a loose framework for any future PCA plan. For example, there is no guarantee that the IRS will implement a plan with a compensation structure that both furthers the principles of the RRA and provides incentives for PCA performance. Similarly, it is left up to the IRS to properly supervise PCA activities, to ensure that taxpayers are well informed of their rights with respect to PCAs, and to create a system that adequately collects and gauges taxpayer feedback on PCAs.

A final problem with the loose legislative framework is the failure to limit the types of cases appropriate for allocation to PCAs. As is discussed above, the IRS, in an effort to conform with the FAIR Act, proposes to only outsource cases where the tax payer has indicated a balance due or has made three or more payments on an amount assessed by the IRS.²²³ The legislation, however, leaves this decision entirely up to the IRS.²²⁴

221. IRS proposals call for some use of incentives and disincentives based on PCA performance. GAO Tax Debt Collection, *supra* note 220, at 11.

222. *Id.*

223. Everson Testimony, *supra* note 30, *Introduction*.

224. *Id.*

B. *Economic Analysis*

Where the main objective is maximizing collection receipts, the question of whether the legislation will adequately protect taxpayers is irrelevant if an outsourcing system will not yield economic benefits to the IRS. If additional IRS allocations would yield greater returns than PCA use, then there is no justification for a PCA program.

In 2002, Commissioner Rossotti reported that hiring an additional 5,450 employees at a cost of \$296.4 million would allow the IRS to collect an additional \$9.47 billion of known tax debts.²²⁵ This would mean a \$31 return for every dollar spent versus \$3 return for every dollar spent under the 25% commission scheme (\$3.25 billion to collect \$13 billion).²²⁶ It is important to remember that any use of PCAs, in addition to PCA compensation, entails costs and a reduction of IRS resources to the extent necessary for oversight activities. According to the Joint Committee on Taxation, the use of PCAs at the 25% rate would bring in less than \$1 billion over ten years, while the IRS could bring in that amount in 1 year with just \$30 million of additional resources.²²⁷ While there might be bias in these figures, there is a large margin of error in them that would still favor allocation of additional IRS resources over the use of PCAs.

In reality, these numbers do not justify legislating a PCA program where better results could be achieved by merely increasing IRS funding. The additional IRS resources necessary for PCA oversight will reduce existing IRS resources likely resulting in more collections that need to be outsourced to PCAs where the rate of return to the government will be lower. It is mind-boggling to think that Congress repeatedly refuses to provide the IRS with adequate funding to collect taxes which are already owed. Collecting the billions already due would provide a stream of revenue to the federal government that would not require members of Congress to anger their constituents by raising taxes. The IRS is the one area of government where allocating additional resources can yield increased, not decreased, federal revenue. Under the numbers discussed above, providing further IRS resources would yield exponential return rates, return rates higher than those under a PCA program. There is no plausible argument for refusing to fund a program that guarantees returns far in excess of its costs.

225. 2002 Report to IRS Oversight Board, *supra* note 30, at 16.

226. 2003 Kelley testimony, *supra* note 3, *Spending Taxpayer Money Wisely*.

227. *Id.*

Due to the enormous backlog in uncollected taxes that has built up over recent years, there still is a place for a PCA program in conjunction with increased IRS funding. PCAs should not be used in lieu of increased IRS funding but could be used to augment the IRS collection program. The sheer volume of uncollected taxes makes it unlikely that any increase in IRS funding would be sufficient to collect all of those taxes due.

In any system, PCAs would be best utilized to collect stale claims. Using a system that compensates PCAs on a percentage basis shifts most of the risk of costs incurred in the case of non-collection to the PCA. While this potentially leads to improper incentives, the system, discussed above, that would deduct from such amounts for infractions during the collection process could be applied. Less certain would be the profitability of a program that compensates PCAs based on other standards such as the number of taxpayers successfully contacted. The IRS should not give up 25% of receipts for claims that it could likely collect. By transferring stale claims to PCAs, however, IRS resources would be freed up to allow for more concentration on newer tax debts where collection is likely to take less effort. While stale claims are less desirable, a free market would determine the transferability of such claims, and, assuming that payment is on a commission basis, this would be at no cost to the IRS unless collected. This would also free up more IRS resources to enforce tax laws through audit activity. Increased audits will also yield more future revenues as taxpayers and tax professionals determine that false reporting and underreporting carries a greater risk in a cost-benefit analysis.

Since the legislation does not define which cases are appropriate for PCA allocation, it will be up to the IRS to implement a plan that best suits the government's needs. A prudent plan would also take into consideration the staleness of a claim determining which claims to allocate to PCAs. Additionally, the IRS should refrain from outsourcing many claims from the "deferred" category. As is discussed above, during the 1996 pilot program, a large percentage of the claims allocated to PCAs were the small claims from the deferred category that the IRS itself could easily have collected by merely offsetting the amounts due against future refunds.²²⁸ The legislation leaves it up to the IRS to not repeat this same mistake.²²⁹

228. GAO/GGD-97-129R, *supra* note 42 at 3.

229. According to a recent GAO report, the IRS recognizes the need to develop methods for determining appropriate claims for PCA placement. GAO Tax Debt

C. Is the Outsourcing of Tax Collection Sound Public Policy?

Determining whether outsourcing tax collection is sound governmental policy requires consideration of factors ancillary to statutory and economic analysis. The statutory analysis above discussed limitations that will be placed on PCA activities and protections that will be afforded to taxpayers. The economic analysis discussed economic advantages that could be achieved by the use of PCAs. Outsourcing taxes is a policy that could potentially affect every taxpayer, and therefore, other factors should be seriously considered. The question of whether we want to subject taxpayers to the actions of private collectors must be posed.

Statutory protections regulating PCA activity and providing for penalties do not guarantee that PCAs will not engage in inappropriate behavior during collection. While the same could be said about regulations with regard to government employees, government employees' main incentive is maintaining their comfortable government jobs while employees of PCAs may have incentives based on their employer's objectives of maximizing collections. It is unlikely that an IRS employee will take the time to harass a taxpayer at 4:00 a.m. as was the case with some PCAs during the pilot program.²³⁰

Similar concerns should be considered with respect to taxpayer security. Once sensitive taxpayer information leaves the confines of the IRS, there is no guarantee that taxpayer security will not be violated. Unlike an IRS employee who enjoys government wages and benefits as well as union membership, a low wage PCA employee may not feel the same level of risk in making a decision to misuse private taxpayer information. In a recent lockbox program where private banks were entrusted with taxpayer checks, Mellon Bank lost over \$1.2 billion in taxpayer checks.²³¹ A GAO report on fiasco found that "oversight. . . was not fully effective to ensure that taxpayer data and receipts were

Collection, *supra* note 220, at 3. After implementation of the PCA program, the IRS plans for continued comparison of PCA and IRS performance. *Id.* The GAO recommends that such evaluation should take into consideration which types of cases constitute the best allocation of IRS resources in light of the fact that there are limited IRS resources available to deal with more complicated, higher priority cases. *Id.* The GAO concluded that, after experience is gained, a study should be conducted that takes into consideration the results that might be achieved by hiring more IRS employees. *Id.* at 4.

230. 2003 Kelley testimony, *supra* note 3, *Privatization of Tax Collection Was Tried and It Failed*.

231. U.S. GEN. ACCOUNTING OFFICE, GAO-03-299, IRS LOCKBOX BANKS: MORE EFFECTIVE OVERSIGHT, STRONGER CONTROLS, AND FURTHER STUDY OF COSTS AND BENEFITS ARE NEEDED (Jan. 15, 2003), available at <http://www.gao.gov/atext/d03299.txt>.

adequately safeguarded and properly processed.”²³² There is no guarantee that similar mistakes would not arise in oversight of a PCA program.

No amount of deterrents provided by the law and IRS policy will dissuade all PCAs operating in a capitalistic society and ultimately motivated by the bottom line from engaging in taxpayer abuse. Additionally, penalties will not deter all low-paid PCA employees from engaging in inappropriate activities. IRS employees with secure government jobs have a much greater incentive to refrain from inappropriate activities. Additionally, oversight of the PCAs will be left up to an already overburdened IRS. For these reasons alone, irrespective of the fact that PCA usage would not produce the same yields as increased IRS funding, outsourcing taxes may just be a bad idea.²³³

The final policy consideration concerns government jobs. Outsourcing tax collection could be used in one of two ways. Either it could be used as a system designed to supplement IRS resources and contribute to more efficient collection activities, or it could be used as a system to replace well paid government employees with benefits and a strong union with low paid non-union PCA employees. To the extent that increasing IRS employees and resources would bring in more revenue than the use of PCAs for collection, the later approach does not constitute sound policy and should be rejected.

VI. CONCLUSION

Outsourcing tax collection is a policy that requires many serious considerations. Every American is potentially subject to PCA activities. Paying your taxes does not guarantee that a taxpayer will not be subject to PCA collection as the result of bureaucratic error. The recently passed legislation provides a loose framework for a future program that leaves numerous considerations with respect to implementation that must be addressed by the IRS in the structuring of contracts and

232. *Id.*

233. “In January 2004, Congress approved the IRS’s Fiscal Year 2004 budget, which would provide the funding to further develop the PCA program, but IRS delayed spending the funds until passage of the legislation appears to be more imminent.” GAO Tax Debt Collection, *supra* note 220 at 3. The IRS officials recognize that major development work still remains and estimate that, upon passage of the authorizing legislation, it will take eighteen to twenty-four months to complete the remaining work on the PCA plan. *Id.* The IRS plan calls for PCA training courses on taxpayer issues, contract provisions that call for the following of federal law and prescribe the appropriate treatment of taxpayers and protection of taxpayer data, compliance checks that include for PCA call monitoring and taxpayer satisfaction surveys. *Id.* at 11-12.

oversight of PCA activities. If such a program is implemented, the method of compensation for private collectors must provide incentives for the fair and equitable treatment of taxpayers. There must be adequate oversight by IRS employees to screen private collectors before granting contracts and to penalize collectors that violate taxpayers' rights and eliminate future use of those collectors with repeated transgressions. The program should not be used as a primary collection tool; it should only be used as a supplementary tool in the collection process. In order to maximize tax receipts, Congress must increase IRS funding and provide for more IRS employees instead of merely outsourcing the problem. There is no sound policy reason for not increasing the budget for a program that would bring in further revenue exponentially. A closely watched, well thought out plan for outsourcing tax collection activities could successfully supplement a corresponding increase in IRS in-house collection activities. Regardless of the course taken, a more efficient collection process is necessary not only to prevent the foregoing of current revenue but, also, to provide taxpayers an incentive to comply with tax laws in the future.