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TAX ADMINISTRATION

IRS Tax Debt Collection
Practices

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Tax Administration: IRS Tax Debt Collection Practices

The Internal Revenue Service (IRS) faces some formidable challenges in collecting tens of billions of dollars in delinquent taxes. As Congress works to balance the federal budget, these unpaid taxes become increasingly important, as do IRS' efforts to collect them. GAO believes that IRS can do more to improve its collection practices. A step in that direction could be the lessons learned from the pilot program testing the use of private debt collectors to assist in collecting tax debts.

The challenges facing IRS' improvement efforts include a lack of accurate and reliable information on either the makeup of its accounts receivable or the effectiveness of the collection tools and programs it uses, as well as an aged inventory of receivables, outdated collection processes, and antiquated technology. The results of these long-standing challenges have led GAO, the Office of Management and Budget, and IRS to recognize IRS' accounts receivable as a high-risk area. To address these challenges, IRS needs to make major changes in the way it does business, but it cannot do it alone.

GAO believes IRS needs a long-term comprehensive strategy to guide IRS' efforts to improve collections of tax debts. This strategy needs to recognize and address the challenges facing IRS. The cornerstone to any improvements lies in having accurate and reliable information. Without this type of information, any changes made to the system may not provide the planned results. GAO also believes that private industry may provide some help in collecting tax debts by assisting in performing some collection-related activities.

Tax Administration: IRS Tax Debt Collection Practices

Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its review of the Internal Revenue Service's (IRS) tax debt collection practices. Every year IRS successfully collects over a trillion dollars in taxes owed the government, yet at the same time tens of billions more remain unpaid. As Congress works to balance the federal budget, these unpaid taxes become increasingly important, as do IRS' efforts to collect them.

While most taxpayers voluntarily pay their taxes on time, some are unable or unwilling to do so. It is this latter group whom IRS must deal with in its efforts to collect delinquent taxes. In doing so, IRS faces several significant challenges, including a lack of accurate and reliable information on either the makeup of its accounts receivable or the effectiveness of the collection tools it has at its disposal, as well as receivables that are often years old, out-of-date collection practices, and antiquated technology. It is these problems and challenges—and their results—that led us, the Office of Management and Budget (OMB), and IRS to recognize IRS' accounts receivable as a high-risk area. To address these challenges, significant changes are needed in the way IRS does business, but IRS cannot do it alone.

Recently, the IRS Commissioner has compared IRS to financial service organizations such as banks, credit card companies, and investment firms. Like these organizations, IRS processes data, maintains customer accounts, responds to account questions, and collects money owed. We agree with the Commissioner's functional comparison and believe that, while there are significant differences between IRS and these private sector businesses, IRS may benefit from using private collectors as a part of its portfolio of collection programs, and it is reasonable to assume that IRS could learn from their best practices as it works to resolve long-standing problems with its debt collection activities.

My testimony today, which is based on past reports and ongoing work, discusses the debt collection challenges facing IRS and the potential benefits of involving private parties in the collection of tax debts.

Long-Standing Problems Continue to Undermine the Effectiveness of IRS Collection Programs

A number of long-standing problems have complicated IRS' efforts to collect its accounts receivable. Of foremost concern is the lack of reliable and accurate information on the nature of the debt and the effectiveness of IRS collection tools.

Better Information Needed

Access to current and accurate information on tax debts is essential if IRS is to enhance the effectiveness of its collection tools and programs to optimize productivity, devise alternate collection strategies, and develop programs to help keep taxpayers from becoming delinquent in the first place.

Without reliable information on the accounts they are trying to collect and the taxpayers who owe the debts, IRS agents generally do not know whether they are resolving cases in the most efficient and effective manner, and may spend time pursuing invalid or unproductive cases. Of the approximately \$200 billion currently in the IRS accounts receivable inventory, IRS data shows that approximately \$63 billion represents taxes that, although they have been assessed, may not be valid receivables, but rather are "place markers" for compliance actions.

For example, under IRS procedures, when IRS' information return matching process identifies a taxpayer who received a Form W-2 but did not file a tax return, IRS creates a return for the taxpayer. Generally, this is done using the standard deduction and single filing status, and often results in the taxpayer owing taxes. IRS then sends balance due notices to the taxpayer reflecting the amount of taxes owed as calculated by IRS—to encourage the taxpayer to file a return with the correct tax amount owed. If the taxpayer does not subsequently file the return, IRS records the amount it calculated as taxes due and generates a receivable. However, when contacted by IRS collection staff, the taxpayer may demonstrate that either no tax or a lesser amount of tax is actually owed. To more efficiently account for and collect money actually owed to the government, IRS would have to be able to differentiate these IRS-calculated accounts from those where there is an acknowledged balance due.

In addition, IRS does not have reliable data on the effectiveness of its collection activities and programs. Consequently, it is unable to target its efforts specifically to the taxpayer and tax debt in question. IRS is currently trying to capture this data on its Enforcement Revenue Information

System (ERIS) and other computerized systems. However, IRS has noted in the past that there are questions regarding the accuracy of the data produced by these systems.

Age and Nature of Tax Debts

The age of the debts in IRS' accounts receivable inventory is also problematic. IRS' inventory of tax debt includes delinquent debts that may be up to 10 years old. This is because there is a 10-year statutory collection period, and IRS generally does not write off uncollectible delinquencies until this time period has expired. As a result, the receivables inventory includes old accounts that may be impossible to collect because the taxpayers cannot be located, or are deceased, or the corporations are defunct.

Of the over \$200 billion total receivables inventory as of September 30, 1995, IRS data show that about \$38 billion was owed by either deceased taxpayers or defunct corporations. Out of a total of 460 accounts receivable cases that we reviewed in our audit of IRS' 1995 financial statements, IRS identified 258 as currently not collectible; 198 of these cases represented defunct corporations, while the remaining 60 cases represented entities that either could not pay or could not be located. These cases represented \$12 billion of the \$26 billion included in accounts greater than \$10 million.

The age of the receivable does not reflect the additional time it took for IRS to actually assess the taxes in the first place. Enforcement tools, such as IRS' matching programs and tax examinations, may take up to 5 years from the date the tax return is due until IRS finally assesses the additional taxes. This reduces the likelihood that the outstanding amounts will be collected.

The age factor significantly affects the collectibility of the debt because, as both private and public sector collectors have attested, the older the debt, the more problematic collection becomes. Because of these and other factors, IRS considers many of the accounts in the inventory to be uncollectible. Specifically, IRS has estimated that only about \$46 billion of the \$200 billion inventory of tax debt as of September 30, 1995, was collectible.

Another factor relating to the collectibility of tax debts owed by individuals is source of income. Taxpayers earning their income from nonwage sources, such as pensions, self-employment, and investments, are more likely to be delinquent in paying their taxes than wage earners

who have taxes withheld from their wages. Taxpayers with nonwage income are required to calculate their projected income and make estimated tax payments to IRS during the year. According to IRS data, the average tax delinquency for taxpayers with primarily nonwage income was about 4 times greater than that for wage earners—\$15,800 versus \$3,600. IRS data also show that, at the end of fiscal year 1995, about \$75 billion, or 74 percent of the \$101 billion in IRS' inventory of tax debts owed by individuals, was owed by taxpayers whose income was primarily nonwage.

Out-of-Date Collection Processes

IRS' collection process was introduced several decades ago, and although some changes have been made, the process generally is costly and inefficient. The three-stage collection process—computer-generated notices and bills, telephone calls, and personal visits by collection employees—generally takes longer and is more costly than collection processes in the private sector.

While the private sector emphasizes the use of telephone collection calls, a significant portion of IRS' collection resources is allocated to field offices where personal visits are made by revenue officers. IRS has initiated programs and made procedural changes to speed up its collection process, but historically it has been reluctant to reallocate resources from the field to the earlier, more productive collection activities. IRS' fiscal year 1997 budget request states that, although "these [revenue officer] positions still comprise the lion's share of IRS' enforcement efforts, they also represent on the margin the least efficient use of IRS resources." Due to budget cuts, however, IRS is in the process of temporarily reassigning about 300 field staff to telephone collection sites to replace temporary employees who were terminated.

Antiquated Computer Systems

Upgrading its computer systems is another challenge facing IRS. IRS is in the midst of a massive long-term modernization effort—Tax Systems Modernization (TSM)—that if successful would, among other things, help IRS to better collect tax debts by providing its collectors with on-line access to information they need, when they need it. Modernized systems would also help provide the management information needed to evaluate the effectiveness of collection tools and the ability to adopt flexible and innovative collection approaches. Existing IRS computer systems do not provide ready access to needed information and, consequently, do not adequately support modern work processes.

Although TSM is not expected to be completed any time in the near future, IRS has started to automate some collection activities. For example, IRS is currently developing an automated inventory delivery system that is intended to direct accounts, based on internally developed criteria, to the particular collection stage where they can be processed most efficiently and expeditiously. This system, which IRS plans to test in July 1996, is intended to move accounts through the collection process faster and cheaper than under the current system.

Another effort under way involves the automation of certain field collection tasks. These tasks, like many in IRS, have for years involved the manual processing of paper, which has resulted in IRS field collection employees spending significant amounts of time on routine administrative duties. The Integrated Collection System (ICS) is a computer-based information system that is intended to automate some of the labor-intensive tasks performed by field revenue officers. While this effort is not a major technological advancement, it will be a step toward helping IRS employees be more productive by spending their time on more effective and efficient collection-related activities. Basic automation is a given in today's business environment, and if IRS is to operate like a private sector business as it says, systems that automate basic work processes are a must.

According to IRS, implementing this system in two pilot districts has resulted in increased collections, faster case closings, and less time spent on each case. IRS employees using the system were also very supportive of it and enthusiastic about its benefits. The system is currently operating in six districts, and IRS plans to roll it out in three additional districts this year. According to IRS, further implementation is dependent on future funding and final measurements of productivity.

Potential Benefits From Involving the Private Sector in Tax Debt Collection

Many private and governmental entities are involved in debt collection. We believe that these entities offer the potential for improving IRS debt collection practices. For example, as is being tried currently, there may be a role for private debt collectors in collecting federal tax debt.

Potential Benefits of Using Private Debt Collectors

In response to concern about the persistent nature of IRS' accounts receivable problems, IRS' fiscal year 1996 appropriations legislation contained provisions that earmarked \$13 million for a pilot program to test

the use of private law firms and debt collection agencies to help collect delinquent tax debts.

In May 1993, we recommended that IRS test the use of private debt collectors to support its collection efforts.¹ IRS had looked into testing the use of private collectors as early as 1991, but had not carried through with any of its plans.

IRS issued a request for proposals from prospective participants in the pilot program on March 5, 1996. The proposals were due by April 12, 1996, and the pilot is to last 1 year. Under the pilot, the private collectors are to attempt to first locate and then contact delinquent taxpayers,² remind them of their tax debt, and inform them of available alternatives to resolve the outstanding obligation.

An important limitation of the pilot is that the private collectors will not be able to actually collect the taxes owed; rather, the intent is for them to facilitate information exchange and contacts between IRS and the taxpayer. There is an OMB policy determination and IRS Office of Chief Counsel guidance that specify that the collection of taxes is an inherently governmental function that must be performed by government employees. Private collectors, however, can perform collection-related activities, such as locating taxpayers and attempting to secure promises to pay.

In addition, the private collectors will face some of the same problems in working the pilot cases that IRS employees face. First, these are not new cases. All will have already gone through much of IRS' collection process, and in some cases, the entire process. This means, in effect, that some of the cases may have been in the accounts receivable inventory for up to 10 years, and some may involve even earlier tax years. The cases may also contain some of the other information problems we discussed previously.

The pilot could provide useful insight into the effectiveness of the techniques and technologies used by the private sector in collecting older accounts. For example, the pilot calls for 40 percent of the cases to be those in which IRS has been unable to locate or contact the taxpayer. The remaining 60 percent are cases in which IRS has successfully contacted the taxpayer, but has been unsuccessful in securing payment. To the extent that the private collectors can locate, contact, and arrange for payment on these cases, the techniques used may be helpful to IRS in its efforts to

¹Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993).

²Face-to-face contacts are not allowed.

improve its collection programs. The private collectors will be bound by the same taxpayer rights and disclosure considerations as apply to IRS employees.

Other useful information could also be obtained from the pilot. For example, IRS could learn what actions are most productive based on the type of case, type of taxpayer, and age of the account. For the information to be useful to IRS and Congress in evaluating the pilot, however, the sample of cases must be drawn and the data captured in such a way that the appropriate analyses and tests can be done. We have not analyzed IRS' methodologies for selecting its sample of cases or for evaluating the pilot.

Industry Best Practices May Be Helpful to IRS

IRS faces many challenges in its efforts to improve the management and collection of its accounts receivable. The key is to find solutions to the major problems we previously discussed and their underlying causes that affect IRS' ability to collect more delinquent taxes. Solutions will take time because the problems are pervasive and may involve all IRS functions and processes.

Currently, IRS is making some changes to its collection process as a part of its modernization effort. We reported in the past that private collectors and states that are engaged in collection activities similar to IRS' may provide some best-practice examples for IRS to use in benchmarking its efforts.

Many states use private collectors to supplement their own collection programs, thereby taking advantage of private sector capability in managing receivables, gaining access to better technology, or avoiding the expense of hiring permanent staff. Although many states—including 33 of the 43 states that responded to our survey—have used private collectors, their experiences have varied widely.³

A majority of the states that responded to our survey used private collectors to collect delinquent individual income taxes owed by taxpayers residing outside their borders. Of the 28 states responding, 14 said that private collectors were effective in collecting individual income taxes. Regarding other types of taxes, the 12 states expressing an opinion were about evenly split on the effectiveness of private collectors. Using these states' experiences as an indicator, IRS could expect some additional

³Because all states did not respond to all of our survey questions, our analysis is not necessarily representative of experiences in all states.

collections from its proposed pilot, but not necessarily a significant windfall. IRS may, however, benefit and learn from the private companies' collection techniques and use of technology.

Next Steps

IRS faces significant challenges in collecting tax debts. As we have previously recommended, because the problems are pervasive across all IRS activities and processes, IRS needs to develop a detailed and comprehensive long-term plan to deal with the major challenges it faces and their interrelationships.⁴ With such a plan, IRS could better assure itself and Congress that it is on the right track and thereby better position itself to obtain the backing and support it needs.

Key to improving IRS' collections of tax debt is the need for up-to-date and accurate information as well as modern equipment and technology. IRS also needs to determine the most cost-effective ways to prevent delinquencies from occurring, as well as what it can do in its return, payment, and compliance processes to reduce the number of invalid accounts entering the collection process. To stay competitive in today's business environment, IRS must continually strive to improve collections by testing new and innovative approaches.

Madam Chairman, this concludes my prepared statement. I would be pleased to answer any questions.

⁴High-Risk Series: Internal Revenue Service Receivables (GAO /HR-95-6, February 1995).

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