Volume 2

TAS Research and Related Studies

Study of Financial Circumstances of Taxpayers Who Entered Into Installment Agreements and Made Payments While Their Debts Were Assigned to Private Collection Agencies

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EXECUTIVE SUMMARY

Pursuant to its private debt collection (PDC) initiative, since April 2017 the IRS has outsourced the collection of certain tax debt to private collection agencies (PCAs). PCAs may offer taxpayers who cannot pay their debts in full an installment agreement (IA), not to exceed five years. PCAs do not gather any financial information from taxpayers and have no obligation or incentive to inquire whether taxpayers are in economic hardship. The TAS studied the financial circumstances of 2,102 taxpayers who, between April 10, 2017 and September 28, 2017, entered into an IA while their debts were assigned to a PCA and made a payment on which the PCA received a commission. Among our findings:

- Almost fifty percent of these taxpayers agreed to make payments even though their incomes were less than their Allowable Living Expenses (ALEs), according to IRS measures; if these cases were worked by the IRS, these taxpayers could be put into "Currently Not Collectable" status;
- More than a fifth had incomes less than the federal poverty level, yet these taxpayers paid $544 on average; and
- Virtually all (94 percent) of taxpayers who receive Social Security Administration (SSA) retirement income and entered into these IAs have incomes below 250 percent of the poverty level. The IRS does not seek to collect these taxpayers' debts pursuant to an automatic levy program, the Federal Payment Levy Program (FPLP), yet it assigns their debts to PCAs for collection.

The National Taxpayer Advocate recommends that the IRS exclude the debts of SSA retirement income recipients whose incomes are less than 250 percent of the federal poverty level from assignment to PCAs and require PCA employees, before offering taxpayers an IA, to: inform taxpayers that they are not required to enter into an IA for an amount that would leave them unable to pay their reasonable basic living expenses; and refer them to the IRS webpage that sets out the ALEs that would apply to them, or, if the taxpayer prefers, print and mail them that information.

INTRODUCTION

In 2017, the IRS began assigning the debts of some taxpayers to private collection agencies (PCAs) pursuant to IRC § 6306. IRC § 6306 requires the IRS to outsource the collection of "inactive tax receivables," a term defined in the statute, provided such receivables are included in "potentially collectible inventory," a term that is undefined in the statute or applicable regulations.[1] The National Taxpayer Advocate has been advised by Chief Counsel that the IRS has discretion to define "potentially collectible inventory" to exclude the debts of SSA retirement income recipients with incomes less than 250 percent of the federal poverty level.[2] As discussed earlier in this report, the IRS has not acquiesced

1 Internal Revenue Code (IRC) § 6306(c)(2).

2 *See* National Taxpayer Advocate 2016 Annual Report to Congress 172-191 (Most Serious Problem: *Private Debt Collection (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*). For purposes of administering the IRS's automatic levy program, the Federal Payment Levy Program (FPLP), the IRS adopted 250 percent of the federal poverty level as a measure that serves as a proxy for economic hardship. The Social Security Administration (SSA) retirement income of taxpayers with incomes less than 250 percent of the federal poverty level is not subject to FPLP levies. *See* Internal Revenue Manual (IRM) 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016). *See also* the U.S. Dept. of Health and Human Resources, *Poverty Guidelines* (Jan. 31, 2017), https://aspe.hhs.gov/poverty-guidelines, showing that the poverty level for a single person in 2017 was $12,060. Thus, 250 percent of the 2017 federal poverty level for a single person was $30,150.

to that position, and assigns these taxpayers' debts to PCAs.[3] Overall, 44 percent of taxpayers who made payments while their debts were assigned to a PCA had incomes below 250 percent of the federal poverty level, according to their recently filed returns.[4]

Pursuant to IRC § 6306, a PCA may contact a taxpayer and, if the taxpayer cannot fully pay the liability, the PCA may offer to arrange an IA for up to five years, or seek IRS approval for an IA up to six or seven years in duration.[5] In exchange for their services, the IRS is authorized to pay the PCAs a fee of up to 25 percent of the amount they collect.[6] According to the IRS's contract with the PCAs, commissions are payable with respect to payments the IRS receives after ten days from assignment of the debt to the PCA (these payments are referred to as commissionable payments).[7] As described earlier in this report, taxpayers entered into IAs and made commissionable payments while their debts were assigned to PCAs even though, according to their recent returns, 45 percent of the time their incomes were less than their ALEs.[8] This study extends the analysis to taxpayers who did not file recent returns.

BACKGROUND

Taxpayers who owe $50,000 or less in delinquent tax and cannot immediately satisfy their tax liabilities in full may be eligible for a "streamlined" IA, which allows them to pay the liability in installments over a period of up to six years.[9] Taxpayers can request a streamlined IA without providing any financial information to the IRS.[10]

Some taxpayers cannot immediately pay their liability in full and are not eligible for, or cannot afford, a streamlined IA. In that case, they may request that the IRS consider an IA for a period of longer than six years, or consider collection alternatives.[11] These requests must be supported by financial

3 *See* Most Serious Problem: *Private Debt Collection: The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with The Law, and Burdens Taxpayers Experiencing Economic Hardship*, *supra*.

4 *Id*. In contrast, this volume 2 study considers the financial condition of taxpayers who entered into IAs after their debts were assigned to a PCA, including those who did not file recent returns.

5 IRC § 6306(b). The National Taxpayer Advocate has serious concerns about the IRS's use of PCAs to enter into installment agreements (IAs) exceeding five years. *See* National Taxpayer Advocate 2016 Annual Report to Congress 172-191 (Most Serious Problem: *Private Debt Collection: The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*).

6 IRC § 6306(e)(1). The IRS is also permitted to retain for itself up to 25 percent of the amount PCAs collect. IRC § 6306(e)(2).

7 Under section 2.3 of the IRS's contract with the PCAs, commissions are generally payable on any payment received 11 days or more after the date the account is transferred to a PCA and up to ten calendar days after the account is returned to the IRS.

8 *See* Most Serious Problem: *Private Debt Collection: The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with The Law, and Burdens Taxpayers Experiencing Economic Hardship*, *supra*.

9 *See* IRM 5.14.5.2, *Streamlined Installment Agreements* (Dec. 23, 2015), providing that streamlined installment agreements may be approved for taxpayers where the aggregate unpaid balance of assessments is $50,000 or less.

10 *See Apply Online for a Payment Agreement or Plan*, https://www.irs.gov/payments/online-payment-agreement-application. IRS, *Streamlined Processing of Installment Agreements* (last visited Oct. 17, 2017). Taxpayers must have filed all required returns to be eligible for any IA. IRM 5.14.1.2 (8)(f), *Installment Agreements and Taxpayer Rights* (Jan. 1, 2016).

11 *See* IRM 5.14.1.4 (2), *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014). For example, the IRS may designate the liability as currently not collectible (CNC) due to the taxpayer's economic hardship. *See* IRM 5.16.1.1, *Currently Not Collectible Overview* (Aug. 25, 2014); IRM 5.16.1.2.9, *Hardship* (Aug. 25, 2014); IRM 5.15.1.16, *Making the Collection Decision* (Nov. 17, 2014). The IRS is also authorized to accept an offer-in-compromise under IRC § 7122 and Treas. Reg. § 301.7122-1(b)(2). Pursuant to IRM 5.14.2.1, *Overview* (Mar. 11, 2011), the IRS may approve a partial-payment IA.

information provided by the taxpayer.[12] To determine whether to approve a request for a non-streamlined IA or a collection alternative, Congress has required the IRS to develop ALE standards to ascertain the extent to which a taxpayer is able to make payments on their tax liabilities.[13] The ALE standards determine how much money taxpayers need for basic living expenses such as housing and utilities, food, transportation, and health care, based on family size and where they live.[14] When compared with taxpayer income, the ALE standards determine the taxpayer's ability to pay his or her tax debt and at what level. If the ALE standards exceed the taxpayer's income, the taxpayer is unable to pay his or her basic living expenses and may be placed in "Currently Not Collectible" hardship status.[15]

By the end of fiscal year (FY) 2017, the IRS had assigned about $920 million of receivables, owed by about 128,000 taxpayers, to one of four PCAs with which it had entered into "qualified tax collection contracts."[16]

Pursuant to procedures implemented by the IRS as part of the PDC initiative, PCAs may solicit immediate full payment from taxpayers, and if that is not forthcoming, PCAs may offer taxpayers an IA of up to five years.[17] If the taxpayer cannot fully pay within five years, but can pay within six or seven years (and the period of limitations on collection will not expire in the meantime), the PCA is required to obtain IRS approval of the proposed IA for that length of time.[18]

TAS reviewed the financial circumstances of 2,102 taxpayers who entered into an IA and made commissionable payments while their debts were assigned to a PCA.[19] The analysis included a comparison of the taxpayer's ALE and income shown on a recently filed return or, in the absence of a recently filed return, an estimate of the taxpayer's income based on third-party payor documents supplied to the IRS. We also considered the size of the liability.

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12 IRM 5.14.1.2 (3), *Installment Agreements and Taxpayer Rights* (Jan. 1, 2016).

13 IRC § 7122(d), relating to offers in compromise. *See* IRM 5.15.1.7(2), Financial Analysis Handbook, *Allowable Expense Overview* (Oct. 2, 2012).

14 *See* IRS, *Collection Financial Standards*, https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards. The allowable living expenses (ALEs) are guidelines. The IRS may allow additional amounts for basic living expenses if the taxpayer substantiates the need to deviate from the standards. IRM 5.15.1.7(5), Financial Analysis Handbook, Allowable Expense Overview (Oct. 2, 2012).

15 *See* IRM 5.16.1, *Currently Not Collectible* (Jan. 1, 2016); IRM 5.16.1.2.9, *Hardship* (Mar. 21, 2017), noting that "hardship exists if a taxpayer is unable to pay reasonable basic living expenses." *See also* IRM 5.15.1.7(2), Financial Analysis Handbook, *Allowable Expense Overview* (Oct. 2, 2012), describing ALEs and noting that "the total necessary expenses establish the minimum a taxpayer and family needs to live."

16 PDC Program Scorecard for Fiscal Year 2017, reporting operational data through Sept. 14, 2017 and IRS costs through Sept. 30, 2017, showing that $ 919,593,380 of tax receivables were assigned, corresponding to the debts of 128,344 taxpayers.

17 The PDC program is implemented in part through the private collection agency (PCA) Policy and Procedure Guide (PPG). PPG Section 10, *Payment Options*, contains the procedures for soliciting payment from taxpayers.

18 The IRS must generally collect tax within ten years after assessment. *See* IRC § 6502. For a description of these arrangements as an "end-run" around the five-year limit on IAs that can be offered by PCAs in IRC § 6306(b), *see* National Taxpayer Advocate 2016 Annual Report to Congress 172, 179 (Most Serious Problem: *Private Debt Collection (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*).

19 Of these taxpayers, 1,676 filed recent returns (*i.e.*, for tax year 2014 or later); their income characteristics are described here and also earlier in this report. *See* Most Serious Problem: *Private Debt Collection: The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with The Law, and Burdens Taxpayers Experiencing Economic Hardship*, *supra*.

RESEARCH QUESTIONS

Of taxpayers who entered into an IA when their debts were assigned to a PCA and made a commissionable payment:

1. What is the relationship of income to the federal poverty level and ALE, stratified by the level of the last recorded balance due; and
2. To what extent were those who entered into IAs recipients of SSA retirement income and what were these taxpayers' incomes compared to the federal poverty level.

METHODOLOGY

TAS Research queried the IRS Compliance Data Warehouse (CDW) to find data on taxpayers with IAs initiated while their debts were assigned to a PCA and who made a commissionable payment on their tax liability. We identified taxpayers who entered into an IA while their debts were assigned to a PCA and made payments during that time through Individual Master File (IMF) transaction codes. We computed ALEs for four categories:

- Food, clothing, and other items;
- Housing and utilities,
- Transportation; and
- Health care.[20]

We computed poverty levels according to the guidelines published by the U.S. Department of Health and Human Services.[21]

We used data from two sources to determine taxpayers' income to which the ALEs would be compared. We considered:

- The income shown on the taxpayer's most recently filed 2014-2016 individual federal income tax return; and
- The taxpayer's income from the Information Returns Master File (IRMF) wage and Form 1099 income (for example, Social Security Administration, miscellaneous, interest, dividend, and Individual Retirement Account (IRA), and pension income).[22]

We applied the following guidelines:

1. If a taxpayer filed a 2014-2016 return:
    a. We used the total positive income (TPI) shown on the most recent tax year return;[23]

20 *See* IRM 5.15.1.7(2), Financial Analysis Handbook, *Allowable Expense Overview* (Oct. 2, 2012), describing ALEs and noting that "the total necessary expenses establish the minimum a taxpayer and family needs to live." In this analysis, we used the 2017 ALE standards.

21 The guidelines are available at https://aspe.hhs.gov/poverty-research.

22 Form 1099, *U.S. Information Return*, is an income information document supplied to the taxpayer and the IRS from third party payors. *See* IRC § 6041(a).

23 The Total Positive Income is the amount of total income excluding losses. It is reported in positive whole dollars. It is zero if not present.

b. For purposes of calculating the applicable poverty level and ALEs, we used the family size, zip code, and ages of the primary and secondary taxpayers who were reported on that return.[24]

c. The annual ALE total for a given taxpayer was computed by multiplying the monthly ALE total by twelve.[25] A taxpayer was designated as below ALE when his or her TPI was lower than that taxpayer's annual ALE total.

2. Where the taxpayer did not file a return for 2014-2016:

   a. We estimated income using third-party data reported for tax year 2016; and

   b. For purposes of calculating the applicable poverty level and ALEs, we treated the taxpayer as under age 65, with a family size of one, and residing in the continental United States in the location with the least amount of allowable housing and transportation costs (with no transportation operating cost).[26]

3. The annual ALE total for a given taxpayer was computed by multiplying the monthly ALE total by twelve. A taxpayer was designated as below ALE when his or her TPI was lower than that taxpayer's annual ALE total.

4. To measure a taxpayer's balance due, we aggregated the Total Module Balance Due from the Accounts Receivable Dollar Inventory (ARDI) for Individual Master File (IMF) taxpayers for debts assigned to PCAs.

FINDINGS

Some taxpayers who entered into IAs and made payments while their debts were assigned to PCAs had incomes that were less than their ALEs. This was particularly true of taxpayers whose incomes were less than 250 percent of the federal poverty level. As Figure 1.1 below shows, of the 2,102 taxpayers who entered into an IA and made commissionable payments while their debts were assigned to a PCA:

- Almost half had incomes less than their ALEs.
- More than a fifth had incomes less than the federal poverty level. All of these taxpayers' incomes were less than their ALEs, but they paid $544 on average.
- More than a quarter had incomes at or above the federal poverty level but less than 250 percent of the federal poverty level. More than eight out of ten of these taxpayers' incomes were less than their ALEs.

24 We used the poverty guidelines from the U.S. Dept. of Health and Human Services website for the year of the return.

25 For purposes of computing ALEs, we applied transportation ownership and operating expenses only for primary and secondary taxpayers reported on those returns.

26 We used the poverty guidelines from the U.S. Dept. of Health and Human Services website for 2016. The 2017 ALE monthly minimum amount was $1,927, consisting of $639 for food, clothing, and other items; $754 for housing and utilities; $485 for transportation; and $49 for health care.

FIGURE 1.1, Relationship of Income to the Federal Poverty Level and to Allowable Living Expenses of 2,102 Taxpayers Who Entered Into Installment Agreements and Made Commissionable Payments while Their Debts Were Assigned to PCAs

Income Compared to Poverty Level	Number of Taxpayers	Percent of Taxpayers	Number of Taxpayers With Income Less Than Allowable Living Expenses	Percent of Taxpayers With Income Less Than Allowable Living Expenses	Average Amount Paid
Income Below the Federal Poverty Level	452	22%	452	100%	$544
Income At or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	553	26%	465	84%	$472
Income At or Above 250 Percent of the Federal Poverty Level	1,097	52%	55	5%	$655
Total	**2,102**	**100%**	**972**	**46%**	

All of the IAs were for debts that were less than $50,000. As shown by Figure 1.2 below:

- The lower the amount of tax owed, the more likely it was to be owed by taxpayers with incomes less than ALEs.
- The lower the amount owed, the more likely it was to be owed by taxpayers with incomes of less than 250 percent of the federal poverty level;
- The ALEs always exceeded the incomes of taxpayers whose incomes were below the federal poverty level. These taxpayers may have foregone necessary living expenses to make payments. Yet in general, the more tax they owed the more they paid on average.

FIGURE 1.2, Relationship of Income to Allowable Living Expenses and Federal Poverty Level of 2,102 Taxpayers Who Entered Into Installment Agreements and Made Commissionable Payments While Their Debts Were Assigned to PCAs, Stratified by Amount Owed

Amount Owed	Income Compared to Federal Poverty Level	Number of Taxpayers	Number of Taxpayers with Income Less Than Allowable Living Expenses	Percent of Taxpayers with income Less Than Allowable Living Expenses	Average Amount Paid
Less Than $2,000	Income Below the Federal Poverty Level	151	151	100%	$217
	Income At Or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	150	127	85%	$173
	Income At Or Above 250 Percent of the Federal Poverty Level	214	17	8%	$286
	Subtotal	515	295	57%	
$2,000 or More and Less Than $4,000	Income Below the Federal Poverty Level	133	133	100%	$384
	Income At Or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	161	137	85%	$327
	Income At Or Above 250 Percent of the Federal Poverty Level	280	12	4%	$426
	Subtotal	574	282	49%	
$4,000 or More and Less Than $8,000	Income Below the Federal Poverty Level	98	98	100%	$593
	Income At Or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	139	119	86%	$437
	Income At Or Above 250 Percent of the Federal Poverty Level	282	15	5%	$596
	Subtotal	519	232	45%	
$8,000 or More and Less Than $10,000	Income Below the Federal Poverty Level	14	14	100%	$1,414
	Income At Or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	34	28	82%	$816
	Income At Or Above 250 Percent of the Federal Poverty Level	86	2	2%	$704
	Subtotal	134	44	33%	
More Than $10,000	Income Below the Federal Poverty Level	56	56	100%	$1,501
	Income At Or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	69	56	81%	$1,359
	Income At Or Above 250 Percent of the Federal Poverty Level	235	9	4%	$1,317
	Subtotal	360	121	34%	
Total	**Overall Total**	**2,102**	**974**	**46%**	**$ –**

As noted above, the SSA retirement income of taxpayers with incomes less than 250 percent of the federal poverty level is not subject to FPLP levies. The group of taxpayers who entered into IAs and made commissionable payments while their debts were assigned to PCAs included 101 SSA retirement income recipients. As shown by Figure 1.3 below:

- Half had incomes below the federal poverty level;
- 94 percent had incomes below 250 percent of the federal poverty level.

FIGURE 1.3, Relationship of Income to the Federal Poverty Level of 101 Social Security Retirement Income Recipients Who Entered Into Installment Agreements and Made Commissionable Payments while Their Debts Were Assigned to PCAs[27]

Income Compared to Federal Poverty Level	Number of Taxpayers	Percent of Taxpayers
Income Below the Federal Poverty Level	50	50%
Income At or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	45	45%
Income At Or Above 250 Percent of the Federal Poverty Level	6	6%
Total	**101**	**100%**

Moreover, as Figure 1.4 below shows:

- SSA retirement income recipients were most likely to owe the lowest incremental amount, less than $2,000;
- The 95 SSA retirement income recipients with incomes less than 250 percent of the federal poverty level paid a total of $46,938, or $494 on average.

27 Rounding causes the total to appear greater than 100.

FIGURE 1.4, Income and Amount Paid by 101 Social Security Retirement Income Recipients Who Entered Into Installment Agreements and Made Commissionable Payments While Their Debts Were Assigned to PCAs, Stratified by Amount Owed

Income Compared to Federal Poverty Level	Amount Owed	Percent of Taxpayers	Total Amount Paid
Income Below the Federal Poverty Level	<$2,000	44%	$4,939
	>=$2,000 to <$4,000	26%	$2,376
	>=$4,000 to <$8,000	24%	$10,563
	>=$8,000 to <$10,000	2%	$275
	>=$10,000	4%	$456
Income At or Above the Federal Poverty Level and Below 250 Percent of the Federal Poverty Level	<$2,000	44%	$3,125
	>=$2,000 to <$4,000	18%	$3,053
	>=$4,000 to <$8,000	18%	$2,836
	>=$8,000 to <$10,000	2%	$230
	>=$10,000	18%	$19,084
	Subtotal		$46,938
Income At Or Above 250 Percent of the Federal Poverty Level	<$2,000	33%	$353
	>=$2,000 to <$4,000	33%	$300
	>=$4,000 to <$8,000	33%	$350
	>=$8,000 to <$10,000		
	>=$10,000		
	Subtotal		$1,003

CONCLUSION

In FY 2017 when taxpayers entered into IAs while their debts were assigned to a PCA, there was an almost fifty percent probability that they agreed to make payments even though their incomes were less than their ALEs. This was especially true of taxpayers whose incomes were below 250 percent of the federal poverty level. Virtually all taxpayers who receive SSA retirement income and entered into these IAs had incomes below 250 percent of the poverty level. Recognizing that SSA retirement income recipients with incomes below 250 percent of the poverty level are likely in economic hardship, the IRS does not seek to collect their debts through FPLP levies, yet it assigns their debts to PCAs for collection.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Exclude the debts of SSA retirement income recipients whose incomes are less than 250 percent of the federal poverty level from assignment to PCAs.
2. Require PCA employees, before offering taxpayers an IA, to:
   a. inform taxpayers that they are not required to enter into an IA for an amount that would leave them unable to pay their reasonable basic living expenses, and
   b. refer them the IRS webpage that sets out the ALEs that would apply to them, or, if the taxpayer prefers, print and mail them that information.

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