Legislative Recommendation #26

Revise the Private Debt Collection Rules to Eliminate the Taxpayers Intended to Be Excluded by the Taxpayer First Act

PRESENT LAW

IRC § 6306 directs the Secretary to enter into qualified tax collection contracts with private debt collection agencies (PCAs) to collect certain "inactive tax receivables."[1] Subsection (d) lists categories of collection cases that are not eligible for assignment to PCAs.

The Taxpayer First Act (TFA) added the following category to the list:[2]

> "[A] taxpayer who is an individual with adjusted gross income, as determined for the most recent taxable year for which such information is available, which does not exceed 200 percent of the applicable poverty level (as determined by the Secretary)."

REASONS FOR CHANGE

The IRS has implemented the exclusion for taxpayers with adjusted gross incomes (AGI) that do not exceed 200 percent of the Federal Poverty Level in a manner that fails to identify those taxpayers accurately. While the TFA directed the IRS to not send the accounts of taxpayers with AGIs at or below 200 percent of the Federal Poverty Level to PCAs, it did not specify how the IRS should determine AGI. There are two possible methods. One method is to rely exclusively on a filed tax return, even if it is not recent. The other method is to rely on third-party information reporting documents (*e.g.,* Forms W-2 and 1099) when no recent return has been filed.

The IRS exclusively uses a taxpayer's last-filed tax return to determine AGI — and if there is no recent return, it will reach back up to *ten years* to locate one. Under this approach, the results may be dramatically underinclusive and overinclusive of the population the provision is designed to protect. Liability determinations and collectibility determinations are made at different points in time. For example, if a taxpayer files a tax return for tax year 2012, the liability determination reflects the taxpayer's income, deductions, and credits for that year. By contrast, if a taxpayer still has an unpaid 2012 tax liability today, the determination of whether the taxpayer has sufficient income to pay the liability is made on the basis of the taxpayer's current financial condition, and not the taxpayer's financial condition in the year the liability was incurred.[3]

The TFA underscored this point by directing the IRS to determine an individual's AGI "for the most recent taxable year for which such information is available." Using tax returns going back ten years to make current collection decisions stands the logic of collectibility determinations on its head. A taxpayer who could afford to pay tax in 2012 may not be able to do so today — and these are the cases Congress intended to exclude

1 IRC § 6306(a) & (c).
2 TFA, Pub. L. No. 116-25, § 1205, 133 Stat. 981, 989 (2019) (adding IRC § 6306(d)(3)(F)).
3 See, *e.g.*, IRC § 7122(d), which directs the Secretary, for purposes of evaluating offer-in-compromise submissions, to "develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses."

from assignment to PCAs. In addition, a taxpayer who could not afford to pay tax in 2012 might have earned additional income or acquired additional assets and be able to make payments currently.

> *Example*: A taxpayer last filed a tax return in 2012 when he earned $60,000. In 2013, he retired due to age or disability. He did not pay his tax liability and still has a balance due. Since 2012, his income has consisted solely of Social Security benefits, and he has not had a filing obligation. Under the IRS's approach, it will look at his 2012 tax return, determine his income is above 200 percent of the Federal Poverty Level, and assign his case to a PCA. Yet this is a case the TFA sought to exclude from assignment to a PCA.
>
> By contrast, if the same taxpayer earned only $30,000 in 2012, and third-party information reports show he earned $100,000 in 2019, the case might not be assigned to a PCA under the IRS's approach, even though the taxpayer can make payments currently.

To ensure that collectibility determinations are made based on current data, TAS has recommended that the IRS utilize information on a tax return if one has been filed in the last two years and, if not, that the IRS compute AGI from the information reporting documents the IRS receives. No method will be perfect. If the IRS uses third-party information reporting documents to make collectibility determinations, income not reported on those documents, such as self-employment income, will not be taken into account. But that is likely to be true even when the IRS relies on filed tax returns, as tax gap studies show most income not reported to the IRS on third-party documents is not reported on tax returns, either.[4]

In addition, the IRS will have to use gross income rather than AGI when relying on information reporting documents because it will not know for which adjustments a taxpayer qualifies. That may have the effect of overestimating a taxpayer's AGI and therefore assigning some cases to PCAs that should have been excluded. Even so, we believe basing collectibility determinations on recent information will be far more accurate than reaching back for information up to ten years old.[5] In a recent audit report, TIGTA reached a similar conclusion and similarly recommended that the IRS consider using "both last return filed information and third-party income information in its methodology to exclude low-income taxpayers from PCA inventory."[6]

RECOMMENDATION

- Amend IRC § 6306(d)(3)(F) to direct the IRS to determine an individual's adjusted gross income "for the most recent taxable year for which such information is available" by reference to the individual's most recently filed tax return if one has been filed in the preceding two years or, if not, by reference to information reporting documents described in part III of subchapter A of chapter 61 of the Internal Revenue Code.

---

4 IRS Pub. 1415, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013, at 14 (rev. Sept. 2019), https://www.irs.gov/pub/irs-pdf/p1415.pdf. The study estimated the net misreporting percentage (NMP) of income subject to little or no information reporting is 55 percent. The NMP is roughly equivalent to the percentage of income that goes unreported. Prior tax gap studies have shown, as one would expect, that the nonreporting percentage is higher for income subject to no information reporting than income subject to little information reporting.

5 A data run the IRS performed to compare the method the IRS is using with the method TAS has proposed found it would exclude roughly the same number of taxpayers. Cases assigned to PCAs as of September 12, 2019, were matched to the Individual Returns Transaction File to determine the last individual income tax return filed and to the Information Returns Master File to determine current income reported by third-party payors. For the reasons described above, we believe the TAS approach would do a better job of identifying the taxpayers whom Congress intended to exclude.

6 Treasury Inspector General for Tax Administration, Ref. No. 2021-30-010, *Fiscal Year 2021 Biannual Independent Assessment of Private Collection Agency Performance* 20 (Dec. 2020).