

Legislative Recommendation #26**Revise the Private Debt Collection Rules to Eliminate the Taxpayers Intended to Be Excluded by the Taxpayer First Act****SUMMARY**

- *Problem:* The tax code prohibits the IRS from utilizing private companies to collect the tax debt of any taxpayer with adjusted gross income (AGI) of 200 percent or less of the Federal poverty level. The IRS currently determines AGI by relying exclusively on a taxpayer's last-filed tax return, going back up to ten years. However, collectibility determinations are normally made on the basis of the taxpayer's current financial condition, and a tax return filed ten years ago is not a reliable measure of a taxpayer's current financial condition.
- *Solution:* Direct the IRS to determine AGI based on third-party information reporting documents (e.g., Forms W-2 and 1099) if no return has been filed in the last two years.

PRESENT LAW

IRC § 6306 directs the Secretary to enter into qualified tax collection contracts with private 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 that do not exceed 200 percent of the Federal Poverty Level in a manner that fails to identify those taxpayers accurately. It has chosen to rely exclusively on a filed tax return, even if the taxpayer has not filed a recent return. Rather than using alternative means to determine the taxpayer's current AGI (e.g., third-party information reporting documents like Forms W-2 and 1099), the IRS reaches back up to *ten years* to locate a return to determine AGI.

This approach produces anomalous results. A taxpayer who could afford to pay tax ten years ago may not be able to do so today – and these are the cases Congress intended to exclude from assignment to PCAs. Conversely, a taxpayer who could not afford to pay tax ten years ago might have earned additional income or acquired additional assets and now be able to make payments.

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 its current approach, the IRS will look at the taxpayer's 2012 tax return, determine the taxpayer's 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.

¹ IRC § 6306(a) & (c).

² TFA, Pub. L. No. 116-25, § 1205, 133 Stat. 981, 989 (2019) (adding IRC § 6306(d)(3)(F)).

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, the National Taxpayer Advocate 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.³

If the IRS relies on information reporting documents, it will have to use gross income rather than AGI because it may not know for which adjustments a taxpayer qualifies, if any. In some cases, 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 that basing collectibility determinations on recent information will be far more accurate than reaching back for information up to ten years old.⁴

The Treasury Inspector General for Tax Administration (TIGTA) reached a similar conclusion and has 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."⁵

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.

3 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. See IRS Pub. 1415, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014-2016, at 20 (Oct. 2022), <https://www.irs.gov/pub/irs-pdf/p1415.pdf>. This 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.

4 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.

5 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).