Analysis

Department of Revenue

Private Collections Firms Report

Analyst: John Borden

Request: Acknowledge receipt of a report on Private Collections Firms

Analysis: The Department of Revenue (DOR) has submitted a report the use of private collection firms, as requested by the Legislature in 2018 (HB 5201), which provided the following instruction:

> Report on the agency's use of private collection firms and private collection firm's rates as compared to the agency's internal collection activities and rates.

DOR transfers debt to PCFs, if there has been no payment on the account for one year as required by statute or earlier under the following circumstances: (a) taxpayer has been identified as being out-of-state; (b) a new debt is companionated or combined with an existing taxpayer's account previously transferred to a PCF; and (c) some small debt. A debt can be cycled through a PCF multiple times and through multiple PCFs.

DOR has contracts with two of three statewide PCF vendors, each of which has a unique price agreement and fee structure based on the percentage of the amount collected. The amount collected differs from the amount of the debt sent to PCF as it includes added penalties, fees, and interest. DOR may charge additional fees for the recording of liens, garnishments, late payments, and federal tax offset. Such collection fees vary, depending upon if DOR is the issuer of a garnishment. PCF fees are set by contract and vary between 17.9 percent and 23 percent.

DOR's PCF activities have increased due to SB 1067 (2017), which instituted the centralized management of *Executive Branch* agency accounts receivable with DOR and including PCF, which previously had been sent to PCF by each individual agency. Additionally, the Core System Replacement project increased DOR's capability to analyze and send debt to PCFs by automating many previously manual processes and procedures.

DOR undertakes collection actions even when a debt is subsequently referred to a PCF (e.g., garnishments at the request of a PCF or tax refund intercepts). If DOR collects revenue on a debt assigned to a PCF, the agency applies the payment to the taxpayer's debt and then notifies the PCF. Therefore, any DOR collection on a debt transferred to a PCF positively impacts the PCF's collection rate.

DOR collection rates for the past nine fiscal years (2008 to 2018) have averaged 17.45 percent for tax debt and 6.85 percent for non-tax debt. PCF collection rates for this same period averaged 2.1 percent for tax debt and 1.38 percent for non-tax debt albeit on with less collection tools than DOR and for debt that has become more challenging to collect.

The maturing of DOR's collection function, coupled with the deployment of information technology, is leading to a more sophisticated understanding of the use of PCFs, their collection rates, and cost

effectiveness as compared to DOR’s in-house collection efforts and costs.

Legislative Fiscal Office Recommendation: Acknowledge receipt of the report.

Heath
Department of Revenue

Request: Report on the Department of Revenue's use of private collections firms as directed by House Bill 5201 (2018).

Recommendation: Acknowledge receipt of the report.

Discussion: House Bill 5201 (2018) directed the Department of Revenue (DOR) to "Report on the agency's use of private collection firms and private collection firm's rates as compared to the agency's internal collection activities and rates."

The Department reports that between FY 2009 and FY 2018, its collection rates have ranged between 15 percent and 25 percent for tax debt, and between 5 percent and 8 percent for other debts. By contrast, private collection firms did not exceed 5 percent of the debt assigned to them during this period, whether tax debt or other debt. The Department then describes differences in collections tools, legal authorities, and types of debt assigned to each entity to explain the very different rate of collections.

The Department should explore ways to numerically compare the collections of private collection firms vis-a-vis the Department. Given the new software tools DOR has at its disposal, the Department should study how to determine statistically the probability of collection of a given debt based on its characteristics, such as age, length of time since payment, and the amount owed. This information would allow the Department to better compare its performance to private collection firms (and compare the performance between firms) adjusted by the collectability of the underlying debt portfolio held by each entity.

A second consideration the Department should add into this equation is the cost of collections for each type of debt. Other Agency Accounts (OAA) rates for full collections range between 15.0 percent and 19.8 percent depending on the owner of the debt. For FY 2018, the Department estimates a cost of funds for collections of $0.12, translating into a rate of 12.0 percent of revenue. The department has proposed revising how this key performance measure is calculated and is in the process of reviewing its OAA rates to reflect changes in staffing approved in the 2018 Legislative Session, so both of these numbers are subject to change and may not reflect the current cost of collections for the Department. By contrast, private collections firm rates range between 17.9 percent and 23.0 percent of the debt for an initial placement.

Adjusting DOR's debt portfolio for collectability and cost of collections will allow better decisions to be made regarding where to assign a given debt, whether a contractor is performing adequately, or where opportunities exist for improving collections practices or statutes. It would be helpful to evaluate the Department's collections function as a whole using cost effectiveness as a key criteria, assuming legal compliance and customer service are not compromised. Without the information described above, it is difficult to understand the policy context and financial impacts of the tradeoff between using private collections firms or in-house staff. The Department should continue working through these issues and keep Chief Financial Office and Legislative Fiscal Office informed on progress.

Oregon

Kate Brown, Governor

Department of Revenue
955 Center St NE
Salem, OR 97301-2555
www.oregon.gov/dor

February 15, 2019

The Honorable Representative Dan Rayfield, Co-Chair
The Honorable Senator Betsy Johnson, Co-Chair
The Honorable Senator Elizabeth Steiner Hayward, Co-Chair
Joint Committee on Ways and Means
900 Court Street NE
H-178 State Capitol
Salem, OR 97301-4048

Dear Co-Chairpersons:

Nature of the Request

The Department of Revenue (DOR) is submitting a report on the use of Private Collection Firms as directed by a budget note included in House Bill 5201 (2018). The note directed the department to report to the 2019 Legislature:

> "Report on the agency's use of private collection firms and private collection firm's rates as compared to the agency's internal collection activities and rates."

Outlined below are highlights from the full report, which is provided with this letter.

Agency Action

In response to the request in House Bill 5201 (2018), DOR has completed a historical and current review of the agency's use of Private Collection Firms (PCFs). Historically, the agency has used PCFs in a variety of ways that align with legislative requirements and the department's priorities. Currently, tax programs use House Bill 3509 (1999) as the basic criteria for sending accounts to PCFs. OAA just began to use PCFs in accordance with Senate Bill 1067. All tax programs, and now OAA, use discretion to send certain accounts to PCFs sooner than what is legislatively required.

The agency also provides an analysis of the collection tools used by PCFs and the department. This analysis lists the advantages, disadvantages, and comparable cross-over. The agency also provided context for differences in collection rates. The agency continues to see PCFs as an important tool in our efforts to optimize collections. The agency is committed to continued evaluation of PCF results to inform future use of their services while remaining focused on continually improving collection outcomes.

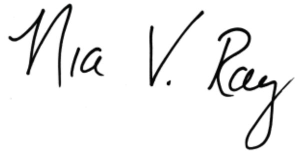
Action Requested

The agency requests that the committee acknowledge receipt of this report.

Legislation Affected

No legislation is affected.

Respectfully submitted,



Nia Ray, Director
Oregon Department of Revenue

2019

Executive summary

Report on private collection firm use and collection rates (HB 5201)

January 18, 2019

150-800-550 PCF (Rev. 01-19)

Introduction

House Bill (HB) 5201 (2018) included the following instructions for the Department of Revenue:

> *Report on the agency's use of private collection firms and private collection firm's rates as compared to the agency's internal collection activities.*

Additionally, the department produced a broader background paper in 2013 that highlights the department's historical partnership with private collection firms (PCFs) and the agency's ongoing strategic approach to PCF use in optimizing collection outcomes.

Background

To understand DOR's current use of private collection firms (PCFs), it is helpful to consider both the department's historical use and its current strategic priorities. The use of PCFs by Oregon state agencies, including DOR, was discretionary prior to HB 3509 (1999). Before HB 3509, DOR primarily used PCFs when unable to locate a debtor, when the debtor was believed to reside outside of the state of Oregon, or after DOR agents had exhausted their collections options. After HB 3509, DOR was required to transfer non-exempt accounts to PCFs when no payment had been received within one year. However, DOR was allowed the discretion to send accounts to PCFs sooner if use of the PCF increased likelihood of successful collection of the debt.

While DOR has used PCFs to collect on tax debt, the department's Other Agency Accounts (OAA) Unit began using PCFs in July 2018 as part of the implementation of the requirements in Senate Bill (SB) 1067. Prior to SB 1067, executive branch agencies had the option to assign their accounts to a PCF or OAA for active collections. However, starting in July 2018, the process by which executive branch agencies collect their liquidated and delinquent accounts changed. The new legislation required executive branch agencies to send their accounts to OAA rather than a PCF and centralized the management of PCF relationships and performance (specific to executive branch agency collections) in OAA. It also required OAA to send executive branch agency accounts to PCFs after six months without a payment rather than returning the account to the originating client agency for them to determine further action, thus increasing PCF use.

Overview of agency collections

Optimizing collection efforts is one of the department's three strategic priorities. As part of the optimizing collection efforts, each collection team within the department employs collection strategies specific to the account types it addresses. Common internal collection strategies—including when and how to use PCFs—focus on collection activities that:

- Maximize collection revenues.
- Streamline processes.
- Leverage GenTax.
- Provide quality customer service to debtors and client agencies.

While there are differences in debt characteristics and collection processes between the department's tax and OAA, there are also strong similarities in their overall collection strategy and approach. Both groups aim to quickly resolve the debts they are responsible for collecting.

Collection rates and differences in collection tools

Historically, DOR has outperformed PCF collection rates by a consistent margin. Multiple factors may contribute to the difference in collection rates. The difference in collection tools available to DOR and PCFs likely contribute to the collection rates. There are some ways that DOR and PCFs are relatively comparable. Both are able to negotiate payment arrangements with a debtor, but DOR has a stronger incentive to offer payment arrangements. DOR's compliance goals consider both short-term gains and long-term revenue stream protection, which is dependent upon taxpayers voluntarily fulfilling their tax filing and payment obligations on an ongoing basis. In contrast, PCFs are more focused on short-term revenue gains. DOR assumes that a roughly comparable level of collection skill and knowledge exists in both DOR and PCF agents.

Conclusion

PCFs serve an important role in DOR's efforts to optimize collections. The department continues to monitor and evaluate results to inform future PCF use opportunities and identify areas for potential improvement or for adjustment. With the implementation of GenTax, the department can now leverage automation and access to better data and analytics to more effectively partner with PCFs. DOR's approach to using PCFs, coupled with internal collections strategies, will remain focused on continually improving collection outcomes.

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2019

HB 5201

Report on private collection firm use and collection rates

January 18, 2019

150-800-550 PCF (Rev. 01-19)

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While DOR has long used PCFs to collect on tax debt, the department's Other Agency Accounts (OAA) Unit began using PCFs in July 2018 as part of the implementation of the requirements in Senate Bill (SB) 1067. Prior to SB 1067, executive branch agencies had the option to assign their accounts to a PCF or OAA for active collections. However, starting in July 2018, the process by which executive branch agencies collect their liquidated and delinquent accounts changed. The new legislation required executive branch agencies to send their accounts to OAA rather than a PCF and centralized the management of PCF relationships and performance (specific to executive branch agency collections) in OAA. It also required OAA to send executive branch agency accounts to PCFs after six months without a payment rather than returning the account to the originating client agency for them to determine further action, thus increasing PCF use.

DOR has updated its approach to PCF use over time to align with its collections strategies, processes, and tools. In 2013, the department produced a broader background paper on use of PCFs by DOR and other tax agencies and a budget note response specific to DOR's use of PCFs. Both are attached for reference.

Overview of agency collections

Optimizing collection efforts is one of the department's three strategic priorities. As part of the optimizing collection efforts, each collection team within the department employs collection strategies specific to the account types it addresses. Common internal collection strategies—including when and how to use PCFs—focus on collection activities that:

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While there are differences in debt characteristics and collection processes between the department's tax and OAA, there are also strong similarities in their overall collection strategy and approach. Both groups aim to quickly resolve the debts they are responsible for collecting.

With the implementation of GenTax, the department has incorporated automated processes into its collections activities. Upon assessment or assignment of a new debt, automated billing and collection letters are generated to ensure debtors receive timely due process notices.

Debts are also automatically analyzed by the system using pre-determined business rules to evaluate the account's collectability. A risk score is then determined and the account is placed in the work queue most appropriate for effective resolution—either a department revenue agent or a PCF. The ability to quickly and effectively score and sort debt was one of the key areas of improvement the department identified in its 2013 budget note response on its use of PCFs. At the time, the department was limited by the technology available, but that has changed since the implementation of GenTax.

Accounts with higher scores are generally worked first internally. Emphasis is placed on phone contact with debtors and establishing voluntary payment arrangements whenever possible before proceeding to other active collection tools.

Speed is an important factor for successful collection and debt resolution. How quickly a debtor is contacted once an account becomes liquidated and delinquent can factor into the ease of resolving the account. Because of this, part of DOR's PCF assignment strategy is to send liquidated and delinquent tax debts to a PCF for immediate collection action if the debt would otherwise remain aging and unworked in the department's accounts receivable due to workload constraints.

Tax and OAA collectors also take advantage of the databases and other information available to them to aid in identifying assets for collection, such as the Financial Institution Data Match program, Employment Department and Driver and Motor Vehicles Division databases or the Department of Justice's State New Hire Reporting. Automated searches are routinely run against data sources to look for new information related to accounts in collections, and garnishments are actively pursued when eligible assets are identified. Collection results are continually monitored and periodic adjustments are made to maximize collections.

DOR Use of PCFs

Comparing collections tools of DOR and PCFs

There are some ways that DOR and PCFs are relatively comparable. Both are able to negotiate payment arrangements with a debtor; however DOR has a stronger incentive to offer payment arrangements. The department's compliance goals consider both short-term gains and long-term revenue stream protection, which is dependent upon taxpayers voluntarily fulfilling their tax filing and payment obligations on an ongoing basis. In contrast, PCFs are more focused on short-term revenue gains.[1]

Both may also generate automated letters to debtors, although the content and frequency of the correspondence differs. DOR assumes that a roughly comparable level of collection skill and knowledge exists in both DOR and PCF agents; however, DOR and PCFs have different sets of collections tools that contribute to their collection success.

DOR agents can:	PCFs can:
• Access confidential and proprietary taxpayer information such as wage, tax return and financial transaction data, as well as • Access state agency databases. • Issue administrative notices of garnishment[2] and liens on property. • Answer detailed questions about Oregon's tax programs. • Make decisions regarding canceling or writing off debt. • Negotiate settlements offers and approve or deny penalty waiver requests (tax debt only). • Access Financial Institution Data Match (FIDM). • Perform site visits to debtor's home or business. • Access some skip tracing tools.	• Auto-dial outgoing phone calls, making contacting debtors less manual and time consuming. • Temporarily hire additional agents when workload exceeds capacity of existing staffing levels (required per DAS contract). • More frequently access multiple fee-based skip tracing tools without procurement and process constraints. Also, dynamically update and purchase more tools as needed.

[1] In 2007, the National Taxpayer Advocate gave testimony regarding a fundamental difference between tax authorities and PCFs as part of a report on the IRS's unsuccessful attempt to use PCFs to collect tax debt. The testimony explained that part of the issue was that PCFs do not and, arguably, should not focus on long-term compliance when collecting, as the "fiduciary duty of a private company is to maximize profits for its shareholders." United States. Congressional Committee on Ways and Means, U.S. House of Representatives. "Hearing: IRS Private Debt Collection." 23 May 2007.

[2] PCFs may request that DOR issue notices of garnishments for accounts being worked at the PCF. Under certain conditions, a PCF may issue writs of garnishment, but only DOR has authority to issue the notices of garnishment. A writ of garnishment requires court action, whereas issuing a notice of garnishment is a statutory authority used by the Department of Revenue (ORS 18.854). Writs of garnishment are typically valid for 90 days and are subject to a minimum wage exemption. Notices of garnishment are not subject to that exemption and these garnishments will continue until the debt is paid in full or the garnishment is released.

Overall, there are some challenges, administrative burden, and risk in sending accounts to PCFs. These include:

- DOR issues administrative notices of garnishment on behalf of PCFs and provides account handling throughout the process, including receipt of payments and communication with the employer or financial institution. This involves internal resources still handling a significant portion of administrative work related to the account even though the department is not performing the collections work.
- DOR has additional tools and access to data that cannot be used while an account is assigned to a PCF without risk of violating the federal Fair Debt Collection Practices Act. DOR cannot take action on assets until the account is returned from the PCF.
- Tax account balances assigned to a PCF are part of DOR's accounts receivable, even though DOR cannot take actions to resolve those debts while they are with the PCF.
- Some debtors are confused about where to go for account resolution when their accounts are assigned to a PCF, resulting in additional administrative work for internal resources.
- DOR resources are still used for customer service, administrative support, and account maintenance while accounts are assigned to PCFs.

Tax debts

DOR's determination as to whether and how to use of PCFs to collect on tax accounts consist of three components: statutory compliance, assignment of small balance accounts, and customer experience. When combined, these considerations ensure accounts are being assigned to PCFs timely and appropriately.

First, the department must comply with statutory requirements for sending liquidated and delinquent tax accounts to PCFs. In accordance with ORS 293.231, the following criteria is used to determine when an account must be sent to a PCF for collection:

- No payment has been made within one year.
    - "Payment" includes direct payments on any of the debtor's accounts, but does not include refund offsets.
- There is no authorized exemption under ORS 293.231(5)(7).

To comply with other collection regulations and DOR policies, DOR has requested and DAS has approved the following additional exemptions to the PCF assignment requirement, as allowed by ORS 293.231(5)(7):

- The department has approved a settlement offer for the account.
- The debtor is in the military and serving in a combat zone.
- The debtor is deceased.
- The debtor is a business known to be actively operating.
- The debtor has been identified as a tax resistor.
- The debtor meets the criteria for suspend collections status under ORS 305.155.
- Debtor has an open and/or active bankruptcy case.
- The debtor is currently incarcerated.
- Debtors who have failed to file a tax return and the department has calculated the tax.

Second, the department assigns accounts with a specific type of small balance to PCFs when the account is liquidated and delinquent, and eligible for collections. The following criteria is used to assign these specific small balance accounts:

- Balance must be less than $1,000.
- No payment received within 90 days.

Assigning these small balance accounts to the PCFs helps ensure DOR is directing Revenue Agent resources to work accounts benefiting from the use of DOR collection tools. These specific low balance accounts can be contacted timely by the PCFs helping support DOR's efforts to maximize collections.

Finally, the third component focuses on improving customer experience and increasing efficiency by keeping all of a taxpayer's accounts together. When a debtor has a tax account already assigned to a PCF, DOR will assign all tax debts for that debtor to the same PCF. Any new tax debt established during the assignment timeframe will also be assigned to the PCF. It's easier for the debtor to have one point of contact for addressing their accounts, and for the department when tracking progress on the collection of these debts.

OAA debts

In relation to the collection of executive branch agency accounts, OAA's determination as to whether and how to use PCFs consists of two components: identification of appropriate accounts and PCF management.

First, accounts must meet one of the following criteria to be assigning to a PCF:

- No payment has been made within six months. "Payment" includes direct payments on any debt owed by the debtor, but not refund offsets.
- The debtor has an existing OAA collection account that is already assigned to a PCF by OAA.
- The OAA collection account risk score is below the minimum threshold for internal collections work. This threshold can be raised or lowered in response to the availability of OAA collection resources. Risk scores in OAA are automatically calculated on a weekly basis.

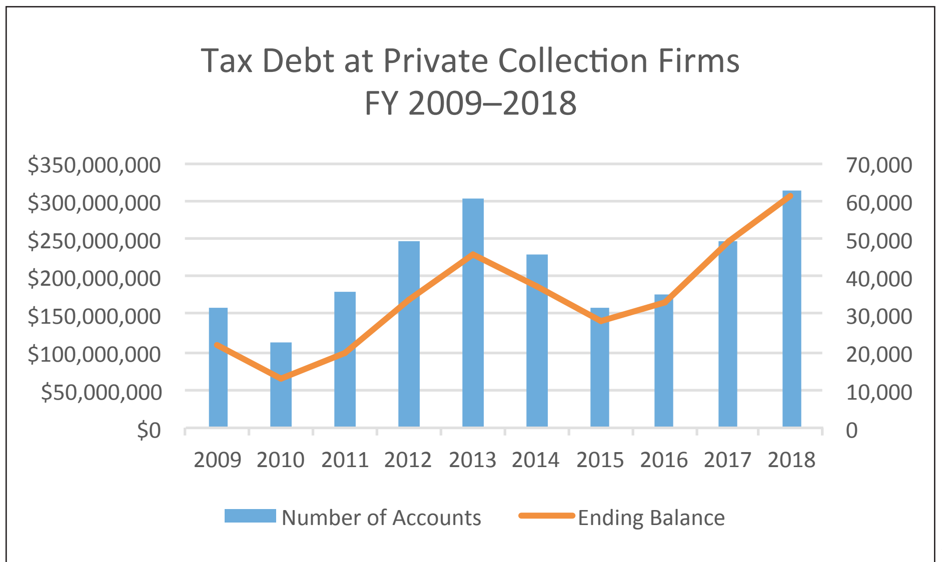
Second, PCFs must be performing at an acceptable level. Prior to the implementation of SB 1067, the PCF oversight activities were handled by disparate state agencies. OAA now consistently receives data and other information from PCFs to assess performance across service providers, including monthly performance metrics. If a PCF is not meeting performance expectations, OAA may consider not sending additional accounts to underperforming PCFs or choose to send accounts to other statewide approved PCFs.

Accounts Receivables and Collection Rates

Due to the difference in tax debt collections versus the OAA centralized collection services, it is useful to distinguish between DOR tax and OAA accounts when discussing accounts receivables and collection rates.

DOR Tax accounts

The chart below shows tax accounts DOR has sent to PCFs. Between 2009 and 2018, the number of accounts sent by DOR to PCFs nearly doubled and the amount of debt has almost tripled. In fiscal year 2009, DOR reported 31,565 delinquent accounts being worked by PCFs, representing slightly over $110 million in delinquent taxes. At the end of Fiscal Year 2018, DOR reported 62,620 delinquent accounts being worked by PCFs, representing $308 million. [3]



[4]

The decline in the number of accounts assigned to PCFs in 2015 was the result of preparation for conversion to GenTax. Prior to the implementation of GenTax for the personal income tax program in 2015, DOR required PCFs to return all accounts to the department for a period of time so the accounts could be transitioned into GenTax. The assignment of collection accounts to PCFs resumed in December 2015.

[3] Reports on Liquidated and Delinquent Accounts Receivable for fiscal years 2009 – 2017 as published by Legislative Fiscal Office. DOR submission to LFO used for fiscal year 2018.

[4] In 2015 DOR pulled back accounts for data conversion and didn't start reassigning debts to PCFs until December. The methodology of reporting liabilities and accounts changed during this conversion period. A single account in GenTax may include multiple liabilities.

It is important to note that accounts are defined differently in GenTax than they were in the department's legacy systems. In the DOR legacy systems, a debtor who owed for multiple account types, for example personal income tax and lane self-employment tax, was considered one account. In GenTax, a debtor with this same example is considered as two accounts.

Another reason for the increase in accounts assigned to PCFs is that DOR is now sending more failure-to-file assessment debt to PCFs. Appropriate calculation of tax liability is dependent upon complete knowledge of the taxpayer's income and tax situations. Failure-to-file (FTF) assessments occur when a taxpayer fails to file a required return and the department estimates their tax liability based on only the information available to the department at that time. Without the full picture, the estimated liability may be more or less than the actual liability, but the taxpayer is responsible for that liability until they file a return showing how their liability should be adjusted.

As discussed in the department's 2013 budget note response about PCF use, the department had requested and received exemption from the requirement to assign these debts to PCFs after a year of no payments as part of its strategy for handling of this type of account. These accounts were traditionally worked in-house because DOR staff had the authority to negotiate the amount of tax liability and could best assist the taxpayer in filing the return(s) required to determine their actual tax liability. At the time, the department stated it was reconsidering its approach to collecting failure-to-file assessment debt, including PCF use. Despite having the exemption, DOR began updating its collection strategy surrounding failure to file accounts in 2014. In collaboration with PCFs, DOR began to manually assign FTF accounts that could not be resolved internally. Today, DOR sends all eligible failure-to-file accounts to PCFs automatically as part of its normal course of collections.

OAA accounts

DOR's OAA unit provides collection services on debts that are part of another agency's accounts receivable. OAA's account inventory is not part of DOR's accounts receivable.

OAA's client agencies are responsible for taking the collection steps required by OAM Chapter 35 and other laws and rules to attempt to obtain payment of their accounts receivable. The steps provided in OAM Chapter 35 ensure Oregon state agencies adhere to due process notification requirements and that further collection action is avoided whenever possible. Agency attempts to resolve their accounts receivable, including the processes to render debt as liquidated and delinquent, are required prior to accounts being assigned to OAA for collection services. Executive branch agencies are required to refer liquidated and delinquent debts to OAA within 60 days of the account reaching liquidated and delinquent status.

Prior to fiscal year 2019, OAA did not work with PCFs in its line of work. OAA staff would attempt to collect on an account for one year. If collection attempts were unsuccessful, OAA would return the account to the originating agency. That agency would then send the account to a PCF for further attempts at collection.

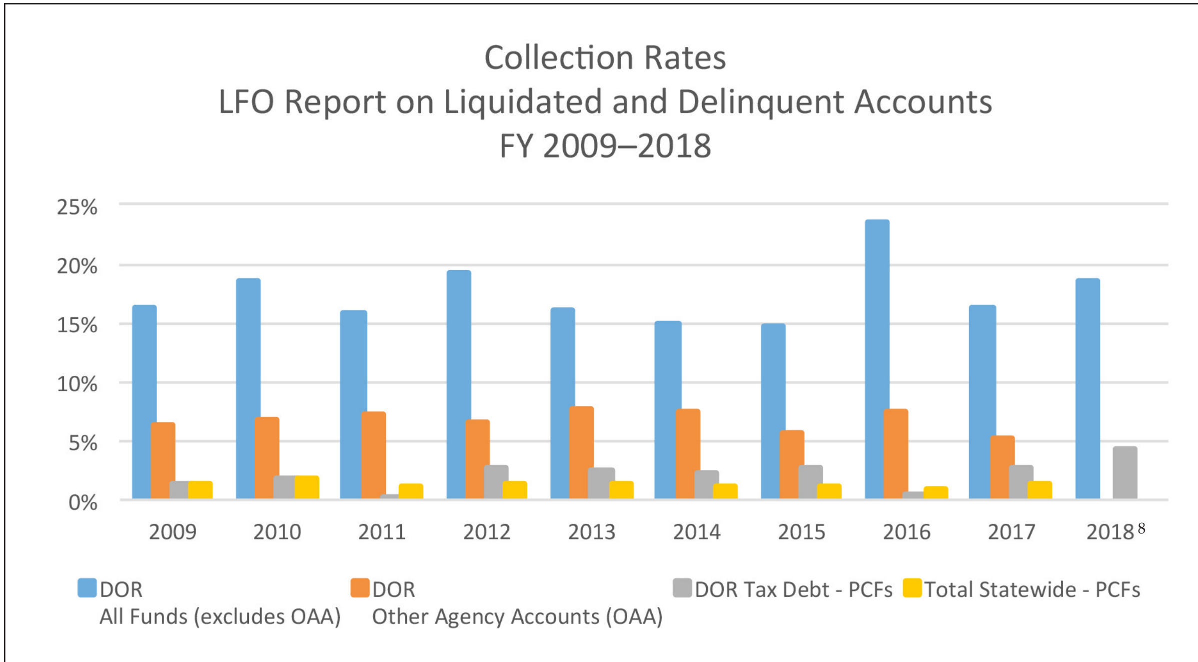
As of July 1, 2018, OAA began managing the PCF referral process for executive branch agency accounts, as required under SB 1067. OAA is required to send executive branch agency accounts—not including tax debts—to PCFs if there is no payment on the account within a six-month period. OAA also has the discretion to send accounts to PCFs earlier than that if it would improve the likelihood of account resolution. Currently, OAA does this when additional debt is received for a debtor who is already being collected on by a PCF, and in other specific circumstances. OAA has sent approximately 4,500 debts with a total amount of $30.7 million to PCFs between July 1, 2018 and September 10, 2018.

Collection Rates

The formula used by the Legislative Fiscal Office (LFO) and the Secretary of State's Office divides the amount collected by the beginning balance plus additions.

$$\frac{\textit{Collections}}{\textit{(Beginning Balance+Additions)}}$$ [5]

The table below shows collection rates since 2009 for DOR's tax and OAA collections, PCFs collecting tax debt, and PCFs statewide based on the information provided in LFO's annual report on liquidated and delinquent accounts.[6]



There are a couple of ways in which this calculation of a collection rate can be too simple to capture the nuance in accounts receivable fluctuations. First, the collection rate does not account for actions other than payments that impact the accounts receivable total. For example, changes due to debts that are written-off, adjustments (both debits and credit), offsets, bankruptcies, and appeals are not accounted for in the year in which they occur. Instead, the debt is removed from the beginning balance used in the calculation for the following year's collection rate.

Another issue is the treatment of additional debt added during the year. The rate calculation formula shown above does not take in to account when the debt was received. For example, collection rate calculations in the LFO liquidated and delinquent report treat a debt received on the first day of the fiscal year the same as a debt received on the last day. Payments that are collected by DOR while the account is assigned to a PCF are also reported in the PCF portion of the LFO report. For example, garnishment payments that resulted from DOR issuing garnishments on behalf of PCFs. [7, 8]

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[5] In response to the 2013 budget note about DOR's use of PCFs, DOR used the formula "total dollars collected during the fiscal year divided by the beginning balance plus half the value of additional liabilities added during the period." DOR has updated the formula to be in alignment with LFO and the Secretary of State.

[6] Reports on Liquidated and Delinquent Accounts Receivable for fiscal years 2008 – 2017 as published by Legislative Fiscal Office. DOR submission to LFO used for fiscal year 2018, as LFO is in the process of publishing 2018 information. DOR tax collections were overstated in the departments FY2016 annual LFO report due to data conversion from legacy systems to GenTax. This reporting error has been corrected for future report years.

[7] DOR tax collections was overstated in the FY 2016 LFO report due to data conversion from legacy systems. This reporting error was corrected for future year reports.

[8] 2018 OAA and Statewide PCF not included. LFO is in the processing of publishing information for fiscal year 2018.

Conclusion

PCFs serve an important role in DOR's efforts to optimize collections. The department continues to monitor and evaluate results to inform future PCF-use opportunities and identify areas for potential improvement or adjustment. With the implementation of GenTax, the department can now leverage automation and access to better data and analytics to more effectively partner with PCFs. DOR's approach to using PCFs, coupled with internal collections strategies, will remain focused on continually improving collection outcomes.

Private Collection of Tax Debt: Background

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August 2013

Updated where possible to provide more current information related to DOR debt levels at PCFs and usage of PCFs by the IRS.

Introduction

There is a long history of debate about privatizing government functions. Within this larger topic is the question of the appropriate use of private entities to collect government revenue, and more specifically, the appropriate role of private entities to collect tax debt. Various non-tax government debts, including student loans and court fines, have been collected for years by private collection firms (PCFs).[2] Regarding tax debt, the IRS and most states, including Oregon, have deployed PCFs in a variety of ways and have had a variety of experiences. As of the end of fiscal year 2016-17, Oregon had $3.5 billion in liquidated and delinquent accounts[3], slightly less than a quarter of which was tax debt. At the time, nearly one million accounts, representing $1.1 billion in both tax and non-tax debt, were being worked by PCFs. (Oregon Legislative Fiscal Office)

The topic of using PCFs for tax debt is often framed in terms of efficiency. That is, if collecting tax debt is a straightforward and well-defined task, the question is, “who can perform the task at the lowest cost?” Unfortunately, this simple view does not adequately reflect fundamental differences between PCFs and tax administration agencies in authority, type of debts and debtors, collection tools, incentives, and desire to promote long term compliance of taxpayers.

The purpose of this paper is to describe the use of PCFs to collect tax debt by the IRS, other states and the Oregon Department of Revenue. The paper will also attempt to provide a framework with which to consider the appropriate use of PCFs, rather than whether they should be used. It follows the following outline:

1. The Nature of Tax Debt Collection
2. The IRS Experience with PCFs
3. Oregon DOR’s Experience with PCFs
4. Utilization of PCFs by Other States
5. Conclusion

[1] The contributors thank Debra Bodenhamer for excellent research assistance.

[2] Although private collection firms (PCFs) are also referred to as private collection agencies (PCAs), particularly in the national dialogue on the topic, for consistency, this paper uses the term private collection firms.

[3] Liquidated and delinquent accounts are those which are past due and for which the past due amounts are known by both the state agency and the debtor.

The Nature of Tax Debt Collection

The collection of tax debt involves numerous facets, including locating debtors, negotiating payment plans and settlement offers, issuing warrants, executing garnishments and applying tax refund payments to outstanding tax liabilities, known as refund offsets. Collections efforts even include negotiating the tax liability with a non-filer after DOR has identified a taxpayer who did not file a tax return but should have, so DOR filed a return for the taxpayer. Revenue agents may assist taxpayers in understanding how to adjust the withholding on their paychecks to avoid owing state tax debt in the future. Because the topic of tax debt is set within the context of tax compliance, there is interest by tax agencies in helping taxpayers be compliant in their tax obligations permanently, beyond simply collecting the specific debt at hand.

Collection of tax debt is often viewed as different from collection of other debt. At the federal level, some of the difference is codified in the Taxpayer Bill of Rights which restricts the collection practices of the IRS to help achieve a balance between protecting taxpayer's rights and collecting federal debt. (United States. Congressional Committee on Ways and Means.) In Oregon, DOR collectors are prohibited from having dollars collected be the "primary evaluation criterion" of the performance appraisal (ORS 305.870). Similar restrictions do not apply to private collectors, although all debt collectors must conduct business according to the Fair Debt Collection Practices Act.[4]

The difference between business debt and tax debt is significant as well. Business debt is usually based on a contract entered by a debtor with a business, either implicitly or explicitly, by the purchase of goods or services on credit, and businesses typically do not extend credit to individuals who are not likely to have the ability to pay off the debt. Tax debt is often not agreed to by the taxpayer, and is generally assessed regardless of the taxpayer's creditworthiness. Tax debt is also magnified by imposition of penalties and interest on debt that in most cases can't legally be written off for at least seven years.

Another way tax debt differs from business debt is that tax revenues are used to fund public services provided by the government. Tax debt which is not collected may represent fewer public services provided, or a situation in which compliant taxpayers pay a larger share toward these services than they would if more taxpayers were compliant.

PCFs represent an additional tool that can be deployed to aid collection efforts. Governments at all levels have used PCFs to collect non-tax and tax debt, but it has typically been in a focused context where the objective is to leverage their comparative advantages. For example, the IRS used PCFs to collect only debt that it was unable to get to and with limited scope. Similarly, the Oregon Department of Revenue has used PCFs to collect certain tax debt, such as that of persons out-of-state. The federal Office of Management and Budget issues guidelines to ensure that 'inherently governmental functions' are not performed by contractors and many states that use PCFs do so based on specific statutory language giving the state authority to engage PCFs, usually with restrictions.

[4] http://www.ftc.gov/os/statutes/fdcpa/fdcpact.shtm

IRS Experience with Private Collectors

The IRS has had at least three episodes in which private collectors were used to collect public debt. The first time private collectors were used to collect federal tax debt was in 1872, and the authority was cancelled soon after because of corruption and lack of substantive results (Thorndike). The IRS also used private collection agencies for approximately one year during 1996-97 on a congressionally-authorized pilot program to evaluate the usefulness of having private collectors locate taxpayers. That program was canceled because it lost money (Congressional Research Service).

The third time the IRS used private collectors was a more extended use that began in 2006 and ended in 2009. The motivation for the IRS to use PCFs was to increase the capacity of the agency's collections efforts at a time when negative public sentiment regarding IRS agents would likely have prevented the agency from obtaining budgetary funding to add agents. PCFs were viewed as a way to assist the IRS in increasing collections efforts to address the growing level of delinquent tax owed the federal government. The IRS made the case to a skeptical Congress for authority for the agency to use PCFs, which was granted under the American Jobs Creation Act of 2004 (AJCA).

From 1954 until the implementation of AJCA, the federal tax code had "implied that only the IRS is authorized to collect taxes."[5] (Congressional Research Service) After AJCA, the IRS engaged PCFs with a narrow scope as a substitute for IRS agents to handle relatively straightforward accounts so that IRS agents could focus on accounts requiring more discretion. This public-private partnership was terminated by the IRS in 2009 amid concerns that PCFs were not appropriate for the collection of delinquent federal tax debt. The IRS later justified the decision by reporting that it was not cost effective to use PCFs, but the report was criticized by GAO, which considered the study flawed and not suitable to use as justification for discontinuing the utilization of PCFs.

Some background about why the IRS requested authorization to use PCFs can be helpful in understanding their use and ultimately the decision to end their use.

IRS Budget Reductions in late 1990s

Congressional hearings on IRS collection practices in 1997 and 1998 included "testimony from apparently law-abiding citizens who came to grief at the hands of abusive [IRS] agents." (Harris) These hearings fostered a view of the IRS that preceded a decline in IRS enforcement activities. Exhibit 1 illustrates how the number of face-to-face audits conducted by agents tapered off in the late 1990s. In the early 2000s, the number of face-to-face audits remained low, while the number of audits conducted through correspondence increased.[6] Exhibit 2 shows the sharp decline of three types of IRS enforcement activities after 1997, corresponding with reduced funding of enforcement efforts.[7]

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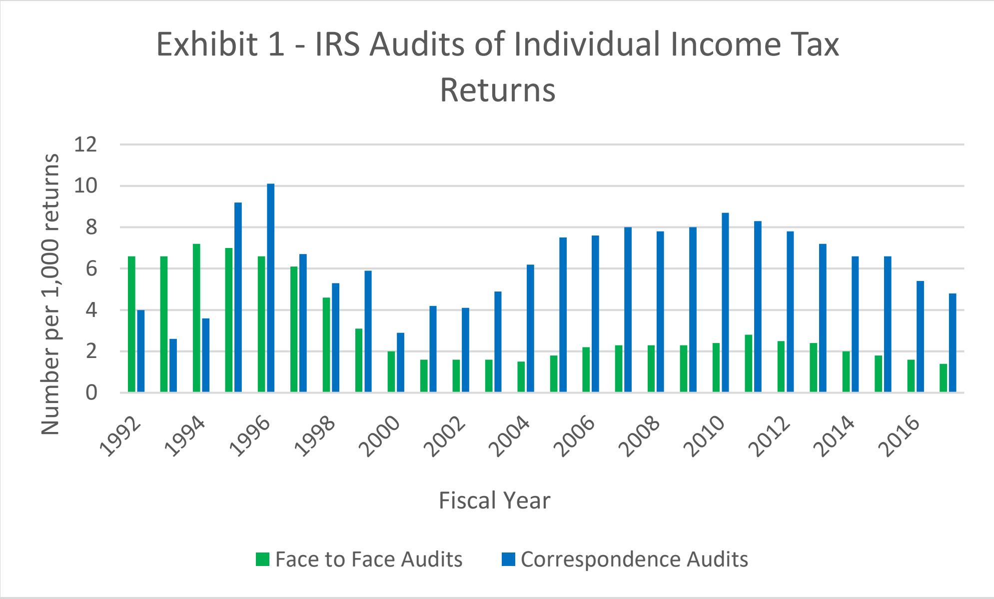
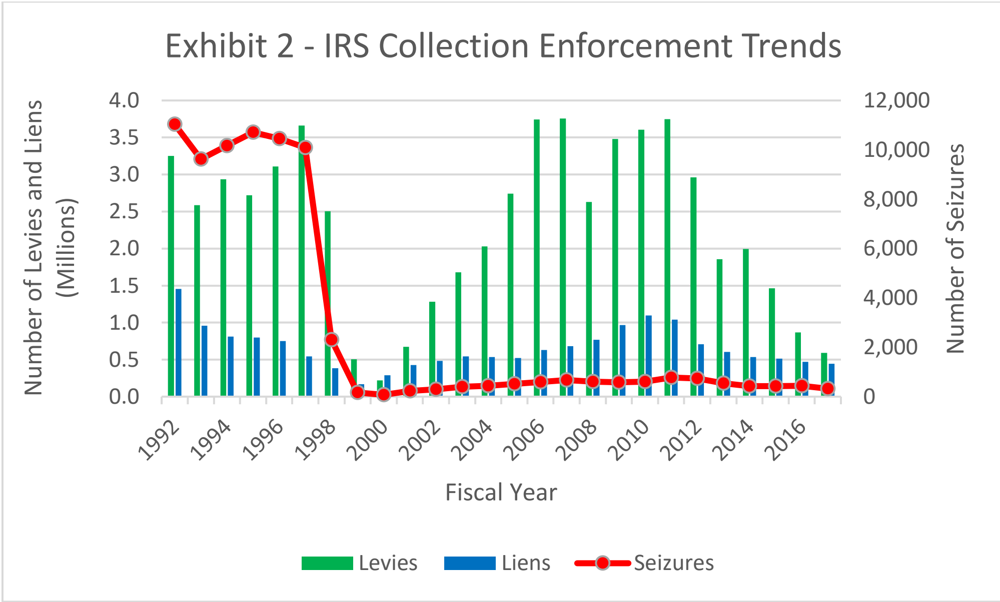
[5] In a 2006 report for Congress, the Congressional Research Service noted that "under IRC Section 6301, only officers, employees and agencies of the Treasury Department may collect 'taxes imposed by the internal revenue laws.' This limitation on the exercise of tax collection authority was included in the Debt Collection Improvement Act of 1996." (Congressional Research Service)

[6] Based on data from Transactional Records Access Clearinghouse (TRAC), Syracuse University, http://trac.syr.edu/tracirs/.

[7] Based on analysis of U.S. Office of Management and Budget (OMB) budget authority data, http://www.whitehouse.gov/omb/budget/Supplemental.





IRS Requests Funding for PCFs in 2004 and 2005 to Increase Collections Efforts

With the budget requests for fiscal years 2004 and 2005, the Bush Administration requested authority for the IRS to use private collectors. The request was presented as an alternative to what appeared to be the politically infeasible increase of IRS staff to perform the same collection functions. At least partly because of the budget request, the Ways and Means subcommittee on Oversight held hearings on use of private debt collectors to collect tax debt. (United States. Congressional Subcommittee on Oversight of the Committee on Ways and Means, U.S. House of Representatives) Considering the testimony presented at the hearings in support or against the use of PCFs is a way to understand the national debate.

To comply with federal law requiring that governmental discretion not be turned over to the private sector,[8] the proposal was for a limited use of private collectors for "those cases likely to be the simplest to collect." The cases were either self-reported or where the taxpayer had made at least three payments but had not paid their debt fully. The IRS would not, "refer cases for which there is any indication that enforcement action may be necessary…" PCFs were to be assigned cases that did not require discretion, and were believed to be resolvable with one or two phone calls.[9]

Taxpayer protections were built into the proposed process by subjecting the PCFs to the same rules of privacy and collection actions as the IRS, and allowing taxpayers to sue PCFs for civil damages. The liability of the federal government was explicitly limited.

Use of PCFs to collect tax debt was supported primarily by collection industry representatives. Most of the supporters' comments were assurances that controls would be in place, taxpayer privacy would be safeguarded, federal laws regarding collections practices would be followed, and PCF agents would not be able to threaten taxpayers to obtain payment. In addition, the use of PCFs by the US Department of Education and Treasury Finance and Management Service were pointed to as successful use of PCFs to collect government debt. It was also noted that over forty states were using PCFs at the time. Other significant points included:

- Federal tax debt was about $249 billion in 2003, and collecting it is important to fairness and may increase voluntary compliance.
- Collection agencies use "best practices" and state of the art technology, and because they compete in the private sector, they are as efficient as anyone is.
- Use of PCFs would allow the IRS to restructure and pursue the most value-added cases.
- PCF agents would have more legal restrictions on their actions than IRS employees do.

Opposition to the use of PCFs was voiced by consumer advocates and the National Treasury Employees Union. The most significant criticisms were:

- The perceived cost of using PCFs was greater than the perceived cost of using IRS employees to collect the same amount of revenue.
- Incentives for private collectors are strictly monetary, which may lead the PCF agents to act in their own interest despite being able to offer a better result to the taxpayer. For example, if current payment in full is compensated higher than payment plans PCFs may aggressively pursue current payment to the detriment of taxpayers.
- Opponents indicated that PCFs have a long, documented history of "abuses," including some examples in the collection of student loan debt used as an example of success by proponents.
- Debt owed to the government is substantially more complicated than business debt, and collecting it is best done by government employees who understand the complexities better than PCF agents do.

[8] The Debt Collection Improvement ACT of 1996 permits federal agencies' use of private collectors, with the express exception of the IRS. The Federal Activities Inventory Reform ACT of 1998 bars the use of private sector firms in conducting work that is "inherently governmental," which includes making value judgments relating to financial transactions or exercising governmental authority. (Congressional Research Service)

[9] From testimony of former IRS Commissioner Mark Everson.

- Profit as the sole incentive changes the collection strategy and may ignore "high-flying tax cheats" and pursue lower-income people who are easier to collect from.

PCFs Authorized in 2004, Used by IRS 2006-2009

Use of PCFs was authorized in 2004, and their use by the IRS began in 2006 and ended in 2009. Congress had been reluctant to grant the IRS authority to use private collectors. The Internal Revenue Code expressly forbade private collection of tax debt, and laws passed in 1996 and 1998 each barred the IRS from using private collectors as well (Congressional Research Service).

In the 2003 hearing, the National Taxpayer Advocate was skeptical of using PCFs, but noted, "There is no question that the IRS must augment its current efforts to collect outstanding tax debts." Her expressed preference was to expand the IRS collection staff, but that option not being available, she concluded that the use of PCFs was a reasonable alternative. She noted that significant controls had to be in place to regulate PCF agent behavior, and that compensation must be based on balanced measures. After the IRS program was implemented and PCFs were being used, her opinion changed.

In 2007, the National Taxpayer Advocate testified that despite her personal efforts and significant efforts of her staff her concerns expressed in 2003 had grown to the point where she called for repeal of the program in her 2006 annual report.(United States. Congressional Committee on Ways and Means, U.S. House of Representatives) She notes that the private sector profit motive is not the correct approach to collecting tax debt, which requires a significant amount of discretion.

> *I believe that the right approach to any collection case must address dual goals: first, to ensure that the taxpayer is able to comply with the tax laws, so as not to exacerbate the noncompliance; and second, to collect the tax after taking into account the taxpayer's particular facts and circumstances. In my view, [PCFs] fail at both of these goals. On the first count, the fiduciary duty of a private company is to maximize profits for its shareholders, which can only be achieved here by collecting the most past-due dollars at the least expense to the company. As the [private debt collection] initiative is structured, the objective of maximizing current and future compliance does not fit into the business model; [PCFs] are compensated solely on the basis of collecting past debts. On the second issue, [PCFs] do not have the ability or the authority to consider the taxpayer's individual circumstances.*

Illustrating her point, she noted that IRS employees may work with taxpayers to increase their withholding, avoiding future past-due tax debt, where PCF agents have no incentive to increase overall compliance or assist taxpayers avoid future debt.

She went on to note that the $71 million in startup and program costs could have been used to increase internal IRS collections, resulting in $1.4 billion in collections, versus the $19.5 million resulting from the program to date. She details many criticisms based on close observation of development and implementation of the use of PCFs.

IRS Study of PCF Cost Effectiveness (Challenged)

The IRS was required to report to Congress on the cost effectiveness of assigning debt to PCFs, and also was advised by GAO to study the topic. IRS designed and implemented a significant study that spanned liabilities assigned over a year. The study was designed narrowly to estimate collection efficiency and costs associated with the IRS collecting debt. The study was divided into two parts. The first examined

the cost effectiveness of additional IRS agents hired to work debt that the IRS identified would be the "next-best" cases to be worked if the IRS had additional resources. The second part of the study assigned some debt to IRS agents that would normally be assigned to a PCF in order to "provide a snapshot view of the relative cost effectiveness of [the IRS] and the [PCFs] on inventory with similar characteristics. " (IRS)

The study concluded that the costs per dollar collected were higher for PCFs than for internal IRS collections. This finding was valid only for the debt designated to be sent to PCFs, which was the relatively easily collected debt believed to be collectable with a couple of successful phone calls and to be not subject to protest.

PCF costs were found to be $.24 per dollar collected, and internal costs were estimated as $.07 per dollar collected. However, the result is not necessarily generalizable to other types of debt, and may have been biased by a number of characteristics of the debt, or by the study design. Note, for instance, that the goal of the PCF program was for PCFs to call taxpayers to obtain payment. However, at least in the early stages, the IRS did not share taxpayer phone numbers with PCFs by policy. Instead, the IRS expected PCFs to find the phone number from external sources.

Citing the results of the cost effectiveness study, IRS cancelled the PCF program in 2009.

The GAO was highly critical of the IRS study, noting specifically that the study design did not support the decision to end the program. GAO believed the results of the study could not be generalized to the entire PCF program because of sample design. GAO called out that study design must match the policy decisions intended to be supported by the study, requiring a very clear question and study objective prior to study design. Note also, that another potential weakness (or point of controversy) in the study is that internal cost estimates are subject to error also because many assumptions must be made to allocate the costs of expenses shared between different functions of the IRS.

PCFs Mandated by Congress in 2015, IRS Starts Using PCFs Again in April 2017

In 2015, Congress enacted legislation requiring the IRS to enter into contracts with PCFs for the collection of inactive tax receivables.[10] The first tax debts were assigned to PCFs in April 2017.

Recently, National Taxpayer Advocate (NTA) has noted that costs associated with administering the PCF program were higher than collections from the program.[11] In 2017, the IRS spent $20 million on start-up and administrative costs for the PCF program. The same year, PCFs collected a total of $6.7 million.

In the report the Taxpayer Advocate noted both the IRS and PCFs receive up to 25% of the amount collected. PCFs receive a commission of up to 25% on amounts collected. The IRS can retain up to 25% to fund the Special Compliance Personnel Program Account. However, the amount credited as paid by any taxpayer shall be determined without regard to the amounts credited to the IRS and PCFs.[12] For example, if a taxpayer pays $100 and the IRS retains 25% of the payment and the PCF responsible for the collection receives a commission of 25%, the taxpayer would still be credited $100, not $50. The

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[10] The Fixing America's Surface Transportation Act (FAST Act) passed in 2015 and added subsections (e) and (h) to IRC § 6306.

[11] National Taxpayer Advocate 2017 Annual Report to Congress, Volume 1, Most Serious Problems, *Private Debt Collection*.

[12] See IRC § 6306(e).

Special Compliance Personnel Program Account appears to be a novel way to fund additional IRS employees to pursue past due tax receivables with money collected by PCFs.

Oregon DOR's Experience with PCFs

Most accounts that are sent by the Oregon Department of Revenue (DOR) to PCFs are sent because of statutory mandate from legislation passed in 1999 which defined the timeline for all state agencies to incorporate the utilization of PCFs and DOR's Other Agency Accounts (OAA) unit into the collections process. Prior to this legislation, PCFs were used on a discretionary basis by DOR, typically for accounts for which the debtor's location was unknown, or if the debtor was known to reside outside of Oregon, and only if DOR agents had exhausted available collections efforts. Although DOR has historically used PCFs above and beyond statutory requirements, the use of PCFs tends to be more responsive to statutory requirements as well as to recommendations from audits conducted by the Secretary of State.

Utilization of PCFs for Oregon's Centralized State Collections Efforts a Statutory Requirement since 1999

A 1979 Opinion of Oregon's Attorney General concluded "that a state agency may contract with a collection agency," but cautioned that "the process is not as simple as the mere assignment of accounts for collection," noting some of the special considerations in the contracting process and in who would control any litigation related to debt worked by a PCF. (State of Oregon, Attorney General)

Additionally, in a footnote to the Opinion, the AG noted several arguments against the employment of collection agencies by the state, though "these arguments do not relate to the legality of employing a collection agency," but are "directed to administrators and are among the matters which they should take into account when considering arguments both for and against the use of collection agencies." These arguments included (paraphrased):

- DOR's ability to offset tax refunds
- DOR would frequently have had a more current address for the debtor
- Collection agencies' charges to state agencies were higher than OAA charges
- When collections are done by state agencies, the Attorney General is available to handle collections matters if "necessary or advisable"
- Student loans have complicating factors

These arguments were important for agency administrators to consider when they were presented more than thirty years ago, but they are not necessarily a comprehensive or relevant list of considerations for DOR regarding the assignment of tax debt to PCFs in the current time. However, we assume that the legality of authority to assign accounts to PCFs, as concluded in the 1979 Opinion, does hold.

The utilization of PCFs by Oregon's state agencies was discretionary until 1999, when Oregon's legislature enacted statutory requirements regarding the role of PCFs in collecting state government debt. These requirements were part of HB 3509 (1999), legislation that required state agencies to prepare an annual report for the Legislative Fiscal Office containing information about liquidated and delinquent accounts of state agencies, and which defined the timeline for agencies to incorporate the utilization of PCFs and DOR's Other Agency Accounts (OAA) unit into the collections process. The legislation came after a 1997 review by Oregon's Secretary of State (SOS) of the effectiveness of collections efforts of five state agencies. The results of the review identified opportunities to improve the collections functions in Oregon state government.

Oregon's interest in studying the topic of government debt collection mirrored interest at the national level. Congress passed the federal Debt Collection Improvement Act of 1996 to address the issue of "a steady increase in the amount of delinquent non-tax debt owed to the United States, and concern that appropriate actions were not being taken to collect this delinquent debt." The Act centralized the collection efforts of the U.S. government, initiated the Treasury Offset Program (TOP) [13] and granted authority to all federal agencies to garnish wages. Even before this 1996 legislation, private collection firms had a role in national collections efforts regarding non-tax debt. There was a "government-wide contract available to federal agencies to refer delinquent debts to private collection agencies." (U.S. Department of the Treasury, Office of Legislative and Public Affairs) The 1996 federal legislation applied only to non-tax debt, while legislation in Oregon did not delineate a clear distinction between tax and non-tax debt.

1997 Secretary of State Review of State Collections Functions Precursor to 1999 Legislation

Like the national government debt, the level of delinquent debt owed to the State of Oregon in the 1990s was steadily rising. There were concerns that not enough was being done and further, that more debt was eventually being classified as uncollectable than was warranted.[14] The 1997 SOS report, "Opportunities to Improve Delinquent Debt Collection by State Agencies," offered two recommendations "to improve the efficiency and effectiveness of the state's collection function." (Oregon Secretary of State, Audits Division) The utilization of PCFs is a material part of the first recommendation that the state form an interagency collection committee to coordinate the collections efforts of state agencies, and to share best practices. SOS specifically recommended that this committee:

- Establish a statewide vendor payment offset program
- Use a statewide master contract to hire private collection firms
- Conduct pilot tests on different ways of assigning accounts to private collection firms, and
- Seek legislative authority for agencies to access information maintained by other state agencies.

In addition to coordinated efforts between agencies, SOS recommended steps toward increased efficiency as appropriate to certain state agencies:

- Request legislative authority to perform administrative garnishments
- Obtain on-line terminal access to Driver and Motor Vehicle Services data
- Improve automation, and
- Use autodialing systems.

One of the key points made in the SOS report is found repeatedly in literature on the subject of collections, that the "key element in the collection process is speed." (Oregon Secretary of State, Audits Division) From the 1997 report:

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[13] The original Treasury Offset Program differed from the federal tax refund offset program currently known as TOP; in 1999, the tax refund offset program was merged into TOP, which initially offset non-tax debt with non-tax payments.

[14] The LRO Staff Measure Summary for HB 3059 (1999) notes, "proponents of this bill assert that substantial sums of money are owed to the state, little effort has been made to collect it, and that agencies classify more debt than is warranted as 'inactive,' or uncollectable."

> *Regardless of whether collections are made by government, private collections services, or other entities, the key element in the collection process is speed. Organizations that start work on debt accounts faster will collect more than organizations that are slower. Debts become harder to collect the older they get because as time passes, debtors disappear, spend their assets, and begin to doubt the seriousness of collection efforts.*

In response to the report, DOR agreed with all of SOS's recommendations, noting which would be under the purview of either DAS or a statewide committee to implement, and responding directly to the recommendations for which DOR would be responsible. DOR committed to propose legislation in the 1999 session to obtain access to the new hire database at the Department of Justice. DOR also committed to evaluate the potential for auto dialing systems. Although DOR agreed with the recommendations for its OAA unit to report weekly rather than monthly to other agencies, and to use DOR's automated case-handling software for accounts, the agency explained why system constraints prohibited these and that they were a lower priority than other agency system requirements. (Oregon Secretary of State, Audits Division)

Oregon State Agencies Implement Recommendations from 1997 SOS Report

Similar to the national government prior to the 1996 Act, SOS's 1997 report discussed how collections efforts by state government in Oregon were decentralized (Oregon Secretary of State, Audits Division). Although not required by legislation, Oregon formed an interagency committee, as recommended by SOS. The Accounts Receivable Core Committee was established in 1999 and was facilitated by Oregon's Department of Administrative Services. The facilitator's position was formalized as Statewide Accounts Receivable Management (SWARM). However, due to budget cuts, the position lost funding, and the interagency committee last met in 2010.

While in existence, the committee implemented a statewide contracting process for hiring private collection firms, a process which continues and likely results in a lower commission rate paid to PCFs than if agencies contracted separately with the firms. While in existence, the committee facilitated joint reporting projects between agencies, including work on the Oregon Accounting Manual, as well as serving as a venue for the sharing of successes and challenges in collections efforts and in partnering with PCFs. Renewed interest in statewide collection centralization resulted in SWARM being reconstituted by legislation in 2015.

In the 1997 report, SOS noted that "one of the most promising techniques" of utilizing technology to improve interagency coordination, used by other states, is "a statewide vendor payment offset program that detects a payment a state agency is to pay to a vendor that owes money to another state agency, intercepts the payment, and offsets it against the debt owed the second agency." (Oregon Secretary of State, Audits Division) An early draft of HB 3509 (1999) included a provision for this program, but it was not included in the final bill. DOR has since started performing statewide vendor payment offsets.

1999 Legislation Focuses on Legislative Fiscal Office Oversight and Prevention of Unnecessary Write-offs

HB 3509 (1999), enacted after the SOS report, did not implement the SOS recommendations, but rather focused on two new requirements. The first was a provision requiring state agencies to submit an annual report to the Legislative Fiscal Office providing information about liquidated and delinquent accounts. The second provision defined a timeline for agencies to incorporate the utilization of PCFs and DOR's OAA unit into the collections process. It (originally) required all agencies to send accounts to

either a PCF or to OAA if no payment had been received within one year. If the account was sent to OAA, and OAA did not collect within one year, the account would then be sent to a PCF for a "reasonable" period of time to attempt to collect on accounts before returning them to the originating state agency.[15]

Based on testimony from legislative committee hearings for the bill, these provisions were enacted to obtain better information about the accounts receivables of state agencies and to address the concern that potentially collectable liabilities may have been being written off inappropriately; rather than let relatively inactive accounts sit and remain stagnant until they are eventually written off, PCFs and/or OAA are given the opportunity to actively attempt to collect the debt.

The legislation did not differentiate between tax and non-tax debt, although in response to testimony during legislative committee hearings, the final bill excluded certain categories of debt. The bill granted authority for DAS to adopt rules for state agencies to follow in order to exempt certain accounts from assignment to a PCF.[16]

Implementation of 1999 Legislation at the Department of Revenue

Prior to HB 3509 (1999), DOR primarily used PCFs when unable to locate a debtor, or when the debtor was believed to reside outside of the state of Oregon. The 1999 legislation required the age of relatively inactive accounts be a factor for bringing PCFs into the collections process.[17]

DOR's Collection Agency Program (CAP) is the unit that manages the relationship between DOR and PCFs. At the time that HB 3509 (1999) was implemented, CAP was a two-person unit performing completely manual tasks. With the 1999 legislation, the workload of the unit dramatically increased. In 2013, the unit had ten employees, including the unit's manager. In 2001, DOR developed the Collection Agency Reporting (CAR) system to add automation to certain processes related to the LFO reporting required by the 1999 legislation and the scheduling of accounts to be sent to private collection agencies.

The unit handles all aspects of managing the tax accounts assigned to PCFs for collection, performing tasks such as: reconciling payment statements; preparing statistical reports, legal documents and PCF commission requests; researching returns and past payment history; answering taxpayer questions; and processing debt cancellations and garnishments. Although the personal income tax program is the primary source of accounts managed by CAP, the unit works with a variety of tax programs.

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[15] Current statute (ORS 293.231) gives OAA six months to collect for all agencies except the Department of Justice, for which OAA has one year to collect (ORS 1.197). However, OAA in effect is allowed to work all agency accounts for a year since, every other year, OAA requests a two-year exemption from DAS to be allowed to work all agency accounts for a year rather than the statutorily allowed six months.

[16] Enrolled House Bill 3509 (1999), Section 4 (2). See also ORS 293.231 (6).

[17] The 1999 legislation brings PCFs into a relatively late phase of the collections process. SOS had suggested that PCFs may be useful in earlier phases of the collections process, for example in "reducing temporary backlogs of un-worked debts, such as low-priority smaller balance accounts." This idea was used by DOR in 2010 for roughly one year for all small balance, delinquent personal income tax accounts. DOR discontinued the policy more due to the agency not being able to keep up with the related administrative support rather than having reduced a backlog of un-worked debts. However, DOR continues to send small balance accounts to PCFs when the taxpayer resides outside of Oregon.

SOS Revisits the Topic of Collections Efforts in 2004, Introduces Some Caution Regarding Utilization of PCFs

In 2004, the Secretary of State conducted an audit "to determine if state agencies could improve their collection of delinquent debt" as well as review progress made related to recommendations from the 1997 review of state collections efforts.

Following up from the 1997 report, SOS included a discussion of the recommendation for DAS to pursue a vendor offset program by which the debt of a vendor doing business with a state is fulfilled by payments that otherwise would be made to the vendor for its services. SOS acknowledged a 2001 letter from DAS describing issues with Oregon pursuing a vendor payment offset program; the primary obstacle was the cost of making the necessary changes to the state's financial system, though DAS was also concerned with reports of seven other states that were experiencing low returns on their investments in vendor offset programs. SOS encouraged DAS to contact three states that had reported successes with programs in their states, and DAS agreed. In addition, DAS indicated that it would pursue additional ideas including piggybacking on the federal tax offset program[18] and proposing legislation "to improve collections when assets are identified." (Oregon Secretary of State, Audits Division)

As with the 1997 SOS audit, the role of PCFs was a material part of SOS recommendations in the 2004 audit.

Improving timeliness of collections efforts

One of the primary findings of the 2004 audit was that "insufficient staffing and large caseloads were preventing timely follow up on delinquent accounts." (Oregon Secretary of State, Audits Division) SOS recommended that agencies with collections units, and particularly DOR's OAA unit, make efforts to increase staffing and reduce caseload, as well as work to identify the most collectible types of accounts. SOS also found that telephone contact was a key determinant of collections. Although telephone contact with debtors is a major and established part of DOR's collections process, insufficient staffing and large caseloads reduced the ability of DOR's collections staff to reach debtors by phone in a timely way.

DOR responded with information about a Policy Option Package that the agency had prepared to add collections staff to the OAA unit. (Oregon Secretary of State, Audits Division) [19]

In a "response for all agencies," DAS indicated that they were in the early stages of initiating a contract with a skiptracing company to assist agencies in locating debtors.[20] Speaking for DOR, DAS also indicated that DOR's OAA unit may pursue automation of data transfers and reports between OAA and other state agencies to increase collections through more efficient processes.

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[18] In 2011, Oregon's legislature passed HB 2550, which expanded the reciprocal agreement regarding tax refunds between DOR and U.S. Financial Management Services (i.e. IRS) to include other federal payments in the Treasury Offset Program. DOR has implemented this provision.

[19] The Policy Option Package was passed by the legislature, and became part of DOR's budget appropriation. DOR hired over 30 new agents for the OAA unit.

[20] A statewide contract with FirstData Corp for skiptracing was completed in 2009.

Cost and risk considerations in partnering with PCFs

Another finding in the report suggests that some accounts may not be cost-effective to send to PCFs. SOS recommended that agencies with collections units review the cost effectiveness of assigning debt after it has been worked by an internal collection unit since audit results indicated that there may be accounts where "private agency collection returns may be less than the state's costs to monitor the accounts." (Oregon Secretary of State, Audits Division) SOS also found a need for stronger oversight of PCFs by the State to ensure that PCFs were providing accurate and complete information regarding account balances and collections activities. These findings introduced some caution about the public-private partnership between state agencies and PCFs.

DAS responded to the finding about oversight of PCFs by describing the existing process at the time, based on Oregon Accounting Manual (OAM) standards and the statewide collection contract, and indicating development of an evaluation form for state agencies to annually evaluate the performance of PCFs with whom they are contracted. Results of the evaluation would be considered when deciding whether or not to renew a PCFs contract with the State. DOR has a well-established process of evaluating the performance and reporting of PCFs. Every August, DOR's CAP unit conducts an annual review of the PCFs that are contracted by DOR in order to assess compliance with contract and disclosure requirements, the completeness of their training, and other topics.

In response to SOS's 2004 report, DAS also indicated that "agencies may develop and submit a cost benefit analysis for certain types of accounts for consideration as an exemption from assignment." DAS noted a proposal to make cost to collect a "Statewide A/R Performance Measure," suggesting that a return on investment approach to account management may help agencies evaluate accounts which may not be cost effective to assign to PCFs. DAS suggested that it may also help to have PCFs return accounts which they consider to be uncollectible to agencies sooner and that they were proposing legislation to this effect. (Oregon Secretary of State, Audits Division) [21]

Utilization of PCFs a Topic in a 2010 SOS Audit of DOR

In August 2010, SOS published a report of an audit performed at DOR's request. The audit focused on two areas: filing enforcement efforts and collection practices. The utilization of PCFs figured prominently in SOS's audit recommendations related to increasing the effectiveness and efficiency of collections.

Importance of timely contact with debtors, preferably by telephone

The report again emphasized the importance of timeliness for successful collections efforts, noting that liabilities being sent to PCFs may not have had a payment for a year. SOS suggested that DOR consider sending newer debt to PCFs, possibly with a lower commission rate, and perhaps as a short-term and/or dynamic strategy.

The 2010 report echoed the 2004 report in emphasizing the importance of telephone contact, noting that "the PCFs we surveyed told us actively pursuing an account through personal contact, rather than just mail correspondence, increases the likelihood of collection." (Oregon Secretary of State, Audits Division) Similar to the 2004 review which found that insufficient staffing and large caseloads prevented

[21] DOR has never required PCFs to return accounts considered to be uncollectible before the statutory deadline, though PCFs may return debt at any time.

timely contact with debtors, SOS found that “DOR’s collections process does not ensure agents actively work new accounts and establish phone contact with the taxpayer in a timely manner."

As one way to facilitate timely contact of debtors by DOR’s revenue agents, SOS recommended that DOR develop “skiptracing alternatives,” since having contact information for debtors is essential for timely communication.

Skiptracing capabilities are typically considered a comparative advantage of PCFs. Although DOR does use the skiptracing vendor contracted at the statewide level, as well as other tools for locating debtors, it is the method of utilization which distinguishes the efforts of PCFs versus DOR. Whereas revenue agents at DOR manually research each individual debtor one at a time, PCFs utilize databases more fully to perform skiptracing efforts in conjunction with the process of prioritizing the accounts.

Utilizing technology in management of accounts

SOS noted the cumbersome account management of accounts once they are assigned to a PCF and recommended further automation of processes. However, SOS did note that one of DOR’s automated processes actually decreases the efficiency of collections efforts. DOR’s system automatically selects taxpayer accounts for assignment to a PCF once a year has passed with no payment activity, often referred to as a ‘clock.’ One taxpayer account may be made up of multiple liabilities, and with each additional new liability assessed the clock on the taxpayer’s account is automatically reset. This causes inefficiencies in opposing ways. In one way, it may cause another full year to pass before potentially being assigned to a PCF. At the same time, the resetting of the clock may initiate redundant DOR revenue agent actions on an account when the probability of successful collection efforts may not have changed. The result is that DOR may repeat actions with a low probability of collection, and a PCF does not have the chance to work the relatively uncollectible debt until the account is much older, and even less collectible.

SOS recommended that DOR use enhanced information technology to measure the results of collections efforts and to identify characteristics of accounts for use in prioritizing and managing the collections process. SOS offered the example of tracking the average time between when the liability is established and first contact with debtor by phone as information that would be useful for account management. Current account balance and garnishment information are also useful for effective account management both in house and in managing accounts assigned to a PCF.

Another recommendation related to account management is determining the costs of each collection activity and identifying what collection activities generate the most revenue. SOS recommended developing “information about debt characteristics, taxpayer filing history and change in filing characteristics, collection efforts, or results of collection approaches.” (Oregon Secretary of State, Audits Division) SOS suggests identifying characteristics of the most collectable debt, which implies the goal of maximizing revenue. This implication is important to consider because compliance efforts at DOR have multiple goals, and efforts at maximizing revenue in the short term could negatively impact efforts to protect long term compliance.[22]

[22] For a more detailed discussion, see “Enforcement Revenue Identification and Modeling,” Oregon DOR, Research Section, January 2012. A good description is in the Executive Summary on p.3.

In DOR's response to the report, the agency noted that an Automated Call Distributor (ACD) system was implemented in March 2010. In addition, the agency was analyzing and streamlining collections processes, including a review of the utilization of PCFs.

Garnishment authority

SOS noted that "DOR has retained control of processing garnishments for accounts worked by PCFs," adding that "PCFs are able to handle garnishments from beginning to end, and it may be more efficient to delegate that responsibility to them…" (Oregon Secretary of State, Audits Division) It is important to note the difference between a writ of garnishment and a notice of garnishment. A writ of garnishment is a court action, whereas state agencies with warrant authority may issue a notice of garnishment under O.R.S. 18.854. DOR may delegate authority to a PCF to seek the court action of a writ of garnishment for debt being collected on DOR's behalf, but there is ambiguity as to whether DOR may delegate authority for a PCF to directly issue notices of garnishment.

A writ of garnishment is a court action that anyone may seek, and the court determines if the garnishment is justified. DOR does not need to grant authority for PCFs to seek a writ of garnishment in the general sense, but the authority is needed to do so for debt being collected on DOR's behalf under the statewide contract.

Any garnishment, writ or notice, garnishes any asset held by a third party. If that asset is wages, a writ of garnishment garnishes the wages for 90 days. If the debt is not paid in full after 90 days, a new writ of garnishment must be obtained. In contrast, a notice of garnishment garnishes wages until the debt is paid in full or until the garnishment is released. A writ of garnishment that garnishes wages is subject to a minimum wage exemption whereas a notice of garnishment for tax debt is not subject to a minimum wage exemption.[23] If there are multiple garnishments on a debtor, the garnishments are implemented one at a time, in the order that they were issued.

Although DOR may delegate authority to PCFs to seek writs of garnishment on DOR's behalf, the benefit of doing so is not evident. It is DOR's current policy to retain authority for issuing all garnishments.

Evolving DOR Collection Agency Program (CAP) Unit

At the time of the SOS audit that was reported on in 2010, DOR's CAP program had undergone process improvements including utilization of electronic file transfers, Excel software and contracting through the DAS statewide contract instead of directly with PCFs. In addition, the unit was coming out of a period of insufficient staffing and high turnover. The unit began to initiate more refined process improvements including sending accounts to PCFs on a weekly rather than monthly basis, automating letters, utilizing document imaging processes, and establishing internal performance metrics.

As shown in Exhibit 3, the number of accounts assigned by DOR to PCFs has nearly doubled between 2009 and 2018. For 2009, DOR reported 31,565 delinquent accounts being worked by PCFs, representing $110 million in delinquent tax (includes penalty and interest). For 2018, DOR reported 62,620 delinquent accounts being worked by PCFs, representing $308 million.

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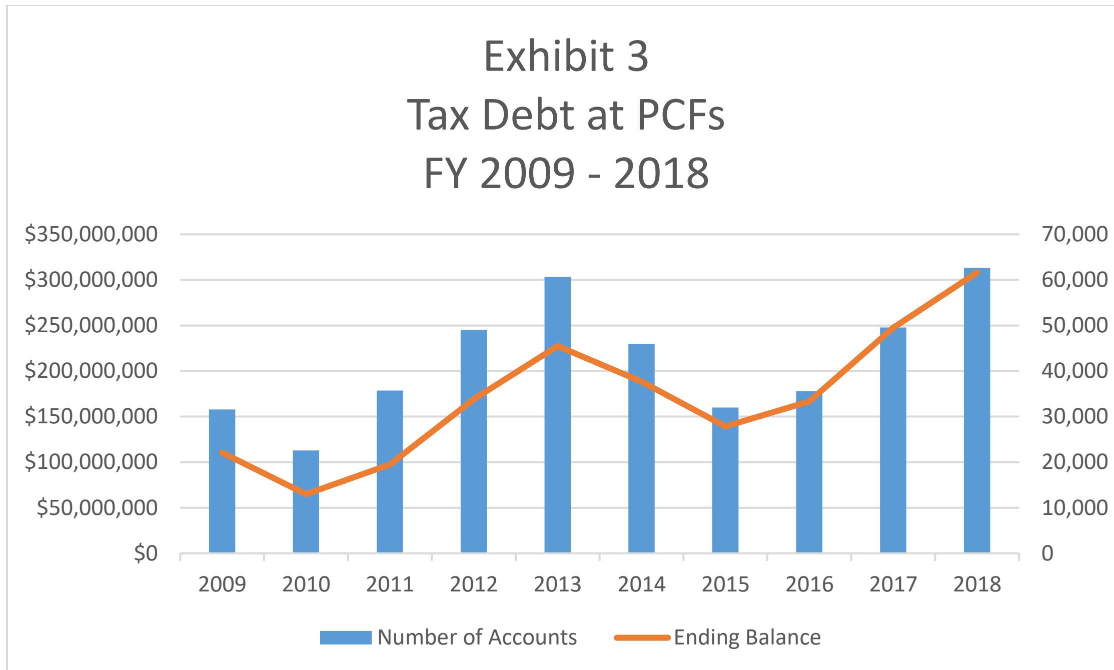
[23] For all garnishments, including writs and notices, 25% of disposable earnings are exempt from garnishment. The minimum wage exemption is an additional exemption for writs of garnishment, as well as for notices of garnishment issued on debts other than state tax debt.



The number of PCFs that CAP has worked with at any point in time has ranged from two to nine. The staff found that more is not better, and by 2010 had determined that contracting with three PCFs at one time seems to be optimal both in terms of account management by CAP and to provide an adequate number of accounts to each firm.[24]

A policy decision driven by the CAP unit was to extend the time period for a PCF to work an account before being returned to DOR. Until that time, accounts had generally been assigned to a PCF for one year before being returned to DOR; CAP extended the time period to two years and later extended the period again to three years. Anecdotal evidence suggests that may take around 36 months for taxpayers who experience financial difficulties to recover. The three-year time period gives PCFs ample opportunity to implement collection techniques. It also reduces the workload of the CAP unit in moving the accounts back to DOR and between PCFs.

Another policy decision implemented by CAP was for DOR to assign certain small balance accounts to PCFs as soon as possible instead of waiting for the one year clock. The assignment of small balance accounts to PCFs early in the collections process was suggested in the 1997 SOS report as a way to help reduce a temporary backlog of liabilities. DOR implemented this policy in 2010 for all delinquent personal income tax (PIT) accounts with a balance below $100. The policy was discontinued within a year – more due to the agency not being able to keep up with the related administrative support than having reduced a backlog of un-worked debts. However, DOR continues to send small balance accounts to PCFs when the taxpayer resides outside of Oregon.

The strategy of assigning the small balance accounts to PCFs was to leverage their autodial capability to efficiently reach a large number of debtors. With a small balance, debtors are more likely to make payments in full in relatively simple payment transactions. Not actively working these accounts, DOR revenue agents are enabled to focus on the larger balance accounts for which DOR agents have a

[24] PCFs have agents dedicated to the collection of debt assigned by state agencies.

comparative advantage, since debtors with relatively larger balances are more likely to require communication with an agent who has account and program knowledge, and the debtors are more likely to need to make payment arrangements and possibly request penalty waivers or settlements.

In 2009, DOR gained authority to pass collections fees to debtors for debts sent to PCFs and implemented the policy on October 1, 2011. Also in 2009, DOR gained statutory authority to report tax debt and debtor information to credit bureaus. Implementation of this provision is not feasible, however, because credit bureaus do not report tax debt reported by tax administration agencies. One reason is that the nature of tax debt differs from the revolving credit included on credit reports. Additionally, credit bureaus report both positive and negative credit information, whereas DOR would only be providing negative tax debt information. Another reason is to maintain consistency of credit reporting among states – credit bureaus would not accept state tax debt unless the policy to report was uniform among all states. For these and other reasons, credit bureaus will not accept tax debt information. Tax debt will only show up on a credit report indirectly if DOR issues a docketed lien on property, which will show up on the credit bureau report as a judgment.

Use of PCFs by DOR Other Agency Accounts

With passage of SB 1067 in 2017, OAA was mandated to begin using PCFs starting July 1, 2018. Prior to this date OAA did not use PCFs to collect on accounts sent from other agencies. OAA will start assigning accounts to PCFs between one and six months after receiving the debt. The debt is prioritized using a scoring model which also determines which collectors at the department work the debts. Accounts will be assigned to two PCFs if collection by the first is unsuccessful. Each PCF has one year to collect on the debt before the department pulls the debt back and sends it to the second PCF.

The department is in the process of refining its scoring model to include new data that SB 1067 made available to OAA. Most notably this data includes State of Oregon income tax returns and information from what is called Financial Institution Data Match, or FIDM, which allows the department to obtain information from financial institutions regarding account balances that debtors have. OAA has also been provided access to the New Hire Report produced by the Oregon Employment Department. These new data sources should allow for additional refinement of how the department defines and uses its scoring model to distribute accounts to collectors.

Comparing Collections Tools of DOR and PCFs

There are some ways that DOR and PCFs are relatively comparable. Both are able to negotiate payment arrangements with a taxpayer.[25] Both may generate automated letters to debtors, although the content and frequency of the correspondence differs. We assume a roughly comparable level of skill of collecting in both DOR and PCF agents, after taking all factors into account. However, DOR and PCFs have a different set of collections tools which contribute to specific comparative advantages of each entity.

In a number of ways, in-house DOR collections units have a comparative advantage:

- Access to confidential and proprietary taxpayer information such as wage, tax return and financial transaction data, as well as access to databases of the Employment Department

[25] However, DOR has a stronger incentive to offer payment arrangements as an option for taxpayers since the agency's compliance goals incorporate long term revenue protection as well as short term revenue gain. In contrast, a PCF's incentive is heavily weighted toward short term revenue gain.

- Authority to easily and quickly issue notices of garnishment[26]
- Authority to make decisions regarding cancellation or writing off of debt, negotiate debt settlements and approve or deny penalty waiver requests
- Ability to answer detailed questions about Oregon's tax programs
- Authority to place liens on property.

In other ways, private collection firms have a comparative advantage:

- Private collection fees are added to a taxpayer's debt, reducing the state's cost of collection
- Auto-dial outgoing phone call technology
- If workload reaches a certain level, will hire additional agents (per contract with DAS)
- Advanced skiptracing capability.

[26] PCFs may request that DOR issue notices of garnishments for accounts being worked at the PCF, and with certain conditions, a PCF may issue writs of garnishment, but only DOR has authority to issue the notices of garnishment.

DOR's CAP Conducts Comparisons of the Collections Efforts of DOR and PCFs

In 2010, CAP conducted two comparisons of the collections efforts of DOR and PCFs. In both efforts, similar to the IRS experience, there were difficulties in obtaining meaningful results, and the reports were challenged.

The intention of the first comparison was to assign roughly the same number and type of accounts to two PCFs to work for several months and then compare the total dollars collected by the PCFs to dollars collected by CAP staff who worked similar sets of accounts over the same period of time. CAP sent 1,000 accounts to one PCF and 1,125 to another. In both cases, the accounts were of various ages and dollar amounts, and both firms knew that their performance was being evaluated.

One of the PCFs charged a flat fee to DOR for all work performed as part of the test and referred most of the debtors to DOR to make payment arrangements; the PCF put DOR's phone number on letters, which overloaded DOR's CAP unit. Also adding to CAP's workload, debtors had customer service issues with this PCF and contacted CAP for resolution. The other PCF charged a collections fee and worked debt in the same way that debt was worked outside of the test.

A second comparison followed in which approximately 250 accounts were sent to each of the three PCFs contracted by DOR at the time, and approximately 250 accounts were monitored in house for comparison, but not assigned to any one DOR agent. The intention was to compare the effectiveness of the PCFs with each other and with DOR over a six month period. The experiment had a relatively small sample size, and results were skewed by an unusually large amount collected for one account, inflating the results for DOR.

In both comparisons, collection costs were not part of the design, and both comparisons were conducted over a relatively short time period (less than a year). In both cases, the reported dollars collected indicated that DOR collected more dollars than PCFs, but the results are not generalizable.

As straightforward as a direct comparison between the collections efforts of DOR and PCFs sounds, there are inherent obstacles to doing so. With any direct comparison, there are numerous ways to measure the outcome. The problem is that by defining the outcome to be measured, the application and interpretation of any study results are limited for activities outside of that definition. In addition, any results would depend heavily on measures of relative costs to collect, which are necessarily based upon subjective assumptions about which costs to include. However, beyond these and other challenges, the appropriate perspective should not be who can perform collection duties for the lowest immediate cost per dollar collected but to determine how DOR can maximize both short term revenue generation and long term compliance by leveraging the use of both internal and external resources.

The meaningful objective is to seek ways to optimize the differences between DOR and PCFs, and to leverage their respective comparative advantages toward achieving strategic goals. With DOR's short and long term goals in mind, and considering the relative strengths of DOR and PCFs collections staff, DOR is ultimately responsible for the most appropriate collections strategies, including the determination of the most appropriate accounts to be assigned to PCFs.

2011 SOS Follow-up to 2010 Audit

In a 2011 follow-up to the 2010 report, SOS acknowledged that DOR "compared its collections results to those of the private collection firms," but added, "we noted factors that made the analysis

inconclusive." SOS recommended that DOR consider "how PCFs could be better utilized to reduce the collections backlog," instructing DOR to include the cost of collection in any analysis. (Oregon Secretary of State, Audits Division)

SOS acknowledged DOR's progress, noting that DOR made a policy change to send debt to PCFs weekly rather than monthly and installed an automated call distributor to streamline incoming phone calls. SOS also noted that DOR implemented "a few semi-automated processes utilizing macros [in Microsoft Excel] to send some information to PCFs," and SOS included the expectation that further automation would be part of the DOR's core systems replacement project. DOR's CAP unit has continued to develop automated processes in Microsoft Excel and Access software in order to process the tasks that may be automated as efficiently as possible. Many processes are still manual.

In the 2011 report, SOS noted DOR's acquisition of two skiptracing tools to improve the department's capability to research the location of debtors, and SOS again recommended that DOR use performance metrics as a management tool and to consider how PCFs may be better used in collections efforts. DOR responded in agreement, noting that the agency had identified "high level outcomes and performance measures for both the collections and non-filer functions."[27]

In Summary: Utilization of PCFs a Facet of DOR Collections Strategies[28]

PCFs have been used by DOR for collections efforts at least in some capacity for years, and utilization has been statutorily required since 2001, so there is an implicit assumption that in Oregon, PCFs are considered appropriate entities to collect tax debt.

The utilization of PCFs in the state since the implementation of HB 3509 (1999) has been primarily driven by statutory requirements. Prior to the 2001 implementation of the 1999 legislation, PCFs were used on a limited basis for out of state debtors or after DOR agents had exhausted their collections efforts. Since 2001, although DOR has used PCFs above and beyond statutory requirements, the agency tends to comply with statutory requirements and to respond to recommendations from audits conducted by the Secretary of State. Still, DOR doesn't necessarily wait until the end of the statutorily defined period before sending an account to a PCF. As permitted by statute, DOR can and does send accounts to PCFs ahead of the one-year clock.

In terms of how DOR views collections strategies, the guiding principle is that speed is the most important factor for successful collections efforts. All collections strategies should contribute to the taxpayers being contacted as soon as possible after their debts become liquidated and delinquent. The idea is to characterize taxpayer accounts in order to select accounts for assignment to a PCF which would result in more delinquent taxpayers overall being contacted more quickly than if a PCF was not used. The method of selecting accounts to be assigned to PCFs – beyond the accounts statutorily required to be sent to PCFs – is important because it reflects DOR's collections strategies toward short and long term agency goals.

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[27] DOR response to the 2011 SOS follow-up to their 2010 audit.

[28] When referring to DOR collections strategies in this paper, we are actually describing the agency's strategy regarding the collection of personal income tax (PIT). Although DOR's CAP unit manages accounts assigned to PCFs which originate from many tax programs, the predominant program is PIT.

How taxpayer accounts are characterized

Historically, DOR has explored the use of PCFs as a tool for collecting state tax debt. DOR is exploring potential analysis-driven strategies for partnering with PCFs. Working debt more efficiently – both within the agency and in partnership with PCFs – allows the relatively more collectible debt to be worked more quickly. The idea is to use automated processes to achieve greater efficiency through segmenting debt into groups with certain characteristics and then prioritizing the way these groups of debt are worked both within DOR and at PCFs.

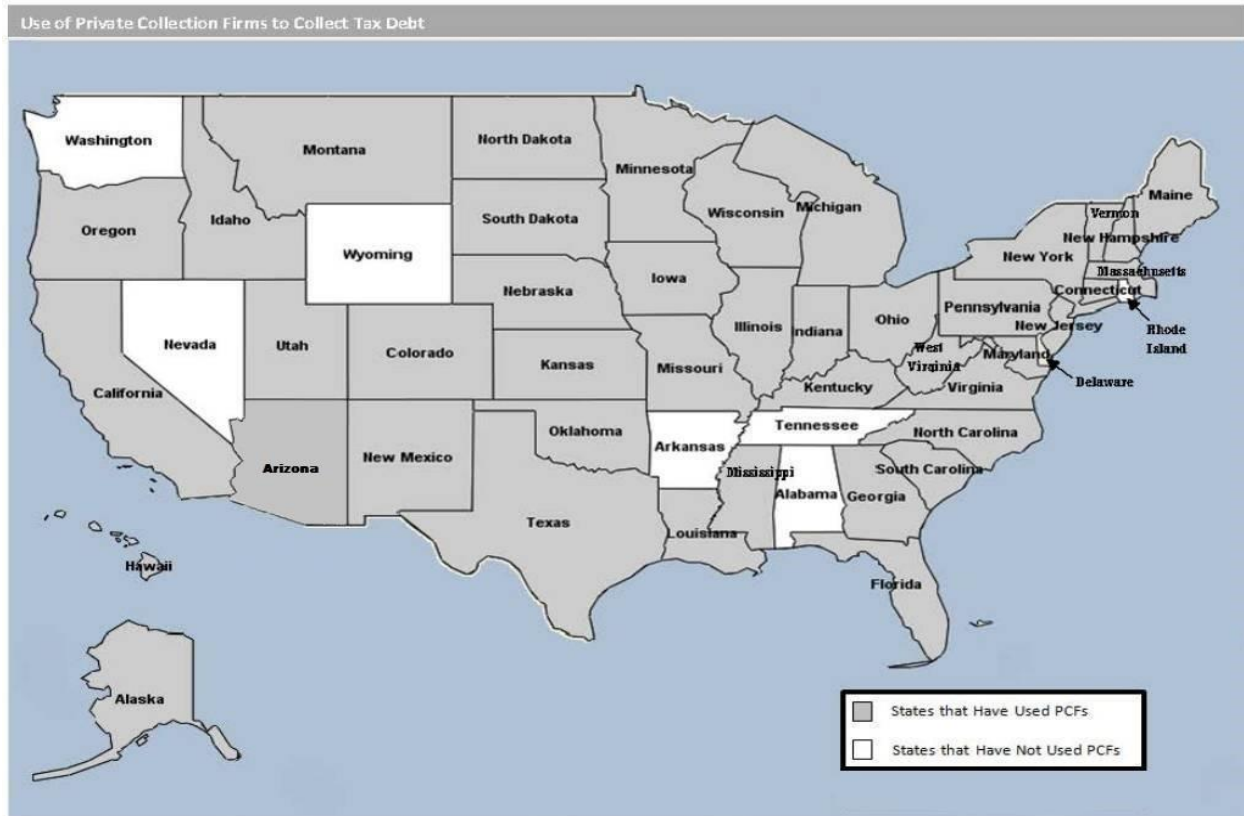
As a short-term strategic action, DOR has categorized accounts based on the size of the outstanding liability. The DOR strategy of assigning small balance accounts directly to PCFs in 2010 was an example of optimizing comparative advantage of DOR and PCFs. As described in an earlier section of this report, the strategy takes advantage of PCFs autodial systems to reach a large number of debtors efficiently, and DOR revenue agents are enabled to focus on the larger balance accounts more likely to require communication with an agent who has account and program knowledge, as well as the authority to negotiate penalty waivers or settlements. The strategy was discontinued because DOR was not able to keep pace with the administrative demands associated with assigning that volume of accounts to PCFs.

There was another agency effort, not related to utilization of PCFs per se, but related to the idea of identifying characteristics of accounts. In 2010, DOR analyzed accounts being worked by DOR's OAA section to be able to sort the accounts into categories and then prioritize the collections efforts of agents according to category. (Oregon Department of Revenue, Research Section) Each account was assigned a number which represented the collectability of the account. The number was a linear calculation based up factors including wage and non-wage income, history of making voluntary payments, and recent phone contact. The accounts were divided into four tiers according to the collectability ranking.

With the ability to segment the accounts in this way, DOR's OAA section could select strategies appropriate for each tier level. The accounts that were ranked highest in terms of collectability were not worked, as these were most likely to be paid with or without direct agent action. The least collectable accounts were set aside since they would have the lowest return for collections efforts. The remaining accounts were actively worked, starting with the relatively collectable accounts and moving then to the relatively uncollectable accounts. The method was found to be beneficial in terms of revenue per agent and in a more efficient use of phone time.

Utilization of Private Collection Firms by States other than Oregon

It is common for states to use PCFs to collect unpaid tax debt, but practices vary widely. (CGI Group Inc.) Utilization of PCFs ranges from states outsourcing no debt to one state (Illinois) that outsources substantially all of its personal income tax (PIT) debt. Of the 50 states, 43 have used PCFs at some point in time to collect tax debt. Seven states are known to have never used PCFs to collect tax debt. Research performed at Florida State University suggests approximately 80% of states that have used PCFs started using them in the last two decades (the 1990s and 2000s). More states first started using PCFs in the 1990s than any other decade. (Jang) [29]



Among states that have used PCFs, it is a common practice is to use PCFs to collect debt once it has already been worked unsuccessfully by state employees. States also often use PCFs to work debt that would otherwise not be worked.

Based on responses from states surveyed for this paper, we include examples of how PCFs are used to collect state tax debt in California, Illinois, Minnesota, New York, Pennsylvania, and North Carolina. Two of the states in particular, California and Illinois, provide case studies for how state utilization of PCFs is shaped by legislation, compensation of PCFs, the treatment of out-of-state debtors, and contractual labor considerations.

[29] Table 8, Use of Private Collection Agency for Tax Collection, lists the year states starting using PCFs. Of the 50 states, 32 have used PCFs and have known starting dates. Of the 32, 2 started in the 1970s, 5 started in the 1980s, 19 started in the 1990s, and 6 started in the 2000s.

Legislation

As with most government programs, private debt collection programs have been created and molded by legislation in different ways. Illinois and California, for example, have passed legislation granting tax administration agencies the authority both to outsource debt to PCFs and to pass fees charged by PCFs to debtors. In Oregon, however, it was passage of legislation requiring the state to outsource debts over a certain age that most influenced the current structure of DOR's Collection Agency Program. Legislation also allows DOR to pass on PCF fees to debtors. Even when states have legislation which grants authority to use PCFs, their strategy for usage of PCFs varies.

In Illinois, legislation allows use of PCFs, and the Illinois Department of Revenue (IDOR) outsources substantially all of its PIT debts, focusing internal resources on corporate income and sales tax collections. Illinois moved its PCF usage to the front of the collection process for PIT debts in 2000. Since this time, Illinois has outsourced substantially all PIT debt once it is over 75 days delinquent. In 2010, the Illinois legislature passed HB 5781 allowing IDOR to add fees charged by PCFs to taxpayers' liabilities. The bill however, did not allow IDOR to pass along internal costs of collection to the debtor. Like Oregon, Illinois can pass fees charged by PCFs on to debtors but cannot pass government tax administration collection costs on to debtors. Yet, even though the two states have similar abilities to pass along fees they do not have similar PCF usage strategies. Illinois outsources PIT debts before it uses internal resources, whereas Oregon outsources PIT debts primarily based upon a statutorily defined timeline, after first attempting to collect in-house.

In California, California Franchise Tax Board's (FTB) use of PCFs has largely been to collect on accounts not cost effective for FTB employees to pursue. In 1984, California passed tax amnesty legislation (AB 3230). As a general rule, when offering tax amnesty government entities tend to include additional penalties on and requirements of those debtors who do not "come clean." California was no exception to the rule in 1984. Along with its tax amnesty legislation the California legislature included the ability to contract with PCFs for collection of substantially all FTB tax and non-tax debt. While, both Oregon and Illinois also have similar authority to outsource tax debt, the strategies between the three states as related to usage of PCFs are different. Illinois outsources all PIT debt at the beginning of collection process, California outsources cases where it has determined in-house collection would be prohibitively expensive, and Oregon largely outsources debts at a certain age or because a debtor is located out-of-state.

Compensation of PCFs

The way in which PCFs are compensated influences the way tax administration agencies use PCFs. In July of 2010, the Illinois Legislature passed Public Act 096-1383 (HB 5781) which added fees charged by PCFs as an additional liability owed the state by debtors. Effective January 1, 2011, Illinois passes fees charged by PCFs to tax debtors.[30]

In California, commissions to PCFs were paid differently depending on whether or not the taxpayer resided in California until a decision was made to no longer outsource out-of-state debt. For in-state debts, the State Controller paid the commission from The Delinquent Tax Collection Fund (Revenue and Taxation Code 19378). For out-of-state debtors, the commission was added to the balance due and paid by the taxpayer. While this structure in itself may not seem to have made outsourcing out-of-state debt

[30] Public Act 096-1383, State of Illinois.

cost prohibitive, the environment in California was such that the required system modifications to include out-of-state debts in the automated process used for in-state debts was not financially viable. It seems the decision to not outsource out-of-state debts was the result of the high cost of automating the process for payments to PCFs.

Out-of-State Debtors

Pursuing out-of-state debtors is expensive. So, it would follow that states would try to outsource this work to collection agencies with a belief they could better use resources elsewhere in their collection programs, especially if tax debtors are responsible for the cost to collect their own debt. Oregon outsources out-of-state debt to PCFs. However, neither California nor New York uses PCFs to collect on debt owed by out-of-state taxpayers.

As of March 2011, about 10% of the delinquent tax debt owed to California FTB is owed by out-of-state debtors. (State of California Franchise Tax Board) Even though pursuing out-of-state debt is relatively more expensive compared to in-state debt, and a considerable amount of FTB debt is out-of-state, California has not outsourced these debts since 2006. New York also does not use PCFs to collect out-of-state debt. In California, the reason for not outsourcing these debts is the cost of upgrading IT systems to automate functions which are already automated for in-state PCF collections. Although there is little evidence pointing to New York having the same system restraints, it could be that New York has similar issues with its system. New York is currently seeking to expand PCF use to out-of-state taxpayers by automating the process.

Labor Contracts

The utilization of PCFs by a state may be restricted according to labor agreements regarding work performed by the state's employees. In California state labor contracts "prohibit outsourcing work that would otherwise be assigned to [state] employees." (State of California Franchise Tax Board) This probably plays a large part in California's decision to outsource debts that are cost prohibitive for internal employees to collect. Separating the debt into heterogeneous groups may allow California to outsource cases which would not have been worked by FTB employees even if they were not outsourced. This also makes it hard to compare collections rates between FTB and PCFs because the same "types" of debts are not worked by internal and external collectors.[31]

In Oregon, the Collective Bargaining Agreement requires agencies to perform a feasibility study for any outsourced contract exceeding $30,000 per year or when the contracting-out will displace bargaining unit members. [32] The study must determine the potential cost savings and other benefits which would result from contracting-out the work in question. The Union (SEIU Local 503) is then allowed to submit an alternate proposal. If the Union's proposal would result in providing quality and cost savings equal to or greater than that identified in the agency's feasibility study the parties will agree in writing to implement the Union proposal. With passage of HB 3509, which allowed DOR to pass collection fees charged by PCFs on to debtors, it is unclear how the feasibility study and Union proposals would compare on quality and cost.

[31] Collections efforts cannot be compared in Illinois since PIT debt is worked exclusively by PCFs.
[32] Collective Bargaining Agreement between Oregon Department of Administrative Services and Service Employees International Union Local 503, Special Agencies Coalition, 2011 – 2013. pp. 8-9.

Individual States

Following is additional detail about the collection process and PCF usage by states that responded to DOR's survey for this paper.

California

In 1984, the California Franchise Tax Board (FTB) initiated legislation requesting authorization to outsource some of its debt collection to PCFs because it was determined that some accounts were "ROI prohibitive" for FTB collection personnel to pursue. (State of California, Statewide Collection Bureau)[33] Two years later, the legislation was implemented as the Private Debt Collection Program. "Outsourcing provides the Franchise Tax Board (FTB) with an alternative collection strategy for accounts that not economically feasible to assign to an FTB collector (specific case referral criteria is proprietary information)." California "typically contracts with three PCFs per procurement and assigns 3,000 accounts per month to each of them." (State of California, Statewide Collection Bureau) FTB's Private Debt Collection Program continuously reviews and makes adjustments to reduce the State's cost so that the volume of accounts referred can be increased without adding to the cost of administering the program. The program collects delinquent non-tax debt for many other state and local government entities in the same manner it collects tax debt. (State of California Franchise Tax Board, Statewide Collections Bureau)

In California a PCF's objective is "to locate the taxpayer and/or their assets and arrange payment in full or an acceptable payment arrangement." (State of California Franchise Tax Board, Statewide Collections Bureau) PCFs are not allowed to issue bank levies, wage garnishments or pursue litigation on behalf of FTB. In fact, FTB's automated collection system continues to search for asset information, file liens, issue wage garnishments and issue bank levies while accounts are assigned to a PCF.

Revenue and Taxation Code in California determines the commission structure within which PCFs are paid. For in-state debtors, the State Controller pays the commission from the Delinquent Tax Collection Fund, whereas, for out-of-state debtors, the commission is added to the balance due and paid by the taxpayer. (State of California Franchise Tax Board, Statewide Collections Bureau) This structure ultimately causes California to not use PCFs to collect debt of out-of-state debtors. FTB is authorized to outsource the collection of out-of-state accounts, but does not currently have an out-of-state collection contract. Out-of-state debtors make up 9% of FTB accounts and 11% of the total value of FTB accounts receivable. (State of California Franchise Tax Board, Statewide Collections Bureau)[34] FTB has not outsourced out-of-state corporation accounts since 2006 and does not outsource in-state corporation accounts due to its ability to suspend corporation licenses.

Outsourcing work done by state employees is always a hot topic and outsourcing of work done by FTB collectors is no different. Administrators are careful to administer contracts in a way that does not violate labor contract provisions which prohibit outsourcing work that would otherwise be assigned to employees. Internal and external collectors cannot work the same kinds of cases, so it is difficult to compare the results of collections efforts between the two groups of collectors. In California it's not so much a question of which group of collectors is better, rather it is a question of which groups of debts are worked by which group of collectors. Regardless of the percentage of accounts outsourced there still

[33] Also based on correspondence between FTB and Oregon Department of Revenue.

[34] See FTB's response on page 7 for details.

must be substantial administrative work undertaken to support the PDC program. Duties performed by California FTB employees administering the PDC program include at least: answering questions from taxpayers as to validity of tax assessments, negotiating terms for filing missing returns; performing liens, garnishments, and levies; and monitoring and addressing customer service complaints including reviewing all phone calls and transcripts detailing actions of PCFs in response to complaints.

Illinois

Illinois is currently the only state that outsources substantially all its delinquent PIT debts before pursuing collection activities with internal resources. It has done so since 2000. Initially, once a tax debt is owed but unpaid (delinquent and liquidated), the IDOR automated letter system sends a notice to the taxpayer. Second, after 75 days, if the debt has not been paid it is sent to a private collection firm. A collection agency then has 180 days to pursue collection of the debt at which time it is returned to IDOR for wage levies, professional license suspension, and 1099 levies. After another six months, if still not collected, the debt is re-sent to a collection agency. Of note is that, during the 75 days between letter and outsourcing, IDOR does not pursue debtors with its own resources.

Minnesota

Minnesota has been utilizing PCFs for more than 30 years. Currently, Minnesota Department of Revenue (MNDOR) uses its own resources to collect debts until it becomes apparent that its resources have been unsuccessful. Debts are then outsourced to a PCF for collection. Debts are returned to MNDOR after one year if no payment has been made. Based on discussion with MNDOR, the age at which debts are sent to PCFs can range anywhere from 45 days to 5 years. Minnesota, like Oregon and in contrast to California and New York, does use PCFs to collect debt from out-of-state debtors.

New York

The New York State Department of Taxation and Finance (NYS DTF) uses a variety of case characteristics and predetermined assignment rules in order to send cases to PCFs. The state does not outsource tax debt owed by out-of-state debtors. New York has been implementing a data warehouse since 2005 that allows many factors to determine how a debt is collected and if it is outsourced. (Miller)

North Carolina

North Carolina does not currently outsource debt collection. After utilizing PCFs between at least 2000 and 2004, a shift in strategy resulted in the in-sourcing of substantially all collections activity previously performed by PCFs. It seems to be the current position of the North Carolina Department of Revenue that in-sourcing of all collections has saved the state substantial money. North Carolina's in-sourcing of debt collection illustrates how fluid a states strategy related to utilizing PCFs can be.

Pennsylvania

The collection process in Pennsylvania's is similar to that of California in that the Pennsylvania Department of Revenue (PDOR) uses PCFs to collect debt after attempts by internal staff have not been successful or the debt is not cost effective to collect. Also like California, there are no cut and dry age of debt rules for sending debts to PCFs, rather a number of factors determine if and when a debt goes to a PCF.

PDOR sends debts to private collection agencies between six months to a year after the debt is past due. Statute does not require debt be sent to PCFs. In 2005, legislation was passed allowing fees charged by

PCFs to be added on to taxpayer's liabilities, but did not include the authority to add internal DOR collection costs to taxpayers liabilities. Discussion with PDOR reveals that the ability of PCFs to collect their fees on top of tax, penalty, and interest due creates a strong incentive to send debts to PCFs. To a large extent, the size of the tax debt determines if and when a debt will be sent to a PCF.

Pennsylvania's delinquent PIT debt collection cycle allows a grace period free from active collections of approximately 100 days which begins after letter of deficiency has been sent. After 105 days debts move to active collection by either the internal PDOR call center or field collection agents. The call center works "small" debts for two to three months before sending them to a PCF. "Large" debts are worked by the call center or field collections staff for up to an additional six months before sending them to PCFs. Pennsylvania actively pursues taxpayers with internal department resources between the time the first letter of deficiency is sent and the time when debt is sent to a PCF.

Conclusion

The use of PCFs to collect tax debt has a varied history. At the national level, the IRS has utilized PCFs sparingly, attempting to do so three times and deciding after each experience not to continue. In 2009, the IRS used the findings of a cost effectiveness study to discontinue utilizing PCFs, although, with the strong opposition voiced by consumer groups and others when the IRS requested funding to use PCFs, the study may have supported an underlying assumption that PCFs are not appropriate in the role of collecting federal tax debt. As of 2017, the IRS has started using PCFs again as a result of legislation passed in 2015.

In Oregon, the Department of Revenue has utilized PCFs to collect out-of-state debt and selected other tax debt for some time. The utilization of PCFs by Oregon's state agencies was discretionary until 1999, when Oregon's legislature enacted statutory requirements regarding the role of PCFs in collecting state government debt. These requirements were part of legislation that came after a review by Oregon's Secretary of State to identify opportunities to improve the collections functions in Oregon state government. The use of PCFs in Oregon has been strongly influenced by recommendations of the Secretary of State Audits and legislation relating to collection.

Although a review of state practices suggests that there are a few states that assign none of their accounts to PCFs, and fewer that assign most of their accounts to PCFs, it appears that most states that use PCFs to collect tax debt do so in a targeted way.

While it is clear that there is a role for utilizing PCFs to collect tax debt, it is also clear that PCFs and tax agencies have different tools, motivations, and comparative advantages. It will always be the case that the incentives of PCFs differ from the incentives of DOR. With a commission-based fee structure, the incentives of PCFs may be biased toward short term revenue generation, which may be only a small part of DOR's goals at a point in time.

DOR also has responsibility to pursue equity within the tax system, bringing as many taxpayers as possible into compliance. Within the bounds of appropriate behavior, DOR may need to use more aggressive collections techniques for taxpayers not willing to pay, and may need to allot resources for working with those willing but not able to pay in order to find workable payment arrangements and solutions toward long term compliance. This is contrary to the perspective held by some that collection of debt is a homogenous process that is equivalent between PCFs and tax agencies. Tax debt is not the same as other debt, and monetary factors are not the only factors in a cost benefit analysis to determine

whether DOR or PCFs should work certain accounts. Qualitative factors are as important as quantitative factors, and the highest benefit may include success toward meeting both short and long term goals such as short term revenue generation and long term voluntary compliance.

The utilization of PCFs for collection of Oregon's tax debt should be framed within the consideration of the best way to optimize the comparative advantages of PCFs and DOR toward both short and long term compliance goals of DOR.

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