

Testimony before the
WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT

regarding

“Use of Private Collection Agencies to Improve IRS Debt Collection”

May 13, 2003

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Mr. Chairman, Representative Pomeroy, and Members of the Subcommittee, the **National Consumer Law Center** thanks you for inviting us to testify today regarding the proposal to employ private debt collectors to collect IRS tax debts. We offer our testimony here on behalf of our low income clients, as well as the **Consumer Federation of America**.¹

The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen many examples of harsh and abusive debt collection practices against low-income people in almost every state in the union. It is from this vantage point – many years of observing the harassment against the less sophisticated and less powerful in our communities – that we supply these comments.²

The use of private debt collectors to collect tax debt raises a number of serious concerns. We believe the IRS should not use private debt collectors, for a number of reasons:

- The debt collection industry has a record of aggressive members who abuse and harass consumers. The potential of exposing millions of taxpayers to collector abuse in the name of the United States will undermine the sense of faith and fairness in our government and tax administration.
- IRS collection of its own debts will be more cost efficient, and it will ensure that taxpayers rights are better protected. IRS employees understand tax law, tax procedure, available payment options, and taxpayer rights and remedies.

If this proposal does go forward and private collectors are used, the proposal must be significantly revised to include strict taxpayers protections, such as:

- Private tax collectors cannot be compensated on the basis of contingency or commission

¹The **Consumer Federation of America** is a nonprofit association of almost 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

² In addition, NCLC publishes and annually supplements sixteen practice treatises which describe the law currently applicable to all types of consumer transactions, including Fair Debt Collection (4th ed. 2000 and Supp.) and Student Loan Law (2d ed. 2002).

alone.

- Financially distressed taxpayers eligible for special IRS protections should not be targeted by private tax collectors.
- Private tax collectors must not be permitted to use the powerful array of special administrative remedies that Congress has granted the IRS.
- Private tax collectors must be covered by all of the protections in the federal Fair Debt Collection Practices Act, including the requirement to stop contacting a consumer if a cease communication letter is sent.
- Private collectors must be required to return a case to the IRS if there is contested liability or the taxpayer seeks a settlement or payment plan.
- Taxpayers who are subjected to private tax collection must be informed of all of their rights, remedies, and available options.
- The privacy rights of taxpayers must be stringently protected.
- The IRS must institute a strict and meaningful oversight system over private collections, including a toll-free complaint line.
- There must be a private right of action for taxpayers to sue private tax collectors who violate their rights, with significant penalties for violations.

Debt Collection Industry's Record of Abuse

While there are many debt collectors who obey the law, there is a significant minority who do not. These collectors pound away at Americans who've fallen behind on their debts with tactics that can be both frightening and illegal. In addition to the horror stories we at the National Consumer Law Center know about, statistics from the Federal Trade Commission tell a similar story. In 2001, the latest year available, the FTC received 15,819 consumer complaints about debt collection agencies – giving debt collectors the impressive title of the FTC's most complained-about industry for the third year running.³ Furthermore, the FTC report characterizes this the tip of the iceberg, stating: "The Commission continues to believe that the number of consumers who complain to the agency represents a relatively small percentage of the total number of consumers who actually encounter problems with debt collectors."

What kind of misconduct has been documented in the debt collection industry? The FTC report cites harassment, threats of violence, racial slurs, calling consumers' work places, revealing alleged debts to third parties and demanding excessive payments. At the National Consumer Law Center, we hear about midnight calls, obscene and lewd language, threats of immediate arrest and imprisonment, bogus threats to seize property without judicial process, and debt collectors posing as government officials.⁴

History of Collection Abuses for Student Loans

³ Federal Trade Commission, Annual Report: Fair Debt Collection Practices Act (June 2002)

⁴ See, e.g. Jean Chatzy, Stop Calling Me!, Time Magazine, March 10, 2003, at 68; Andrea Coombes, Debtor Abuse, CBS Marketwatch.com, February 20, 2003, available at www.CBSmarketwatch.com.

Some have said that the Department of Education's privatization of collections is a success story and should be a model for the IRS. I'm sorry to tell you that from the consumer perspective, this is not true. Many of the debt collection abuses I speak of have occurred in the student loan context. Private collectors of student loans have repeatedly deliberately deceived consumers by misrepresenting themselves as the Department of Education. They've overcharged consumers for collection fees, used misleading telegrams to trick borrowers, browbeaten borrowers into unaffordable payment plans, threatened them with actions that collectors can't take, and pressured consumers to borrow from relatives.

Moreover, one of the three collection agencies that IRS has chosen to ask for advice on privatizing tax collections has been the subject of repeated lawsuits over its student loan collections.⁵ Another company expected to bid on this proposal has been known to misrepresent itself to consumers by using the Department of Education's name on its stationary and to intimidate and confuse consumers with its claim of affiliation with the IRS.⁶

Some of the abuses in the student loan context have specifically arisen because of the fact a federal government program is involved. Student loan borrowers have many important rights, such as discharges, deferments, different payment options, and exemptions, creating a complex scheme for collections. Yet many private collectors do not have enough knowledge about these schemes, which results in consumers being deprived of important options to which they are legally entitled. Even worse, some private collectors misrepresent these rights or steer consumers into options more profitable for the collector. For example, collectors have been known to strong-arm student loan borrowers into agreeing to payment plans that the borrowers could not afford and did not want, despite the consumer's rights under the Higher Education Act to a reasonable and affordable payment plan.⁷ Collectors have threatened to offset federal benefits for SSI recipients, even though SSI benefits are protected. They steer consumers into loan refinancing options which may not be appropriate for the consumers. Some collectors

⁵ See *Romine v. Diversified Collection Services*, 155 F.3d 1142 (9th Cir. 1998); *Kort v. Diversified Collection Services*, 2001 WL 881449 (N.D. Ill. August 2, 2001); *Farley v. Diversified Collection Services*, 1999 WL 965496 (N.D. Ill. September 30, 1999).

⁶ See *Peter v. GC Services*, 310 F.3d 344 (5th Cir. 2002); *Gammon v. GC Services*, 27 F.3d 1254 (7th Cir. 1994) (debt collector used its status as IRS software vendor to imply to credit card debtors that it had special access to IRS).

⁷ See, e.g., *Arroyo v. Solomon and Solomon*, 2001 WL 1590520 (E.D.N.Y. Nov. 16, 2001).

aggressively threaten wage garnishments, failing to inform or misrepresenting the rights of consumers to hearings and exemptions. Others charge collection fees that exceed the amounts authorized by Department of Education regulations.⁸

Tax Debts Will Be Collected More Efficiently and Fairly by IRS Employees

The administrative scheme and rights of taxpayers under tax law is just as complicated as that under student loan law, if not more so. The potential for collectors to misunderstand or misrepresent these rights or steer taxpayers away from options that do not as richly compensate the collector is even more worrisome. Of course, the complexity of the tax scheme raises the simple question - why not give the IRS adequate resources to do its job. The IRS is uniquely qualified to collect taxes - its employees understand tax law, tax procedure, available payment options, and taxpayer rights and remedies. If IRS is not being given by the Congress the resources it needs to do additional collections, Congress should provide adequate resources to the IRS, and not give up precious tax dollars and the well-being of taxpayers to an aggressive industry well-known for abuses amongst its ranks.

Furthermore, this proposal will not provide more money to Treasury, or it will do so on the backs of those least able to defend themselves. Collection agencies will want the easiest, freshest, least complicated cases. These are the same cases, however, that IRS could easily handle. Such “cherry picking” will ultimately mean fewer, not more, tax dollars in the coffers of Treasury.

As for those high flying tax cheats, the public should not be under the illusion that private collectors will solve that problem. It is not the modus operandi of private collectors to handle complex tax shelters, fraudulent property transfers, or discover hidden assets. They will not want to deal with millionaire tax dodgers with phalanxes of high-priced lawyers. Private debt collectors will want cases involving middle and working class wage earners, whose salaries are easily garnishable and who are unable to afford legal representation.

Collector Compensation Should Not Be Based on Contingency Alone

While not perfect, another reason IRS employees are preferable to private debt collectors is that IRS employees do not have the powerful incentives that encourage them to pursue measures that are not in the best interests of both taxpayers and the tax system. The current proposal to pay collectors 25% is a recipe for abuse and harassment. Even though the collectors’ fees are not added on top of the tax debt, a 25% contingency system provides a potent motivation to collectors to engage in aggressive tactics, while ignoring taxpayer rights. After all, every dollar collected from a taxpayer means 25 cents for the collector, which inevitably will spur certain collectors to push the envelope and the law. In addition, collectors will steer taxpayers away from less profitable options to which the taxpayer is entitled. One simply cannot have a proposal to use private debt collectors that is fair to taxpayers if the compensation

⁸ See, e.g., *Padilla v. Payco General American Credits*, 161 F.Supp.2d 264 (S.D.N.Y. 2001).

structure is based on contingency alone.

Financially Distressed Taxpayers Should Not Be Targeted by Private Tax Collectors

Many taxpayers who owe tax debts are not deadbeats. Studies have shown that overwhelmingly consumers fall behind on their debts because something unexpected and catastrophic happened - a serious illness, a death in the family, the loss of a job. Very few consumers deliberately avoid their debts when they have the ability to pay them. The majority of debtors are your friends, relatives, and neighbors – good people who want to pay their debts but simply can't and still stay afloat, and who have every intention of paying once they get back on their feet. To let loose private hired guns on these already vulnerable families will only cause increased family distress and social costs that can be substantial.

Thus, if IRS is permitted to farm out its collections to private debt collectors, a critical issue will be the selection of which taxpayers will be subject to that collection. Currently, there are significant protections for low-income and financially-distressed taxpayers, including the availability of “currently not collectible” status. It would undermine the fundamental fairness of tax administration to permit private debt collectors to target families that qualify for taxpayer protections based on their sheer poverty. Without clear safeguards keeping private collectors targeted at higher income tax delinquents, private collectors will have few scruples about using strong pressure for payments from financially distressed households. IRS employees are reputed to be strong collectors but most will work with families that have fallen on hard times.

Taxpayer's Rights Must Be Protected

Other strict protections must be included in any legislation permitting private tax collection, to avoid the abuses we've seen in the student loan area. First, taxpayers must unequivocally, clearly and conspicuously be informed of all their rights and the types of relief available to them. As mentioned earlier, student loan private collectors have an abysmal record of according consumer loan rights, such as fraudulent school discharges to fraud victims, loan deferments to returning students. Thus private debt collectors must be required to provide a copy of IRS Publication 1 (Your Rights as a Taxpayer) and Publication 594 (The IRS Collection Process) with the first written communication or within 5 days of the first oral communication.

Private collectors cannot be permitted to use IRS administrative remedies, such as non-judicial levies, liens, and garnishment. In the student loan context, the use of administrative garnishments has given collectors an overwhelming weapon with which to wring submission from borrowers, using threats to bully those who are entitled to discharges or other remedies. Imagine what private debt collectors, some of whom are already known for making bogus threats to seize homes to frighten consumers, will do if they actually have the power to place non-judicial liens on a taxpayer's home. Not only should collectors not have special administrative remedies, there must be strict prohibitions against collectors representing or implying that they have the right to use such remedies, with significant penalties for violation. A false threat is just as devastating for unsophisticated taxpayers.

Private Tax Collectors Must be Covered By ALL of the Protections Under Federal Debt Collection Law

Private collectors of IRS debt must be covered by Fair Debt Collection Practices Act (FDCPA).⁹ The FDCPA provides the most important protection for consumers from abusive or unfair actions by debt collectors. While a few states have adopted similar statutes, in the overwhelming majority of states, the FDCPA remains the primary law specifically delineating the permissible activities of debt collectors. The finding articulated by Congress in 1978 remains valid today, in that “[e]xisting laws and procedures [other than the FDCPA] for redressing these injuries are inadequate to protect consumers” 15 U.S.C. § 1692(b).

The FDCPA establishes general standards of proscribed conduct, defines and restricts abusive collection acts, and provides specific rights for consumers.

- The standards protect a consumer from invasion of privacy, harassment, abuse, false or deceptive representations, and unfair or unconscionable collection methods.
- Specific acts that are prohibited include late night or repetitive phone calls and false threats of legal action.
- The Act gives a consumer the right to require a collector to stop all collection contacts.
- It requires a collector to deal with a consumer's attorney when the consumer has one.
- It gives a consumer the right to require a collector to verify the existence, legality, or amount of a disputed debt it is attempting to collect.
- The courts require strict adherence to the Act's explicit terms to accomplish the remedial and preventative goals of Congress.

⁹ Private collectors of tax debts are currently mostly likely not covered under the FDCPA because tax arrears are not considered consumer “debts” under that Act. See Pollice v. National Tax Funding, 225 F.3d 379 (3rd Cir. 2000); Beggs v. Rossi, 145 F.3d 511 (2nd Cir. 1998).

In fact, the FDCPA was the model for the fair tax collection rights at 26 U.S.C. § 6304. However, certain critical FDCPA protections are missing from section 6304, and mere application of that section as currently proposed is not enough to protect consumers.¹⁰ In particular, private collectors must be subject to section 1692c(c) of the FDCPA, which requires that they cease contacting a consumer, with certain exceptions, if the consumer sends a written notification stating that the consumer wishes the debt collector to cease further communication with the consumer. This is the single most important “release valve” for distressed families to avoid harassment and get an aggressive collection agency off their backs immediately, without need to resort to a lawsuit or a cumbersome complaint process. When a consumer is being harassed by a debt collector, even a few weeks delay can cause unbelievable stress and anxiety on his or her family. Of course, the IRS will have the option of taking the case back or pursuing administrative or legal remedies if the consumer has sent a cease communication letter.

Private Tax Collectors Should Not Be Permitted to Handle Contested Liability, Offers-in-Compromise, or Payment Plan Negotiation

Another important right not present in 26 U.S.C. § 6304 is the right to validation of a debt. Section 1692g of the FDCPA gives the consumers the right to dispute a debt or its amount, and requires the debt collector to go back to the creditor to verify the debt. For tax debts, we believe there should be a special validation requirement, in that if the consumer disputes liability or amount, the case must be returned back to IRS. Private debt collectors cannot be permitted to handle issues of contested tax liability. Unsophisticated taxpayers must be protected from paying amounts that are not actually owed — an accurate determination of tax liability is beyond the ability of most consumers and will not be in the interest or within the skills of the private tax collector.

Furthermore, the case must be returned to IRS if the taxpayer wants a payment plan or settlement— these options cannot be negotiated by collector. As discussed earlier, private collectors have a history of browbeating consumers into payment plans they cannot afford. Not only will an unrealistic payment plan result in more taxpayer distress and ultimately prove a failure, but it will undermine the ability of the taxpayer to ensure that she can pay this year’s tax obligation, thus subverting current tax compliance to line the private collector’s pockets.

Under the FDCPA, consumers must be given certain notices, including information about the right to have the debt validated. Because of the unique nature of tax debts and the options available to taxpayers, taxpayers must be given additional information in plain language so that they are informed of their taxpayer rights. This notice must inform taxpayers of the right to return the case to IRS if the consumer: 1) disputes liability or amount of liability; 2) wants to apply for an Offer-in-Compromise; or 3) wants a payment plan. In addition, the written

¹⁰The omission of certain requirements in 26 U.S.C. § 6304 is not surprising since that section was intended to apply to IRS collectors, i.e., the original creditor. Original creditors are usually subject to fewer requirements than third party collectors. However, since the IRS is proposing to use third party collectors, all of the requirements of the FDCPA must apply to those entities.

communication should include notice of the taxpayer's FDCPA rights, including the right to send a cease communication letter. It should include a prominent disclosure that the collector is not the IRS, but a private contractor and is not entitled to use special IRS administrative remedies. Finally, as discussed above, copies of IRS Publication 1 and 594 should accompany the written communication.

Taxpayer Privacy Must Be Protected

Another concern is the privacy rights of taxpayers. The IRS treats personal tax information as confidential and private. There must be strict prohibitions against use or sharing of IRS data for purposes other than collection of federal tax debt. This prohibition must include sharing of information internally within a private collection agency and with affiliates or credit bureaus. The current proposal would impose on private collectors the same restrictions against dissemination of taxpayer information as IRS employees are currently subject to. However, even when privacy protections exist, private contractors have an abysmal record of protecting the confidentiality of taxpayer information.¹¹ It is not difficult to posit that taxpayer privacy will be compromised as tax returns are shared with increasing number of collectors, many of whom may have other debts they are pursuing against the taxpayer, such as state tax debts¹² or consumer credit debts. After all, if a taxpayer is unable to pay his federal tax debts, it is likely he cannot pay his state tax debts or his credit cards debts – and the information in the IRS database will be temptingly available for the private collector to use to collect those debts as well.

The IRS Must Establish a Strict Oversight Program and a Meaningful Complaint Process

Private debt collectors have never been completely successful with clamping down on the bullying culture within their ranks. If there are those debt collectors who have no compunction against violating the FDCPA and other laws, even official IRS prohibitions may not be adequate. This is a risky experiment, at best, that the IRS is proposing. Thus, the IRS must establish a stringent oversight and monitoring program for its private collection program. There must be frequent audits and compliance reviews with real penalties for poor performance in respecting taxpayer rights. Employees of private debt collectors must be required to give out their real names and some sort of identifying information, so that rogue employees can be identified. One tactic used in the debt collection industry is that employees will refuse to give their names or will give false names so that consumers and their attorneys cannot track down the employee who actually perpetrated abuse. This permits the debt collection agency to disclaim responsibility for and knowledge of abusive employees.

There must be a toll-free complaint line and staff assigned specifically to deal with

¹¹ See, e.g., Office of the Inspector General, Social Security Administration, Federal Agencies' Control over the Access, Disclosure and Use of Social Security Numbers by External Entities, February 2003.

¹² An unanswered issue is how federal-state information sharing agreements on tax collection will play out when private debt collectors are involved.

complaints. Furthermore, taxpayer complaints must be weighted seriously against a private collector. Many debt collection complaints are based on oral communications. The IRS must not be permitted to discount taxpayer complaints on the basis that “it’s just your word against theirs.”

Taxpayers Must Have the Right to Take Legal Action Against Private Collectors Who Violate Their Rights

In conjunction with a stringent IRS oversight program, there must be a private right of action for private collector violations, with significant penalties. To use the current scheme under IRC, 26 U.S.C. § 7433 is inadequate. Section 7433 only provides for actual damages; it does not provide for any statutory damages or the right to file class actions. The primary "actual damages" suffered by most victims of abusive debt collectors are those that flow from mental distress. Loss of sleep, anxiety, stress, and worry may be very hard to prove months and years later, and are always difficult to place a monetary value on. Also the cost and discomfort to the injured consumer of getting on the witness stand and reliving the collector's abuse during a former period of financial distress in order to prove actual damages deters many consumers. Without statutory damages or class actions, actual damages will not be adequate to deter abuse. Private collectors will shrug off lawsuits as a slap on the wrist or a cost of business. Only strong public oversight with private enforcement can ensure that we will have a private debt collection scheme that balances collections with fairness to taxpayers.

Conclusion

Based upon over 30 years of experience on behalf of consumers in debt collection matters, we at NCLC have grave concerns about the current proposal to permit IRS use of private debt collectors. The experience in the student loan context would predict, not a shining success as some have promised, but a legacy of taxpayers being harassed, deprived of their lawful rights and options, and misled. Taxpayer abuse by private tax debt collectors will not reflect well on the IRS, our tax administration, or our government.

If this proposal is to go forward, it must be significantly revised to include strict taxpayers protections and a meaningful oversight system. Private debt collectors must not be permitted to use the special collection powers of the IRS, negotiate payment plans or settlements, deal with contested liability, or even hint that they can do any of the above. Private debt collectors should never be sicced on financially distressed low-income taxpayers. Private debt collectors must be bound by ALL of the requirements of the federal Fair Debt Collection Practices Act. Taxpayers must be informed of all of their rights and options in dealing with tax debt. Taxpayer privacy must be respected. Private tax collectors who violate the law must be subject to both meaningful sanctions by IRS as well as private enforcement. Only with all of these protections will we have a chance of avoiding the abuses that have plagued student loan collections as well as debt collection in the private sector.

Thank you for the opportunity to testify today.

