

2014

Oregon Department of Revenue

Budget Note Response

Use of Private Collection Firms by DOR

Executive Summary

January 2014



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This paper is in response to the following Budget Note attached to the Department of Revenue's 2013 Appropriation Bill:

The Department of Revenue shall report to the Legislature in 2014 on the use of private collection firms (PCFs) including: age of accounts sent to PCF, amount of accounts turned over to the PCF (total and individual), time it takes PCF's to collect past due accounts, collection rate, and the amount and type of fees charged to clients.

As the agency responsible for administering income taxes for the State of Oregon, the Department of Revenue (DOR) has the overarching responsibility of collecting state income tax debt. For any given liability, there are various ways that the debt may be collected. The use of private collection firms (PCFs) is one of a number of tools used by DOR to collect tax debt, primarily personal income tax debt.

There are fundamental differences between DOR and PCFs in authority, type of debts and debtors, collection tools, incentives, and desire to promote long term compliance of taxpayers. In understanding these differences, it is possible to develop public-private partnerships that leverage the strengths of collections efforts of both DOR and PCFs. DOR seeks to partner with PCFs in a way that optimizes the relative strengths of DOR and PCFs toward the short and long term compliance goals of DOR, and to increase collections capacity.

The use of PCFs by Oregon's state agencies was discretionary until 1999. In 2001, DOR implemented 1999 legislation to send non-exempt debt to PCFs if a year has passed without payment activity. Outside of the statutory requirement (both before and since the 1999 legislation), DOR primarily sends accounts to PCFs if the location of the debtor is unknown or known to be out of state, or if DOR is unable to identify a wage or asset source for the debtor. The ability to more fully and strategically use PCFs is constrained by DOR's system capabilities. This is expected to change with the agency's new core systems.

There are a number of considerations for the strategic use of PCFs. DOR's long and short term compliance goals are the foundation for any strategy. Strategies of using PCFs should optimize the comparative advantages of DOR and PCFs in support of compliance goals. DOR's partnership with PCFs works within the constraints of DOR's system capabilities and business processes, as well as within the statewide contract between the State of Oregon and PCFs. The use of PCFs by DOR depends on situational factors such as the level and composition of DOR's accounts receivable, the staffing level at DOR, and economic conditions.

DOR will continue to study and explore the use of PCFs as a valuable tool for collecting state tax debt. The agency is exploring potential analysis-driven strategies for partnering with PCFs. DOR will develop business strategies, and adjust these strategies over time, to define characteristics for grouping and prioritizing accounts for collection. DOR will continue to look at ways to use PCFs most effectively in the agency's collection efforts.

This report expands on these points and presents the statistics specified in the Budget Note.

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Background

As the agency responsible for administering income taxes for the State of Oregon, the Department of Revenue (DOR) has the overarching responsibility of collecting state income tax debt. For any given liability, there are various ways that the debt may be collected. The use of private collection firms (PCFs) is one of a number of tools used by DOR to collect tax debt, primarily personal income tax debt.

The topic of a tax administration agency using PCFs to help meet its responsibility of collecting 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. After an unsuccessful attempt at using PCFs to collect tax debt on behalf of the Internal Revenue Service, the National Taxpayer Advocate in 2007 gave testimony that describes a fundamental difference between tax authorities and PCFs. Whereas tax authorities have the goal that taxpayers will voluntarily file tax returns and pay taxes on an ongoing basis, the “fiduciary duty of a private company is to maximize profits for its shareholders.”¹

Private collection firms have different motivations and collections tools than tax authorities. In understanding these differences, it is possible to develop public-private partnerships that leverage the strengths of collections efforts of both tax authorities and PCFs.

In partnering with PCFs as a means to increase the collections capacity of state tax debt, the use of PCFs are 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.

Use of private collection firms by DOR

In Oregon, the Department of Revenue has used private collection firms (PCFs) to collect out-of-state debt and selected other tax debt for some time. The use of PCFs by Oregon’s state agencies was discretionary until 1999 when Oregon’s legislature enacted a statutory requirement for most state agencies to send non-exempt state government debt to PCFs if a payment had not been received for a year. Prior to its 2001 implementation of this requirement, DOR primarily used PCFs when unable to locate a debtor, or when the debtor was believed to reside outside of the state of Oregon.²

The ability to strategically use PCFs is constrained by DOR’s system capabilities. DOR has periodically implemented internal strategies for collecting accounts with a balance due less than \$100, and adopted a strategy of sending small balance accounts to PCFs in 2010. This took advantage of PCFs autodial systems to more efficiently reach a large number of debtors that each owed small amounts so DOR’s in-house revenue agents could focus on larger balance accounts that are more likely to require communication between the taxpayer and a revenue agent with account and program knowledge and the authority to negotiate penalty waivers or settlements. The process of moving debt to PCFs is highly manual. DOR discontinued this strategy of sending the small balance accounts to PCFs because DOR was not able to keep pace

¹ United States. Congressional Committee on Ways and Means, U.S. House of Representatives. “Hearing: IRS Private Debt Collection.” 23 May 2007.

² Regardless of being exempt or not, liabilities can and are sent to a PCF by DOR at any time. DOR does not have to wait for the year without payment to pass before sending a liability to a PCF.

with the administrative demands associated with the manual process. It was not considered beneficial to shift additional DOR staff away from other collections efforts to the labor-intensive work of managing the accounts being worked by PCFs.

The landscape at DOR is changing, and the agency anticipates obtaining additional capability with the upcoming core systems replacement—including the capability to group and prioritize debt for collection. This not only will enable DOR to more efficiently conduct in-house collections efforts, it will provide the means to more fully partner with PCFs by studying certain types of debt that would be more beneficial for PCFs to work.

DOR currently works with two private collection firms through a statewide contract. Following are statistics related to the use of PCFs by DOR.

Age of liabilities³ sent to PCFs by DOR

There are two characteristics of how liabilities are processed that complicate the presentation of the average age of liabilities sent to PCFs. First, any given liability may be sent to a PCF multiple times.⁴ Because of this, the calculated average age of liabilities sent to PCFs is skewed by the relatively older liabilities that may have previously been sent to a PCF and subsequently returned to DOR before being sent again to a PCF.

The second characteristic is that a new liability of a taxpayer is processed with any existing liability of the same taxpayer, a process called companionation. All liabilities of a taxpayer are typically worked as one account. If a taxpayer's account is already at a PCF, any new liability will immediately be sent to the PCF as well so that collections efforts are made on all of a taxpayer's liabilities at the same time. These relatively newer liabilities also skew the calculated average age of liabilities.

Without attempting to gauge the impact of these two characteristics, we calculate the annual average age of all liabilities for each of the last five fiscal years. The age is measured from the time that the liability enters DOR's collections system (ACT). Exhibit 1 shows that, in fiscal year 2012–13, the average age of a liability sent to a PCF was 2.7 years. The average age has steadily decreased over the past five years.

³ Although the budget note uses the term "accounts," figures in this document are reported at a liability rather than account level. The liability is the frame of reference for this report, since a debtor's account may include multiple liabilities among tax programs and/or state agencies, and across time periods.

⁴ This should be less of a factor going forward. Previously, DOR gave PCFs one year to work the debt before requiring that it be returned to DOR. At that time, DOR would see if there was any change that would make garnishment possible. If not, with the idea that different PCFs may have slightly different tools, the debt would then be sent to another PCF to work. DOR subsequently changed the time period for PCFs to work debt to two years and then to three years. Currently, PCFs have three years to work the debt, and if the debt is returned to DOR, it is assumed that the PCF will have utilized all tools possible, and it is unlikely that it will be sent again to a PCF.

Exhibit 1: Age of liabilities sent to PCFs

FY	Days		Years	
	Mean	Median	Mean	Median
2009	2,211.9	1,994	6.1	5.5
2010	1,363.4	924	3.7	2.5
2011	1,309.1	848	3.6	2.3
2012	1,145.4	683	3.1	1.9
2013	965.4	528	2.7	1.5

Exhibit 2 shows that, in fiscal year 2012–13, the average age of a liability sent to a PCF for the first time was 1.9 years. The average age of liabilities sent to PCFs for the first time has fluctuated around an average of two years since fiscal year 2009–10.⁵

Exhibit 2: Age of liabilities sent to PCFs for the first time

FY	Days		Years	
	Mean	Median	Mean	Median
2009	939.2	664	2.6	1.8
2010	763.2	518	2.1	1.4
2011	665.8	470	1.8	1.3
2012	833.4	519	2.3	1.4
2013	692.0	464	1.9	1.3

Number of liabilities sent to PCFs by DOR and balance at transfer

The following tables report the number of liabilities sent to PCFs and the total balance to be collected at the time of the transfer. Exhibit 3 reports on all liabilities sent to PCFs for the last five fiscal years. Exhibit 4 reports on liabilities sent to a PCF for the first time.

Exhibit 3: Liabilities sent to PCFs by fiscal year⁶

FY	Collection firm 1		Collection firm 2		All PCFs ⁶	
	Number	Balance at transfer (in millions)	Number	Balance at transfer (in millions)	Number	Balance at transfer (in millions)
2009	11,700	\$14.1	10,200	\$24.9	57,600	\$106.4
2010	10,400	\$12.4	11,200	\$22.5	45,700	\$70.5
2011	21,000	\$23.8	21,200	\$36.2	46,700	\$64.5
2012	20,500	\$35.2	21,400	\$37.5	41,900	\$72.7
2013	22,100	\$42.2	17,000	\$39.9	39,100	\$82.1

⁵ Oregon statute requires that non-exempt liabilities be sent to a PCF after a year has passed without payment on the account. The mean and median ages of accounts first sent to PCFs are consistently greater than one year. There are a number of valid reasons for this. For example, a taxpayer may have been making payments and then stopped, or a wage source may have been lost for a taxpayer who was being garnished. An account may have been exempt, such as due to bankruptcy, and was subsequently sent to a PCF after the bankruptcy cleared.

⁶ The figures for all PCFs include liabilities sent to any PCF, and these figures will be larger than the sum of liabilities sent to Collection Firms 1 and 2.

Exhibit 4: Liabilities sent to PCFs for the first time by fiscal year

FY	Collection firm 1		Collection firm 2		All PCFs ⁷	
	Number	Balance at transfer (in millions)	Number	Balance at transfer (in millions)	Number	Balance at transfer (in millions)
2009	2,200	\$2.6	2,500	\$5.1	12,800	\$19.7
2010	4,800	\$4.4	5,500	\$10.8	23,900	\$30.7
2011	12,500	\$11.2	8,200	\$14.2	24,400	\$28.6
2012	17,000	\$27.2	16,500	\$27.4	33,500	\$54.6
2013	18,200	\$33.8	14,800	\$30.7	33,000	\$64.5

Time it takes PCFs to collect past due DOR liabilities

Gauging the time it takes PCFs to collect past due DOR liabilities is not a straightforward task. The main complication is in identifying what it means “to collect.” One challenge in calculating a fixed measure is that the balance due is not a static figure. Not only are penalties, fees and interest added to the tax liability, but the original tax can be adjusted if a taxpayer files an amended tax return.

Another challenge is in determining what counts as a liability being collected. Most accounts sent to a PCF are not “paid in full.” In fact, most of these accounts do not receive a payment at all. Since the majority of liabilities sent to PCFs have been in DOR’s collection process for at least a year, it is expected that these liabilities would be relatively more difficult to collect.

Typically, DOR’s in-house collections staff gauge efforts in terms of receiving a payment. This is also a useful frame of reference for gauging the effectiveness of collections efforts of PCFs.

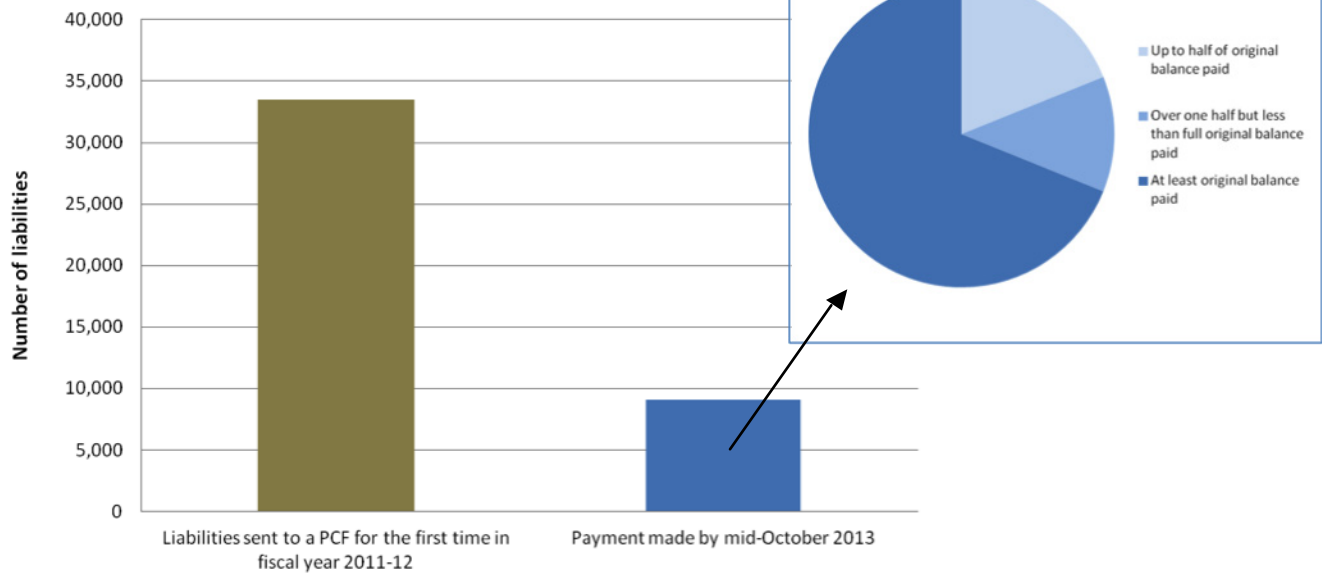
To illustrate, consider the 33,500 liabilities first sent to a PCF in fiscal year 2011–12. As shown in Exhibit 5, approximately 9,000, or 27 percent, had a payment by mid-October 2013. It took 227 days on average for the first payment to be made.⁸ Of the liabilities with any payment made, nearly 70 percent of liabilities received payments totaling at least the amount of the original liability.⁹ Payments can exceed the original liability balance due to additional penalties, fees and interest. This example suggests that receiving any payment is a proxy for a substantial amount of liability being paid.

⁷ The figures for all PCFs include liabilities sent to any PCF, and these figures will be larger than the sum of liabilities sent to Collection Firms 1 and 2.

⁸ The median number of days to receive the first payment was 184.

⁹ The original liability at the time of first being sent to a PCF includes penalties and interest already incurred by that time.

Exhibit 5: Liabilities first sent to a PCF in fiscal year 2011-12



Collection rate of PCFs

The calculation of a collection rate is challenging for reasons similar to those discussed in the previous section. For fiscal year 2012–13, \$9.5M was collected for liabilities that were assigned to PCFs during the fiscal year. The total dollars in liabilities at the beginning of the fiscal year was \$228.0M, with \$82.1M¹⁰ added during the year, for a 3.5 percent collection rate.¹¹ This collection rate represents the rate of collections for accounts assigned to PCFs, though the collections may have been made by a PCF, by DOR or through an automated offset process. For fiscal year 2012–13, nearly 25 percent of payments on liabilities after being assigned to a PCF were from garnishments. For the same period, 17.5 percent of payments came from automated tax refund offsets.

Amount and type of private collection fees

The Oregon Department of Administrative Services procures a statewide contract for all private collections firms that will collect debts owed to the State of Oregon. During the procurement process, each PCF negotiates an individual price agreement. As a result, each PCF has a unique collections fee structure, as reflected in Exhibit 6. Collections fees are a percentage of the amount collected.

¹⁰ These figures differ from those in DOR's report to LFO on liquidated and delinquent personal income tax accounts which only includes liquidated and delinquent debt. For fiscal year 2012–13, the LFO report included \$6.3M in collections of DOR liabilities that were assigned to a private collection firms. The total dollars in liabilities at the beginning of the fiscal year was \$167.4M, with \$84.9M added during the year, for a three percent collection rate.

¹¹ The collection rate is calculated as the total dollars collected during the fiscal year divided by the estimated total dollar value in liabilities for the same period, which is calculated as the beginning balance plus half the value of additional liabilities added during the period.

Exhibit 2: Age of liabilities sent to PCFs for the first time

Collection firm 1	Collections fee—23% Collections fee if DOR issues garnishment—10%
Collection firm 2	Collections fee for 1st time assigned to this PCF—17.9% Collections fee for 2nd time assigned to this PCF—22% Collections fee for subsequent assignments to this PCF—26% Collections fee if DOR issues garnishment—10%
Other fees	Record and release fees ¹² —\$16–\$29, varies by county Garnishment fee—\$10, \$20 if joint garnishment is issued against both debtors on a joint account Late payment penalty fees—5% of unpaid tax Fee for federal tax refund offset—\$22 per offset

In fiscal year 2012–13, Collection Firm 1 charged DOR’s clients \$513,000 in collections fees, \$362,000 for in-state debtors, and \$151,000 for out-of-state debtors. In the same year, Collection Firm 2 charged \$348,000, \$221,000 for in-state and \$127,000 for out-of-state.

Context for the strategic use of PCFs

DOR’s strategic use of PCFs can be considered within the context of the following:

- DOR’s long and short term compliance goals are the foundation for any strategy.
- Strategies of using PCFs should optimize the comparative advantages of DOR and PCFs in support of compliance goals.
- DOR’s partnership with PCFs works within the constraints of DOR’s system capabilities and business processes, as well as within statutory requirements and the statewide contract between the State of Oregon and PCFs.
- The use of PCFs by DOR depends on situational factors such as the level and composition of DOR’s accounts receivable, the staffing level at DOR, and economic conditions.

DOR’s compliance goals

DOR’s current compliance goals reflect the intention to balance the generation of short term revenue with long term voluntary compliance. The agency seeks to treat all taxpayers fairly and reduce the time to resolve outstanding tax due to the state. To meet compliance goals, DOR attempts to maximize public and private partnerships, including partnering with PCFs. An important element in DOR’s future compliance efforts will be the analysis of collections data to better understand the nature of debt and debtors, and to use this information in managing collections efforts.

¹² For a given liability, both a record and a release fee are typically assessed. So, in a county with a \$16 fee, \$32 would be added to the liability amount: \$16 for the record fee and \$16 for the release fee. The range of fees reported in this table represents the fees charged by counties at the time of writing this report.

Comparative advantages of DOR and PCFs in collecting tax debt

DOR and PCFs have a different set of collections tools that contribute to specific comparative advantages of each entity regarding the collection of state tax debt.

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
- Authority to easily and quickly issue notices of garnishment
- 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, PCFs will hire additional agents (per contract with DAS)
- Advanced skiptracing capability
- Use of systems capability to prioritize and work accounts more strategically than at DOR.

The latter two items may no longer be comparative advantages of PCFs with DOR's upcoming core system replacement. DOR expects to expand skiptracing capability and implement processes to prioritize and strategically work accounts on an aggregate level.

Constraints of DOR's system capabilities and business processes

Currently, many processes within the agency are manual, and this is particularly true for the management of accounts that are sent to PCFs. DOR anticipates additional system capabilities and business process improvements with the implementation of new core systems. With new systems, many manual tasks will be replaced with automated processes. One benefit will be to increase the capacity for DOR to manage accounts being worked by PCFs.

To strategically work debt, DOR needs to dynamically group and prioritize debt by characteristics such as the size, age and source of the debt. DOR has the ability to sort data by a wide variety of characteristics, but not on a broad scale suitable for strategic work agency-wide. With improved systems, DOR intends to incorporate collections prioritization methods that will not only support strategically working debt within DOR, but will also support a more comprehensive use of PCFs in collecting tax debt.

Situational factors: Accounts receivable, staffing, and economic conditions

The strategy around the use of PCFs is also shaped by situational factors such as the level and composition of accounts receivables, staffing at DOR, and economic conditions.

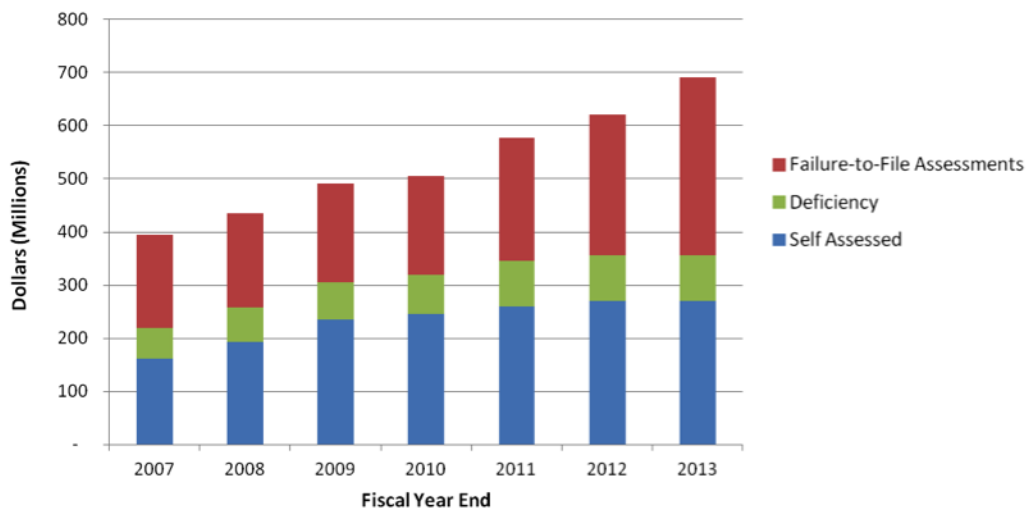
Accounts receivable

Personal income tax accounts receivable grew by \$70.3 million to \$691.1 million in fiscal year 2012–13.¹³ These accounts receivable may be categorized into three groups: failure-to-file assessments, deficiency liabilities and self-assessed liabilities. The red bars in Exhibit 8 represent accounts receivable from failure-to-file assessments. These liabilities occur when DOR identifies a taxpayer who did not file a tax return but should have, so DOR files a return for the taxpayer and sets up a liability due.¹⁴ Deficiency liabilities, in green, are liabilities resulting from an error in the tax amount due as indicated on a return as filed by a taxpayer. Self-assessed liabilities, in blue, are liabilities that result from a taxpayer directly filing a tax return reporting they owe.

Growth in the level of accounts receivable from fiscal year 2006–07 through fiscal year 2010–11 was primarily from growth in liabilities from taxpayers who directly filed returns reporting what they owed. However, from fiscal year 2011–12 to 2012–13, the level of accounts receivable representing taxpayers who filed tax returns was flat. The growth in accounts receivable during that period was almost entirely due to failure-to-file assessments.

Although failure-to-file assessments have been exempt from automatically being sent to PCFs since 2001, DOR manually sends these types of liabilities to PCFs on a case by case basis. The growing level of accounts receivable has prompted DOR to consider whether it would be feasible for PCFs to more fully assist in bringing down the level of accounts receivable through targeting these types of liabilities. This represents a change in thinking for DOR. Historically, DOR thought that these accounts were more appropriate for in-house collections efforts since DOR has the authority to negotiate the tax liability and assist the taxpayer in filing a return.

**Exhibit 7: Personal Income Tax
Accounts Receivable**



¹³ These figures are based upon DOR personal income tax and withholding financial transactions data and differ from figures reported in the annual LFO report which only includes liquidated and delinquent debt. Per the annual LFO report, personal income tax accounts receivable grew by \$77.8M to \$662.5M in fiscal year 2012–13.

¹⁴ The failure-to-file assessment category includes liabilities for taxpayers who subsequently filed a return after receiving a failure-to-file assessment from DOR.

DOR staffing

Although the agency's collections positions are relatively more fully staffed than in recent years, there has been high turnover, so many employees are relatively new at their jobs, and some of the more experienced agents are tasked with classroom training and mentoring, reducing their time for collections activities. With a stronger staffing situation, DOR is more likely to be able to partner with PCFs more strategically. However, the way that DOR's staffing situation impacts the use of PCFs is ambiguous and depends on circumstances.

Economic conditions

Although Oregon's employment growth is outpacing that of the nation, the growth is modest, and there is concern that the jobs added in the recovery from the Great Recession are concentrated in both low and high income rather than middle income categories. Oregon's unemployment rate was 7.8 percent in September 2013, higher than the national rate of 7.2 percent for the same month.¹⁵

With the current economic recovery, DOR expects some overall increase in taxpayer's ability to pay, with a higher number of taxpayers having a wage source and meeting filing thresholds. However, with the slow recovery and trend toward lower income jobs, DOR does not expect a dramatic increase in most taxpayer's ability to pay. Those with large amounts due will likely need to make payment arrangements. Many taxpayers will continue to have difficulty making payments—those seeking work that remain unemployed and particularly those who have left the labor market and are no longer seeking work.

DOR's future use of private collection firms

Historically, we have explored the use of PCFs as a tool for collecting state tax debt. We are 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. This will be facilitated with the additional system capacity and efficiency anticipated with the agency's new core systems. Another benefit that we expect to gain from the new systems is the ability to send monthly bills to taxpayers who have set up a payment plan. This is a model used by the IRS.

Like most state agencies in Oregon, we are required to send non-exempt debt to PCFs after a year has passed with no payment activity. Outside of this requirement, we send PCFs selected debt if the location of the debtor is unknown or known to be out of state, or if we are unable to identify a wage or asset source for the debtor. This way of using PCFs is in line with our comparative advantages of having access to various proprietary databases, such as Employment Department data, and the authority to easily and quickly issue garnishments. We leverage the PCF comparative advantages of having outgoing phone autodial and advanced skiptracing capabilities. Our agents make the determination as to which liabilities will be sent to a PCF according to the business practices established for working their individual queues.

To more fully and strategically use PCFs, we must implement automated processes for managing accounts that are sent to PCFs. We also need the capability to efficiently categorize

¹⁵ U.S. Department of Labor, Bureau of Labor Statistics: <http://www.bls.gov/bls/unemployment.htm>

and prioritize debt. When we have attempted to send PCFs a much larger number of accounts in the past, we have been constrained by our manual processes. We anticipate that our new systems will enable us to automate many of the current processes and create efficiencies for our agency and for PCFs working debt on our behalf.

One particular area to explore is the use of PCFs to assist with collecting debt due to tax returns filed by DOR for a taxpayer who did not file a return but should have. As noted, most of the recent growth in DOR's accounts receivable is due to liabilities from these failure-to-file assessments. We have traditionally worked these types of liabilities in house since we have the authority to negotiate the tax liability and assist the taxpayer in filing a return. In fact, these types of liabilities are currently exempt from the statutory requirement to send debt to PCFs after a year has passed with no payment activity. However, we are changing our thinking around the collection of failure to file liabilities. There may be potential to include PCFs more fully in collecting on these liabilities.

In terms of which accounts are the most suitable at any point in time for PCFs to work, we have some ability to segment debt, but not efficiently and on a broad scale. Part of the appeal of the new system is the ability to efficiently segment debt into groups according to certain characteristics such as the size of the account and previous payment history of the debtor. The system will give us an opportunity to explore many ways to sort and rank debt and will enable us to more efficiently incorporate data from other sources which could provide useful information to help understand debtors' ability and willingness to pay.

We will develop business strategies to define the characteristics for grouping and prioritizing the data. Strategies are expected to adjust to changing factors such as those noted earlier in this report. We will continue to look at ways to use PCFs most effectively in our collection efforts.