DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

May 18, 2007

The Honorable Charles E. Grassley
Ranking Member, Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Grassley:

I am responding to your letter dated May 3, 2007, on the Private Debt Collection (PDC) program. As requested, we updated the information contained in our January 26, 2007, response to the Joint Committee on Taxation to reflect activity through the end of April 2007.

As of April 28, 2007, we have placed 37,689 accounts with the PCAs at a value of $255.4 million. The PCAs have collected close to $20 million, which is tracking toward the higher end of our projections.

As requested, we will continue to provide status updates on the PDC program. We will send the updates to your office within two weeks of the end of each month.

I hope the information we provided is helpful. Please contact me or call Floyd Williams at (202) 622-4725 if you have additional questions.

Sincerely,

Kevin M. Brown
Acting Commissioner

Enclosure

Response to Questions from Joint Committee on Taxation Update
May 14, 2007

1. Current Results
In its first few months, the Private Debt Collection (PDC) initiative has surpassed initial planning assumptions for revenue generated and compliance impact. *Baseline projections call for a 10-15% collection yield over a 12 month period with a goal of a two-thirds case resolution rate over a similar period.* As more time passes, further conclusions can be drawn regarding actual performance vs. initial projections. In the first 2 months of operations, the dollars collected surpassed collections from the entire 1996-1997 program. The Private Collection Agencies (PCAs) have also performed well in their casework quality measures.

As of April 28, 2007, we placed 37,689 entities and 51,414 modules with the PCAs at a value of $255.4M. From these cases, 3,973 have resulted in full payment and 1,467 installment agreements have been approved to date. As of April 19, 2007, the PCAs have collected $19.49M in gross revenue with $15.53M considered commissionable revenue which resulted in $3.38M in payments to the PCAs.

Category	Measure	Period Ending	Program Cumulative
Financial and Operations	Dollars Placed (Assessed Module Balance)	4/28/07	$255.4M
	Entities Placed	4/28/07	37,689
	Modules Placed	4/28/07	51,414
	Actual Payments	4/19/07	$19.49M
	Commissionable Payments	4/19/07	$15.53M
	Commissions Paid	4/12/07	$3.38M
	Full Payments	4/28/07	3,973
	Installment Agreements	4/28/07	1,467
	Written Opt Out Requests	4/28/07	210
Quality	Taxpayer Satisfaction	11/27/07 – 3/30/07	94%
	Reported Contract Concerns	4/26/07	69 (0.18% of Entities Placed)
	Taxpayer Advocate Service (TAS) Referrals	3/31/07	276
	Regulatory and Procedural Accuracy	4/30/07	98.1%
	Timeliness	4/30/07	98.8%
	Professionalism	4/30/07	100%

2. Composition of The First Placement of Cases Assigned to PCAs[1]

a. Case Placement Characteristics for September 7, 2006 Placement
We were able to gather the information requested from our original placement of inventory. More time would be needed to analyze all cases that have been assigned, as we would need to analyze each weekly placement separately. However, since cases assigned through

[1] *The information in subsections a through c reflects historical data and therefore will not need to be updated monthly.*

January 25, 2007 were all from the same inventory group, we would expect the data to be similar for the approximately 26,000 assigned cases. All cases assigned on September 7, 2006 were individual income tax cases, with a single module balance due under $25,000 which is not under dispute by the taxpayer. These cases are drawn from Form 1040 delinquencies which can include returns with Schedules C, D, F as well as wage-earners. The table below shows the breakdown between Non-business Schedule cases and Schedule C and F cases placed with PCAs on September 7, 2006.

	Form 1040, Non-Business Schedules	Form 1040, Schedules C & F	Total
Number of Cases	6,905	4,657	11,562
Dollar Value	$45.26M	$20.02M	$65.28M

Cases are drawn from select inventory types that current IRS resources are not able to work through internal collection streams. Definitions of each current inventory type and their contribution to the September 7, 2006 placements are presented below.

Inventory Type	Definition	% Composition in First Placement
Status 24 (Queue)	Low Priority - Awaiting assignment based on available resources	54%
Transaction Code 530 Closing Code 03	Reported as Currently Not Collectible; Unable to Locate	1%
Transaction Code 530 Closing Code 12	Reported as Currently Not Collectible; Unable to Contact	10%
Transaction Code 530 Closing Code 39	Reported as Currently Not Collectible; Shelved due to lack of resources	35%

The majority of cases are based on balance due on return assessment sources as shown in the tables below. As previously stated all cases are agreed assessments and we consider them financial receivables.

Assessment Source	% Composition in First Placement
Balance Due on Return	69%
Other Agreed Assessments	31%

b. Average Age of Debt for Cases Placed September 7, 2006

For cases placed on September 7, 2006, the average age of debt from time of initial assessment to selection for PCA assignment is 949 days (by number of cases) with the following distribution.

Aged Days	% Composition in First Placement
121 – 180 Days	0%
181 – 360 Days	34%
361 – 720 Days	12%
721 – 1080 Days	11%
1081 – 1440 Days	15%
1441 – 1800 Days	15%
1801 – 2160 Days	9%
2161+ Days	4%

* Includes 760 cases that were not sent to PCAs post-suppression

c. Average Amount of Debt for Cases Placed September 7, 2006

Average balance due based on the aggregate assessed balance is $5,645. Distribution of cases across dollar categories is shown below.

Dollar Category	% Composition in First Placement
< $1,500	22%
$1,500 - < $5,000	30%
$5,000 - < $10,000	31%
$10,000 - < $25,000	17%

d. Major Differences across Placements

For the period September 7 - December 19, 2006, the program placed cases with the characteristics listed in section 2a. Changes in the average amount of debt and the average age of debt are a result of adjustments across the four inventory types. For the 24,497 cases placed through December 19, 2006, the average age of debt is 1,018 days and the average balance due based on the aggregate assessed balance is $4,199. Beginning in February 2007, we made more substantial changes to the inventory mix as listed below.

Start Date	New Type of Placement
February 2007	Multiple year cases
February 2007	Cases between $25,000-$100,000 balance due
March 2007	Cases with a designated taxpayer representative (CAF) before assignment (Post-assignment CAF cases are already being placed)
May-September 2007	Test of cases with associated delinquent return (TDI)

Information Updated as of April 2007

The data provided on the characteristics for the first placements applied to all placements through January 25, 2007. Beginning on February 8, 2007, the case characteristics changed slightly with the largest change to the balance due ceiling, which was increased from $25,000 to $100,000. Below are the statistics for the cases placed through April 28, 2007.

PDC Cases Placed Characteristics	
Average Balance (on 9/6/06)	$5,646
Average Balance (on 2/2/07)	$4,053
Average Balance (on 4/28/07)	$4,836
Highest Balance (on 4/28/07)	$88,932
Balances more than $50K (on 4/28/07)	256
Balances more than $100K (on 4/28/07)	0

e. *Current Status of September Placements*

Of the 11,562 modules placed in September 2006, approximately 3,059 (27%) have resulted in a full payment, installment agreement, or other type of closure (e.g. bankruptcy, decedent identification). We expect additional closures from this inventory as we continue processing those cases returned from the PCA whose contract was not extended. Approximately 8,517 modules were returned from the PCA from all placement months, and we are reviewing them for closure using information on file.

Of the $65.28M placed in September 2006, $11.98M has been collected through March 22, 2007, which is 18.4% of the assessed dollar balance placed. Collections for this placement are exceeding the projections planned, which ranged between $6.69M - $8.93M for this placement in March 2007.

3. Nature of the Liability of Cases Assigned to PCAs[2]

All cases assigned to PCAs are financial receivables that are self-reported or agreed upon amounts with the taxpayer.

a. Age of Cases

While it is not feasible to report time from the date the taxpayer filed, IRS systems do track cases from time of posting. For cases selected on September 7, 2006, 82.5% are considered simple balance due cases, indicating that the initial assessment is at the time of posting. For the remaining 17.5% of cases[3], we expect the time between posting and assignment to be between 1-3 years. An average and distribution of age based on initial assessment is presented in section 2b.

b. Criteria for Case Assignment

We have developed collection inventory management strategies designed to prioritize existing receivables in accordance with the availability of the resources required to perform the work. For a case to then be assigned to a PCA, it must reach one of the qualifying statuses, and satisfy additional criteria including minimum age in current condition. The case is then placed in the available inventory pool for distribution based on the weekly selection for each firm.

c. IRS Activities on Cases

Prior to being placed with PCAs, all cases have undergone IRS low cost collection efforts including IRS notice streams. Depending on the case priority, telephone personnel may have pursued some cases.

d. Minimum Time to Case Assignment

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[2] *The information in this section will not be updated monthly.*

[3] *Underreporter Program, Exam Assessments and Adjustments are considered non-simple balance due cases.*

Based on programming criteria and internal processes, the earliest a case could be placed with PCAs after posting in IRS systems is 4 months, which translates to about 6 months after filing.

e. Self-reported and Contested Cases

Cases selected for PCAs are self-reported liabilities and agreed upon assessments. If the taxpayer disputes their balance due after assignment to a PCA, PCA Policy and Procedures Guide outlines detailed procedures for handling Taxpayer Disputes. When the taxpayer disputes the tax amount or any penalties, the PCA must fully document all the taxpayer's issues and make a case referral to the Referral Unit (RU), staffed by IRS technicians, within 24 hours of securing the information. During the dispute review by the RU, the case will remain in the PCA's inventory; however the PCA must ensure no further collection activity takes place on the case until the RU contacts the PCA with written instructions. Also outlined are procedures for referring cases to the Taxpayer Advocate Service.

4. Dedicated Personnel

Updated as of April 2007

The IRS currently has 44 employees working both full- and part-time providing direct PDC program oversight and performing case related activities. These employees are divided between SB/SE Headquarters, Philadelphia Service Center (PSC) and Kansas City Service Center (KCSC). This staffing encompasses the Oversight Unit (inventory management, contract administration and quality review), as well as the Referral Units (taxpayer telephone assistance and PCA case contacts). Since not all of the employees work full-time on the project, their hours would currently translate to 24 FTEs for fiscal year 2007. The Oversight Unit has 12 full time staff - 1 Manager, 1 Management Assistant, 3 COTRs, 3 Management Information System (MIS) Analysts and 3 Quality Analysts. The Referral Units consist of 32 employees with 2 Managers, 2 Lead Contact Representatives (CR), 2 Inventory Control Specialists and 26 CRs. Throughout this implementation year, these numbers may vary slightly as new hires/detailed employees are added and the exact needs required to perform unanticipated activities (e.g. processing cases returned from PCA whose contract was not extended) are determined.

Additionally, there are currently 23 employees working in the project office which is the equivalent of an additional approximately 22[4] FTE for the year. Project team involvement is critical during the initial phases of this program with emphasis placed on ensuring systems are in place to prevent unauthorized disclosures, abridgement of taxpayer rights, etc. The project team is divided into leadership, technical, operations and strategy teams. The project leadership, technical and operations teams are expected to transition ongoing tasks to the permanent teams and stand down their work on the project during 2008. The precise transition will be mapped as we complete the next contract competition and finalize systems modifications required for inventory placements over the next few years. Only the Oversight Unit, Referral Unit and the strategy team, accompanied by some technical support, will remain on the project after 2008.

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[4] *Support from Counsel and Procurement is included in the overhead rates applied in the FTE calculations. This includes 1 FTE for TAS support on project management activities; the exact amount of TAS time spent on related casework is still being finalized.*

5. Response to Issues Raised by Taxpayer Advocate Service

a. Release of Proprietary Information

Project officials, together with representatives from IRS Procurement and the Office of Chief Council, are evaluating the release of appropriate sections of proprietary information to the public, including portions of PCA operations plans and the scripts that PCA employees use in taxpayer contacts. All of these documents were previously provided to the National Taxpayer Advocate. Further, the project team will include a statement in the next contract competition detailing the PCA-furnished information to be made available to the public.

b. Cost Effectiveness Study

In its original design, the study was created to determine the best use of additional funds to IRS by working the "next best case" as determined by IRS prioritization. This will illustrate the overall tax administration benefit of the use of PCAs and was covered in the GAO report issued in 2004. In addition to the "next best" comparison, the revised study will place cases with IRS personnel from the same inventory types as are being placed with PCAs. This will permit as direct a comparison as possible between similar PCA and IRS collection efforts.

c. English as a Second Language

PCAs have demonstrated initial capabilities for handling English as a second language cases. We have asked PCAs to report on their multi-language capabilities based on a "Readily accommodate", "Accommodate with some effort", "Accommodate through services available within the firm's locality" basis. In addition, the Referral Unit has provided multi-language support to the PCAs. Project officials will include English as a second language support as a requirement in the next RFQ, rather than an operations plan item, using the level of support required in this phase as a baseline for the requirement.

6. Program Costs and Projected Revenues

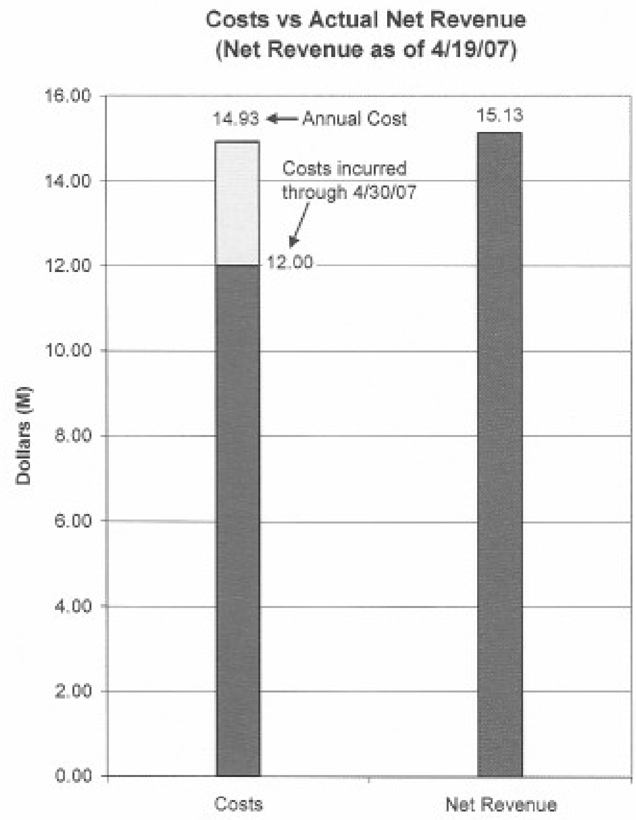
Information Updated as of April 2007

a. Program Costs

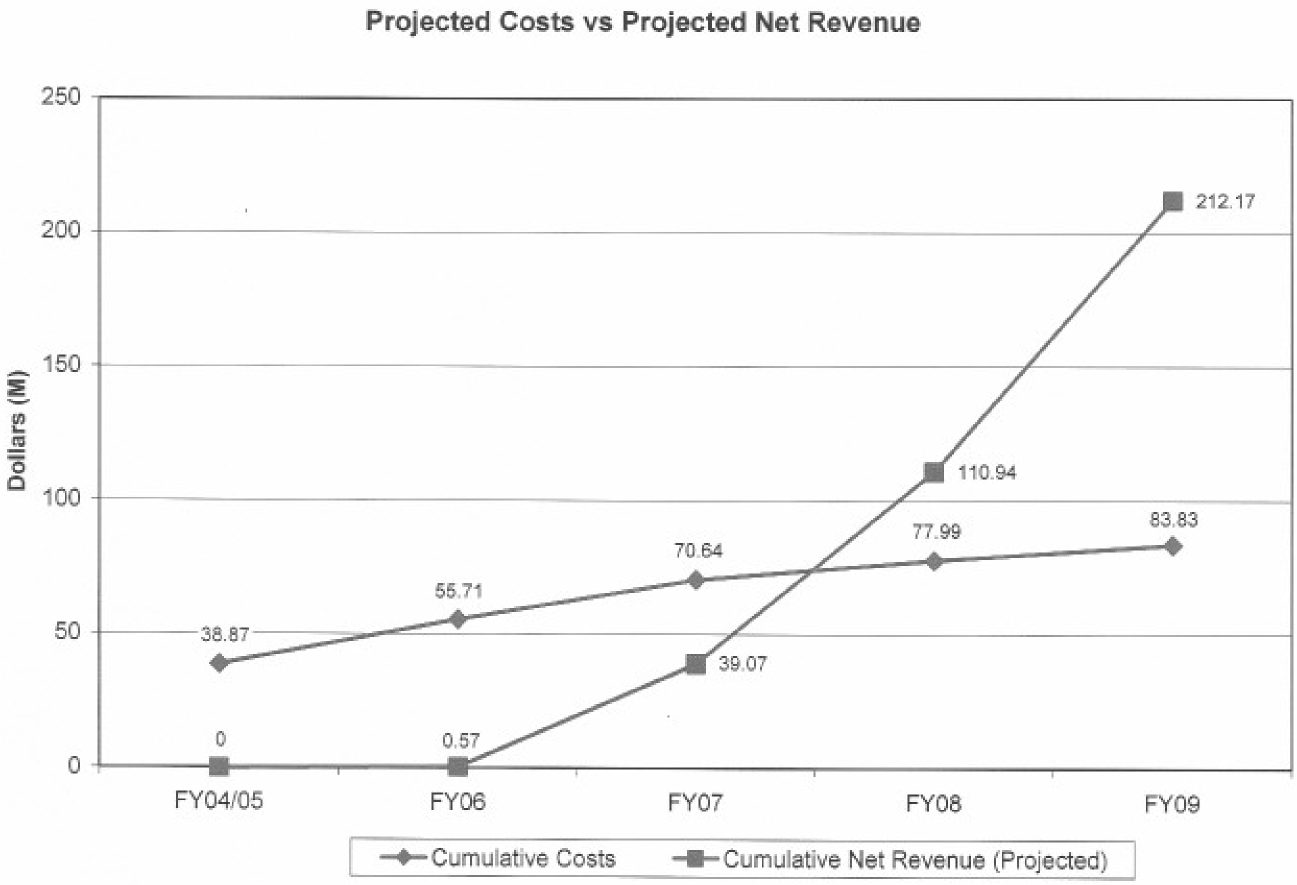
Based on conservative revenue projections, PDC is expected to reach its break-even point for all funds appropriated in April 2008 and is projected to generate between $1.5B and $2.2B in revenue over ten years. During this implementation year, there is the potential that other costs may be incurred due to unexpected activities. The Program did not set or publish an original estimate for break-even point but will continue to monitor delivery against the expected costs.

	FY04/05	FY06	FY07	FY08
Projected Revenue	-	$0.57M	$45.7M	$88M
PCA Fees Estimated	-	-	$8.7M	$19.3M
Adjusted Net Revenue	-	$0.57M	$37M	$68.7M
Program & IT Costs	$38.87 M	$16.84 M	$14.93 M	$7.35 M
Net Benefit	**($38.87 M)**	**($16.27 M)**	**$22.07 M**	**$61.35 M**
Cumulative Net Benefit	**($38.87 M)**	**($55.14 M)**	**($33.07 M)**	**$28.28 M**

Note: FY08 MITS costs updated April 30, 2007 to reflect placeholder amounts from the FY08 budget are included. Unfunded needs for FY07 & FY08 are not included. All other costs were updated February 2, 2007.



Costs vs Actual Net Revenue
(Net Revenue as of 4/19/07)
Dollars (M)
16.00
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
14.93 Annual Cost
Costs incurred through 4/30/07
12.00
15.13
Costs
Net Revenue

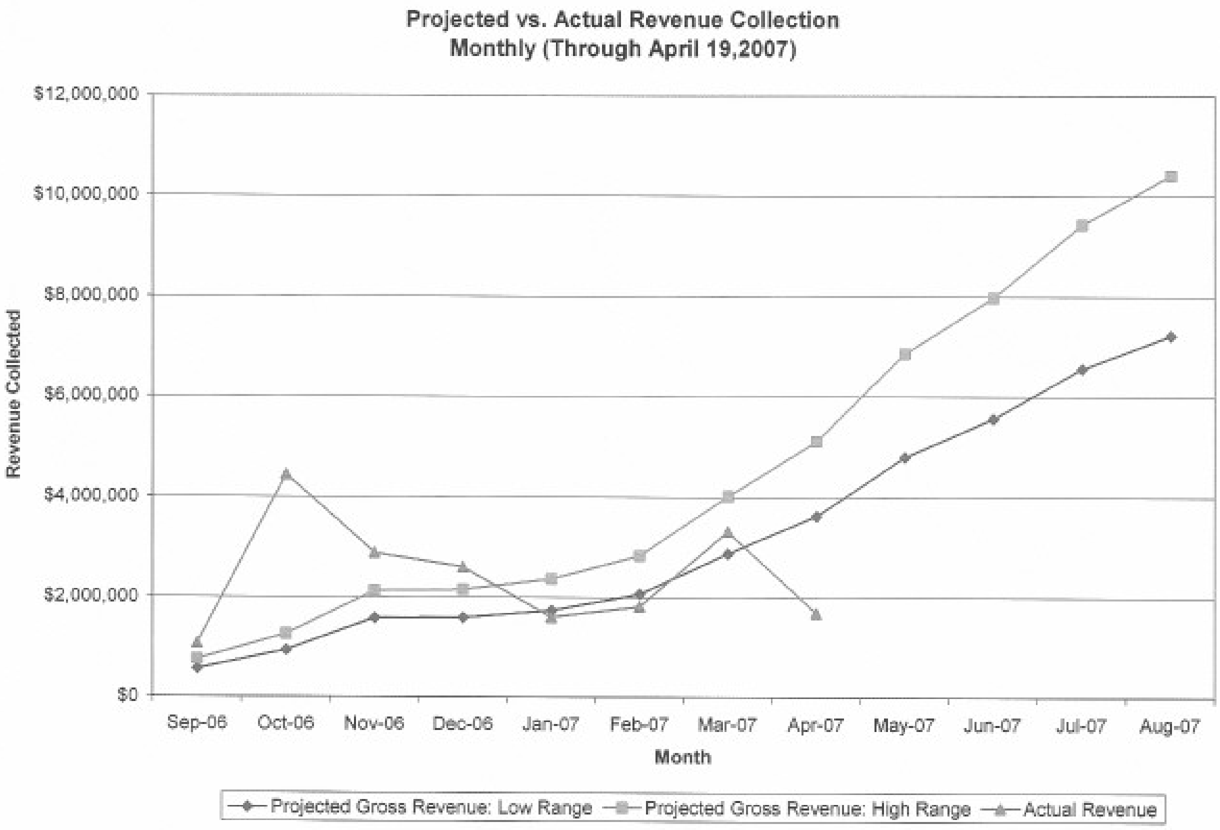


Projected Costs vs Projected Net Revenue
Dollars (M)
250
200
150
100
50
0
38.87
55.71
70.64
77.99
83.83
0
0.57
39.07
110.94
212.17
FY04/05
FY06
FY07
FY08
FY09
Cumulative Costs
Cumulative Net Revenue (Projected)

b. Revenue Projections

Original projections for gross revenue by the Office of Tax Analysis in 2004 called for the collection of $1.4B over 10 years. Currently the program is tracking towards the higher end of the projections. As of April 19, 2007, the gross revenue collected was $19.49M[5] while the projected range for revenue at the end of April is between $15.05 M - $20.69 M

	10 year Projections thru 2017
Total Cases Placed	*2.9M*
Total Dollars Placed	*$13.9B*
Predicted Gross Revenue	***$1.5B -$2.2B***
Estimated Commissionable Revenue	*$1.4B-$2.1B*
Estimated Net Revenue	*$1.2B - $1.8B*
Retained Acct Estimate	*$362 M- $546M*



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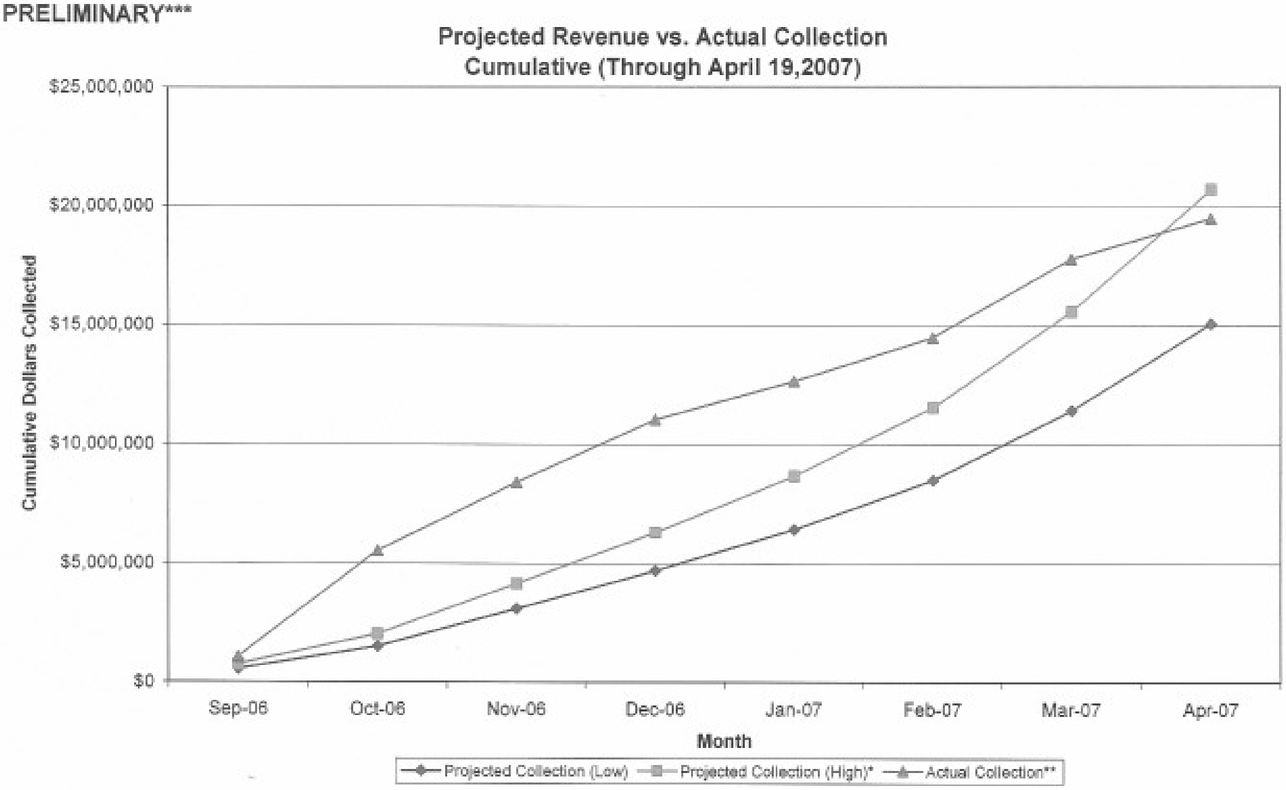
[5] *Collections in March-April 2007 were adversely impacted by IRS' decision not to extend the contract of one of its PCAs.*
- PCA 2 averaged $892K in commissionable collections from Oct 2006-March 2007
- PCA 2 had 372 modules ($1.6 million) of Installment Agreements in March 2007
- Volume of new modules placed fell from just under 10,000 in February to an average of 7,709 in March and April but the IRS anticipates increasing its placements to the remaining two PCAs in the coming months.

PRELIMINARY***



Note: Revenue projections are as of December 18, 2006

c. Return on Investment (ROI)

Overall, the IRS Return on Investment (ROI) is about 4 to 1. ROI resulting from IRS enforcement programs ranges from $3 to $14 for every additional $1 invested, depending on the type of enforcement activity. For example, labor-intensive activities such as the Collection Field Function have lower ROIs, and automated activities such as Automated Underreporter have high ROIs.

For the PDC program specifically, the potential return is between 3.2 to 1 and 3.6 to 1 for FY 2007, the first full year of implementation. This estimate is based on FY07 gross revenue of $45.7M - $65M, divided by the operating costs of the program, which include payments to Private Collection Agencies (PCAs) averaging 18.5% of gross program revenues and fully loaded projected FTE costs of $5.99M[6].

In FY08, we expect the PDC ROI will increase to between 4.0 to 1 and 4.3 to 1, once the program is in steady state. We base this estimate on FY08 gross revenue projections of $86M - $127M compared to operating costs of approximately $5.84M[7] in IRS costs and the average 18.5% payments to the PCAs.

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[6] *The $5.99M includes labor, benefits and non-labor costs incurred by the PDC program office, PDC project team, and support provided from Counsel, Small Business Self-Employed Finance, Procurement and Taxpayer Advocate Service. It also includes costs for performing background investigations and contractor support for the PDC Business Team. This does not include Information Technology (IT) system development and maintenance costs.*

[7] *Due to fluctuating costs, there may be additional costs incurred that would result in the actual ROI being closer to the low end of the range. The $5.84M does not include MITS Maintenance costs which were included in FY08 costs ($7.34M) on a prior page.*