

CRS Report for Congress

Federal Government Debt Collection: An Overview of the Treasury Offset and Federal Payment Levy Programs

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Summary

One of the numerous functions performed by the Financial Management Service (FMS) at the Treasury Department is the collection of delinquent tax and non-tax debt owed to a variety of state governments and federal agencies.

In managing the collection of this debt, the FMS relies on two programs it operates with assistance from several federal agencies: the Treasury Offset Program (TOP) and the Federal Payment Levy Program (FPLP). Both programs allow the FMS to offset or reduce specified federal payments to individuals or companies in order to satisfy qualified tax or non-tax debts. The TOP deals with federal non-tax debts (e.g., delinquent federal student loans) and state tax and non-tax debts, whereas the FPLP is targeted at federal tax debt only.

This report describes the origins and current status of both programs and discusses legislative initiatives in the 110th Congress to expand or modify their scope or design. It will be updated to reflect recent developments affecting either program.

Two bills passed by the House but not considered by the Senate would expand the list of federal payments subject to continuous levy under the FPLP. In February 2008, the House passed H.R. 4848. One of its provisions would direct the Centers for Medicare and Medicaid Services (CMS) to participate in the FPLP. It would also require CMS to take all necessary steps to ensure that all payments to health care providers under Medicare Parts A and B are processed through the program by the end of September 2011. The FMS and Internal Revenue Service would be required to provide all needed assistance to enable CMS to meet that deadline.

In addition, in late June 2008, the House passed a measure (H.R. 6275) to raise the exemption amounts for individual taxpayers under the alternative minimum tax in 2008. Among the offsets included in the bill is an amendment of IRC Section 6331(h)(2) that would allow the FMS to apply a continuous levy to federal payments to vendors that sell or rent property to the federal government and are delinquent in the payment of their federal taxes.

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Federal Government Debt Collection: An Overview of the Treasury Offset and Federal Payment Levy Programs

The Financial Management Service (FMS) is a bureau within the Treasury Department that serves four main purposes: it offers payment services to other federal agencies, operates the federal government's systems for collecting and depositing funds, provides government-wide accounting and reporting services, and manages the collection of delinquent debt owed to a variety of state and federal government agencies.

In managing the collection of this debt, the FMS relies on two programs it operates with assistance from several federal agencies. One is known as the Treasury Offset Program (TOP), which is designed to collect various delinquent non-tax debts (including overdue child support payments) by offsetting certain federal payments disbursed by FMS to individuals holding the debt. The second program, the Federal Payment Levy Program (FPLP), employs a procedure known as a continuous levy to collect overdue federal taxes from taxpayers who receive certain federal payments also disbursed by the FMS.

This report briefly describes the origins and current status of both programs and discusses legislation being considered in the 110th Congress to expand their scope. It will be updated to reflect recent developments affecting either program.

Origins and Current Status of the Federal Payment Levy Program

The FPLP grew out of a provision of the Taxpayer Relief Act of 1997 (TRA97, P.L. 105-34), which became Section 6331(h) of the Internal Revenue Code (IRC). In establishing the legal foundation for the program, Congress was hoping to improve the collection of delinquent taxes. IRC Section 6331(h) promotes this aim in two ways. First, it allows the Internal Revenue Service (IRS) to share with the FMS the confidential tax information needed to set up and operate a continuous levy program. Second, IRC Section 6331(h) gives the IRS the exclusive authority to activate a continuous levy on taxpayers with overdue tax debt.¹ Since July 2000, the FMS and

¹ U.S. Congress, Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1997*, JCS-23-97 (Washington: GPO, 1997), p. 219. Two other provisions of the act made noteworthy changes in the previous continuous levy. One modified the levy so that it applied to “non-means tested recurring” federal payments such as Social Security (continued...)

IRS have jointly managed the FPLP. Before the passage of TRA97, the IRS lacked the authority to create an automated process for identifying taxpayers with delinquent tax debt who receive federal payments and levying those payments.²

The FPLP facilitates the collection of overdue federal taxes by imposing a continuous levy on designated federal payments disbursed by the FMS to business and individual taxpayers holding delinquent tax debt. Such a levy remains in effect until the overdue federal taxes are paid in full. Current tax law allows the following payments to be levied (or reduced):

- federal employee retirement annuities,
- federal payments to federal contractors,
- federal employee travel advances or reimbursements,
- certain Social Security benefits, and
- some federal salaries.

Except for payments to federal contractors, the FMS is authorized to reduce those payments up to 15% to satisfy a delinquent tax debt. By contrast, payments to federal contractors can be reduced by 100%, or the amount of the overdue tax, whichever is lower.³

A critical component of both the FPLP and TOP is a database of individuals and companies with delinquent federal and state tax and non-tax debts that is maintained by the FMS. Federal and state agencies that collect debts on behalf of other agencies or are owed debts provide and update the information stored in this database.

The process of initiating a continuous levy mimics the process of initiating an offset through the TOP. To begin the levy process, the IRS sends an electronic file containing tax debt information to the FMS, which adds it to the TOP database.⁴ The FMS then searches for matches between the names and taxpayer identification numbers (TINs) in its database on pending federal payments and the names and TINs in its database on delinquent tax accounts. If a match is found, the FMS notifies the IRS, which in turn notifies the taxpayer in question of its intent to levy certain federal payments to that individual or company until the tax debt is paid in full. If 30 days pass with no reply from the taxpayer, the IRS authorizes the FMS to levy all eligible federal payments to that individual or company. The levy remains in effect until the tax debt is paid in full, or until the taxpayer makes other arrangements with the IRS

¹ (...continued)

payments. The other provision changed the levy so that it could reduce eligible federal payments to a taxpayer by as much as 15%.

² U.S. General Accounting Office, *Tax Administration: IRS' Levy of Federal Payments Could Generate Millions of Dollars*, GGD-00-65 (Washington: April 2000), p. 3.

³ A provision of the American Jobs Creation Act of 2004 raised the share of payments to federal contractors that can be levied from 15% to 100%.

⁴ In an effort to avoid imposing a levy on taxpayers who are not subject to one or levying payments for more than a taxpayer owes, the IRS updates the tax files in the FMS database once a week, except when maintenance work is being done on IRS's master tax file.

to pay off the debt. Whenever a payment is levied, the FMS sends a letter to the taxpayer explaining which payment was reduced and by how much, and advising the taxpayer to contact the IRS to resolve the matter.

Some federal tax debt cannot be collected through the FPLP, as a matter of law or policy. More specifically, the agency cannot levy the assets of individuals who have filed for bankruptcy, have applied for tax relief as an innocent or injured spouse, have made alternative payment arrangements with the IRS (e.g., an offer-in-compromise), or are suffering from certain hardships (e.g., residing in a federally declared disaster area) to recover overdue taxes. In January 2007, the IRS withheld 57% of the individual and business tax debt in its master file database from collection through the FPLP, down from a share of 60% in January 2006.⁵

The IRS activated for continuous levy \$63 billion in delinquent tax accounts in FY2007, up from \$53 billion in FY2006. But activating such an account for levy does not necessarily mean the overdue tax will be collected immediately. There is typically a huge gap between the total value of tax accounts subjected to the levy process and the total amount of delinquent taxes collected through that process in the same year. Collection of overdue taxes through the FPLP totaled \$345 million in FY2007, up from \$303 million in FY2006 and \$89 million in FY2003.⁶

Origins and Current Status of the Treasury Offset Program

The TOP arose from several provisions of the Debt Collection Improvement Act of 1996, which authorized the Treasury Department to establish a mechanism for withholding or reducing certain federal payments to pay off delinquent federal and state non-tax debt held by individuals. The Internal Revenue Service Restructuring and Reform Act of 1998 enlarged the scope of the TOP when it authorized the collection of state tax debt through the offset of federal income tax refunds.

Under the current program, the FMS offsets or lowers a variety of federal payments to satisfy an individual's delinquent federal non-tax debt, child support obligations, or state income tax debt. To be eligible for offset, the debt must be delinquent for a minimum of 180 days. The agency began offsetting payments to collect overdue federal non-tax debt in January 1999 and overdue state income taxes in January 2000. IRC Section 6402(e) and relevant state statutes allow the FMS to undertake this effort. At the present, 39 states and the District of Columbia participate in the offset process.

The following federal payments can be continuously offset:

⁵ Based on data obtained from Lisa Laparan of the IRS in an e-mail sent on June 9, 2008.

⁶ Financial Management Service, Office of Legislative and Public Affairs, *Fact Sheet: U.S. Department of the Treasury Delinquent Debt Collection, Fiscal Year 2007*, available at [<http://www.fms.treas.gov/news/index>].

- retirement payments from the Office of Personnel Management,
- IRS tax refunds (up to 100%),
- some vendor payments (up to 100%),
- federal employee travel payments,
- some federal salary payments (up to 15%), and
- Social Security benefit payments (see below).

Social Security benefit payments began to be offset in May 2001. The amount of the offset is the lesser of an individual's total debt, 15% of his or her monthly benefit payment, or the amount by which the monthly payment exceeds \$750.

The FMS offsets these payments on the basis of data on eligible delinquent debt it receives from federal and state agencies that either collect debt on behalf of other government agencies or are owed debts. Before the FMS issues a payment eligible for offset, it compares the information in its database on payment recipients with the information in its database on delinquent debt. If there is a match between the name and TIN of a recipient and the name and TIN of a debtor, the payment is offset to the extent allowed by law.

Before a federal agency refers a debt to the FMS for collection through the TOP, it sends the responsible individual three letters over a period of a few months informing him or her of its intent to offset future payments until the debt is paid in full. The final two letters are sent 60 days and 30 days before the initial offset is to take place. Each letter provides the name of the agency receiving the offset payment, along with the name and telephone number of an agency employee who can answer any questions about the overdue debt. The FMS also sends offset notices with the same information to the debtor 60 days and 30 days before the initial offset.

Debt collections through the TOP totaled \$3.6 billion in FY2007 and \$30.8 billion from the program's inception in FY1999 through FY2007.

Legislation in the 110th Congress to Modify the Scope of TOP and FPLP

Spurred by heightened concern over the size of the federal budget deficit and the federal tax gap, the 110th Congress is considering several proposals that would expand the scope of the FPLP.⁷ None would affect the operation of the TOP.

⁷ In its latest baseline forecast for the federal budget, the Congressional Budget Office estimated that the budget will have a deficit of \$357 billion in FY2008 and a cumulative deficit of \$339 billion from FY2009 through FY2013. See Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2009* (Washington: March 2008), Table 1-1, p. 2. The federal tax gap is the difference between the amount taxpayers should have paid and the amount they actually paid on a timely basis. There are two measures of this gap: the gross tax gap and the net tax gap. The latter reflects the amount of unpaid taxes in a given year eventually collected by the IRS through enforcement activities. According to the latest estimate by the IRS, the gross tax gap was \$345 billion (continued...)

At the center of congressional debate on the issue is the Medicare Provider Accountability Act, which has been introduced in the House (H.R. 4287) and the Senate (S. 1307). The act would require the Centers for Medicare and Medicaid Services (CMS) to make its payments to health care providers and vendors under Medicare Parts A and B available for screening for delinquent tax debt under the FPLP over two years: 50% of payments would be screened the first year and 100% of payments the following year.⁸ In addition, the proposal would subject these CMS payments to screening under TOP in a bid to recover more non-tax debt, such as unpaid child support and student loans. Finally it would implement a recommendation by an interagency federal task force (the Federal Contractor Tax Compliance Task Force, or FCTC) to speed up the process for recovering unpaid taxes through the FPLP. Under current law, the IRS has to send four tax bills and a special levy notice to a taxpayer before the agency can impose a levy on any property held by that individual or company. H.R. 4287/S. 1307 would streamline the process by enabling the IRS to initiate a levy of eligible federal payments to a tax debtor after what is known as a “notice and demand” for payment has been sent but before any levy notice and appeal proceedings have begun.

Congressional interest in the systematic offset of Medicare payments to providers under Parts A and B has grown in response to a report issued by the Government Accountability Office (GAO) at a hearing held by the Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations on March 20, 2007. The report found that the CMS had no “mechanism to prevent physicians, health professionals, and suppliers who have tax debts from enrolling in or receiving payments from Medicare.”⁹ Though the FPLP had been in operation since 1997, the CMS had not participated in it or an interagency task force formed to improve the program’s effectiveness. In the view of GAO researchers, this lack of involvement has entailed a significant loss of federal revenue over time. In their estimate, if CMS payments to health-care providers and vendors for Part B alone had been subject to levy through the FPLP, the federal government might have collected between \$50 million and \$140 million in delinquent taxes in the first nine months of 2005.¹⁰ As of September 30, 2005, according to the report, more than 21,000 physicians, health care providers, and suppliers who received Medicare Part B payments owed over \$1 billion in unpaid federal income, payroll, excise,

⁷ (...continued)

and the net tax gap \$290 billion in 2001. For more information on the gap and how it is measured, see CRS Report RL33882, *Tax Gap and Tax Enforcement*, by James M. Bickley.

⁸ Part A of Medicare offers hospital insurance to participants, while Part B provides supplementary health insurance for a wide range of outpatient medical care.

⁹ Government Accountability Office, *Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System*, GAO-07-587T (Washington: Mar. 20, 2007), p. 5.

¹⁰ *Ibid.*, p. 5.

unemployment, and other taxes.¹¹ Most of these taxpayers were organized for tax purposes as either sole proprietors or limited liability companies.

The House passed a bill (H.R. 4848) in February 2008 that included a provision directing CMS to participate in the FPLP. Under the provision, which would amend Title XVII of the Social Security Act, the CMS would be required to do whatever is necessary to ensure that at least 50% of payments under Parts A and B are processed through the program within one year after the passage of the act, at least 75% of such payments are processed through the program within two years, and all such payments are processed through the program by September 30, 2011. In addition, the bill would require the FMS and IRS to assist the CMS in meeting those deadlines.

What is more, in late June 2008, the House passed a measure (H.R. 6275) to raise the exemption amounts for individual taxpayers under the alternative minimum tax in 2008. Among the offsets included in the bill is a proposed amendment of IRC Section 6331(h)(2) that would allow the IRS to apply a continuous levy to federal payments to vendors that sell or rent property (as opposed to goods and services) to the federal government and are delinquent in the payment of their federal taxes.

In its budget request for FY2009, the Bush Administration expressed support for using the FPLP to screen CMS payments to vendors and providers under Medicare Parts A and B for overdue federal and state taxes. The Administration also proposed eliminating the current 10-year limitation on the collection of delinquent federal non-tax debt through administrative offset.

In a related development, the Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations held a hearing in November 2007 on the delinquent federal taxes owed by healthcare providers receiving payments under Medicaid and the possibility of collecting those taxes through the FPLP. The hearing was the fifth in a series exploring federal contractors with federal tax debts. It was intended to discuss the main findings of a 2007 report by the GAO that focused on Medicaid providers. According to the study, more than 30,000 Medicaid providers from seven states owed a total of over \$1 billion in overdue federal taxes in FY2006.¹²

A significant barrier to subjecting federal Medicaid payments to the FPLP has been their legal status. In consultation with the IRS Office of Chief Counsel, the Federal Contractor Tax Compliance Task Force (FCTC) has concluded that such payments do not qualify as “federal payments” under IRC Section 6331(h)(2)(A) — and thus cannot be continuously levied to collect delinquent federal taxes.¹³ Instead,

¹¹ GAO researchers say that these taxpayers probably owed more in unpaid federal taxes on that date, but it cannot be determined how much more. The IRS tax database used to derive the estimate of over \$1 billion does not account for taxes owed by firms and individuals that have not filed tax returns or that failed to report all their income. See *ibid.*, pp. 9-10.

¹² Government Accountability Office, *Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System*, GAO-08-17 (Washington: Nov. 2007), p. 8.

¹³ The FCTC was established in 2004 to address some of the key tax compliance issues (continued...)

according to these officials, federal payments to state Medicaid agencies are “more in the nature of a state entitlement than a federal payment includable in the FPLP.”¹⁴ In reaching this conclusion, the task force took into consideration the actual flow of Medicaid funds, the relationship between the federal agency that disburses the funds (CMS) and the state agencies receiving them, and the legal responsibility of CMS and the state Medicaid agencies in the case of a failure to pay providers for their services.

Companion bills introduced in the House (H.R. 5764) and the Senate (S. 2843) would remove this barrier by authorizing the IRS to subject “any (federal) payment to any medicaid provider or supplier under a State plan under title XIX of the Social Security Act” to continuous levy under the FPLP in order to pay delinquent federal taxes. The bills do not specify that a particular method be used for implementing such a levy, nor do they provide funds to cover the cost of doing so.

¹³ (...continued)

raised in a 2004 report by the Government Accountability Office on the unpaid tax liabilities of defense contractors. A central objective of the task force is to improve the operation of the FPLP. The task force is composed of representatives from the Department of Defense, IRS, FMS, Defense Finance and Accounting Service, CMS, General Services Administration, Office of Management and Budget, and Department of Justice.

¹⁴ See testimony of Linda Stiff, then the Acting IRS Commissioner, at a hearing held by the Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations on Nov. 14, 2007.