BUREAU OF THE
Fiscal Service
U.S. DEPARTMENT OF THE TREASURY

Assessing Interest, Penalties, and Costs

May 14, 2014

Establishing Debts

- Creditor agencies are required to establish debts.
  - Debt is any amount owed to the United States
    - 31 U.S.C. § 3701(b); 31 CFR 900.2(a)
  - Includes establishing interest, penalties, and costs
    - 31 U.S.C. § 3717; 31 CFR 901.9

Establishing Debts

- Exceptions to rules regarding interest, penalties, and costs:
  - program-specific rules
  - debt existing prior to October 1982
  - loan and contract provisions (including repayment agreements)

Assessing Interest:
Why it is necessary

- Interest compensates the government for the loss of the use of funds when a debt is not timely paid.

- Agencies **<u>must</u>** charge a minimum annual rate of interest on an outstanding debt that is owed to the United States.

Assessing Interest: When it is required

- Interest starts accruing from the date of delinquency.
  - Generally, this date is the date the agency mails the notice to the debtor.
  - Interest must be waived if debt is paid within 30 days.
- Interest continues accruing until the debt is paid in full or otherwise resolved.

Assessing Interest: Calculating the amount

- At minimum, interest is the same as Treasury’s Current Value of Funds Rate.
  - equal to the average investment rate for the Treasury tax and loan accounts
  - https://www.fms.treas.gov/cvfr/index.html

Assessing Interest: Calculating the amount

- Different rates may be warranted in certain circumstances.
  - A higher rate may be warranted if agency can demonstrate necessity.
    - Only in compelling circumstances (and similar debtors should be treated similarly).
    - Justification should be documented.
  - Agencies can also charge a different rate if rate is set by contract or by program-specific statute.

Assessing Interest: Calculating the amount

- The rate remains fixed for the duration of the delinquency.
  - Exception: breached repayment agreement (agency *may* charge new interest rate)
- Interest cannot be compounded or charged on administrative costs and penalties.
  - Exception: breached repayment agreement (agency *must* add charges that accrued but were not collected to the principal under the new payment agreement)

Penalties:
Why they are necessary

- Penalties discourage delinquency and encourage payment in full.

- See 31 U.S.C. § 3717; 31 CFR 901.9

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Penalties:
When they are required

- Agencies **must** charge a penalty on **any amount** outstanding more than 90 days.
- Penalty is charged from the date of delinquency.

Penalties: Calculating the amount

- 6% of the debt (principal plus interest plus costs) per year.
  - May charge less than 6% only with a compelling reason

Administrative Costs: Why it is necessary

- Agencies <u>must</u> charge costs to cover the costs of collection.
- <u>See</u> 31 U.S.C. § 3717; 31 CFR 901.9.

Administrative Costs:
When they are required

- Agencies must charge debtors for the administrative costs of collecting debts, once they become delinquent.

Administrative Costs: Calculating the amount

- Administrative costs cover the costs associated with collecting a debt from the date of the delinquency.
  - Administrative costs are calculated either as:
    - actual costs incurred for the individual debt; OR
    - the average cost incurred at similar stages of delinquency for similar types of debt.
      - Administrative costs may be calculated as a percentage of the amount collected.
  - Administrative costs accrue at a specific stage of delinquency or when actual cost is incurred.

Administrative Costs: Calculating the amount

- Administrative costs include:
  - Agency’s cost in servicing the delinquent debt
    - Staffing
    - Cost of systems used to track delinquent debts
    - Costs of credit reports, commercial databases, etc.
  - Agency’s costs from fees charged by DMS
  - Agency’s cost from fees charged by private collection contractors

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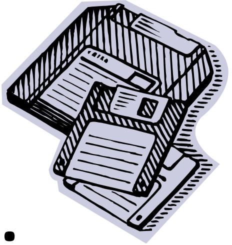
Administrative Costs: Calculating the amount

- Administrative costs do not include:
  - Cost of providing due process (e.g., hearings) <u>if</u> agency is passing on direct costs, rather than average costs over the whole program.
  - Cost of servicing current debt (e.g., initial billing notice).
  - Costs that would have been incurred by the agency regardless of whether the debt became delinquent.

Assessing Interest, Penalties, & Costs: The COLA alternative



- A Cost of Living Adjustment (COLA) is an alternative to interest, penalties, and administrative costs.
  - percentage by which the Consumer Price Index for year preceding the adjustment exceeds the Consumer Price Index for the year in which the debt was determined or last adjusted.
  - Increases to administrative debts using the COLA alternative shall be computed annually.

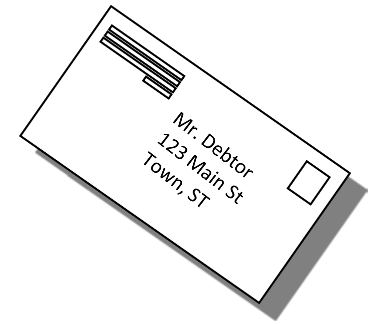
Assessing Interest, Penalties, & Costs: The COLA alternative

- Generally, a COLA should not be used.
- But, a COLA may be used:
  - on administrative debt;
  - if interest and other charges are difficult to calculate due to the age of the debt (or other similar justification); and
  - if charging interest alone and waiving penalties and administrative costs would not accomplish the same objective as using the COLA.
- Agencies should ensure that new debt collection systems have the capabilities to properly assess interest, penalties, and costs.

Application of Partial Payments

- Application of partial payments
  - contingency fees (e.g., DMS fees, private collection agency fees)
  - penalties
  - administrative costs
  - interest
  - principal
- See 31 CFR 901.9(f)

Prerequisites to Assessing these Charges



- Due Process
  - Agency must notify the debtor of the requirements regarding interest, penalties, and costs.
    - unless requirements for these charges are included in contractual agreement.
- Affirmative Collection
  - Agencies are required to take aggressive debt collection action.
  - Informing debtors of these charges can be an effective collection tool.

Exceptions to Assessing Interest, Penalties, and Costs

- Waiver (see next two slides)
- Agency's regulations shall specify circumstances in which such charges will not accrue for periods during which collection activity has been suspended pending agency review.

Mandatory Waiver

- Debt is paid within 30 days of the date of delinquency.
  - Interest and costs must be waived.
- If the interest provisions of the Servicemember's Civil Relief Act (SCRA) apply.
  - 6% limit on annual “interest” for debts incurred prior to military service, if servicemember provides written notice and copy of military orders
- 31 U.S.C. 3717(d); 31 CFR 901.9(g)

Permissive Waiver

- In limited circumstances, interest, penalties, and administrative costs, can be waived (in whole or in part for each separate charge), **on a case-by-case basis**, beyond the 30-day grace period and regardless of the amount of the debt:
  - if there is statutory authority to waive the underlying debt
  - on a case-by-case basis (extension of 90 day grace period)
  - compromise standards
    - E.g., inability to pay full debt
  - against equity and good conscience
    - E.g., agency did not complete hearing within statutory require time frame (may waive charges that accrued during agency's delay)
  - not in the best interests of the United States

- 31 U.S.C. 3717(d), (h); 31 CFR 901.9(g)

Hypothetical Questions

- Can agencies offer an “amnesty month” to waive interest, penalties, and costs for any debtor who agrees to pay the principal amount of the debt?

- Can agencies impose interest, penalties, and costs on states and localities?

- If a debtor appeals the validity of a debt, can interest be charged during the duration of the appeal?

- Can the debtor be charged for the costs incurred as a result of the appeal?

Questions