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CLOSING THE TAX DEBT LOOPHOLE: WHY THE FTC SHOULD ENFORCE THE DEBT RELIEF RULE AGAINST TAX DEBT RELIEF COMPANIES

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I. INTRODUCTION

"Do you owe back taxes? Are you tired of the IRS breathing down your neck? Call us today! We'll help you settle your tax debt for pennies on the dollar! We've helped thousands of people just like you to cut tax debt in half in just six months!"[1] Although some people know a scam when they see one, to those who find themselves in serious debt, an advertisement like this can sound like the answer to their prayers.[2] While some debt relief companies do legitimately try to help their customers, many others prey on consumers' misfortune, ignorance, and monetary mismanagement by promising incredible results and taking payment upfront, but failing to actually help reduce the customer's debt.[3]

By 2009, so many people had complained of deceptive advertising, lack of results, and outright fraud in the debt relief industry that the Federal Trade Commission ("FTC") promulgated a rule regulating what companies could promise in their sales pitches and prohibiting companies from accepting fees prior to rendering a service.[4] Surprisingly, the FTC excluded one category of debt relief companies from the ambit of these protective provisions—*tax* debt relief companies, thus allowing these entities to continue engaging in the same fraudulent and deceptive practices that the FTC found so injurious to consumers.[5]

This article aims to explain why the FTC should reverse its decision

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[1] *See Reduce IRS Tax Debt Up to 85% by IRS Tax Relief Programs*, YOUTUBE (Feb. 10, 2013), https://www.youtube.com/watch?v=nGBW9jmEoAk; *TV Commercial*, YOUTUBE (Oct. 28, 2010), https://www.youtube.com/watch?v=PJNNOEBOUsg; *TV Commercial*, YOUTUBE (Dec. 15, 2011). https://www.youtube.com/watch?v=0F-JGBoJE4E.

[2] Donna Fuscaldo, *Don't Become a Victim of a Tax-Relief Scam*, FOX BUS. (July 30, 2013), http://www.foxbusiness.com/features/2013/07/30/dont-become-victim-tax-relief-scam.html ("'Tax scams are alive and kicking,' says Mitchell Freedman, a certified public accountant in Westlake Village, Calif. 'More and more people are being caught up in them.' Looking to prey on the desperate, scam artists peruse tax lien notices to identify taxpayers that have Uncle Sam breathing down their necks and then offer them bogus tax resolution services.").

[3] *Id.* ("'In most cases, they ask the customer to pay a fee in advance; unfortunately, all too frequently, they do nothing,' says Freedman, noting that one company was able to fraudulently collect tens of millions of dollars on behalf of tax payers without bringing any resolution in just a few years.").

[4] FTC Telemarketing Sales Rule, 75 Fed. Reg. 48,458 (Aug. 10, 2010) (codified at 16 C.F.R. pt. 310) [hereinafter Final Rule].

[5] *FTC Enforcement Policy: Tax Debt Relief Services and The Debt Relief Amendments to the Telemarketing Sales Rule*, FED. TRADE COMMISSION (Oct. 27, 2010), https://www.ftc.gov/system/files/attachments/press-releases/ftc-issues-enforcement-policy-statement-new-debt-relief-rule/102710tsrdebtrelief.pdf [hereinafter FTC Policy Statement].

to exclude tax debt relief companies from the regulations it deemed necessary to protect consumers from abuses prevalent in the industry. Section I describes the historical context leading to the birth of the debt relief industry, the rise of abusive practices therein, and the largely failed attempts to reduce those practices. Section II explains the FTC's decision to craft and impose new regulation, the "debt relief rule," despite opposition from the industry. The Section goes on to describe the FTC's unexpected decision to defer enforcement of the rule against tax debt relief companies. Section III proposes that the FTC close the current tax debt loophole in order to grant injured parties a more effective litigation path towards remedy. This Section also explains that enforcing the debt relief rule against tax debt relief companies comports with the FTC's policy goals in creating the rule, as tax debt relief companies pose the same threat to consumers as the rest of the industry.

II. BACKGROUND

A. Birth of the Debt Relief Industry

In the late 1990s and early 2000s, Americans found themselves in increasing amounts of debt, and the inability to make required payments became more common.[6] The first generation of debt relief companies emerged at the behest of creditors hoping to recoup the unpaid debt of overextended consumers on the verge of default.[7] These companies, which operated as nonprofits, offered three types of assistance to indebted consumers.[8]

"Debt management" providers, acting as intermediaries to the creditor, helped debtors to map out a practical installment plan intended to facilitate full payment of the customer's debts, usually within a three to five year period.[9] Other entities offering "debt settlement" guided a customer nearing default in making a settlement offer of a lump sum to each creditor, typically in an amount substantially less than the full debt.[10] A third strain of providers, calling themselves "debt

[6] Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 41991 (proposed Aug. 19, 2009) [hereinafter Proposed Rule].

[7] *Id.* at 41,990, 41,994 ("For decades, debt relief services were almost exclusively the province of nonprofit credit counseling agencies (''CCAs''). Beginning in the mid-1960s, creditor banks initiated this model, providing funding for CCAs with the intent of reducing personal bankruptcy filings.").

[8] *Id.*

[9] *Id.* ("[C]ounselors work as a liaison between consumers and creditors to negotiate a 'debt management plan' ("DMP") — usually for the repayment of credit card and other unsecured debt.").

[10] *Id.* at 41,993.

negotiators," communicated with creditors on their customer's behalf to suspend penalty fees and obtain lower monthly payments and interest rates.[11] While a majority of the industry focused on credit card debt, a handful of companies carved out a niche by specializing in assisting consumers with tax debt.[12] Instead of negotiating with credit card companies and banks, these agents dealt with the Internal Revenue Service ("IRS") and state tax entities.[13]

As consumer debt rose, the largely unregulated debt relief industry grew to meet the increasing demand and shifted to a for-profit model.[14] Unfortunately, increasing opportunity, competition, and specialization in the industry did not result in increased efficiency, efficacy, and customer service, but instead, in a proliferation of abusive and deceptive practices against a vulnerable and largely defenseless customer base.[15] Opportunists began to capitalize on the desperation and ignorance of indebted consumers by exaggerating their abilities to solve debt problems, but becoming less vigilant about fulfilling their promises.[16]

B. Rise of Abusive Practices in the Debt Relief Industry

The debt relief industry became infamous for defrauding customers and engaging in other abusive practices.[17] In addition to making unauthorized withdrawals from customer accounts, the most common abusive practices involved deceptive advertising and fee structures that required customers to pay upfront, before the rendering of services and regardless of whether the customers ever received those services.[18]

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[11] *Id.* at 41,997.

[12] Sandra Block, *Some Tax Resolution Companies Are Scams*, USA TODAY (May 24, 2011, 1:30 PM), http://usatoday30.usatoday.com/money/perfi/columnist/block/2011-05-23-tax-resolution-scams_n.htm.

[13] *Id.* (Although many of these agents are tax attorneys, certified public accountants or "enrolled agents" (tax professionals authorized to practice before the IRS), some hold no qualifications and call themselves "tax consultants," but are nothing more than specialized salespersons.).

[14] Proposed Rule, *supra* note 6, at 41990–93 ("As consumer debt has grown in recent years, so have the number and type of entities that provide, or purport to provide, services to consumers struggling with debt . . . These developments have created an opportunity for a new debt relief business model offered by for-profit debt settlement companies.).

[15] *Id.* at 41,993.

[16] *Id.* at 42,002.

[17] *Id.* at 41,995.

[18] *Id.* at 41,994.

1. Deceptive Advertising and Fraud

Increased competition and opportunity rewarded debt relief companies willing to say whatever was necessary to convince consumers to purchase their services.[19] Companies grossly misrepresented the success rates of their programs and the satisfaction of past customers,[20] and failed to disclose the potential risks and pitfalls of participating in their programs.[21]

Companies used tempting hooks to grab potential customers' attention, saying they could settle debt "for pennies on the dollar" or "for a fraction of the debt owed."[22] They guaranteed a certain percent reduction in total debt[23] or promised relief in a specific amount of time.[24] They promised they could stop contacts from creditors and debt collectors, and that they could reduce monthly payments, interest rates, and late fees.[25] Companies touted special relationships with credit card companies that would facilitate favorable negotiations that consumers could not achieve on their own.[26]

Predictably, many companies failed to deliver.[27] Oftentimes, these promises were outright lies or gross exaggerations meant only to mislead customers.[28] In some cases, relief took much longer than advertised while monthly fees accumulated or the company achieved much less favorable terms than they promised.[29] Sometimes,

[19] *Id.* at 41,995.

[20] *See, e.g.*, FTC v. Innovative Sys. Tech., Inc., No. CV 04-0728 GAF (JTLx) (C.D. Cal. 2004) (prohibiting "debt resolution experts" from making factual misrepresentations "material to a consumer's decision to buy or accept . . . services"); FTC v. Debt-Set, Inc., No. 1:07-cv-00558-RPM (D. Colo. 2007) (requiring "clear and conspicuous" disclosure of information to prospective customers).

[21] Proposed Rule, *supra* note 6, at 42,002. For example, some creditors simply refuse to accept a settlement offer, change their interest rates, or reduce penalty fees.

[22] *Id.* at 41,993. *S ee also* FTC v. Am. Tax Relief LLC, No. CV 11-6397 DSF (PJWx), 2012 WL 8281722, at *3 (C.D. Cal. Aug. 8, 2012).

[23] *See, e.g.*, FTC v. Innovative Sys. Tech., Inc., No. CV 04-0728 GAF (JTLx) (C.D. Cal. 2004); FTC v. Debt-Set, Inc., No. 1:07-cv-00558-RPM (D. Colo. 2007).

[24] *See, e.g.*, FTC v. Innovative Sys. Tech., Inc., No. CV 04-0728 GAF (JTLx) (C.D. Cal. 2004); FTC v. Debt-Set, Inc., No. 1:07-cv-00558-RPM (D. Colo. 2007).

[25] Proposed Rule, *supra* note 6, at 41,993.

[26] *See* FTC v. Debt Solutions, Inc., No. CV06-0298JLR (W.D. Wash. 2007).

[27] Proposed Rule, *supra* note 6, at 41,994.

[28] *Id.*

[29] *See, e.g.*, *Growth of the Debt Settlement Industry*, DEBT SETTLEMENT USA, at 10, *available at* https://www.ftc.gov/sites/default/files/documents/public_comments/debt-settlement-industry-public-workshop-536796-00006/536796-00006.pdf (''Fraudulent firms also regularly fail to provide the services promised to consumers by claiming that they can help them become debt free in an unrealistically short

continued . . .

companies attempted to help their customers, but failed because some creditors simply refused to negotiate or accept a settlement offer, change interest rates, or reduce penalty fees.[30] In these situations, hopeful customers often suffered increased penalties, mounting interest, and damaged credit scores; meanwhile, the debt relief companies refused to refund the fees already paid that they had not earned.[31]

2. Upfront and Excessive Fees

The practice of charging upfront fees caused the greatest harm to consumers.[32] Some companies charged thousands in upfront fees and punishing monthly payments without providing any service to the customer, while others glossed over their fee structure during the sales pitch, locking customers into a program that they could not afford and refusing to provide a refund.[33] Many customers complained that the debt relief company they hired for assistance disappeared after receiving the initial payment.[34] Other customers received continued assurances of progress on their case, only to discover later that the company had done no more than complete preliminary paperwork.[35]

amount of time and/or promise too low of a settlement.'').

[30] Proposed Rule, *supra* note 6, at 42,002 ("The fact that some creditors and debt collectors will not participate in debt relief programs—whether to offer concessions or accept a lower balance repayment option—is likely unknown to consumers.").

[31] *Id.* at 41,996.

[32] *Id.* ("Consumers often suffer irreparable injury as a result of paying a fee in advance of receiving services offered by a debt settlement company. These consumers, relying on the representations of results, pay fees to debt settlement companies believing that most or all of the payments are being saved for the promised debt settlement. Telemarketers' practice of taking fees before a settlement is obtained results in a number of adverse consequences: late fees or other penalty charges, interest charges, delinquencies reported to credit bureaus that decrease the consumer's credit score, and sometimes legal action to collect the debt. Given what appear to be the relatively low success rates for debt settlement plans, consumers who pay substantial fees up-front are likely to be harmed.").

[33] FTC v. Debt-Set, Inc., No. 1:07-cv-00558-RPM (D. Colo. 2007) (alleging that defendants misrepresented that they would not charge consumers any up-front fees before obtaining the promised debt relief, but required a substantial up-front fee). *See also AG Cooper Seeks to Stop Sham Credit Counselor*, N.C. OFF. ATT'Y GEN. (Oct. 10, 2006), http://www.ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Press-Releases/AG-Cooper-seeks-to-stop-sham-credit-counselor.aspx; Tracy Turner, *State Accuses Columbus Man of Credit-Counseling Scam,* COLUMBUS DISPATCH (July 12, 2006), www.columbusdispatch.com/live/contentbe/dispatch/2006/07/12/20060712-D1-01.html.

[34] Proposed Rule, *supra* note 6, at 42,007.

[35] FTC v. Debt-Set, Inc., No. 1:07-cv-00558-RPM (D. Colo. 2007) (asserting

continued . . .

Thousands of customers found themselves even further in debt than before they enlisted these companies for help.[36]

Tax debt relief companies actively participated in these abusive behaviors.[37] TaxMasters, a now defunct Texas company, committed 110,000 violations of the state's Deceptive Trade Practices Act and was ordered to pay $113 million of a $195 million judgment to defrauded customers.[38] A woman who famously called herself "The Tax Lady" on late-night television commercials settled a $34 million lawsuit for fraudulent business practices with the California Attorney General.[39] The FTC successfully sued a nation-wide provider of tax debt relief services, American Tax Relief, in a case discussed in detail later in this paper.[40]

C. Attempts to Reduce Abusive Practices

Many of the abusive practices that consumers accused the debt relief industry of perpetrating were already prohibited under the Federal Trade Commission Act[41] ("FTC Act"), which proscribed deceptive advertising.[42] Additionally, the Telemarketing and Consumer Fraud and Abuse Prevention Act[43] ("Telemarketing Act") already protected consumers from unwanted solicitous phone calls and the use of

that the defendants failed to take any action on clients' cases until months of payments had accrued); FTC v. Connelly, No. SA CV 06- 701 DOC (RNBx) (C.D. Cal. 2006) (alleging that defendant failed to inform consumers that 45% of their total program fees had to accrue before he would begin work on their account); James O'Toole, *TaxMasters Slapped with $195M Fraud Judgment*, CNN MONEY (Mar. 30, 2012, 7:24 PM), http://money.cnn.com/2012/03/30/news/companies/taxmasters-fraud/ (explaining that the state alleged that TaxMasters misled clients by claiming its employees would immediately begin work on a case, sometimes causing customers to miss IRS deadlines).

[36] *The Debt Settlement Industry*, CTR. FOR RESPONSIBLE LENDING (June 29, 2010), http://www.responsiblelending.org/research-publication/debt-settlement-industry ("Often, enrolling in a debt settlement service puts consumers in a worse position, i.e. facing increased debt, higher risk of (or actual) bankruptcy, ruined creditworthiness, heightened collections efforts and even lawsuits.").

[37] O'Toole, *supra* note 35.

[38] *Id.*

[39] Mark Anderson, *State Settles Suit Against 'Tax Lady' Roni Deutch*, SACRAMENTO BUS. J. (Aug. 10, 2015, 9:50 AM), http://www.bizjournals.com/sacramento/news/2015/08/10/state-settles-suits-against-tax-lady-roni-deutch.html.

[40] *See infra* note 113; *infra* Section III(a)(i).

[41] 15 U.S.C. § 45 (2012).

[42] *Id.*

[43] 15 U.S.C. § 6101–6108 (2012).

deceptive or coercive sales practices in such calls.[44] But the FTC, state attorneys general, and injured consumers struggled to enforce these laws against debt relief companies because of difficulty in discovery, complicated proof structures, and loopholes that allowed some companies to escape regulation.[45] Additionally, oftentimes the consumers injured by the abusive acts of debt relief companies simply lacked the resources necessary to pursue legal action.[46]

III. THE NEED FOR SPECIFIC REGULATION

As the problems continued, the FTC determined that further, more specific regulation was necessary to protect the public.[47] The Telemarketing Act authorized the FTC to promulgate rules to further the goal of consumer protection and empowered the FTC, private persons, attorneys general, and other state officials to bring civil action

[44] 15 U.S.C. § 6102 (2012).

[45] *See* Proposed Rule, *supra* note 6, at 41,997–42,000. *See also FTC Testifies About Ongoing Efforts to Protect Consumers from Deceptive Debt Relief Scams*, FED. TRADE COMMISSION (Aug. 12, 2010). The FTC Act's prohibition of the use of certain kinds of advertising (using deceptive or misleading statements or failing to disclose material terms of an agreement) can be difficult to enforce for several reasons. Finding sufficient proof can be a challenge when the offending statements were made verbally and without any record. Plaintiffs face difficulty in showing that the customer reasonably relied on any particular statement, even if one can show that the statement was made and that it was improper. Companies can often escape regulation by asserting that any illegal advertising practices were employed by a single rogue employee. The TSA only applies to telemarketing practices in which a company places unsolicited calls to the potential customer. Prior to the 2009 amendments to the TSR, a company could escape enforcement of the TSR's provisions if prospective customers call the company in response to advertisements seen on television or heard on the radio. The proliferation of advertisements and activities on the internet also demonstrated the insufficiency of the scope of the TSR. Proposed Rule, *supra* note 6, at 41,999. Additionally, the industry has a long history of companies masquerading as nonprofits while operating for profit. The IRS discovered scores of companies abusing nonprofit status by reaping the benefits without adhering to the restrictions.

[46] *The Debt Settlement Industry*, CENTER FOR RESPONSIBLE LENDING, http://www.responsiblelending.org/other-consumer-loans/debt-settlement/research-analysis/Debt-Settlement-The-Basics.pdf (last visited Apr. 4, 2016) ("The debt settlement model is an inherently flawed one, in that it requires consumers who are deep in debt (typically $20,000–30,000 worth, if not more) to save significant sums of money to settle each individual debt, but requires them to pay hefty up-front fees and monthly fees that leave the consumer with little savings left for settlement.").

[47] Proposed Rule, *supra* note 6, at 41,996–98 ("Based on its enforcement and outreach experience, including information from the Workshop, the Commission tentatively has concluded that additional legal restrictions are needed to address pervasive illegal conduct occurring in the sale of debt relief services.").

for violations of the Act.[48] The FTC crafted a rule requiring certain disclosures to help potential customers to make better informed decisions in purchasing debt relief services and prohibiting the practice of collecting payment prior to the performance of services.[49] However, the FTC excluded tax debt relief companies from the scope of its rule, leaving this sector of the debt relief industry unregulated.[50]

A. Low Rate of Success of Providing Promised Services

The Association of Settlement Companies ("TASC"), a trade association in the debt settlement industry, admits that rogue companies exist, operating fraudulent and abusive businesses at odds with interests of the legitimate industry.[51] TASC submitted to the FTC the results of a self-reported survey of its members to show the effectiveness of legitimate debt relief companies.[52] However, the survey's unimpressive results accomplished just the opposite—notably, fewer than twenty-five percent of customers completed debt relief programs when "completion" was defined as settling at least seventy percent of enrolled debt.[53] When the TASC allowed the term to go undefined,[54] the "completion" rates ranged from thirty-five to sixty percent.[55]

[48] 15 U.S.C. § 6102(b) (2012).

[49] 16 C.F.R. § 310 (2015).

[50] FTC Policy Statement, *supra* note 5.

[51] *See generally TASC Position Paper*, FED. TRADE COMMISSION (Mar. 9, 2016), *available at* https://www.ftc.gov/sites/default/files/documents/public_comments/debt-settlement-industry-public-workshop-536796-00013/536796-00013.pdf.

[52] *Id.*

[53] *See* CENTER FOR RESPONSIBLE LENDING, *supra* note 46 (While this figure is not quoted outright in the TASC's letter, the Center for Responsible Lending arrived at this figure by calculating the difference between the percent reported *either* completed *or* remaining in the program [35.4%] and the percent reported still remaining in the program [9.8%] to conclude that 24.4% had completed the program). *See also* Letter from the Association of Settlement Companies (TASC) to the Federal Trade Commission, commenting on the FTC's proposed amendments to the Telemarketing Sales Rule on the marketing of debt relief services at 10 (Oct. 26, 2009), *available at* https://www.ftc.gov/sites/default/files/documents/public_comments/2009/10/543670-00202.pdf.

[54] *See* Proposed Rule, *supra* note 6, at 41,995. By not defining "completion," the TASC allows companies to report "completion" when a customer settled 80% of his or her debt, or 50% of his or her debt, or simply was no longer enrolled as a customer, regardless of whether any debt was settled at all.

[55] *See TASC Position Paper*, *supra* note 51. *See also* Proposed Rule, *supra* note 6, at 41995. Some companies considered "completion" to mean settlement of 50%, 75%, or even 85% of debts. Some companies recorded a "completion" for a customer who was once enrolled in a program, but is no longer enrolled, without regard for whether any debts were settled at all.

Enforcement actions against debt settlement companies reveal an even bleaker picture of the industry.[56] In an action against a California company, the FTC presented evidence showing that only 1.4% of customers who entered the company's program obtained the promised result.[57] In another case, evidence revealed that 12–14% of customers had debts settled to the extent the company promised.[58] In requesting a restraining order against a Washington company, the FTC alleged that the company failed to achieve promised results in 99.5% of cases and failed to obtain any reduction in interest rates in 80.4% of cases.[59] A state action in New York alleged that two debt settlement companies provided promised results to 0.33% and one percent of their customers, respectively.[60]

B. Effect and Prevalence of Upfront and Excessive Fees

Even when companies succeeded in reducing debt, customers often lost these savings through payment of fees to the debt relief company.[61] Most companies charged an upfront fee equal to a certain percentage of the *debt* enrolled in the program, instead of retaining a portion of the *savings* that the company obtained for the customer.[62] TASC reports that companies commonly charge upfront fees equal to fourteen to eighteen percent of the customer's debt, which often represents a large percentage of the savings achieved.[63] The FTC reported companies charging advance fees as high as thirty to sixty percent of the consumer's debt.[64]

The advance fee model interferes with customers' ability to make

[56] Proposed Rule, *supra* note 6, at 41,995.

[57] *Id.* (citing FTC v. Nat'l Consumer Council, Inc., No. SACV04-0474 CJC (JWJX) (C.D. Cal. 2004)).

[58] *Id.* (citing FTC v. Connelly, No. SA CV 06- 701 DOC (RNBx) (C.D. Cal. 2006)).

[59] *Id.* (citing FTC v. Debt Solutions, Inc., No. 06- 0298 JLR (W.D. Wash. Mar. 6, 2006)).

[60] *Attorney General Cuomo Sues Debt Settlement Companies for Deceiving and Harming Consumers*, N.Y. ST. OFF. ATT'Y GEN. (May 19, 2009), http://www.ag.ny.gov/press-release/attorney-general-cuomo-sues-debt-settlement-companies-deceiving-and-harming-consumers.

[61] Proposed Rule, *supra* note 6, at 42,000.

[62] *Id. See also General Response*, TASC (Dec. 1, 2008), https://www.gpo.gov/fdsys/pkg/FR-2009-08-19/html/E9-19749.htm.

[63] Proposed Rule, *supra* note 6, at 42,000. Recall that this is the self-reported average from companies who are members of the trade organization. Anecdotal customer reports and other research show substantially higher fees.

[64] FTC v. Credit Restoration Brokers, No. 2:10CV00030, 2010 WL 1230609 (M.D. Fla. Jan. 9, 2010).

payments on their current debt or save enough to offer a lump-sum settlement to creditors, effectively making customers more likely to fail.[65] Even assuming that the company succeeds in reducing the consumer's debt, the company must save the person *more* than the amount charged for the consumer to have reaped any benefit.[66] The FTC also noted several instances in which companies claimed to charge no upfront fee, yet waited until the customer's monthly fees had accumulated to a certain percentage of the debt before they began work on that case.[67] Coupled with the low success rates of the industry, the fee structure highlights the abusive nature of the industry that allows companies to ensure that they receive payment regardless of whether the customer enjoys a benefit.[68]

The picture of the industry's effectiveness is deliberately blurry at best and shrouded in deceit and fraud at worst, and even the most disciplined and credible members of the industry often fail to provide the advertised service.[69] These shortcomings of the industry justify the FTC's decisions to increase regulation despite opposition.[70]

C. Industry Opposition to Regulation

[65] Proposed Rule, *supra* note 6, at 42,007 ("The practice of charging substantial up-front fees, as is the case with many debt relief services, is inherently inconsistent with the purported goal of the services.").

[66] *See FTC Policy Statement on Unfairness*, FED. TRADE COMMISSION (Dec. 17, 1980), https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness. *See also id*. For example, if a person enrolls $20,000 of debt, assuming a 15% fee, he or she must pay $3,000 upfront. The debt relief company must then save the customer *more* than $3,000 in the debt relief process for the customer to enjoy any benefit from the service at all.

[67] *See, e.g.*, FTC v. Debt-Set, Inc., No. 1:07-cv-00558-RPM (D. Colo. 2007) (alleging that defendants misrepresented the fee structure, telling customers that they did not charge an upfront fee, but waiting until their monthly payments reached a certain amount before beginning work on that); FTC v. Connelly, No. SA CV 06-701 DOC (RNBx) (C.D. Cal. 2006) (alleging that defendant failed to inform consumers that 45% of their total program fees had to accrue before he would begin work on their account).

[68] Proposed Rule, *supra* note 6, at 42,008 ("However, the record lacks empirical data on whether debt relief companies actually provide the debt relief as represented to consumers. In fact, the federal and state law enforcement record demonstrates that few, if any consumers who pay upfront fees, receive any benefits from the advance fee practice. Thus, any increase in costs resulting from the advance fee ban would be unlikely to outweigh the consumer injury resulting from the current fee practice.").

[69] *Id.*

[70] *Id.* ("Moreover, while the Commission acknowledges that debt relief services may have labor and operating costs, it notes that the actual benefit of allowing entities to recover these costs largely rests on their ability to deliver represented results—an ability that still remains largely unsupported by the record.").

The FTC received input from interested parties and industry members when it held a public workshop called "Customer Protection and the Debt Settlement Industry"[71] in 2008 and again during the notice and comment period of the rulemaking process.[72] Unsurprisingly, many debt relief companies opposed the regulation of their industry,[73] while others recognized the need for reform with respect to outright fraud, but advocated for regulation that would minimally burden the supposedly legitimate companies.[74]

The FTC rejected this approach for two reasons.[75] First, even legitimate debt relief companies have a poor track record of providing any benefit for their customers.[76] Secondly, the FTC perceived such overarching abuse of customers in the industry that it determined protecting consumers required more restrictive means than the industry members found palatable.[77] Therefore, the FTC, in crafting regulation, did not prioritize the continued operation of every company.[78] Instead, the FTC justifiably considered the potential shrinking of the industry to be part of the solution rather than a problem to be avoided.[79]

Many members of TASC agreed with the FTC's assessment that regulation prohibiting misleading and deceptive statements would improve the industry standard.[80] On the other hand, they opposed the advanced fee ban, arguing the necessity of upfront fees to pay for initial personnel and operating costs.[81] The FTC dismissed this argument,[82] arguing that consumers should not pay until they know whether or not the company will perform those services, pointing to the low success rates in the industry and the many lawsuits in which consumers complained that they paid an upfront fee and received nothing in

[71] Press Release, Federal Trade Commission, FTC to Host Debt Settlement Workshop (June 6, 2008), *available at* https://www.ftc.gov/news-events/press-releases/2008/06/ftc-host-debt-settlement-workshop.

[72] *See* Proposed Rule, *supra* note 6, at 41,998 (illustrating the Commission's invitation for written comments on the proposed rule).

[73] Final Rule, *supra* note 4, at 48,465.

[74] *See* Proposed Rule, *supra* note 6, at 42,008.

[75] *See id.* at 42,005–06; CTR. FOR RESPONSIBLE LENDING, *supra* note 36.

[76] *See* CTR. FOR RESPONSIBLE LENDING, *supra* note 36 ("The data shows that few consumers benefit while many are harmed . . . success rates are low, while fees are high and often, at least some debt (and commonly substantial debt) remains.").

[77] Proposed Rule, *supra* note 6, at 42,006.

[78] *Id.*

[79] *Id.* at 42,008.

[80] *Id.* at 41,997–98; Transcript of FTC Consumer Protection and Debt Settlement Industry Workshop (Sept. 25, 2008), 33, 46, 212–13, *available at* https://www.ftc.gov/sites/default/files/documents/one-stops/debt-relief-and-credit-repair-scams/officialtranscript.pdf.

[81] *TASC Position Paper*, *supra* note 51, at 6.

[82] Proposed Rule, *supra* note 6, at 42,008.

return.[83]

The debt relief business contains many inherent uncertainties,[84] and the debtors' vulnerability and desperation make them more susceptible to believing misleading advertising or taking a potentially high-payoff risk.[85] Therefore, allowing payment of fees only *after* the company provides the service gives consumers the best chance to succeed in paying off their debt and ensures that companies cannot cut-and-run.[86]

D. The FTC's Debt Relief Rule

In August 2009, the FTC proposed amendments to the Telemarketing Sales Rule ("TSR") to reduce abuse in the debt relief industry.[87] The final rule, published in 2010,[88] requires entities selling debt relief services for profit to make specific disclosures to potential customers in order to improve consumers' understanding of the potential benefits and risks, and the likelihood of success of the programs before they decide to buy.[89] Most significantly, the final rule forbade debt relief companies from requesting or accepting any fee prior to providing the promised service.[90] The rule also required companies to keep certain records to facilitate oversight and enhance compliance.[91]

The required disclosures increase the likelihood that consumers will

[83] *Id.*

[84] Proposed Rule, *supra* note 6, at 41,195–96. Is the creditor willing to make concessions or accept an offer of settlement? Will the customer be capable of adhering to the terms of the offer? Will the use of a debt relief program merely make the consumer's problems worse by triggering more late fees and worsening his or her credit score?

[85] *Id.* at 41,993.

[86] *Id.* at 42,002.

[87] *See generally id.*

[88] Final Rule, *supra* note 4.

[89] *Id.* at 48,465. The final rule required the following four disclosures: (1) the amount of time necessary to receive the represented results; (2) the amount of savings needed before the settlement of a debt; (3) if the debt relief program includes advice or instruction to consumers not to make timely payments to creditors, that the program may affect the consumer's creditworthiness, result in collection efforts, and increase the amount the consumer owes due to late fees and interest; and (4) if the debt relief provider requests or requires that the customer place funds in a dedicated bank account at an insured financial institution, that the customer owns the funds held in the account and may withdraw from the debt relief services at any time without penalty, and receive all funds in the account. *Id.* The FTC decided not to include three additional disclosures that it had originally proposed: (5) that creditors may pursue collection efforts pending the completion of the debt relief service; (6) that any savings from the debt relief program may be taxable income; and (7) that not all creditors will accept a reduction in the amount owed. *See id.*

[90] *Id.*

[91] *Id.*

make prudent choices,[92] but the ban on advance fees protects even the desperate and uninformed consumer.[93] Many of the deceptive advertising techniques lose their effectiveness if the company must perform the promised service before the consumer pays the fee.[94] Therefore, the advance fee ban reduces the company's incentive to inflate consumer expectations with misrepresentations.[95]

Enforcement of the advance fee ban is also substantially simpler than suing for fraudulent and deceptive advertising.[96] In a suit for deceptive advertising, a plaintiff may fail because of the subjectivity of several malleable elements (such as a specific statement's capacity to mislead a reasonable consumer)[97] or because solid evidence of these elements may not exist (a common problem when attempting to prove a particular plaintiff reasonably relied on the defendant company's claims).[98] To prove a violation of the advance fee ban, the enforcing entity must establish only that (1) the company sold debt relief services (and was therefore subject to the rule) and (2) the company accepted fees prior to rendering the service.[99] The clarity and simplicity of the advance fee ban reduces a company's chance of wriggling out of enforcement because of a lack of sufficient evidence to show reliance or by claiming a rogue employee acted on his own.[100] Examples of these differences are discussed in Section III.

Taken together, these provisions represent a well-calculated effort to reduce the ability of debt relief companies to injure people already experiencing financial distress.[101] Therefore, it is puzzling that the FTC decided to defer enforcement of this rule against companies dealing in tax debt relief.[102]

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[92] *See id.* at 48,469–70.

[93] *Id.*

[94] *Id.*

[95] *Id.*

[96] *See infra* Section III(i)(a)-(b) and accompanying notes.

[97] *See infra* Section III(i)(a) and accompanying notes.

[98] *See infra* Section III(i)(a) and accompanying notes. To succeed on a claim for deceptive advertising, the injured party must show: (1) that a certain statement was made, (2) that the statement was inaccurate or lacked a reasonable basis in fact, (3) that the statement was likely to deceive or mislead the consumer, (4) that the consumer reasonably relied on the statement, and (5) that the customer's reliance on the statement proximately caused the injury. *See infra* Section III(i)(a) and accompanying notes.

[99] *See* FTC v. E.M.A. Nationwide, Inc., No. 1:12-CV-2394, 2013 WL 4545143, at *5 (N.D. Ohio 2013) (meeting these requirements constitutes a per se violation of the rule).

[100] *See infra* Section III(i)(a)-(b) and accompanying notes.

[101] Final Rule, *supra* note 4, at 48,467.

[102] FTC Policy Statement, *supra* note 5.

E. The FTC Defers Enforcement of the Rule Against Tax Debt Relief Companies

The proposed rule did not distinguish tax debt relief companies from the rest of the industry.[103] When promulgated in August 2010, the FTC's final rule specifically provided coverage of "all types of unsecured debts, including credit card, medical, and tax debts."[104] Before the provisions took effect in October, the FTC issued a policy statement announcing it would defer enforcement of the new provisions against entities providing tax debt relief services because some providers of these services had questioned whether tax debt qualified as "unsecured" debt since the IRS can potentially obtain a lien one's assets.[105]

Although the statement assures that the FTC "is considering other options, including additional rulemaking, to address deception and abuse within the tax debt relief industry," this supposedly temporary deferment remains in effect without any further comment or explanation.[106] The original provisions of the TSR do apply to tax debt relief companies,[107] but these companies can still charge upfront fees and need not make the required disclosures, even though the FTC found such restrictions appropriate for the rest of the industry.[108]

Without the benefit of these consumer protections, tax debt relief companies continue to engage in the actions that the FTC set out to eliminate in 2009.[109] The persistence of the problem is evidenced by the many complaints of fraud,[110] attempted judicial action,[111] and the

[103] Proposed Rule, *supra* note 6, at 41,999 ("The Commission intends that the definition of 'debt relief service' encompass a broad swath of debt relief activities, including offers of debt settlement or negotiation services and debt management plans. The definition of 'debt relief service' is, however, limited with regard to the underlying nature of the debt involved and would not reach offers regarding consumers' secured debt, such as mortgage loans.").

[104] Final Rule, *supra* note 4, at 48,467.

[105] FTC Policy Statement, *supra* note 5.

[106] *Id. See also Telemarketing Sales Rule*, OFF. INFO. AND REG. AFF., RIN3084-AB19 (Spring 2011), *available at* http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201510&RIN=3084-AB19 ("The Commission is considering possible amendments to the TSR to address tax debt relief services.").

[107] FTC Policy Statement, *supra* note 5.

[108] *Id.*

[109] *Tax Relief Companies*, FED.TRADE COMM'N CONSUMER INFO. (April 2013), https://www.consumer.ftc.gov/articles/0137-tax-relief-companies.

[110] *See infra* notes 223–26 and accompanying text.

[111] *See generally* Fed. Trade Comm'n v. Am. Tax Relief, 751 F. Supp. 2d 972 (N.D. Ill. 2010) (granting of a preliminary injunction against a tax debt relief company for violations of the Federal Trade Commission Act).

FTC's own Consumer Information page, posted in April 2013, which continues to warn consumers about the "fraudsters" contaminating the tax debt relief industry.[112]

IV. PROPOSAL: CLOSE THE TAX DEBT LOOPHOLE

The FTC should reverse its current position of non-enforcement of the debt relief rule against tax debt relief companies. The FTC originally deferred enforcement as a stopgap to allow time to conduct research and analysis.[113] The FTC took this position without notice,[114] and therefore the decision reflects only the interests of the regulated entities, leaving the regulatory beneficiaries without a voice.[115] The propriety of the abrupt decision to defer enforcement remains questionable since none of the comments prompting the FTC to take this stance appear on the rulemaking record.[116] Although the FTC's 2012 Regulatory Agenda promised that it would "[consider] possible amendments to the TSR to address tax debt relief services,"[117] the FTC did not include an invitation for public comment on the matter.[118]

The FTC's decision to defer enforcement against tax debt relief companies directly conflicts with the FTC's express goal to "encompass a broad swath of debt relief activities, including offers of debt settlement or negotiation services and debt management plans."[119] Tax debt relief companies create the same danger of injury as any other debt relief company and should therefore receive the same regulation.[120] The evidence of the strained attempts by injured consumers and regulators to rein in the practices of tax debt relief companies indicates the necessity of bringing these entities under the ambit of the rule as originally promulgated.[121]

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[112] *Tax Relief Companies*, *supra* note 109.

[113] *See* FTC Policy Statement, *supra* note 5.

[114] *See id.*

[115] *See supra* notes 103–112 and accompanying text.

[116] *See* 5 U.S.C. §§ 552–553 (2012). The APA requires agencies to provide notice of the issues at stake in a rulemaking proceeding, as well as a chance to comment on them. Because this is only a policy statement and not a rule, it would be difficult to challenge its propriety. Also, although the APA allows that at some point agency inaction can constitute an improper delay, even these five years that have passed since the FTC stated that it was considering the issue, this delay may not be sufficient to trigger judicial remedy. *Id.*

[117] *Telemarketing Sales Rule*, REGULATIONS.GOV, RIN3084-AB19 (Jan. 20, 2012), *available at* https://www.regulations.gov/#!documentDetail;D=FTC-2012-0008-0001.

[118] *See id.*

[119] Proposed Rule, *supra* note 6, at 41,999.

[120] *See generally infra* notes 211–226 and accompanying text.

[121] *See id. See also infra* notes 122–188 and accompanying text.

A. Advance Fee Ban Simplified Litigation

1. *FTC v. American Tax Relief*—An Uncharacteristic Success

The FTC successfully stopped an abusive tax debt relief company in a case against American Tax Relief ("ATR"), a national company now infamous for defrauding American taxpayers out of nearly $100 million.[122] The national scope of this case, abundance of incontrovertible evidence, and egregious nature of the conduct alleged facilitated the FTC's success.[123] However, this case illustrates the disadvantages of pursuing a tax debt relief company under the FTC Act instead of alleging a violation of the advance fee ban.[124] Although it succeeded against ATR,[125] the FTC may have failed in a similar case with slightly different facts. Enforcing the advance fee ban against tax debt relief companies would reduce these disadvantages, bringing faster and more reliable outcomes.[126]

On November 4, 2010, the Northern District of Illinois granted the FTC's request for a preliminary injunction against ATR for violation of the FTC Act.[127] On August 8, 2012, the Central District of California granted summary judgment for the FTC on the central issues, facilitating settlement.[128] To succeed under the FTC Act, the plaintiff

[122] Colleen Tressler, *Bill Comes Due for Bogus Tax Relief Company*, FED. TRADE COMMISSION CONSUMER INFO. (Feb. 5, 2013), https://www.consumer.ftc.gov/blog/bill-comes-due-bogus-tax-relief-company.

[123] *See* FTC v. Am. Tax Relief, LLC, No. CV 11-6397 DSF (PJWx), 2012 U.S. Dist. LEXIS 188329, at *8–22 (C.D. Cal. Aug. 8, 2012).

[124] *See id.*

[125] *Id.* at *22.

[126] FTC v. E.M.A. Nationwide, Inc., No. 1:12-CV-2394, 2013 WL 4545143, at *5 (N.D. Ohio Aug. 27, 2013) (granting the FTC's motion for summary judgment for violation of the debt relief advance fee prohibition solely on the evidence that a single customer paid $1,078.25 without receiving the advertise debt relief service, ordering monetary damages as well as permanently enjoining the defendant from working in the debt relief industry). This demonstrates that proving violation of the advance fee ban requires only two elements: (1) that the company sold debt relief services and (2) that the customer paid a fee before the company provided the service.

[127] FTC v. Am. Tax Relief, LLC, 751 F. Supp. 2d 972, 976 (N.D. Ill. 2010). ATR later agreed to a settlement order imposing a $103.3 million judgment against the defendants, which the FTC agreed to suspend the judgment once defendants had surrendered approximately $16 million in cash and assets. When printed in a headline, this certainly sounds like a victory for the FTC; however, the final settlement amount will reimburse the FTC, and subsequently the injured consumers, only approximately 15% of the harm endured. *See* FTC Policy Statement, *supra* note 5.

[128] *See Am. Tax Relief*, 2012 U.S. Dist. LEXIS 188329, at *8–22.

must prove the defendant made misleading or deceptive representations about its ability to reduce potential customers' tax debt, using one of two tests.[129] The FTC could show that express or implied advertising claims made by defendants were false,[130] or that the defendants had no reasonable basis for asserting the claims.[131] After showing either falsity or lack of reasonable basis, the FTC must then prove that (1) the representations were material; (2) the representations would likely mislead a reasonable consumer; (3) the consumer reasonably relied on these representations in deciding to purchase the services; and (4) reliance on these representations resulted in injury to the consumer.[132]

Proving these elements can present difficulties due to the detailed factual requirements and the subjective nature of the reasonableness standard.[133] The FTC succeeded in this case because of the abundance of undeniable evidence, the strength of ATR's deceptive claims, and the egregiousness of the company's conduct.[134]

a. Evidence that Defendant Made Certain Claims

The FTC submitted into evidence transcripts of radio and television commercials as well as hardcopies of widely disseminated flyers and mailings,[135] which stated that ATR had "helped thousands of people reduce their tax debt."[136] The FTC offered copies of the scripts the company provided to the sales representatives encouraging use of misleading assurances that the potential customer qualified for IRS programs.[137] The FTC also had recordings of calls in which ATR sales staff made such representations to undercover FTC agents.[138] In this

[129] FTC v. Pantron I Corp., 33 F.3d 1088, 1096 (9th Cir. 1994).

[130] *Id.*

[131] *Id.*

[132] FTC v. Am. Tax Relief LLC, 751 F. Supp. 2d 972, 977–78 (N.D. Ill. 2010).

[133] *See* Brown v. Consumer Law Assoc., 283 F.R.D. 602, 611–16 (E.D. Wash. 2012).

[134] *Am. Tax Relief*, 751 F. Supp. 2d at 978–79. ("To support its claim that ATR made material misrepresentations in its advertisements and in its dealings with consumers, the FTC has submitted declarations from consumers who were—for all intents and purposes—scammed by ATR; each paid significant fees to ATR, yet received little or nothing in return, and each said they were induced to do so by ATR's promises and guarantees that it could settle tax liabilities for a small percentage of the debt claimed by the IRS . . . Beyond that, the record contains an abundance of evidence showing that consumers were harmed, not helped, by ATR.")

[135] *Id.* at 977–78.

[136] *Id.* at 977.

[137] *Id.* at 980.

[138] *Id.* at 977; FTC v. Am. Tax. Relief LLC, No. CV 11-6397 DSF (PJWx), 2012 WL 8281722, at *5 (C.D. Cal. Aug. 8, 2012).

case, the FTC enjoyed the benefit of concrete evidence that ATR made certain representations[139] and to whom ATR made them.[140] In many other cases,[141] the only evidence of the deceptive or misleading statements lives in the memories of the victims of the scams, which a court could justifiably call into question.[142]

b. Falsity of Claims or Lack of Reasonable Basis

The two relevant representations in the ATR case were specific enough that the FTC could prove they were either false or that the company lacked a reasonable basis to make them.[143]

The FTC could disprove the first statement (that the company had reduced the debt of "thousands" of people) because of the word "thousands."[144] ATR's own records showed that it had successfully reduced the debt of fewer than 1,000 people, clearly contradicting the statements made to consumers.[145] If the company had advertised more generally, perhaps that it had helped "many" people, then the FTC would have had difficulty establishing the statement as false or lacking reasonable basis.

The second category of representations included the guarantees made to specific potential customers that they would qualify for an IRS tax relief program.[146] The FTC had no trouble disproving these statements due to their strength and directness.[147] First, the staff made the statements without possessing any information about the customer that could justify such a statement.[148] Secondly, sales representatives with no tax expertise made the statements rather than tax professionals.[149] If the employees had said "I will not know for sure until I look at your records, but I am sure you will qualify for one of the programs," the FTC would have struggled to show that they lacked a reasonable basis.[150] The FTC succeeded here only because the sales

[139] *Am. Tax Relief*, 751 F. Supp. 2d at 977–78.

[140] *Id.* at 984–85.

[141] *See, e.g.*, Exclaim Mktg., LLC v. DirecTV, LLC, No. 5:11-CV-684-FL, 2015 WL 5773586 (E.D.N.C. Sept. 30,2015). *See also* Superior Performers, Inc. v. Phelps, 1:15CV134, 2016 WL 67699 (M.D.N.C. Jan. 5, 2016).

[142] *See* Brown v. Am. Tax Relief, 2007 WL 2174876, No. 0016771 at *1 (N.Y.Supp.) (Trial Order).

[143] *Am. Tax Relief*, 2012 WL 8281722 at *4–6.

[144] *Id.* at *3 ("There is no question that these statements were false.").

[145] *Am. Tax Relief*, 751 F. Supp. 2d at 982.

[146] *Am. Tax Relief*, 2012 WL 8281722 at *5.

[147] *Id.* at *5.

[148] *Id.*

[149] *Id.*

[150] Indeed, in 2007, injured consumers brought a case in New York against the

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staff made bald assurances that each customer qualified for specific government programs.[151]

c. Materiality of Defendant's Claims

The court held that ATR made the claims *because* they would be material to anyone considering purchasing tax debt relief services.[152] Hearing that a company had helped thousands of people would certainly influence someone who needed relief.[153] Similarly, a guarantee of qualification for a certain available program would also impact a reasonable person's decision to purchase the services.[154]

d. Customers Relied on Defendant's Claims and Reasonableness of Reliance

The FTC offered substantial evidence that the complaining witnesses relied on the advertisements and promises made by sales representatives in deciding to purchase ATR's services.[155] The evidence included affidavits from many injured customers who stated that they purchased ATR's services because the sales representatives promised to reduce their tax debt by a specific amount, in a specific amount of time, or at a specific cost.[156] The evidence also included the statement of an attorney previously employed by ATR describing phone calls that she fielded daily from customers who were upset after being

same company using many of the same mailings. Mintz v. Am. Tax Relief, LLC, 837 N.Y.S.2d 841, 843, 846–47 (2007). The court dismissed the claims relating to the postcards that contained two claims: first that ATR's "staff of tax professionals has helped thousands settle their taxes for Pennies-on-the-Dollar," and second that Congress had passed new laws that made it easier to settle debt and many people that did not qualify before could now take advantage of the new laws and settle for much less. *Id.* at 843. The court found the second statement was not specific enough to be proven false and that the first and second statements, taken together not strong enough for the customers to rely upon it as a promise or guarantee. *Id.* at 846–47. The court only allowed the case to go forward relating to postcards that contained the pennies-on-the-dollar language as well as "[i]f you owe the IRS or are in an unbearable Monthly Payment Plan that seems to get you Nowhere, we can help you Today." *Id.* at 843.

[151] FTC v. Am. Tax Relief LLC, No. CV 11-6397 DSF (PJWx), 2012 WL 8281722 (C.D. Cal. Aug. 8, 2012); FTC v. Am. Tax Relief LLC, 751 F. Supp. 2d 972, 980–81 (N.D. Ill. 2010).

[152] *Am. Tax Relief*, 2012 WL 8281722 at *4–6.

[153] *Id.* at *4 ("The above statements . . . were unquestionably material.").

[154] *Id.* at *5 ("There is also no question that these representations about the callers' qualifications for relief were material.").

[155] *Am. Tax Relief*, 751 F. Supp. 2d at 978–79.

[156] *Id.*

misled by the company's sales representatives regarding their ability to qualify for IRS programs.[157] The standard for reasonable reliance is subjective, but the strength of the statements ATR made allowed the court to find that relying upon them was reasonable.[158]

e. Reliance on Claims Proximately Caused Consumers Harm

ATR's customers paid substantial fees upfront and received absolutely nothing in return.[159] The Better Business Bureau also received 375 complaints about ATR, and even at the preliminary injunction stage, the FTC had compiled and submitted specific statements from forty-three individuals.[160]

The judge that granted the FTC's motion for preliminary injunction expressed his initial hesitation to rely solely on testimony from the complaining witnesses, yet at every turn, the court found that it did not need to.[161] The court made clear that it would have reached a different result without such solid, incontrovertible evidence.[162] Statements from prior employees prevented the ATR from arguing that a rogue sales representative made the statements and did not represent the company's practices as a whole.[163] A case on a smaller scale or with less abundant,

[157] *Id.* at 980 (See, specifically Ms. Garcia's declaration: "'[t]here was a distinct pattern to customers' calls and complaints. Most of them said that they had been told they'd qualified for an OIC and some of them said that they had been told that ATR would be able to get interest and penalty abatements for them. They also said that the sales people had promised them that ATR could settle their debts so that they wouldn't have to pay the IRS anywhere close to what they owed.'").

[158] *Id.*

[159] *Id.* at 975.

[160] *Id.* at 979.

[161] *Id.* at 984–85. "Frankly, given the nature of these transactions, the Court initially viewed the consumers' statements with some skepticism." *Id.* The injured customers complained that they paid large sums upfront and received nothing in return; and when they confronted the company about the lack of results, the representatives became "unprofessional and even abusive" and blamed the customers. *Id.* One of the ATR representatives memorialized his own unprofessional and abusive treatment of a dissatisfied customer in a signed letter, printed on company letterhead. *Id.*

[162] *Id.*

[163] FTC v. Am. Tax Relief LLC, No. CV 11-6397 DSF (PJWx), 2012 WL 8281722, at *2 (C.D. Cal. Aug. 8, 2012) ("[T]he Court has relied on the statements of former ATR sales representatives regarding the practices of the ATR sales department. This includes things that the ATR representatives knew, what they personally told consumers, what they overheard . . . ATR management telling other employees. The Court has generally not relied on testimony of tax resolution department employees as to the practices of the sales representatives . . . the Court has relied on documentary evidence observed in and seized from ATR's offices by

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advantageous evidence could certainly have a different result.

2. Brown v. American Tax Relief—*An Example of the Challenges Posed by Suing for False Advertising Rather Than Violation of Advance Fee Ban*

Brown v. American Tax Relief,[164] a 2007 class action brought in New York, provides a potent example of the difficulties faced when customers injured by tax debt relief companies must seek relief under false advertising statutes instead of using the ban on advance fees.[165] The named plaintiff in this case paid a $5,000 fee upfront to ATR after receiving some postcards containing arguably misleading or deceptive claims; she received no service in return and suffered as a result.[166]

Although the court found that the plaintiff adequately stated a claim for relief,[167] the court denied the plaintiff's motion to certify a class of similarly situated New York residents who also received the postcards and paid advance fees ranging from $1,000 to $5,000.[168] The court reached this conclusion because it found that (1) the class was over-inclusive; and (2) the "questions of fact affecting individual class members [would] predominate over fact questions common to the class."[169]

a. Class was Over-Inclusive

While noting the New York rule that "the criteria . . . considered in granting class action certification is to be liberally construed,"[170] the

government agents.").

[164] Brown v. Am. Tax Relief LLC, No. 0016771, 2007 WL 2174876, at *7 (N.Y.S. Mar. 19, 2007) (Trial Order).

[165] *Id.* at *2.

[166] *Id.* at *3.

[167] Plaintiff adequately alleged breach of contract (because ATR promised to obtain tax debt relief for her in exchange for $5,000) as well as claims under General Business Law § 349 (requiring a showing of an act or practice that is deceptive or misleading in a material way and that plaintiff was injured by reason thereof) and § 350 (requiring the same showing in addition to a showing that the plaintiff relied upon the underlying deceptive misrepresentations). *Id.* at *12–13.

[168] *Id.* at *13.

[169] *Id.* at *9.

[170] *Id.* at *7 (citing Kidd v. Delta Funding Corp., 289 A.D.2d 203 (N.Y. App. Div. 2001). "[I]n New York, a class action may be maintained only if: (1) the proposed class is so numerous that joinder of all members is impracticable; (2) common questions of law or fact predominate over any questions affecting only individual members; (3) the claims of the representative parties are typical of the class as a whole; (4) the representatives parties will fairly and adequately protect the interests of the class; and (5) the class action is superior to other methods for the fair

continued . . .

court held that the class was over-inclusive.[171] A class is over-inclusive "when the proposed class is defined so broadly that it encompasses individuals who have little connection with the underlying claim or who have not been harmed by the defendants' allegedly wrongful conduct."[172] The class members all received postcards containing ATR's claim that it could settle tax obligations for "pennies-on-the-dollar,"[173] and the court agreed that these were likely misleading or fraudulent.[174] However, the court held that the class would likely include individuals who did not rely on these claims, but decided to purchase services for a different reason (for example, to obtain one of the other advertised tax services) and therefore was over-inclusive.[175]

b. Individual Questions Predominate over Common Questions

The court further denied the motion for class certification because the individual questions of fact would outweigh the common questions of fact.[176] The fatal individual questions of fact included "issues of causation and reliance as to each member of the putative class" as well as which tax service each plaintiff purchased and what representations ATR made to each plaintiff.[177] This court's decision demonstrates the factual and procedural challenges faced by plaintiffs who attempt to remedy a harm by alleging deceptive advertising, as opposed to a violation of the advance fee ban.[178] Both proving causation and demonstrating reasonable reliance for each particular plaintiff requires individualized factual showings that can stand in the way of successfully certifying a class.[179] A suit for violation of the advance fee ban does not require the problematic demonstration of an individual plaintiff's reliance on any particular misrepresentation or any showing of why each plaintiff decided to purchase services.[180]

Instead, plaintiffs could easily satisfy the simple factual questions

and efficient adjudication of the controversy." *Brown*, 2007 WL 2174876, at *6–7 (citing Klein v. Robert's Am. Gourmet Food, Inc., 28 A.D.3d 63, 69–70 (N.Y. App. Div. 2006).

[171] *Brown*, 2007 WL 2174876, at *7.

[172] *Id.*

[173] *Id.* at *8.

[174] *Id.* at *9.

[175] *Id.*

[176] *Id.* at *10.

[177] *Id.*

[178] *Id.* at *7–10.

[179] *Id.* at *10.

[180] *See, e.g.*, FTC v. E.M.A. Nationwide, Inc., No. 1:12-CV-2394, 2013 WL 4545143, at *5 (N.D. Ohio Aug. 27, 2013).

necessary to prove an alleged violation of the advance fee ban[181]—did the plaintiffs pay the company a fee prior to receiving services and did the plaintiffs suffer injury as a result?[182] In such a case, the common questions of law and fact would have predominated over the individualized questions and the class would not have been over-inclusive, as all members suffered injury due to paying the advance fee.[183] The court would likely have certified the class, allowing all plaintiffs convenient and efficient access to the justice system that the class action tool provides.[184]

Class actions create an efficient vehicle for similarly situated plaintiffs, who have been injured at the hands of a common defendant, to aggregate their resources in order to reach a remedy.[185] This procedural tool particularly benefits economically distressed plaintiffs, such as those defrauded by a tax debt relief company.[186] Enforcing the

[181] *See supra* text accompanying note 99 (identifying the threshold question of whether the company was in the business of selling debt relief services in order to establishing that it is subject to the TSR's debt relief amendments).

[182] *E.M.A. Nationwide*, 2013 WL 4545143 at *5 (N.D. Ohio Aug. 27, 2013).

[183] Brown v. Consumer Law Assoc., 283 F.R.D. 602, 611–16 (E.D. Wash. 2012) (explaining the certification process for a class under Fed. R. Civ. P. 23(a) and (b) for plaintiffs alleging a per se violation of Washington's Consumer Protection Act which prohibits charging an upfront fee in excess of $25.00). *See also* Gregory v. Preferred Fin. Sol., No. 5:11-CV-422 (MTT), 2013 WL 6632322 at *12 (M.D. Ga. Dec. 17, 2013) (certifying a class of plaintiffs accusing a debt relief company of charging fees in excess of the maximum imposed by Georgia's Debt Adjustment Act. The court stated that the only individual factual questions that must be answered would be (1) the enrollment fee, calculated as a percentage of the customer's total debt; (2) the monthly fee; (3) the number of months each member participated in the program; (4) the settlement fee, calculated as a percentage of total debt settled; and (5) whether the customer received a refund. This case involved more individual factual questions than the advance fee ban would require, but the court held that "[a] brief examination of each class member's billing history would establish both the Defendants' liability and the amount of damages to be awarded to that member. Accordingly, the Court [found] the questions common to all class members predominate over individualized questions").

[184] Laura J. Hines, *The Dangerous Allure of The Issue Class Action*, 79 IND. L.J. 567, 567 (2004) ("The class device holds out the promise of resolving issues 'common' to all plaintiffs in a single trial, preventing wasteful and repetitive litigation of similar issues, and the possibility of inconsistent results. And collective adjudication allows plaintiffs to pool resources against better-financed defendants").

[185] Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) ("The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor").

[186] Deborah R. Hensler & Thomas D. Rowe, Jr., *Beyond "It Just Ain't Worth It": Alternative Strategies for Damage Class Action Reform*, 64 LAW & CONTEMP.

continued . . .

advance fee ban against tax debt relief companies would make class actions more accessible to injured plaintiffs,[187] and, as stated above, increase the likelihood of success on the merits.[188]

The FTC provided only one explanation for deferring enforcement against tax debt relief entities: tax debt may not be considered unsecured debt.[189] The "secured" versus "unsecured" delineation is, in this context, arbitrary and serves only to create a loophole for tax debt relief companies to charge upfront fees without serving consumers.[190] Determining whether tax debt qualifies as secured or unsecured debt involves examining the intricacies of bankruptcy and tax law, and goes beyond the scope of this paper.[191]

In short, the IRS has some power to place liens on debtor's assets with a court order,[192] but in some bankruptcy actions, courts treat tax debts as unsecured debts.[193] Typically, tax debts that are more than three years old become general unsecured non-priority claims in bankruptcy.[194] Although a debtor usually cannot avoid a tax lien in bankruptcy, the IRS has only limited power to attach an individual's property.[195] Fortunately, in the context of the debt relief industry, the distinction does not impact the analysis. Tax debt relief is a subcategory of general debt relief—the two industries pose the same problems that can be solved through identical regulations.[196]

PROBS. 137, 145–46 (2001) ("[O]ne of the key purposes of class action [is] facilitating litigation precisely when many persons have suffered, as a result of another's wrongdoing, losses that are too modest to allow them to obtain individual counsel").

[187] *See* Hines, *supra* note 184.

[188] *See supra* notes 118–150 and accompanying text.

[189] FTC Policy Statement, *supra* note 5. *See also* BLACK'S LAW DICTIONARY 488–89 (10th ed. 2014) (provides several definitions for debt and defines unsecured debt as "debt not supported by collateral or other security").

[190] *See supra* notes 104–108 and accompanying text. *See also infra* notes 197–199.

[191] *See* Leonard C. Walczyk, *An Overview of Taxation Issues in Bankruptcy*, N.J. LAWYER 17, 18 (June 2001), http://qmob.com/wjslaw/sites/default/files/pdfs/Walczyk1.pdf.

[192] C. RICHARD MCQUEEN & JACK F. WILLIAMS, TAX ASPECTS OF BANKRUPTCY LAW § 8:2 (3d ed. 2015).

[193] *See generally* Larry Heinkel, *Eliminating IRS Tax Debts—Why Bankruptcy May Be Better Than an OIC to Resolve Your Client's Tax Debts*, 82 FLA. B.J. 56 (2008).

[194] MCQUEEN & WILLIAMS, *supra* note 192, § 8:13.

[195] *See* 26 C.F.R. §1.163-10T(o)(1)(iii) (2015) ("A debt will not be considered to be secured by a qualified residence if it is secured solely by virtue of a lien upon the general assets of the taxpayer or by a security interest, such as a mechanic's lien or judgment lien, that attaches to the property without the consent of the debtor."). *See also* Heinkel, *supra* note 193, at 56.

[196] *See supra* notes 182–192 and accompanying text.

Enforcing the debt relief rule against tax debt relief companies fits neatly within the FTC's own policy goals.[197] In its Final Rule, the FTC excluded "secured debt, such as mortgage loans," not because mortgage and secured debt companies did not pose a problem, but because the FTC "anticipate[d] comprehensively regulating such conduct under its new mortgage loan rulemaking authority."[198] While the secured loan and mortgage industry operates in a unique way, requiring particularized regulation, tax debt relief companies operate in much the same way as general debt relief companies[199] and should be subject to the same rules.

B. Same Business Model, Different Creditor

By acting on their own behalf, debt-owing consumers can achieve the same or substantially similar results as debt relief companies supposedly provide, regardless of whether the debtor owes money to a credit card company or the IRS.[200] Consumers seem to fear both public and private creditors as equally intimidating and ruthless.[201] Hoping to encourage taxpayers to make direct contact and avoid risky tax debt relief companies, the IRS and state tax entities have attempted to make themselves more accessible.[202] The IRS expressly invites taxpayers to contact them directly to negotiate any of the available adjustment

[197] Proposed Rule, *supra* note 6, at 41,999 ("The Commission intends that the definition of 'debt relief service' encompass a broad swath of debt relief activities, including offers of debt settlement or negotiation services and debt management plans.").

[198] *Id.*

[199] *See, e.g.*, Sandra Block, *Some Tax-Resolution Companies are Scams*, USA TODAY (May 24, 2011, 1:30 PM), http://usatoday30.usatoday.com/money/perfi/columnist/block/2011-05-23-tax-resolution-scams_n.htm; Geoff Williams, *Debt Settlement Companies: How the Process Works*, DAILY FINANCE (Dec. 23, 2010, 12:00 PM), http://www.dailyfinance.com/2010/12/23/debt-settlement-companies-how-the-process-works/.

[200] *Tax Relief Companies*, *supra* note 109.

[201] *See* Jeff Poor, *Walter Williams: 'Americans Deserve the IRS',* DAILY CALLER (May 29, 2013), http://dailycaller.com/2013/05/29/walter-williams-americans-deserve-the-irs/. *See also Dealing with Creditors*, AFL-CIO, http://www.aflcio.org/About/Community-Services/When-the-Paycheck-Stops/Dealing-With-Creditors (last visited Apr. 20, 2016).

[202] *Tax Relief Companies*, *supra* note 109 ("If you owe back taxes and don't know how you're going to pay the debt, the FTC, the nation's consumer protection agency, says don't panic, take a deep breath, and consider your options. If you are having trouble paying bills, it's often better to try to work out a payment plan with the creditor yourself than to pay someone else to negotiate a plan for you.").

plans.[203] The IRS also created the Taxpayer Advocate Service, an independent organization within the IRS, to help taxpayers deal with debt.[204]

Tax attorneys, accountants, and enrolled agents can provide helpful insight in filing tax returns, handling audits, or reviewing a taxpayer's file to discover errors or anomalies.[205] Tax debt relief companies, on the other hand, typically do no more than attempt to enroll the taxpayer in one of a few standard programs offered by the IRS.[206] Tax debt relief agents arguably provide a less valuable service compared to their private debt relief counterparts because IRS agents exercise little discretion in accepting or rejecting offers.[207] Instead, formulas and straightforward criteria determine whether or not a taxpayer qualifies for a particular program.[208]

While tax debt relief companies often advertise a skill or connection that allows them to strike special deals with the IRS, taxpayers can accomplish everything these agents can accomplish by applying for relief programs online or by simply calling the IRS directly.[209] The lack of utility of the tax debt relief industry, coupled with the prevalence of abusive practices, provides the FTC with a strong incentive to protect consumers from these companies, specifically by imposing the advance fee ban.[210]

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[203] *Id.* ("According to the IRS, you can apply for an Installment Agreement, OIC, or penalty or interest abatement *without the help of a third party*").

[204] *Id.* (explaining that state tax entities vary in policy, but most of them offer similar programs and options to help taxpayers deal with their debt.).

[205] *Id.*

[206] *Id.* (explaining that an "installment agreement" arranges for a taxpayer who cannot afford to pay the amount owed in full to make smaller monthly payments with interest to avoid penalties like a tax lien or levy. A taxpayer can make an "offer in compromise" to settle their debt for less than the amount owed, but the IRS typically only accepts such an offer if the taxpayer has exhausted other avenues. A tax debtor can occasionally obtain a penalty abatement if he or she cannot pay the taxes owed because of some special hardship . . . Interest abatement relieves the taxpayer of fees and interest while still requiring payment of the taxes, but is also rare).

[207] *Id.*

[208] *Id.* (explaining that an installment agreement is the most common, and in certain situations, the IRS cannot deny a request for an installment agreement if the amount owed is less than $10,000. Under the Fresh Start Initiative, most people with less than $50,000 in tax debt can obtain a streamlined installment agreement that allows repayment over a six-year period by simply applying online).

[209] *Id.* (nothing that although only a narrow group of people will qualify for the other programs, the taxpayer can find out if he or she qualifies without enlisting costly assistance).

[210] Debbie Edwards, *NATDRC Conference to Address Ways to Eliminate Fraudulent Lead Aggregators From the Tax Debt Resolution Industry*, TAX RESOLUTION SERVICES, CO. (May 2012),

continued . . .

C. Tax Debt Relief Companies Remain a Threat

In April 2013, nearly three years after promulgation of the debt relief rule, the FTC posted an informational page on its website warning consumers against tax debt relief companies, referring to them as "fraudsters."[211] The page, which remains active as of this writing, recounts the nightmares of tax debtors injured by tax debt relief companies, demonstrating that the problem of abuse in the industry persists.[212]

A website called bestdebtcompanies.com [213] uses an objective

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http://www.taxresolutionservicescompany.com/lead-aggregators-tax-debt-resolution-industry.asp (last updated May, 2012); Diane Freda, *Tax Practice: OPR Targets Tax Debt Resolution Industry In Campaign Against Sanctionable Practices* (May 24, 2012) (a statement by the Office of Professional Responsibility ("OPR") within the IRS announcing its jurisdiction over the tax debt resolution industry and its intention to crack down on abusive practices within it. The statement further provided that enforcing the broad duty of due diligence can involve taking disciplinary action against tax professionals who are "giving premature assurances that a taxpayer will get relief from tax liability, making misstatements about the length of time needed to process a debt relief request application, or . . . providing false hope in order to extract money from a desperate tax debtor." However, the statement also noted a legitimate question about whether industry practices have improved since the OPR threatened action. The OPR never released any information about its success or failure in disciplining tax professionals for this conduct. When this author contacted the OPR, the representative stated that the OPR does not make available to the public the reasons for disciplinary action for any individual professional, nor does the OPR maintain statistics of the specific infractions they have prosecuted). *See also Unethical Tax Debt Resolution Companies' Dubious Policies Do Not Represent the Industry as a Whole, Says Tax Resolution Services, Co.*, PR NEWSWIRE, (Apr. 4, 2012), http://www.prnewswire.com/news-releases/unethical-tax-debt-resolution-companies-dubious-policies-do-not-represent-the-industry-as-a-whole-says-tax-resolution-services-co-146075585.html (last visited Apr. 1, 2016) (describing the creating of a trade association, supposedly in order to improve the reputation and ethical integrity of the industry. However, this association seems to have evaporated, leaving only dead links to websites and what now appears to be an advertising ploy to lend a shroud of legitimacy to an industry that had fallen out of favor with the public after a string of enforcement actions against nationally recognized tax debt relief companies.).

[211] *Tax Relief Companies*, *supra* note 109.

[212] *Id.* (noting that some paid thousands in upfront fees, only to find that the tax debt relief companies made unauthorized charges to their credit cards or withdrawals from their bank accounts; some were misled by promises of quickly eliminating debt; other eventually discovered the company had fraudulently omitted asset information on financial statements submitted to the IRS, which seemed to achieve a favorable result for the taxpayer in the short-term, but created enormous financial and legal problems in the long-run).

[213] *Tax Debt Relief Made Simple*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/tax-relief-companies/ (last visited Feb. 25, 2016).

standard to evaluate debt relief companies on a scale of one to ten,[214] and creates a forum where customers post reviews of companies they hired to assist them with tax debt.[215] Both the scores given by the website operators and the comments from customers illustrate that abuse in the tax debt industry remains a problem.[216] Twenty-three out of the forty-six companies reviewed received a score of less than 5.0 out of 10.0 from the website staff,[217] and only fifteen companies received consumer ratings of more than 5.0.[218]

The website's "#1 Staff Pick," Tax Defense Network,[219] received two-hundred reviews from satisfied customers[220] and only nine reviews from dissatisfied customers, [221] demonstrating that, assuming this website can be believed, legitimate tax debt relief companies do exist and provide a valuable service.[222] However, the customer reviews of the nine companies with the worst consumer rating paint a worrisome picture. [223] These nine companies received exclusively negative

[214] *How We Rank–Understanding our ranking criteria,* BESTDEBTCOMPANIES.COM, https://bestdebtcompanys.com/how-we-rank/ (last visited Mar. 31, 2016) (explaining how the company uses specific criteria to give each company a score: price, time in business, Better Business Bureau rating, specialization in tax services, staff accreditations, professional association members, refund policy, consumer reviews, and expert review, which includes financial standing of organization, the number of industry experts and professionals, the company's ability to scale, historical revenue and growth, past and current lawsuits, customer service, and transparency).

[215] *Tax Debt Relief Made Simple*, *supra* note 213.

[216] *Id.*

[217] *Id.*

[218] *Id.*

[219] *Tax Defense Network*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/tax-defense-network-review/.

[220] *Id.* (four customers gave a score of seven, and 204 customers gave a score of eight to ten).

[221] *Id.* (five scores of zero, and four scores of four).

[222] *See, e.g.*, *id.*

[223] *See Signature Tax Group*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/signature-tax-review/ (indicating one review from 2015 wherein a customer lost $2,200); *Freedom Tax Relief*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/freedom-tax-relief-review/ (received one review in 2015 wherein a customer paid $3,600 upfront and received nothing); *Consumer Tax Relief* received three reviews from customers in 2014 and 2015 who paid $200, $4,000, and $4,000 respectively in upfront fees and received no service in return. *Tax Debt Relief*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/consumer-tax-relief/; *US Tax Shield*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/us-tax-shield-review/ (received two negative reviews in 2015, with one dissatisfied customer paying $3,500); *Tax Defense Partners*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/tax-defense-partners-review/ (received six negative reviews from 2014 to 2016, with customers reporting lost fees of $10,000,

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customer reviews, all of which were posted from 2014 to 2016. Each customer reported that they had paid advance fees (ranging from $200 to more than $20,000)[224] but received nothing in return.[225] Many customers reported an inability to contact the company after payment and others reported that the company simply bounced them between staff members until they gave up.[226] While customer reviews should sometimes be taken with a grain of salt, this information shows that abusive practices by tax debt relief companies have continued during the past two years.

D. A Simple Solution

The FTC should reverse its current policy of deferring enforcement against tax debt relief companies because these companies remain a threat to consumers. In 2009, the substantial hazard that debt relief companies posed to vulnerable consumers compelled the FTC to take action and promulgate a comprehensive rule to reduce abusive practices. What should have been a temporary policy has quietly become five years of allowing tax debt relief companies to continue to defraud the public. Requiring these companies to adhere to the ban on advance fees would provide a useful tool for injured consumers seeking judicial remedy and aligns with the FTC's policy of consumer protection.

$6,800, $6,800, and $5,000); *Tax Group Center*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/tax-group-center-review/ (received five negative reviews from 2014 to 2016, with customers reporting paying upfront fees of $20,000 and $1,500); *Clear Creek Consulting* BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/clear-creek-consulting-review/ (received one review from a dissatisfied customer in 2015); *Top Tax Defenders*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/top-tax-defenders-review/ (received a score of zero in 2016); *911TaxRelief.com*, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/911taxrelief-review/ (received a negative review in 2015 wherein the customer lost a $1,500 fee).

[224] *See, e.g.*, *supra* text accompanying note 223.

[225] *See, e.g.*, *supra* text accompanying note 223.

[226] *See, e.g.*, *supra* text accompanying note 223.