



**Personal Income Tax
Refund Examination Program:
Proactive Planning
And
Timely Response**

FTA Annual Conference

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Agenda



- Two Challenges
 - Addressing Refund Fraud
 - Funding the Program
- Funding Considerations and Advantages
- Refund Fraud Prevention Program Overview
- Implementation and Results – YEAR ONE
- Implementation and Results – YEAR TWO
- Proactive Planning and Timely Response
- Lessons Learned

Two Challenges



The Program Challenge

- In 2012 there was a growing awareness that fraudulent income tax refund filings were increasing dramatically. What would be PA's response?

The Solution

- Our agency needed filters and processes to identify and handle fraudulent income tax return filing. Our scope included intentional under-reporting or tax avoidance for valid taxpayers. A business partner's knowledge and tools were needed.

Two Challenges



The Funding Challenge

- Appropriations are difficult to come by, especially for new initiatives. There is agency capacity (HR and IT infrastructure) to manage additional high-value programs, but only if funding can be found.

The Solution

- Agencies are empowered to enter into contracts paid for by the additional revenue collected, or costs saved, by the project.

Two Challenges



Funding the Program - Advantages

- *We have paid only for success.*
The vendor added to existing processes. This made the benefits baseline ZERO. The vendor shared our goal and metric – reduce erroneous refunds
- *We established a successful partnership.*
Vendor state tax subject matter expertise (SME) helped change and is improving our processes as part of this public-private partnership.
- *We acquired desired technology.*
Identity validation and a project-specific data warehouse were acquired.

Funding the Program – will contingent fee work for your agency?

- Are you exploring projects that will have directly measurable benefits – in revenue or cost savings?
- Would you benefit from (must you use) an alternative funding source, other than appropriated funds?
- Note the need for (and benefit of) legislation.
- Adopt a solid methodology for measuring benefits.

PA Personal Income Tax Differences

- Rate is flat 3.07%
- No earned income credit
- No offset of losses in one class of income (business) against positive income in another class (compensation)
- Some statistics
 - Average refund is a little more than \$200
 - Only about 1/3 of taxpayers get refunds

Procurement Timeline

- Fraud Detection Consulting services category added to ITQ, a pre-qualified contract.
- Procurement committee formed
- Research done prior to drafting RFQ including collection of best practices.
- RFQ issuance was on March 11, 2013.
- Need for implementation prior to start of the 2014 processing year

Implementation

- Collaboration between DOR and vendor to establish business rules and selection criteria.
- Incorporated contractor resources:
 - Data analytics infrastructure
 - Subject matter (tax compliance) expertise
- Interface with current processing system minimized large work effort from DOR.
- Use of prior year return data to validate selection criteria.
- Approximately six months to implement.

Results – Year One



- 24 New Rules Implemented
 - Wage/Withholding (WH) related rules
 - Unreimbursed Expenses (UE) related rules
 - Out-of-State Credit (OSC) related rules
 - Special Tax Forgiveness (SP) related rules
 - Identity (ID) related rules
- \$11.0 million in reduced refunds with over \$1.375 collected in additional billings for current tax year
- \$5.75 million billed for previous tax years with over \$2.1 million collected thus far

Results – Year One



Pennsylvania Governor's Innovation Office Award



Results – Year Two



- Business rule refinements
 - Wage/Withholding (WH) related rules
 - Unreimbursed Expenses (UE) related rules
 - Out-of-State Credit (OSC) related rules
 - Special Tax Forgiveness (SP) related rules
 - Identity (ID) related rules
- Process changes to address practitioner concerns
- Major fraud exposure addressed and avoided
- \$5.7 million in reduced refunds with over \$837,000 collected in additional billings for current tax year thus far

Example One – The Intuit Challenge

- Awareness of the problem – valid taxpayers discover TurboTax has already been used by fraudsters to file their income tax returns.
- Consulting with other states – confirmation of PA insights and analysis
- 2/7 – the Saturday solution. Filters implemented quickly to respond to threat and filter out potentially fraudulent returns
- Looking back – we were ready.

Example Two – Unreimbursed Expenses

- Individuals are entitled to documented expenses that are not reimbursed by employers
- Not fraud – DOR analysis flagged intentional overstatement of expenses/underreporting of tax
- Not a change in policy but a significant new investment in examination of this issue.
- Communications were not managed well. Paid preparers felt ill-prepared to assist their taxpayer clients.
- Year 2 improvements

Example Three – “Breached” Employers/EINs

- Internal and external verification of the breach of PII with large employers and/or service providers
- Customized filters help prevent fraudulent refund claims using stolen identities
 - Leveraged prior year data
 - Minimized “false positive” denial of claims for valid taxpayers and tax returns

Lessons Learned



- Executive sponsorship is crucial. Our agency initiative for income tax underreporting and fraud aligned with broader administration goals.
- Try to plan flexibility. PA doesn't have the same income tax as other states (not federally based); our plans still permitted us to succeed.
- Balance business needs with technology. Tax SME resources to help boost planning are as important as the technology/systems which produce results.

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