



RESEARCH REPORT

Taxpayer and Government Official Perspectives  
on State Income Tax Refund Identity Fraud

June 2015

## Table of Contents

Background and Methodology .....	3
Executive Summary .....	3
Income Tax Refund Identity Fraud Awareness.....	4
Income Tax Refund Identity Fraud Concern .....	6
State Income Tax Refund Fraud: Perceptions of Taxpayers and State Officials .....	7
Appendix: Taxpayer Demographics.....	11

## BACKGROUND AND METHODOLOGY

### OVERVIEW

Identity-theft related income tax refund fraud has been a growing issue facing our nation and will continue to be for years to come. The problem of federal income tax refund identity fraud has been well-covered by the media; however, there has not been a comprehensive review of the topic at the state level, until now. Alongside the Governing Institute, LexisNexis® Risk Solutions surveyed taxpayers and interviewed state government officials to gain both group's perspectives on the issue.

### METHODOLOGIES

An online survey conducted by the Governing Institute received 2,013 responses from individuals living in income tax states who filed for state taxes in 2013. Respondents were contacted through a panel and quotas were applied to ensure the sample matched the general population.

Governing Institute analysts also conducted 31 in-depth telephone interviews with state government officials in income tax-collecting states, each lasting 30-45 minutes. Department of Revenue Agency Heads were initially contacted; however, these targets may have directed interviewers to more appropriate interviewees.

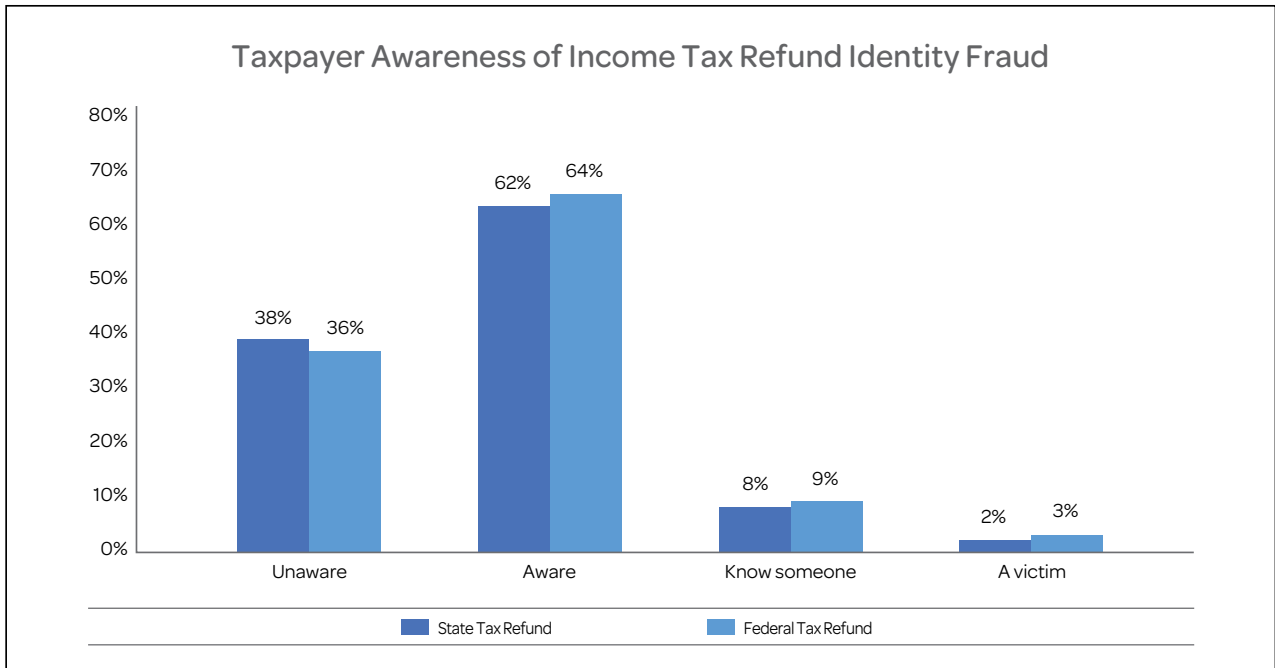
## EXECUTIVE SUMMARY

- **While a majority of taxpayers are aware of state-level income tax refund identity fraud and believe it occurs frequently, few have been personally impacted.** Taxpayers believe stolen identities are used more frequently for credit card fraud than for state or federal income tax refund fraud.
- **Estimating the incidence of income tax refund identity fraud is challenging for state officials.** Even though a majority of states keep fraud-tracking metrics, current systems make establishing accurate benchmarks difficult.
- **Government officials are significantly more concerned with state income tax refund identity fraud than taxpayers.** Eighty-six percent of government officials consider it a “Major” problem compared to 33 percent of taxpayers who are “Extremely Concerned” about a fraudulent return being filed with their identity. Officials are most concerned with the growth and magnitude of fraud.
- **Taxpayers believe state governments are responsible for detecting and preventing income tax refund identity fraud – but are also willing to do their part.** Support is high among taxpayers for including unique, identifying questions on returns, payment delay in cases of multiple returns filed under one name, and the sharing of personally identifiable data across states.
- **State officials feel that current income tax refund identity fraud prevention systems are reactive – identifying, rather than combating and reducing, fraud.** Officials identify several areas for improvement in policies and procedures:
  - Resource sharing/collaboration between state and federal agencies
  - Increased time to assess all filings (taxpayers expect a one month delay for a compromised return)
  - More predictive, automated, flexible procedures and systems
- **Government officials identify Georgia, Louisiana, New York, Indiana, and California as leaders in combating state-level tax refund fraud.**

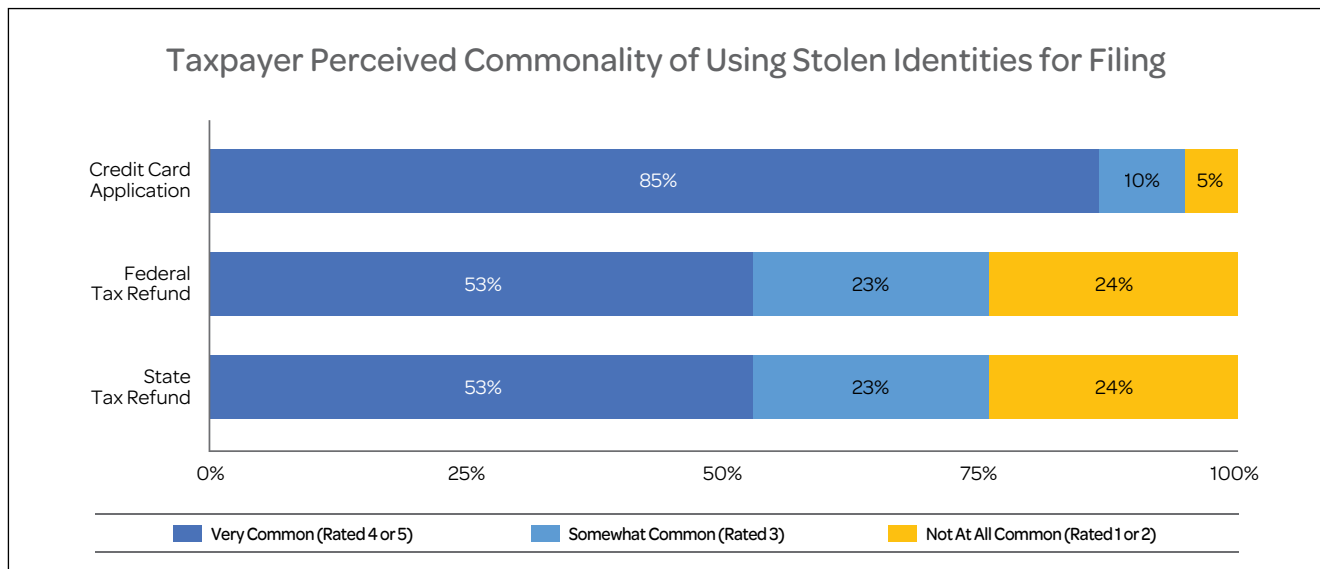


## INCOME TAX REFUND IDENTITY FRAUD AWARENESS

While a majority of taxpayers are aware that individuals file fraudulent tax returns, very few know someone who has been a victim or have been a victim themselves. Taxpayers estimate equal frequency of federal and state-level refund fraud (both lagging credit card fraud).

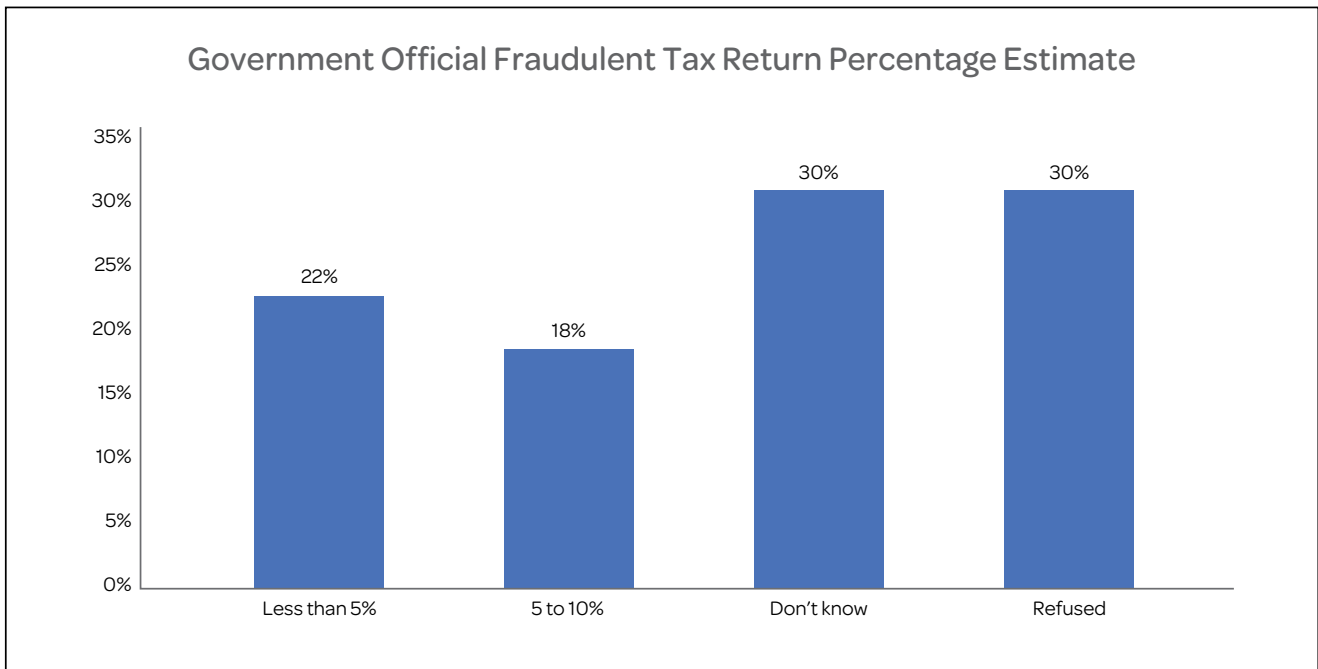


Base: All Respondents (n=2,013). Percentages add to more than 100 percent as multiple responses were accepted. Which of the following situations relating to state income tax refund identity fraud, if any, are relevant to you personally?

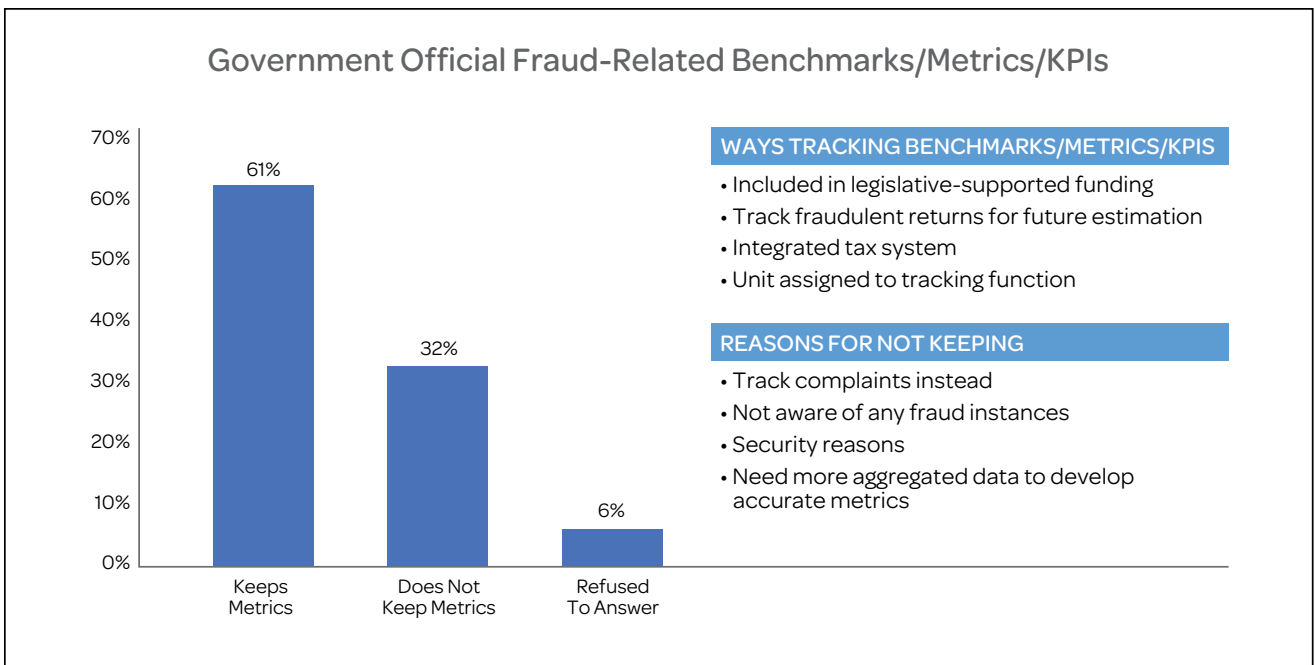


Base: All Respondents (n=2,013). How common do you think it is for an individual to use stolen identities to do each of the following: Fill out a credit card application, File for a federal tax refund, File for a state tax refund.

Government officials find it challenging to estimate the incidence of income tax refund identity fraud within their states. While nearly two thirds of states are tracking state income tax refund identity fraud for their states, far fewer (40%) were able to provide an estimate on the amount of fraud within their state. Those making estimates on the amount of state tax refund identity fraud do so based on benchmarks/metrics/key performance indicators (KPIs) they keep.



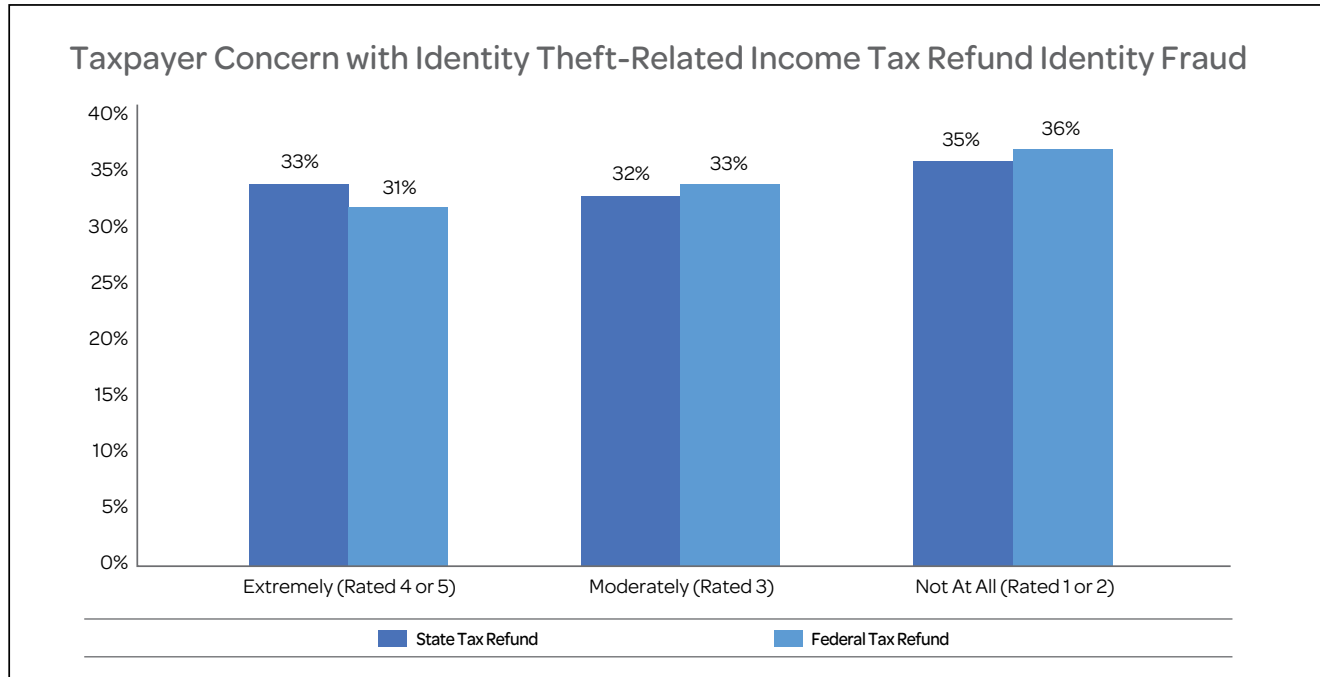
What percentage of tax refunds are found as fraudulent? *Four states were not asked this question.*



Does your state keep any benchmarks, metrics, or KPIs on how much fraud is taking place or has been prevented? If so, what are they?

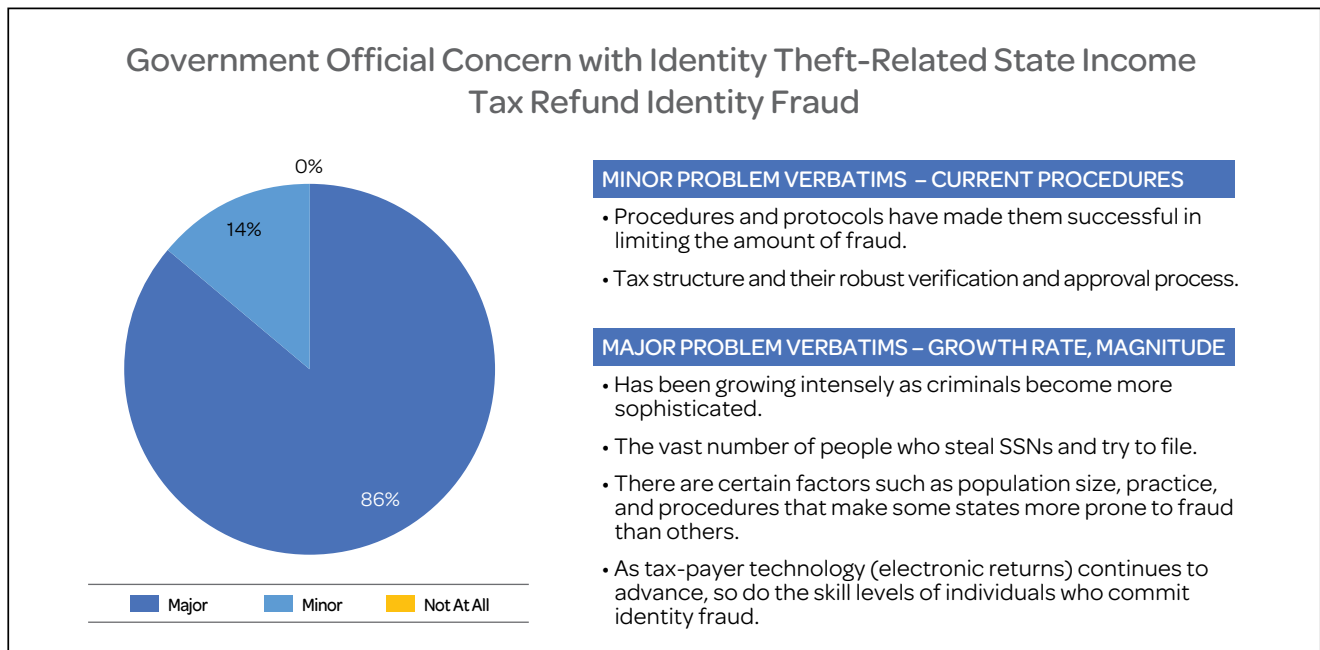
## INCOME TAX REFUND IDENTITY FRAUD CONCERN

Taxpayers are relatively concerned with identity theft-related state income tax identity fraud at both the federal and state levels (6 in ten are at least moderately concerned).



Base: All Respondents (n=2,013). How concerned are you that someone might steal your identity and fraudulently file a state income tax return using your personal information?

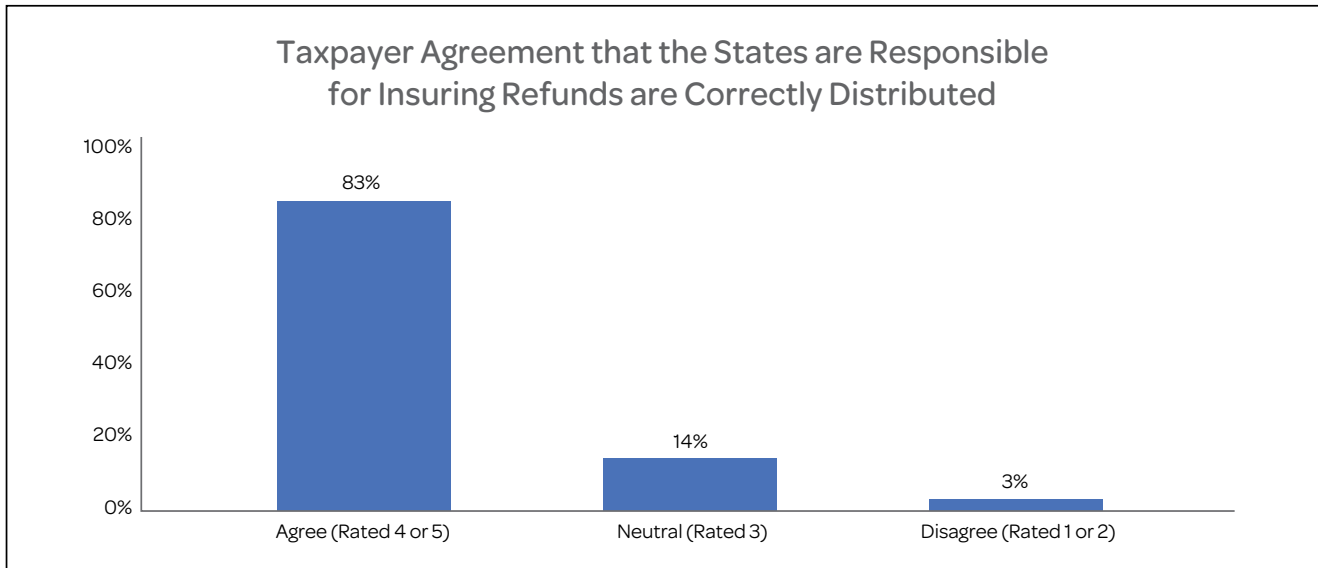
State government officials, however, are much more concerned than taxpayers about the impact of fraud on the state income tax refund process than taxpayers, with 86 percent of interviewees believing it to be a major problem.



Is identity fraud within the state tax refund process a major problem, minor problem, or not a problem at all? Why? *Two states declined to participate in this question.*

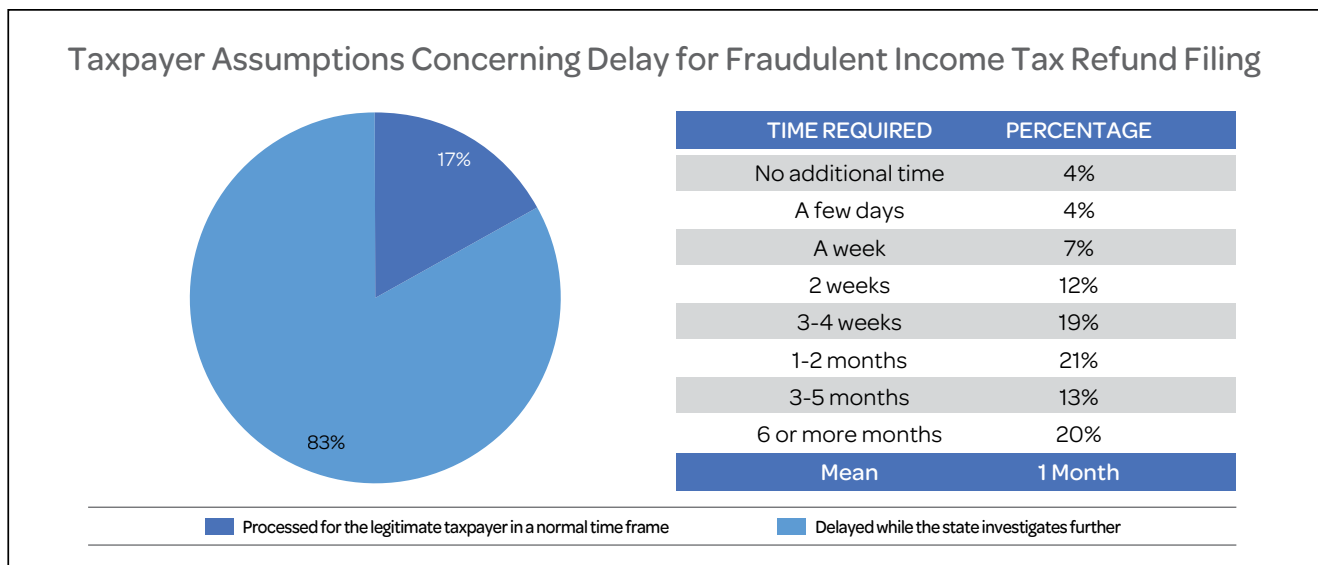
## STATE INCOME TAX REFUND IDENTITY FRAUD – PERCEPTIONS OF TAXPAYERS AND STATE OFFICIALS

Not surprisingly, a majority of taxpayers believe the state government bears responsibility for the correct dispensation of state income tax refunds.



Base: All Respondents (n=2,013). To what extent do you disagree with the statement: The state government should be responsible for ensuring that my state income tax refund is sent to the correct individual.

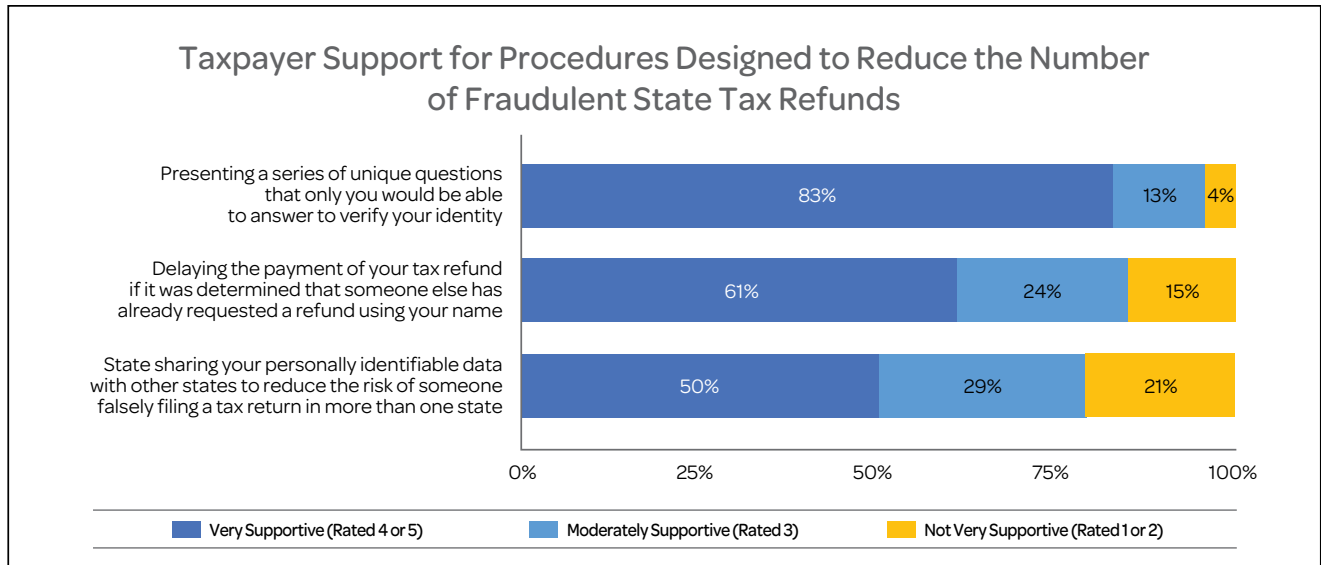
In the case of a fraudulent income tax refund filing, a large majority of taxpayers (83%) believe there would be a delay (one month on average) while the state investigates the return.



Base: All Respondents (n=2,013). What would you expect, from the options below, to happen if a taxpayer attempts to file their income tax return and someone else has already fraudulently filed in their name?

If a tax return had to be delayed while a state investigated the situation further, how much additional time, if any, (on average) do you anticipate it should take before the taxpayer received their refund?

Taxpayers are very supportive of implementing procedures designed to reduce the incidence of fraudulent state tax refunds, particularly for unique, identity-verifying questions.



Base: All Respondents (n=2,013). Listed are several procedures that your state could implement as part of the state tax return process. If you knew that these procedures were being used to reduce the number of fraudulent tax returns being submitted, how supportive would you be of each?

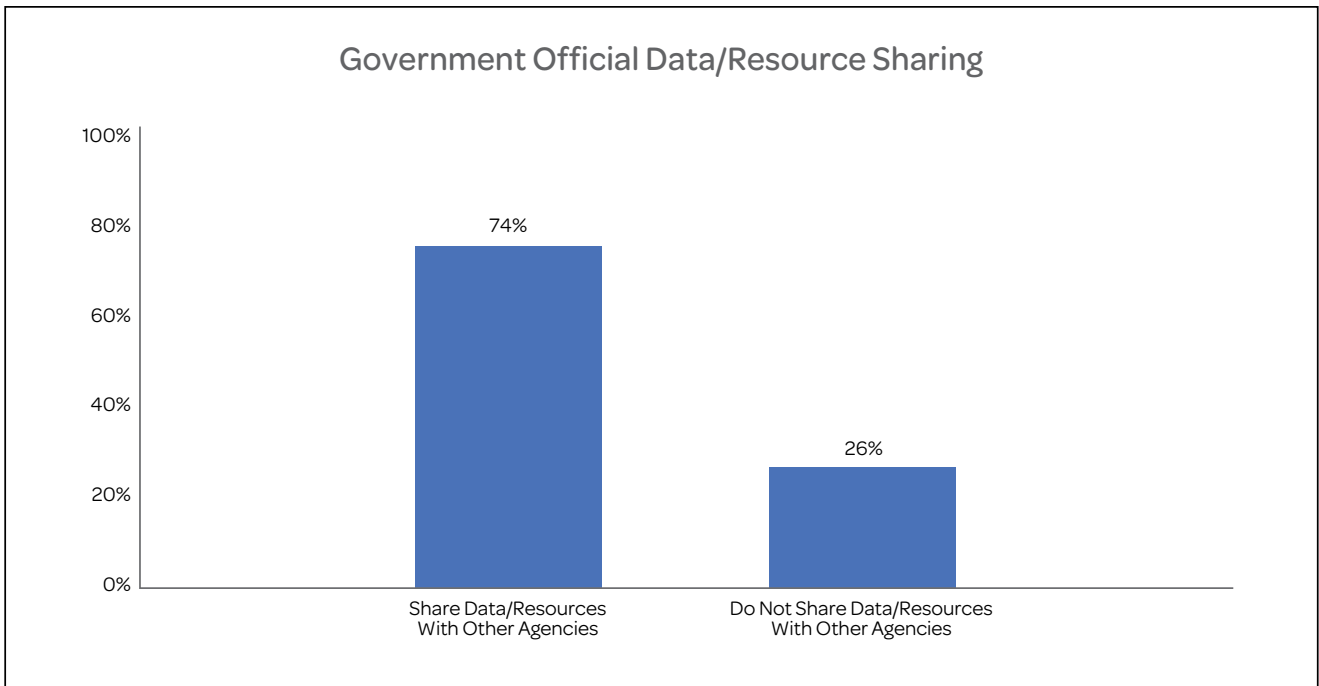
State government officials note a variety of established procedures designed to reduce fraudulent income tax refund payments and protect citizens. Systems that share data/resources are common (74% share data/resources with other agencies) – especially the Federation of Tax Administrators (FTA) sponsored Suspicious Filer Exchange Program (SFEP).

### Government Official Procedures for Reducing Income Tax Return Identity Fraud

IN-HOUSE DATABASES AND SYSTEMS	EXTERNAL DATABASES AND SYSTEMS
<ul style="list-style-type: none"> <li>• ID Verification</li> <li>• ID Theft Filters</li> <li>• Integrated Tax Systems</li> <li>• Edit Systems to Track Return Negligence</li> <li>• Return Review and Validation</li> <li>• Data Warehousing</li> <li>• Internal State Programs</li> <li>• Rules-Based Systems</li> </ul>	<ul style="list-style-type: none"> <li>• ID Verification</li> <li>• ID Theft Filters</li> <li>• Social Security Administration Death Master File</li> <li>• LexisNexis</li> <li>• GenTax</li> <li>• Internal Revenue Service</li> <li>• Federal Trade Commission</li> <li>• Local/State Police Forces</li> <li>• United States Postal Service</li> </ul>
OTHER SYSTEMS	
<ul style="list-style-type: none"> <li>• Fraud Detection Group</li> </ul>	<ul style="list-style-type: none"> <li>• Public Education Programs</li> </ul>

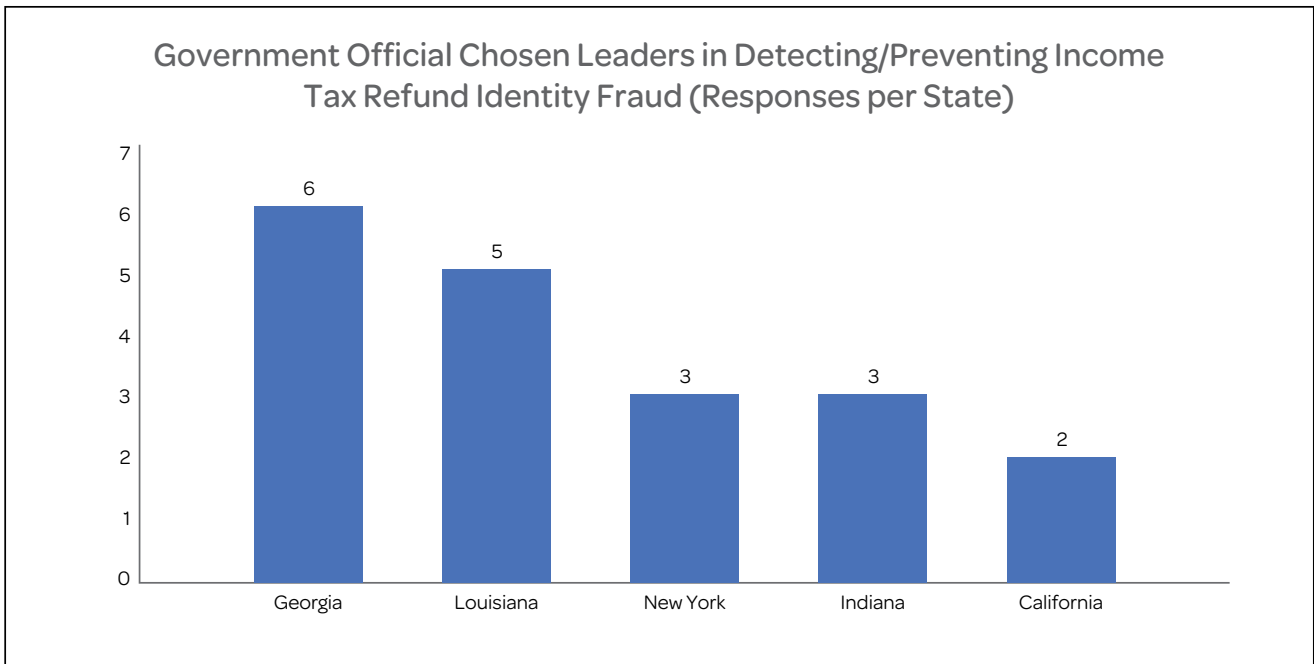
What procedures or protocols, if any, are in place to protect both the state and citizen from paying out fraudulent payments? *Eight states declined to participate in this question.*





Do you share data and/or resources to combat identity fraud in the tax refund process with other agencies (within your state, other states, federal or private sector)? Why or why not?

Interviewees identify five states as leaders in the detection and prevention of state income tax refund identity fraud, all of which have policies and procedures in place and pursue fraud at the criminal level (done by 81 percent of states interviewed).



How familiar are you with what other states are doing to prevent identity fraud in the tax refund process? If familiar, what state(s) would you say are the industry leader/leading edge in this area? Why?

In general, officials feel current procedures assist in identifying cases of state income tax refund identity fraud:

### Government Official Stated Strengths of Current Fraud Prevention Procedures

Procedure	Examples
Interrogating returns before refund disbursal	<ul style="list-style-type: none"> <li>• “Processes are successful in the fact that they interrogate every single tax return before they disburse the respective refund.”</li> </ul>
Reviewing a higher number of returns	<ul style="list-style-type: none"> <li>• “The ID verification process has been able to successfully identify fraud based on the returns that were submitted.”</li> <li>• “The procedures being developed with RSI will better identify tax returns that are likely fraudulent.”</li> </ul>
Authenticating identities leading to manual examination	<ul style="list-style-type: none"> <li>• “Their identity verification process provides their agency the ability to authenticate if the person submitting the return is the correct individual.”</li> <li>• “Ability to delay or hold a refund before they issue it to verify some of the information on it is a huge asset and strength to the state.”</li> </ul>
Allowing processors to adapt “on the fly”	<ul style="list-style-type: none"> <li>• “Department of Revenue developers control the front end of their tax system, rather than using a third party vendor. This allows them to be very flexible upon encountering any potential issue that may emerge.”</li> </ul>

What are the strengths of these current procedures/protocols? *Ten states declined to participate in this question.*

However, they feel these procedures are not effectively combating and reducing the problem.

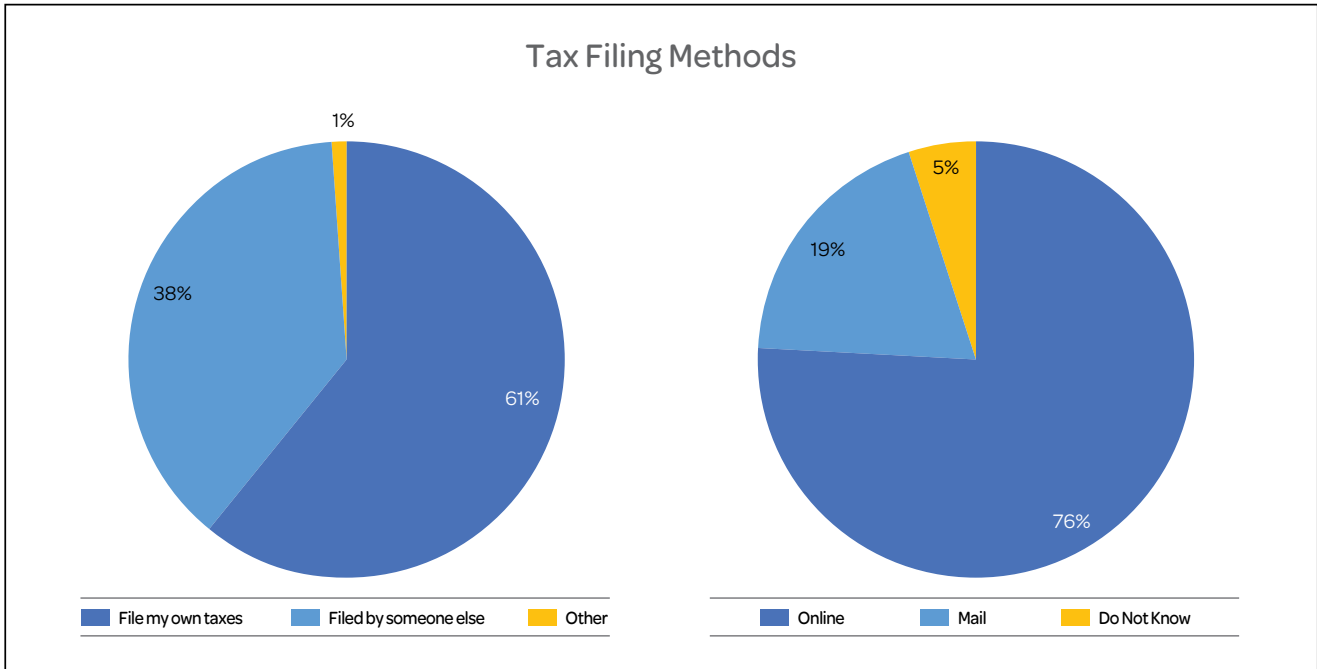
### Government Officials Stated Weaknesses of Current Fraud Prevention Procedures

Issue	Examples
Magnitude of the problem	<ul style="list-style-type: none"> <li>• “The department is never ahead of the individuals who are committing tax fraud.”</li> <li>• “It is almost impossible to identify where the next attack is going to come from.”</li> </ul>
Limited time and resources	<ul style="list-style-type: none"> <li>• “There is not enough time to thoroughly examine each individual tax return and guarantee that no more fraudulent activity is taking place.”</li> <li>• “The state simply needs more resources. They need more people to speed up the process.”</li> <li>• “Allocating enough staff to take part in the ID verification process was somewhat considered a weakness this past year.”</li> <li>• “There is no criminal investigative unit within the department.”</li> </ul>
Lack of flexibility	<ul style="list-style-type: none"> <li>• “Wish their current system provided greater flexibility and was more modernized.”</li> <li>• “The DOR does not have as much capability as preferred to be able to cross-check their data sources on a real-time computing basis. Not only are they unable to fully review their data sources in regards to returns going through their edit system, but other information of the specific tax payer who is in question that could help them verify if the return is in fact legitimate is not available.”</li> <li>• “There are things they wish they can do to help stop identity theft. It could be in the form of a better identifier that Social Security numbers because the latter are not as secure anymore.”</li> </ul>
Lack of predictive analyses	<ul style="list-style-type: none"> <li>• “More predictive analysis and faster resolution.”</li> <li>• “Wished that his agency could predict where the next fraud attack will be coming from.”</li> </ul>
Lack of information sharing	<ul style="list-style-type: none"> <li>• “More federal databases would always be helpful.”</li> <li>• “More discussions between state agencies are needed to better coordinate which agencies are in charge of covering certain aspects of the issue.”</li> <li>• “A nation-wide network could be developed so they could be in more contact with other entities. This network would partially share up-to-date information about fraudulent crimes and practices taking place throughout the nation.”</li> </ul>

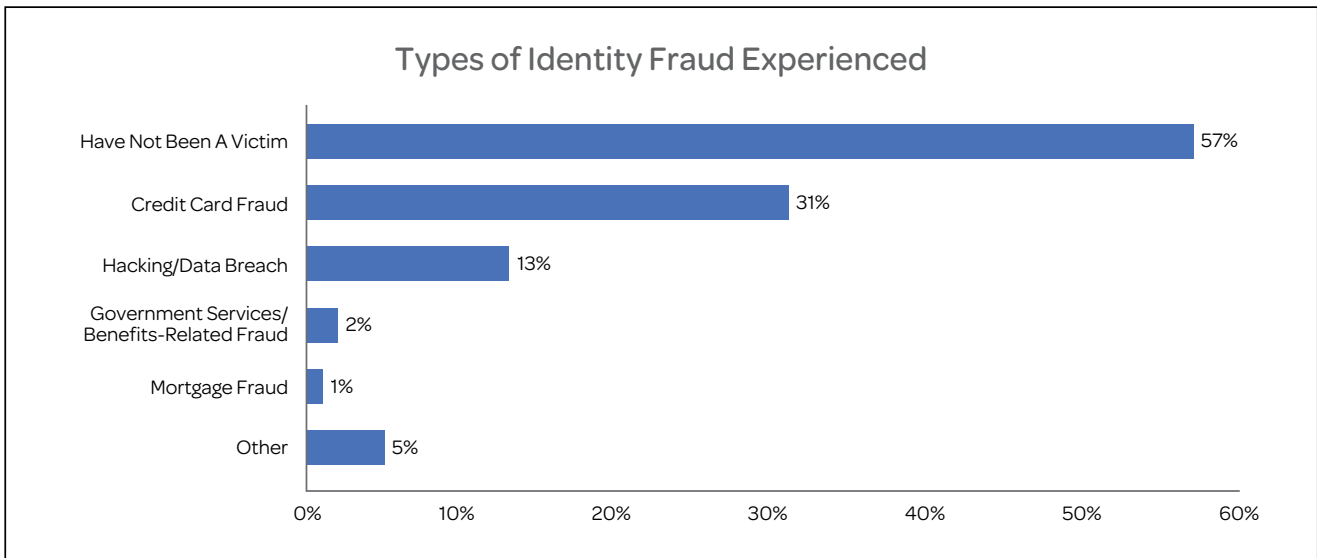
What are the weaknesses of these current procedures/protocols? *Ten states declined to participate in this question.*

## APPENDIX: TAXPAYER DEMOGRAPHICS

### TAX FILING CHARACTERISTICS

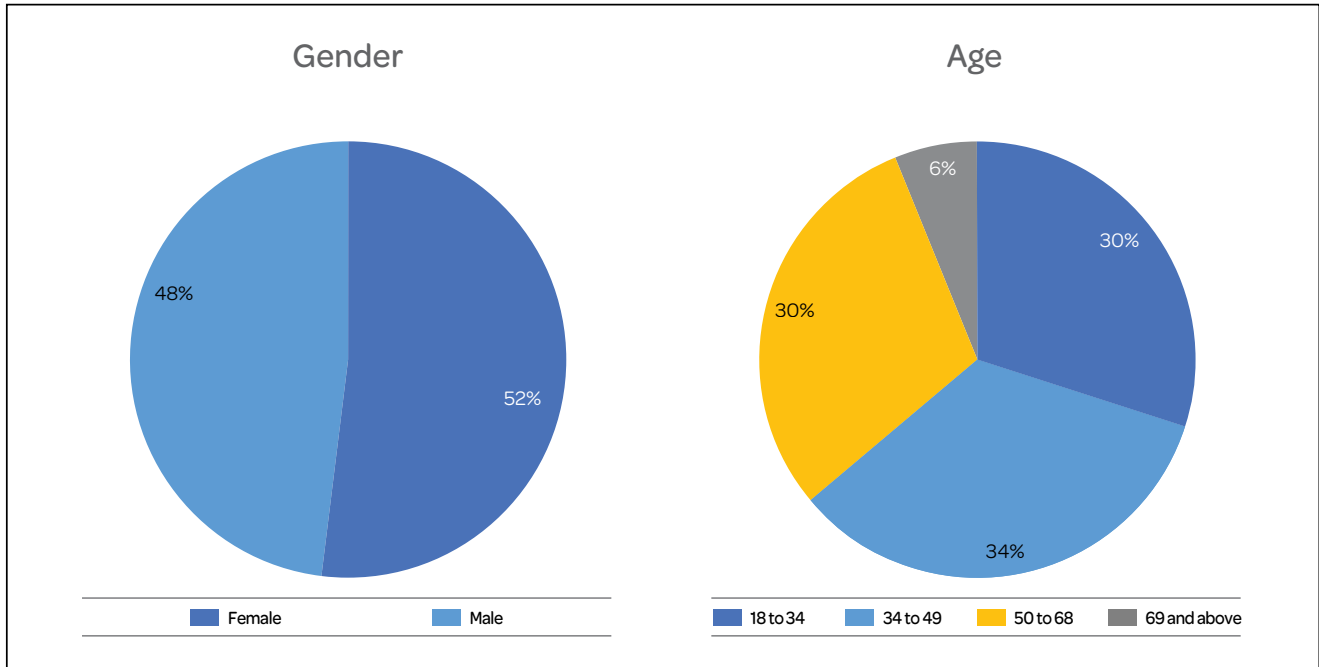


Base: All Respondents (n=2,013). Which method did you use to file your taxes last year? How did you file your taxes?

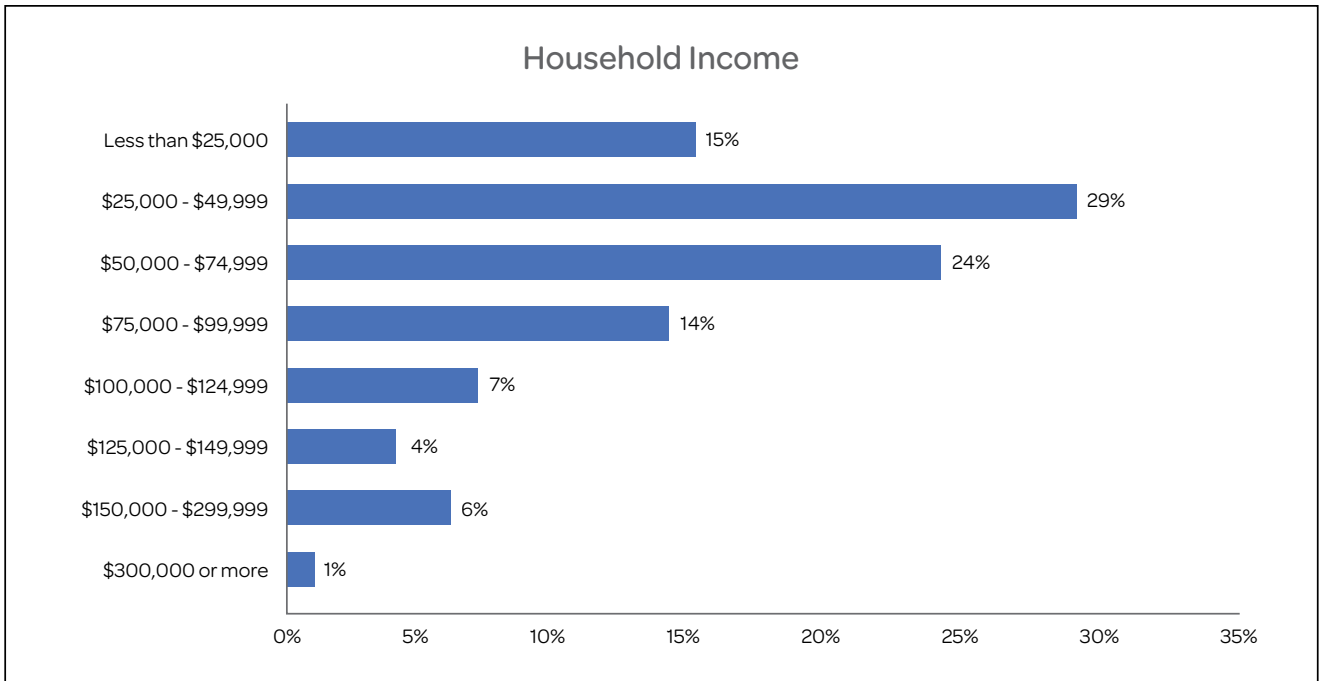


Base: All Respondents (n=2,013). Have you ever been a victim of any kind of identity theft or identity fraud?

PERSONAL CHARACTERISTICS



Base: All Respondents (n=2,013). What is your gender? What is your age?



Base: All Respondents (n=2,013). What is your total household income?

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Call 888.579.7638 or visit

[Identitygov.com](http://Identitygov.com)

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