NCSL Presentation

Saving Treasuries Substantial Revenue through State DOR, IRS and Private Sector Collaboration

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Background on Credit Karma

- Free credit scores, credit reports, credit monitoring, financial management tools and more
  - Over 75M members
  - Over 1B scores to consumers
  - Over $500M in revenue
  - Nearly 1M federal tax filings last year, approximately 750,000 state returns
- Helping members make financial progress in the US and parts of Canada
- Offices in San Francisco, Los Angeles, Charlotte, Cary
- Launced Credit Karma Tax January 2017

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Agenda

In the past, Federal and State Treasuries allowed criminals to steal billions of dollars through the annual income tax filing obligation but recent innovations by all stakeholders have made it much more difficult to defraud government taxing agencies. Learn how this public private partnership is saving your state millions of dollars every year and better protecting your constituents from identity theft.

- Criminal use of tax products
- State efforts
- Security Summit
- Future State

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Criminal Use of Stolen Identities in the Tax World

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First - Understand the Threat

- The Department of Revenue is a treasure trove of data that can be converted to stolen income tax refunds, and any other government financial claim that can be obtained in your state.
  - Unemployment compensation
  - Housing
  - Medical expenses
  - They are very creative and BOLD

  Tax refund fraud is more financially rewarding than running drugs on the street. Less chance of dying or getting caught and it pays much better!

Scope of Problem - Tax Refund Fraud

GAO Highlights

Highlights of GAO-15-119, a report to congressional requesters

Why GAO Did This Study

IRS estimated it prevented $24.2 billion in fraudulent identity theft (IDT) refunds in 2013, but paid $5.8 billion later determined to be fraud. Because of the difficulties in knowing the amount of undetected fraud, the actual amount could differ from these point estimates. IDT refund fraud occurs when an identity thief uses a legitimate taxpayer's identifying information to file a fraudulent tax return and claims a refund.

GAO was asked to review IRS's efforts to combat IDT refund fraud. This report, the second in a series, assesses (1) the quality of IRS's IDT refund fraud cost estimates, and (2) IRS's progress in developing processes to enhance taxpayer authentication.

GAO compared IRS's IDT estimate methodology to *GAO Cost Guide* best practices (fraud is a cost to taxpayers).

January 2015

IDENTITY THEFT AND TAX FRAUD

Enhanced Authentication Could Combat Refund Fraud, but IRS Lacks an Estimate of Costs, Benefits and Risks

What GAO Found

Identity Theft (IDT) Refund Fraud Cost Estimates. The Internal Revenue Service's (IRS) fraud estimates met several *GAO Cost Guide* best practices, such as documenting data sources and detailing calculations. However, the estimates do not reflect the uncertainty inherent in measuring IDT refund fraud because they are presented as point estimates. Best practices suggest that agencies assess the effects of assumptions and potential errors on estimates. Officials said they did not assess the estimates' level of uncertainty because of resource constraints and methodological challenges. Because making different assumptions could affect IDT fraud estimates by billions of dollars, a point estimate (as opposed to, for example, a range) could lead to different decisions about allocating IDT resources. Reporting the uncertainty that is already known from IRS analysis (and conducting further analyses when not cost prohibitive) might help IRS communicate IDT refund fraud's inherent complexity.

IRS Estimates of Attempted IDT Refund Fraud, 2013

Source: GAO analysis of IRS data. | GAO-15-119

In 2013 the IRS paid out $5.8 Billion to criminals who filed fraudulent refunds. State returns are linked to the federal return so while not a one to one correlation always, most of the time a state will see the same fraudulent return that the IRS did.

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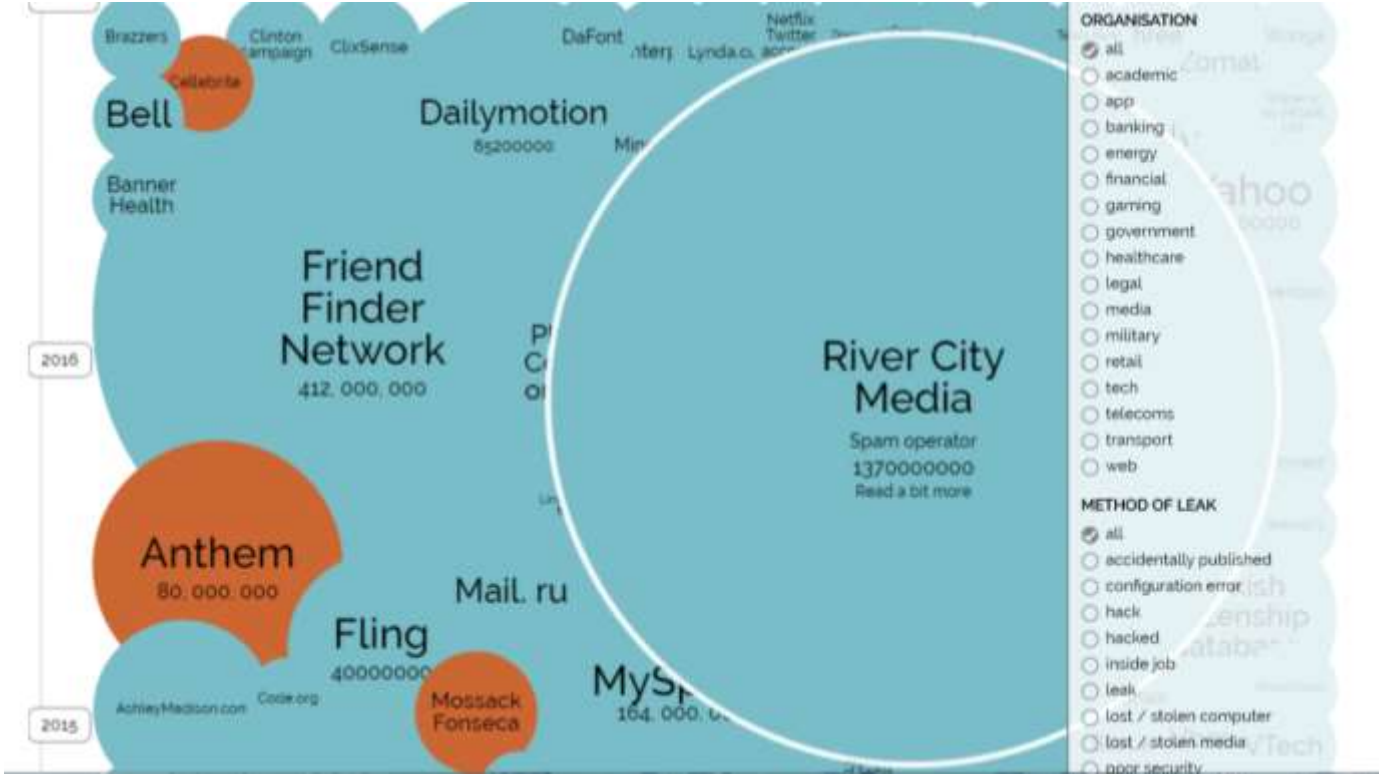
Fueled by the Plethora of Stolen Data Flooding the Dark Web - http://www.informationisbeautiful.net/visualizations/worlds-biggest-data-breaches-hacks/



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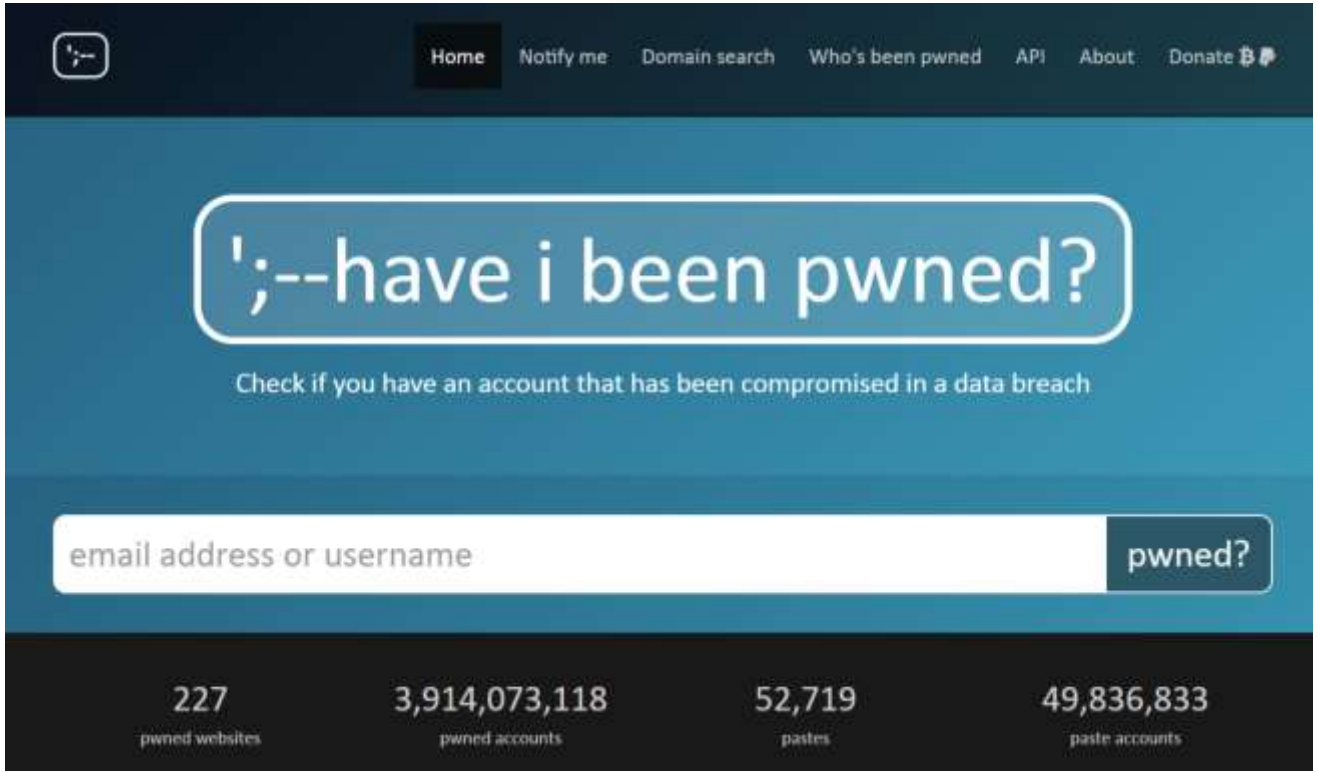
https://haveibeenpwned.com/



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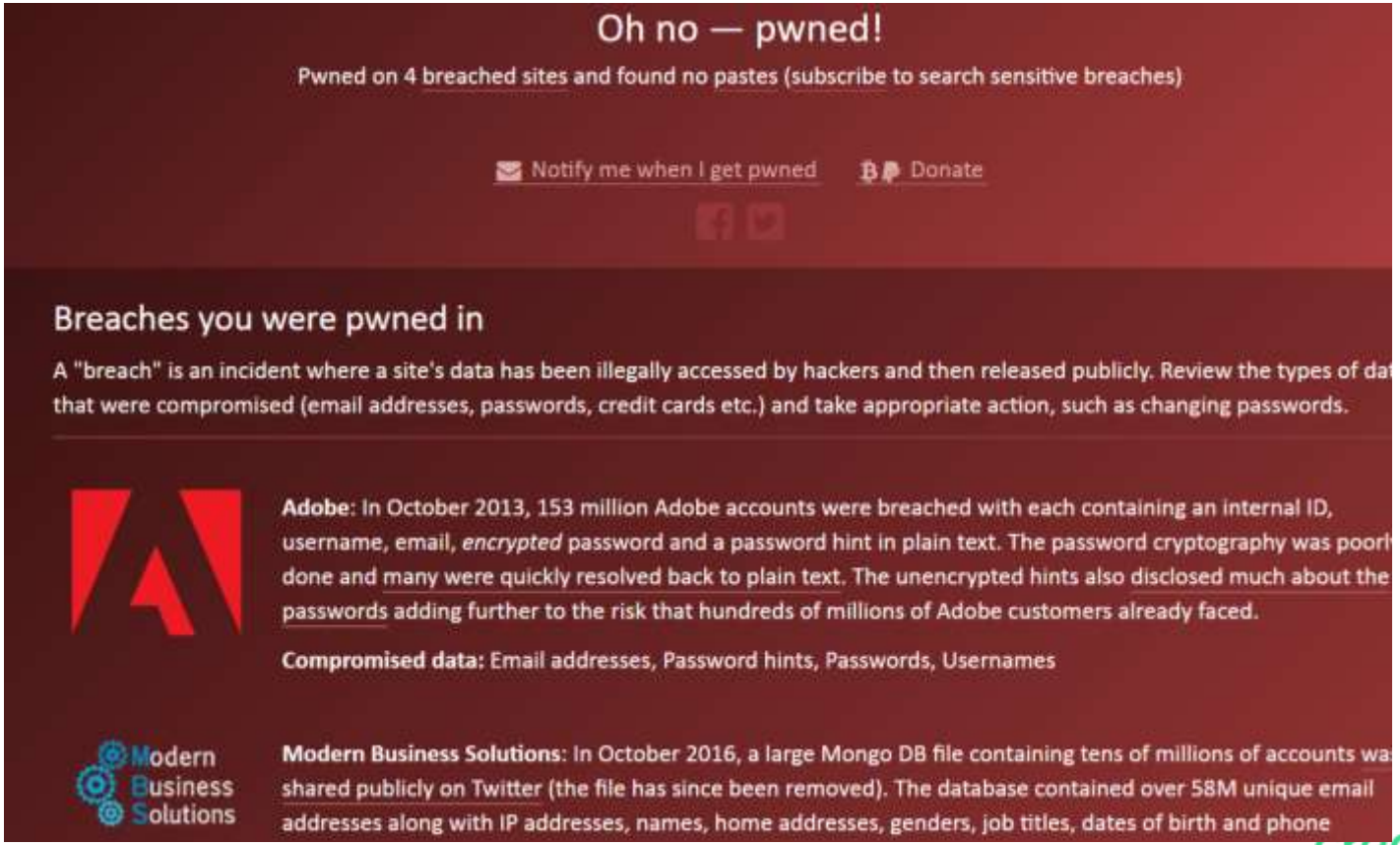
It is highly likely some or all of your info is already out on the dark web.



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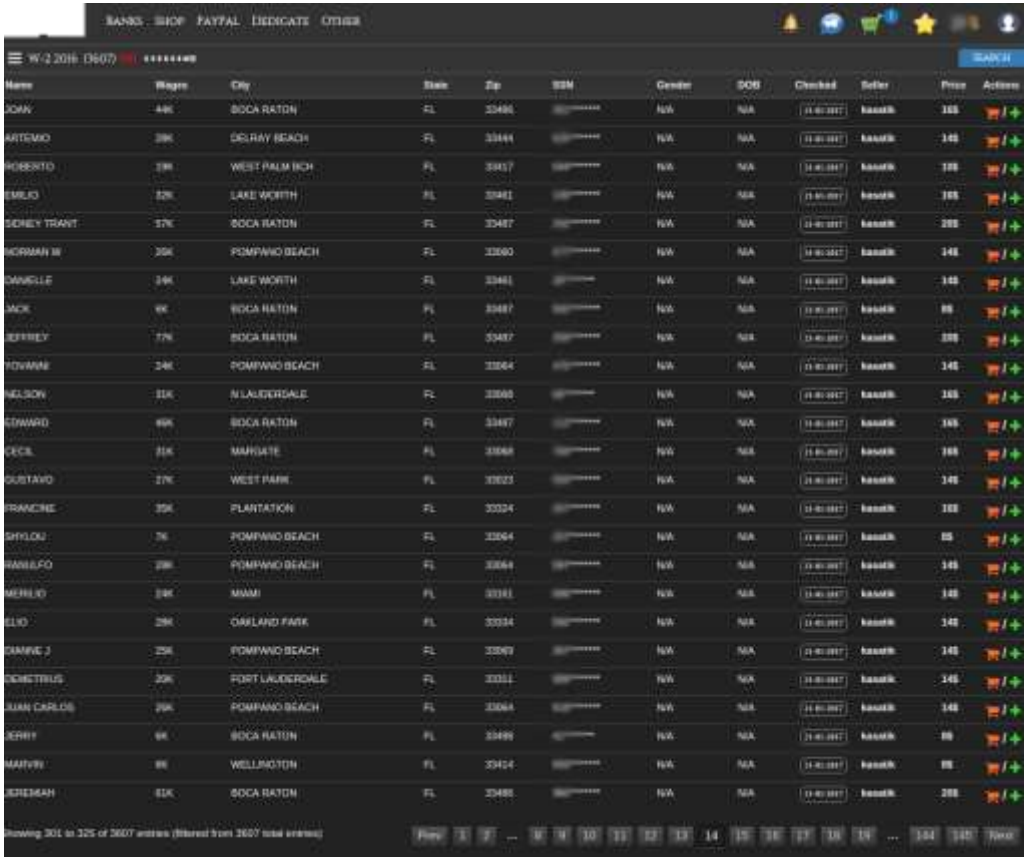
W2s For Sale in the Underground Market



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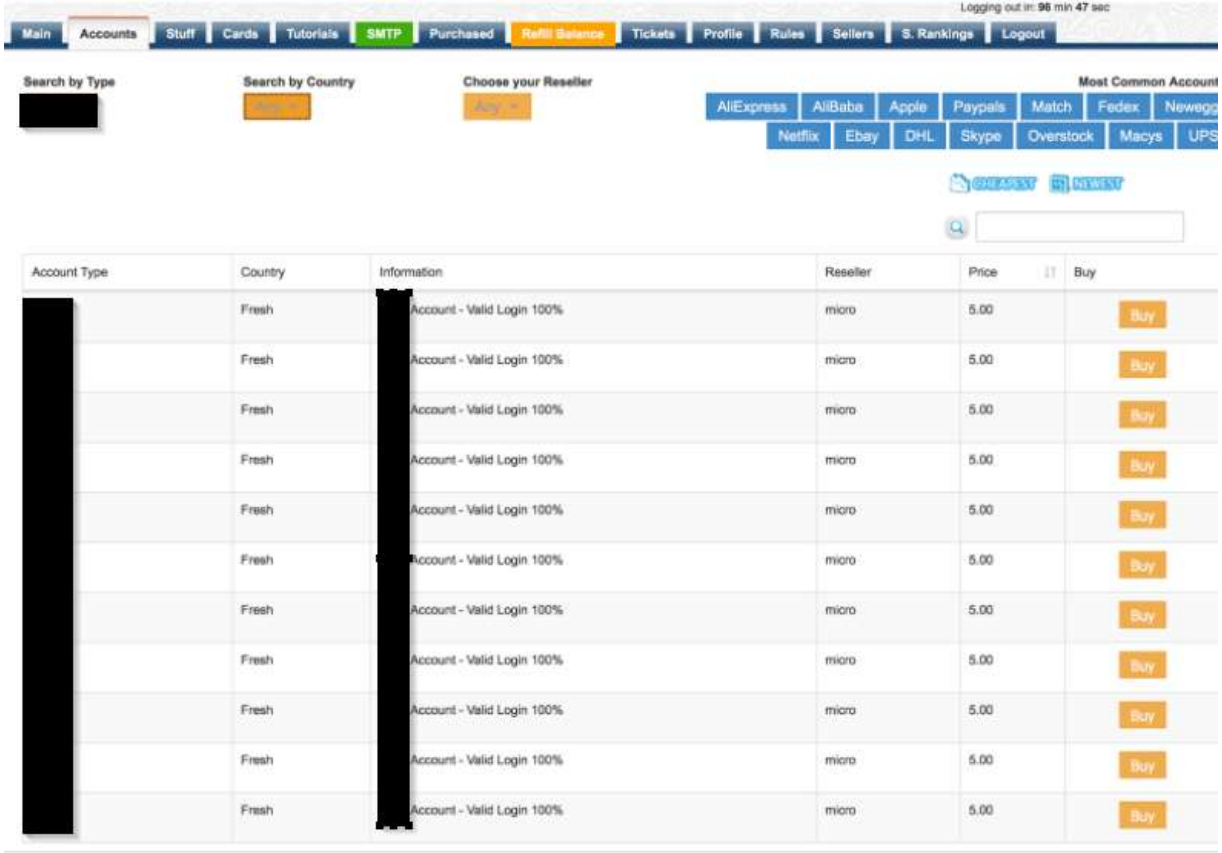
Major Tax Preparer Accounts for Sale in the Underground



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Meanwhile, back to the State Department of Revenue

- States saw a substantial increase in fraudulent returns and reports from taxpayers of ID theft and started implementing filtering techniques and solutions.
  - Fraud Manager (module within a state's integrated tax administration technology.
    - Uses certain fields on the return with prior history with the taxpayer to spot exceptions. Helpful but causes a lot of manual review. For example, a sign of possible fraud is using a different bank account from the prior year.
    - Retraining DOR employees from spotting good old fashioned tax cheaters to spotting new fangled identity theft situations.

All efforts helped but it was a SILO effort because each state was handling on their own and with no IRS involvement.

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Use of External Sources to Authenticate the Taxpayer

- Data aggregators like Lexis Nexis or Thompson Reuters assist in legitimizing the taxpayer is the real taxpayer and not a criminal
- Driver's License look up of the number, issuance date and expiration date
- More communication with taxpayer when it is not clear if they are the real taxpayer
  - Can be a quiz asking for knowledge based answers based on credit history info from the bureaus or data aggregators
  - Answer questions online or by phone

  Pay refunds later to use the extra time to evaluate prior to paying refund

  Some are pricey but interagency cooperation is a must. Explore law changes if necessary to leverage the date housed in each agency.

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Other Types of Fraud

- Tax Refund Fraud is the main issue, however…
  - Any agency that pays claims, benefits is a target
  - Blackmail
  - Employment fraud
  - Wire fraud
  - Money laundering (fraudulent refunds crossing state lines and U.S. borders)
  - Criminal conspiracies to defraud the government and to use financial institutions in facilitation of fraud
  - Bank fraud, mail fraud… etc., etc.
- Tax data is valuable to criminals!!

Even with States Stepping up Their Game…

- Working in a silo is never a great long term solution so states started working with a national association called the Federation of Tax Administrators (FTA) to pool ideas, share results, and collaborate.

- Early in the tax season in 2015, the nation's leading online tax software company was shutdown for varying periods of time by the IRS and most of the states due to the high volume of fraudulent returns reported.

WATERSHED MOMENT!

- The next month the IRS Commissioner formed the IRS Security Summit. This is the first time in history that the IRS, the States and the software tax prep companies were brought together to fight the fraud.

IRS Security Summit

- “This unprecedented partnership continues to put strong new safeguards in place for the 2016 tax season,” IRS Commissioner John Koskinen said. “We are breaking new ground in the battle against identity theft. Taxpayers will have more protection than ever when they file their tax returns.”

Targeted working groups have formed to addressed specific needs and are manned by subject matter experts from the IRS, State DOR and Private Sector companies. Is your state involved?

Fantastic results in just a short period of time

So far for 2017, individuals reporting identity theft have **declined sharply** compared to the same time in 2016 and 2015.

In the first five months of 2017, about 107,000 taxpayers reported being victims of identity theft, compared to the same period in 2016, when 204,000 filed victim reports.

That's about 97,000 fewer victims – representing **a drop of 47 percent**. For comparison, there were nearly 297,000 identity theft victims during the first five months of 2015.

https://www.irs.gov/uac/newsroom/don-t-take-the-bait-step-3-security-summit-safeguards-help-protect-individualsrenew-focus-on-curbing-data-breaches-and-business-identity-theft

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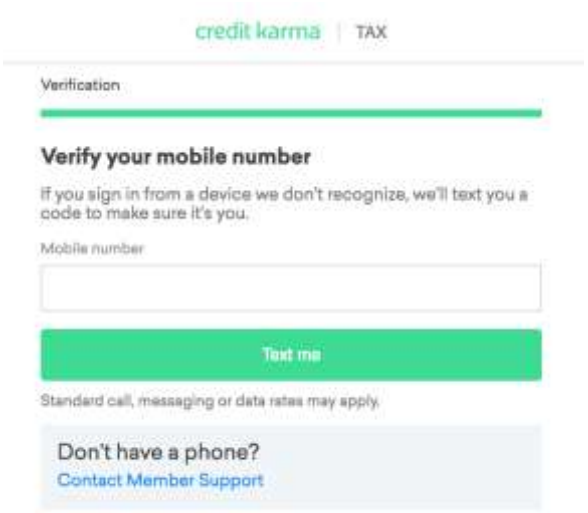
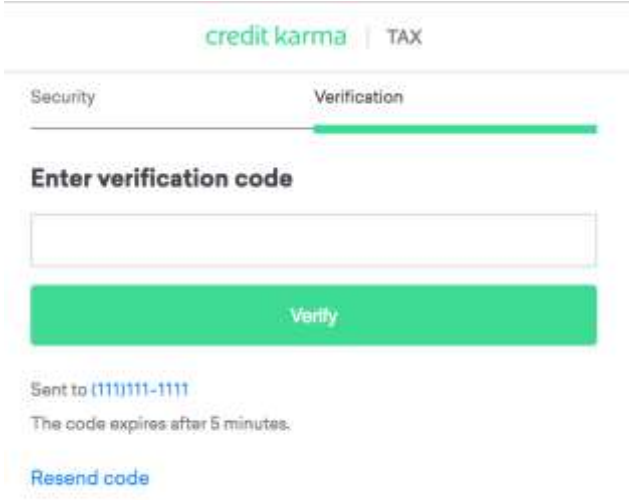
Examples of Initiatives that Contributed to the Reduction

Multi-factor Authentication





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ID Verification

Third party verification services

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Other changes that have helped

- Delay paying refunds to allow more filtering techniques
- Driver's license real time validation
- W-2 Matching real time to ensure
  - Employee is reporting accurate wages
  - Employer actually remitted the funds
  - Mandating the W-2 copy sent to employee is sent to the DOR by end of January. What does your state law or regulation say about this? The Path Act mandated this to be sent to the IRS by 1/31.
- Internal ID Theft Fraud Units – civil and criminal charges
- Selfies or other biometric types of ID Validation. www.alabamaeid.com

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Criminals Evolve as the IRS and States innovate

- W-2 Phishing Schemes are a great example. As the W-2 information was used as a new filtering tool, the criminals went on a nationwide frenzy to obtain as many as they could get to sell on the dark web. Most popular method was sending an email in the name of the CEO or other top executive asking for copies of the W2s to be emailed to them.

- **Don’t Take the Bait!**
- https://www.irs.gov/uac/newsroom/don-t-take-the-bait-step-3-security-summit-safeguards-help-protect-individualsrenew-focus-on-curbing-data-breaches-and-business-identity-theft

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The fight to protect state and federal treasury dollars from criminals will evolve as the criminals adapt to our solutions, but with the new collaboration between state DOR's, the IRS and tax preparation software companies is making it harder and harder for criminals to profit from a fraudulent tax return.

Questions?

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