Statement
Of
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Before the
House Committee on Oversight and Government
Reform
Subcommittee on Government Operations

Hearing
On
Examining the Skyrocketing Problem of Identity
Theft Related Tax Fraud at the IRS
Friday August 2, 2013

Intro

Chairman Mica, Ranking Member Connolly, and members of the Sub-Committee,
my name is Doug MacGinnitie. I am the Commissioner for the Georgia Department of Revenue.
I'd like to thank the Committee on Oversight and Government Reform, Subcommittee on
Government Operations for inviting me to speak this morning. To give you some brief
background, I have been Commissioner for 2 ½ years. Prior to my involvement in the public
sector, I was in the insurance industry so the only background I had in the tax business was as a
payer.

Background on Georgia Taxes

First, I think it is always helpful to start with the big picture. Georgia is the 9th largest state in
the Union with approximately 9.8 million residents. In 2012, we had roughly 5 million
taxpayers: 4.25 individuals and 750,000 companies. The Georgia Department of Revenue
collects approximately $20 billion in taxes, which is 98/99% of all state tax revenue in Georgia.
The vast majority of state tax revenue in Georgia is individual income tax (50%) and sales tax
(35%)

Last year, we processed 4.256 million individual income tax returns. Of those returns, 2.95
million were for refunds totaling $2.1 billion. So we are, like all taxing authorities, a big data
processor. We process $20 billion a year but have to keep and manage all of the information
related to that $20 billion.

To help visualize how a Revenue Department works, I like to ask people to visualize an old
conveyor belt manufacturing process. A return shows up at the Department (either
electronically or paper). That return is loaded into our systems (if paper, we scan it and shred
the paper) and then it starts its way down the conveyor belt. As it goes down the conveyor, we
check the return for all sorts of things. Do the numbers add, are they taking the correct
deductions, … If something isn't right with the return, it is kicked off the conveyor belt into a
pile and each pile has to be reviewed/worked by someone at the Department. If the return
checks out, it hits the end of the conveyor and a refund is issued.

Once the systems are set up, the number of returns coming to us matters less than how many
people we have to work the manual piles.

Fraud

Several years ago, long before my time, folks at the Georgia DOR began to see fraudulent
returns and then they started trying to fight the fraud. In 2005, a group within the agency was
established with the mission to processing of fraudulent

returns and prosecuting those individuals who were filing them. It is called the Office of Special Investigations (OSI).

At first, OSI helped put in place some pretty simple rules that the system used to check refund claims.   Back to the conveyor analogy, as a return/refund was moving down the conveyor belt it was checked against those fraud rules. If the return/refund failed those rules, it would be kicked out and someone at the Department would review the return. If it looked fraudulent, then it would be held indefinitely. If it checked out upon further review, it would be processed. An example, if too many refunds were being sent to the same post office box, we would stop processing any more returns to that address. Might be ok, but might not and we wanted to take a closer look.

Well, as we evolved and as the criminals evolved we began to realize that the vast majority of the fraud involved identity theft. Some of the fraud was the actual person making fraudulent claims on their tax return, but more often someone was using a legitimate taxpayers information and filing a fraudulent claim in their name with the legitimate taxpayer having no idea someone had filed a return in their name – at least until the legitimate taxpayer tried to file and was blocked because someone had already used their name and social security number.

We also realized that our ability to look at a return and tell that the filer had appropriated someone else's identity was limited. Just looking at a return doesn't really tell you much, and our ability to look at other sources of data was/and to a great extent still is limited.

Personal experience showed it could happen to anyone. In 2011, when my wife and I filed our joint return, it was rejected because someone had already filed a federal and state tax return in her name. If that doesn't seem ironic to you, nothing will. So not only am I familiar with this topic as a tax administrator, I am also familiar with it as a victim (or semi-victim)

Current Program

All of that said, our old rules based approach made a difference. In 2011, that program stopped 132,006 refunds totaling $91,546,874, (that's calendar year; FY is 109,884 refunds totaling $71.6 million); but as I noted above, we knew we still had a significant hole around identity theft.

In fall of 2010, approached by a company called Lexis/Nexis with a proposal to help fight the ID theft. Not surprisingly, we get called on all of the time by various vendors and consultants who pitch us on ideas on how to make our operations more efficient or solve a problem for us. Usually I leave these meetings thinking – "Well, you are right about what the problem is" but with no real confidence they can help us fix the problem – at least not cost-effectively.

I remember clearly leaving the meeting with Lexis/Nexis thinking – not only do they understand what the problem is, they have put together a program that might really work – and they were willing to get paid only if it was a good investment for the state.

So in 2012, after a record short deployment, we implement a 2nd part to our fraud fighting program with Lexis/Nexis. The program works as follows:

 After our systems are done checking a return/refund, information from every refund that we think is ok to process is sent to our vendor who runs it through their databases to look for signs of identity theft. If, based on the criteria we have set up with L/N, the refund looks suspicious, we will hold the refund and a letter and email is sent to the taxpayer asking the taxpayer to go to a website and answer a few questions about the taxpayer that only they would know – much like if you credit card is stolen. If the questions are answered correctly, the refund goes back into queue and it is paid. If the questions are not answered correctly or no attempt is made to answer the quiz, the refund is held indefinitely and then eventually reversed out.

In putting together the program, we attempted to balance the various goals of processing refunds as quickly as possible, protecting the state's money, and protecting taxpayer's identities. We have now run this program for 2 processing seasons. In the first year, there was definitely a learning curve but this year it went very smoothly.

The results have been very good. The process adds1 to 5 days, depending on how long it takes the taxpayer to receive an email or letter to the processing of a refund. In 2012, the program stopped 44,158 refunds totaling $23,483,870. It cost us $2,604,516 ($2.5 million base fee plus, $104,516 commission).

From a business perspective, the program is a no-brainer. We spent $2.6 million and saved $$23.5 mil ($23, 483,870) and protected numerous taxpayers from having the hassle of dealing with us and fixing their accounts.

Final thoughts

Our experience is that tax fraud is a growing and serious problem. Last year, our programs stopped 160,000 fraudulent tax returns totaling $99 million. That means3.8% of all returns filed with the Georgia DOR were identified as fraudulent.

Our anecdotal experience, based on investigations of various fraud schemes, is that many of the schemes appear targeted at the federal level with the state portion being a bonus. The dollars involved federally are much larger – because of higher income tax rates. But even if you just take the 3.8% number and don't change the dollar amounts, the stakes are huge for the state and the IRS.

Criminals react to what we are doing and are getting more sophisticated. But the challenges we are facing are not unique. Every financial institution and data processor are facing the same challenges, and we need to look to what they are doing as a model. We are by no means stopping 100% of the fraudulent filings, but we need to keep evolving.

Thank you again for the opportunity to appear before you today. I am happy to answer any questions you may have.