

IDENTITY THEFT TAX FRAUD

QUICK STATS

- ✘ **CONFERENCE:** Spending
- ✘ **TEAM:** Internal Revenue Service
- **FUMBLE:** More than \$5 billion in fraudulent refunds
- **HOW TO RECOVER THE BALL:** Implement accelerated W-2s and identity verification processes

Every year IRS issues more than \$300 billion in tax refunds to more than 110 million taxpayers. For most taxpayers it is a day when they can get some of their hard-earned money back. For others it is the beginning of a nightmarish realization that someone stole their identities and filed fraudulent returns on their behalf. Billions of dollars in fraudulent returns are paid out every year, and the problem may only get worse. IRS estimates it paid \$5.2 billion in fraudulent identity theft refunds in 2013, but that amount could explode to \$21 billion as soon as next year.³⁴⁸

Fraudsters take advantage of IRS's "pay first, ask questions later" refund model. Under the "look-back" approach, "Rather than holding refunds until completing all compliance checks, IRS issues refunds after conducting selected reviews."³⁴⁹ Because of the timing, IRS issues refunds months before they can match and verify the information with the W-2s. According to a GAO report on this process, by March 1, 2012, IRS had issued about 50 percent of all 2012 refunds before accessing the W-2 data verified by the SSA.³⁵⁰ As GAO notes, "If IRS had access to W-2 data earlier—through accelerated W-2 deadlines and increased electronic filing of W-2s—it could conduct pre-refund matching and identify discrepancies to prevent the issuance of billions in fraudulent refunds."³⁵¹

In many ways the IRS tax refund system is similar to the pay-and-chase scheme that has plagued the

American healthcare system. The best way to combat identity theft tax fraud is to have a robust pre-refund strategy rather than try to recover funds after they are issued. GAO notes that, "Recapturing a fraudulent refund after it is issued can be challenging—if not impossible—because identity thieves often spend or transfer the funds immediately, making them very difficult to trace."³⁵²

RECOVERY

If Congress designed the system from scratch today, no one would come up with such a deeply flawed tax process. But since Americans are used to getting their returns at a certain date and time every year, there is reluctance to transition the refund and implement stronger matching and anti-fraud measures. The dollar and social costs of identity theft are too great for the traditional date of returns to remain the same. Congress should consider accelerated W-2s and delayed tax refunds until the W-2s are verified by IRS. This could apply pressure to incentivize employers to submit W-2s earlier. Even though matching W-2s prior to refunds could cause a few refund delays, it will likely only be a one-time transition issue for the taxpayer. Ultimately American taxpayers should be able to trust their government to safely process their most secure information and create efficient practices to combat fraudulent identity claims.

For more information, please visit:

[CNBC: Tax-refund fraud to hit \\$21 billion, and there's little the IRS can do](#)

[GAO: Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud](#)

[GAO: Report: Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud](#)