



STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

April 14, 2015

Kenneth Adams
Acting Commissioner
Department of Taxation and Finance
William A. Harriman State Campus
Building 9, Room 217
Albany, NY 12227

Re: Report 2014-1A-001

Dear Acting Commissioner Adams:

This report summarizes the findings and recommendations resulting from our Office's examination¹ of Department of Taxation and Finance (Department) personal income tax refunds processed during the calendar year January 1, 2014 through December 31, 2014. The objective of our examination was to determine whether refunds approved by the Department for payment were appropriate and processed in accordance with applicable New York State tax laws and regulations.

A. Results of Examination

We returned 13,380 questionable refunds, totaling about \$55.6 million, to the Department for follow-up evaluation and appropriate action. For those returned, we verified that 11,965 refunds totaling \$42.9 million would have resulted in overpayments totaling \$26.3 million. The Department continues to follow up on the remaining questionable refunds our Office identified. Based on this year's results, the refund overpayments we prevented averaged about 61 percent of the dollar amount of the taxpayer's original refund request. Therefore, we estimate our efforts will prevent an additional \$7.7 million $((\$55.6 \text{ million} - \$42.9 \text{ million}) \times 61 \text{ percent})$ in refund overpayments, for a total savings of \$34 million.

We shared a draft report with Department officials and considered their comments (Attachment A) in preparing this final report. The officials agreed with the findings and stated that the Department has attempted unsuccessfully to acquire external data to prevent unwarranted credits. The Department should continue to pursue Legislative authorization to obtain this data. Officials stated they will continue to seek improvement opportunities that would increase the Department's abilities to effectively identify and prevent erroneous refunds.

¹We performed our examination in accordance with the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, as well as Article II, Section 8, and Article VII, Section 111 of the State Finance Law.

B. Background and Methodology

The Department processes all New York State personal income tax returns, using various business strategies and solutions in evaluating every personal return. All returns that result in refunds are subject to audit by the State Comptroller prior to payment. We work collaboratively with the Department and acknowledge their efforts in saving more than a reported \$450 million in calendar year 2014.

We selected Department-approved refunds for examination using audit filters to identify high-risk transactions. Because we audit the entire tax return associated with the refund, we may determine a refund is questionable for reasons other than those initially identified by our filters. We also obtained additional data from select New York State and New York City agencies. These data assisted us in identifying taxpayers who claimed refundable credits for which they were ineligible.

During our examination period, the Department processed almost 7.4 million refunds totaling over \$8.5 billion. From this population, our filters identified 196,626 refunds totaling over \$841 million for potential examination. We examined 37,900 refunds totaling almost \$480 million.

C. Details of Findings

Of those refunds examined, we identified and returned to the Department 13,380 questionable refunds totaling about \$55.6 million, summarized as follows:

Reason for Stopping Refunds	Number of Refunds	Dollar Value of Refunds
Taxpayer claimed refundable credits based on incorrect information, such as fake or inflated number of dependents or understated income.	7,789	\$25,215,452
Tax preparer submitted returns with refundable credits based on incorrect information.	1,590	4,845,593
Taxpayer had questionable income adjustments	1,131	3,342,008
Taxpayer had a questionable social security number	1,009	2,588,150
Taxpayer had questionable itemized deductions	337	1,537,245
Taxpayer claimed incorrect wages and withholding	290	972,599
Taxpayer failed to claim correct New York City Income	196	692,074
Taxpayer failed to claim correct New York State Income	69	2,135,754
Other	969	14,232,838
Total Refunds Stopped	13,380	\$55,561,713

We continued to match data we obtained from select New York State and New York City agencies to identify taxpayers who claimed unwarranted refundable credits. This allowed us to stop 2,620 questionable refunds valued at about \$8.3 million, which is included in the first category in the table above. Based on input from the Department, the Governor proposed language in his 2015 Executive Budget that would allow the Department to obtain this data directly; however, this change was not included in the 2015-16 State Budget.

As indicated in the chart above, we stopped the remaining 10,760 questionable refunds totaling \$47.3 million because the refunds included: refundable credits based on incorrect information, questionable adjustments, questionable social security numbers, overstated deductions, incorrect wages and withholding, and other errors.

Recommendations

- 1) *Continue to pursue obtaining external data to prevent unwarranted credits.*
- 2) *Continue to identify and implement other opportunities to help identify and prevent erroneous refunds.*

We thank the management and staff of the New York State Department of Taxation and Finance for the courtesies and cooperation extended to our auditors. Since your response to our report is in agreement with these recommendations, there is no need for further response. If you choose to provide a response, we would appreciate receiving it by May 14, 2015 indicating any actions planned to address the recommendations in this report.

Sincerely,

Bernard J. McHugh
Director of State Expenditures

cc: Ed Chaszczewski, Deputy Commissioner
James Brunt, Director of Internal Audit
Joseph Carzo, Director of Audit Division
Lynne Belokopitsky, Director of Personal Income Tax



Department of Taxation and Finance

JOSEPH A. CARZO
Director of Tax Audits
Audit Division

April 2, 2015

Mr. Bernard J. McHugh
Director of State Expenditures
Office of the State Comptroller
110 State Street
Albany, New York 12236

Re: Draft Report 2014-1A-001

Dear Mr. McHugh:

The Office of the State Comptroller (OSC) conducts an annual examination of the personal income tax refunds processed by the Department of Taxation and Finance (Department). This letter responds to the draft report summarizing the OSC findings and recommendations for the calendar year January 1, 2014, through December 31, 2014. Thank you for the opportunity to comment on the draft report. The professional relationship between our two agencies continues to be highly productive as we work collaboratively to ensure the accuracy and completeness of personal income tax filings and any resulting refund claims.

The draft report summarizes the questionable refunds returned to the Department by OSC during the 2014 calendar year. It also summarizes recommendations for corrective actions, including recommending that the Department continues to pursue external data to prevent the allowance of unwarranted credits. Many of the refunds referred involved the Dependent Care Credit, for which OSC has successfully secured subsidy data from external sources. The Department has attempted unsuccessfully to acquire the external data used by OSC in verifying these credits. As noted in your report, legislative changes have been proposed that would grant the Department statutory authority to acquire the external data directly. Although not included in the 2015-16 State Budget, we are hopeful legislative authorization will eventually be granted, which in turn will provide for efficiencies within the verification process.

The report includes a secondary recommendation: to continue to identify and implement other opportunities to help identify and prevent erroneous refunds. The Department continues to be a recognized leader among taxing authorities in the use of business technologies and analytics solutions to prevent erroneous refunds. The Department applies various business strategies and solutions in evaluating every personal return within the processing stream, with the ultimate goal of assuring the accuracy and integrity of each return filed and the corresponding refund. Our efforts to prevent erroneous refunds of highly suspect and/or fraudulent refund claims have yielded a savings in excess of \$450 million during the 2014 calendar year.

We continue to seek improvement opportunities that would further increase our abilities to effectively identify and prevent erroneous refunds. Recently, we have expanded our Fraud Analysis and Selection Team (FAST), which is charged with analyzing patterns within return filings to thwart refund scheme activity. The Department continues to liaise with the Federation of Tax Administrators (FTA) and the IRS to vet anomalies in filings and/or filing patterns of participating states. Our business analytics are evaluated continually, ensuring those most effective are given higher priorities. And, we continue to evaluate and implement all opportunities to use external data/solutions as we work to assure the integrity of the refunds we issue.

Mr. Bernard J. McHugh

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April 2, 2015

The Department would like to thank you and the OSC staff that assist us throughout the year in ensuring the integrity of refund processing. The continued partnership lends to our successes in this most important mission.

Sincerely,



Joseph A. Carzo
Director of Tax Audits