DEPARTMENT OF TAXATION
2018 Fiscal Impact Statement

1. **Patron** T. Monty Mason

2. **Bill Number** SB 531
   House of Origin:
   _____ **Introduced**
   _____ **Substitute**
   _____ **Engrossed**

   Second House:
   __X__ **In Committee**
   _____ **Substitute**
   _____ **Enrolled**

3. **Committee** House Finance

4. **Title** Department of Taxation; Reestablish an Accelerated Refund Program

5. **Summary/Purpose:**

This bill would require that the Department of Taxation ("the Department") reestablish an accelerated refund program for Virginia taxpayers filing income tax returns in person or via the United States mail with a local commissioner of the revenue. Such program would be required to be similar to the program discontinued on December 1, 2016.

This bill would be effective for taxable years beginning on and after January 1, 2018.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

8. **Fiscal implications:**

<u>Administrative Costs</u>

The Department has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. The Department considers implementation of this bill as routine, and does not require additional funding.

The Department will provide specific administrative costs on any legislation that is not "routine." Additionally, the Department will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, the Department will identify the costs at that time.

<u>Revenue Impact</u>

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2019. The Department ended the Accelerated Refund Program ("the ARP") due to concerns about identity theft and refund fraud. The premise of the ARP was that if subsequent review identified errors in a return, the Department could recover the portion of any refund issued that was determined to be erroneous. However, criminals who file fraudulent returns may conceal their identities, making recovery extremely difficult. While identity theft and refund fraud have been issues for a number of years, the Internal Revenue Service and state revenue agencies, including the Department, have seen significant growth recently regarding the number of fraudulent refund returns filed. To address this issue, the Department has implemented new processes to identify and deny fraudulent refunds claims. During Calendar Year 2017, the Department was able to stop approximately $45 million in fraudulent refund claims.

Because refunds under the ARP were issued without the Department being able to perform its detailed analysis of the return, the Department's processes were ineffective at stopping refund fraud for refunds sought under the ARP. Therefore, if the ARP or a similar program is reinstated, refunds issued through such program would not be adequately evaluated through the Department's existing fraud models and other review procedures and would be subject to increased instances of fraud. The extent of the negative General Fund revenue impact that would result is unknown because it is unclear how quickly and to what extent fraudsters would use such a program to file fraudulent refund returns.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

<u>Background</u>

The ARP was developed by the Department to enable eligible Virginia taxpayers to receive their individual income tax refunds faster. The ARP was available to taxpayers filing a Virginia resident income tax return in the current year:

- Who filed a Virginia resident individual income tax return in the previous year; and
- Whose name, address, Social Security number, and filing status were the same as reported on the previous year's return.

When the ARP was implemented in 1988, the Department was heavily reliant on manual procedures for processing paper returns. Such processing required personnel to transcribe tax return data into the Department's computer systems and review such data for errors before any refund could be issued. Because manual processing could be time-consuming, such processing resulted in delays in the time it took for an individual to receive his or her refund.

Today, the majority of returns are filed electronically rather than in paper form. Even for those returns filed on paper, the Department has automated many aspects of processing paper returns by making greater use of technology. The move away from manual processing of paper tax returns has greatly reduced the time it takes for an individual to receive his or her refund.

At the same time, the Department has been required to subject returns claiming refunds to greater scrutiny due to increased incidents of identity theft and attempted refund fraud. The Department uses numerous models that evaluate return data against numerous criteria to identify potentially fraudulent returns claiming a refund. These pre-refund filters stop the issuance of the vast majority of fraudulent refunds.

However, returns filed under the ARP do not receive the same scrutiny. As explained above, refunds were issued under the ARP to eligible taxpayers before the Department performed detailed processing of the return. Therefore, the Department was unable to adequately evaluate returns to determine whether they were potentially fraudulent before issuing a refund. As a result, the Department ended the ARP, effective December 1, 2016.

In its final years, there was a significant decrease in the number of taxpayers who received a refund through the ARP, as shown below:

Calendar Year	**Number of Taxpayers Using ARP**
2016	54,380
2015	81,170
2014	92,207
2013	99,250
2012	112,456
2011	101,832
2010	104,722
2009	140,761
2008	189,997
2007	220,620

Proposed Legislation

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cc: Secretary of Finance

Date: 2/5/2018 JJS
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