



STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER

April 16, 2014

Thomas H. Mattox  
Commissioner  
Department of Taxation and Finance  
William A. Harriman State Campus  
Building 9, Room 217  
Albany, NY 12227

Re: Report 2013-1A-001

Dear Commissioner Mattox:

This report summarizes the findings and recommendations resulting from our Office's examination<sup>1</sup> of Department of Taxation and Finance (Department) personal income tax refunds processed during the calendar year January 1, 2013 through December 31, 2013. 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 12,746 questionable refunds, totaling over \$93.3 million, to the Department for follow-up evaluation and appropriate action. To date we have verified that \$36.5 million of those would have resulted in overpayments. The Department continues to follow up on the remaining questionable refunds our Office identified. Based on prior years' results, the overpayments prevented from refunds we return to the Department average about 46 percent of the dollar value of refunds. Therefore, we estimate our efforts prevented an additional \$26.1 million in refund overpayments  $((\$93.3 \text{ million} - \$36.5 \text{ million}) \times 46 \text{ percent})$ , for a total savings of \$62.6 million.

We shared a draft report with Department officials and considered their comments (Attachment A) in preparing the final report. The comments of the Office of the State Comptroller on the Department's response are included as Attachment B. Department officials agreed with our findings and recommendations. The Department has taken significant steps to address and

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<sup>1</sup>We 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 and Article 22, Section 686 of the State Tax Law.

remedy the problems experienced in 2013 related to errors caused by a third-party vendor processing paper personal income tax returns. Department officials also agreed to continue their efforts to obtain data which will assist them in preventing unwarranted credits and to seek opportunities to improve the Department's effectiveness in identifying and preventing erroneous refunds.

## **B. Background and Methodology**

The Department processes all New York State personal income tax returns. As part of this process, the Department contracted with a third-party vendor to scan and capture the required data from taxpayers' paper tax returns and associated schedules and documents. All returns that result in refunds are subject to audit by the State Comptroller prior to payment.

We selected Department-approved refunds for examination using 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 our initial filter. We also obtained data from select New York State and New York City agencies. These data helped us identify taxpayers who claimed refundable credits that they were ineligible to receive.

During our examination period, the Department processed over 7.5 million refunds totaling almost \$8.9 billion. Of this, we selected 33,175 refunds totaling over \$712.5 million for examination.

## **C. Details of Findings**

Of those transactions selected, we identified and returned to the Department 12,746 questionable refunds totaling over \$93.3 million, as summarized in the following table:

Reason for Stopping Refund	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	6,860	\$21,597,215
Tax preparer submitted returns with refundable credits based on incorrect information	2,236	6,150,150
Taxpayer claimed incorrect wages and withholding	1,001	6,240,927
Taxpayer had questionable social security number	987	2,425,354
Taxpayer failed to claim correct New York State income	225	4,773,348
Taxpayer had questionable itemized deductions	183	1,575,210
Taxpayer failed to claim correct New York City income	127	375,046
Two largest errors caused by third-party vendor	2	36,050,261
Other (e.g. various errors on return)	1,125	14,113,214
Total Refunds Stopped	12,746	\$93,300,725

The number of questionable refunds we stopped during the year was higher than usual. This was due, in part, to refunds the Department approved that were generated based on errors made by a third-party vendor when scanning and capturing data from taxpayers' paper returns. Two of the largest questionable refunds were data-capture errors totaling \$36 million made by the third-party vendor. The Department continues to work with the third-party vendor to improve the reliability of data associated with paper returns.

In addition, we were able 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 1,967 questionable refunds valued at almost \$6.4 million, which is included in the first category in the table above. The Department should obtain this data itself to help prevent unwarranted credits.

As indicated in the chart above, we stopped the remaining 10,777 questionable refunds totaling almost \$50.9 million because the refunds included: refundable credits based on incorrect information, incorrect wages and withholding, overstated deductions, questionable social security numbers, or other errors.

**Recommendations**

- 1) *Continue working with the third-party vendor to resolve data errors created during scanning of taxpayers' paper returns.*
- 2) *Obtain and use data directly from select New York State and New York City agencies to help identify unwarranted credits.*
- 3) *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 is in agreement with this report, there is no need for a further response unless you feel otherwise. If you choose to provide a response, we would appreciate receiving it by April 30, 2014.

Sincerely,

Bernard J. McHugh  
Director of State Expenditures

Enc: Attachment A  
Attachment B

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



**STATE OF NEW YORK**  
Department of Taxation and Finance  
W. A. Harriman Campus  
Albany, NY 12227

**EDWARD CHASZCZEWSKI**  
DEPUTY COMMISSIONER

April 3, 2014

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

Re: Draft Report 2013-1A-001

Dear Mr. McHugh:

On an annual basis, the Office of the State Comptroller (OSC) conducts an ongoing 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, 2013 through December 31, 2013. We appreciate the opportunity to comment on the draft report. The professional and collegial relationship between our two agencies continues to be highly productive as we collaboratively work to ensure the accuracy and completeness of individual income tax filings and refund claims.

The draft report notes that for the 2013 calendar year, the Department's processing of paper personal income tax returns was performed by a new vendor. During the 2013 filing season, we experienced a significant number of timeliness failures and data accuracy and processing errors committed by the vendor. The Department deployed substantial in-house resources to correct the vendor's processing mistakes and, collaborating with our colleagues in OSC, we worked diligently to ensure accurate and timely return and refund processing for New York filers. Consistent with the first recommendation in the draft report, the Department has already undertaken significant steps to address and remedy the processing problems experienced in 2013. Among the many corrective actions implemented during the current 2014 filing season, we have deployed a Department team to work on-site with the vendor to monitor performance and implement the remedial solutions required to achieve the timely and quality processing of paper returns. We are also continuing to identify improvements to operating practices and process design to ensure the accurate and timely processing of paper personal income tax returns. As a result, we have seen improvement in nearly all measurements of accuracy.

The draft report also notes that [REDACTED] data from [REDACTED] was successfully used by OSC to identify 1,967 refunds improperly claimed on taxpayer returns filed during the 2013 calendar year. The draft report recommended that the Department acquire access to this important data. We agree that this data will facilitate the administration of the [REDACTED] and will continue our efforts to obtain this information through a memorandum of understanding or legislative authorization.

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Comment  
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Consistent with the third recommendation in the draft report, it is well documented that the Department is a strong proponent for, and user of, innovative business intelligence and analytics solutions in pursuing our tax administration mission. To effectively evaluate the accuracy of every personal income tax return, various highly sophisticated strategies and solutions are applied by the Department during the return processing function; the ultimate objective is to assure the accuracy and integrity of each return filed and refund claimed. We continuously evaluate our processes and technologies to improve and optimize this function. These considerable efforts have yielded \$350M - \$400M in annual savings through the identification of highly suspect and fraudulent refund claims. We will continue to seek improvement opportunities that will further heighten efficiencies and effectiveness in identifying and preventing erroneous refunds.

The Department would like to thank you and the OSC staff that assist us in ensuring the integrity of the refund processing function. I look forward to our continued partnership.

Sincerely,



Edward Chaszczewski  
Deputy Commissioner

State Comptroller Comments on Auditee Response

1. We redacted information from the Department's response to protect confidential tax information. We also removed this information from our final report.