



Case Study

How the Idaho State Tax Commission Helped Reduce Fraud with IDR

Withholding fraud is a highly recognized problem in the tax systems so the Idaho State Tax Commission addressed the issue by implementing Intelligent Document Recognition technology.

INTELLIGENT DOCUMENT RECOGNITION

The Business

The Idaho State Tax Commission, headquartered in Boise, the state capital, administers the state's tax laws and collects taxes and fees either electronically or through mail-in or drop-in payments. Taxes include, but are not limited to, Income (Corporate, Individual and Withholding), Sales, Beer/Wine/Tobacco/Cigarette, and Fuels. The Commission serves approximately 1.7 million individuals and 60,000 employer accounts.

The Challenge

Withholding fraud is a highly recognized problem in tax systems. Fraudulent filers steal thousands of dollars from states each year. The electronic filing of individual income tax returns has increased the exposure for potential fraud. Individuals who prepare and electronically file their own returns have the ability to falsify W-2 withholding amounts. Employers, who withhold and pay one amount may create and file W-2s for different amounts with the state governments.

The ability to match withholding information from an employee income tax return to the employer wage and withholding information submitted by employers is long overdue. While states have looked to the IRS and SSA to provide combined electronic reporting of wage and withholding information, there is no current plan in the foreseeable future for them to do this.

From the states' perspectives, the process of capturing this information has meant time-consuming sorting and data entry of the desired fields. While IRS provides guidelines for the layout and content of wage and tax statements, they allow for the dimensions of the W-2 to vary. This results in forms of various and different orientations. ICR technology has not lent itself to automated data extraction on these types of semi-structured forms, without building a template for every variation, which could mean hundreds of templates that may vary from reporting year to reporting year. Additionally, because of many state statutes, refunds must be made in a set number of days, making the comparison between employer and employee filings

impossible before issuance of the refunds.

The interest in capturing and comparing the wage and withholding information to catch discrepancies, non-compliance and, most importantly, instances of fraud, has gone mostly unrealized.

The Solution

The Commission was looking for a way to automate the capture of employees' W-2 data submitted with their tax return and compare it to the employer wage and withholding information submitted by employers. The W-2s are already imaged as part of the up-front scanning process of Personal Income Tax filings and employers wage and withholding reports. The Commission did not want to introduce prepping, batching and exception handling to their current process, so it was desirable that the process of identifying the W-2 be automated as well.

The Idaho State Tax Commission opted to install eFLOW - a scanner and host independent forms processing module which provides:

- Automatic form(s) identification through Intelligent Document Recognition (IDR)
- Intelligent Character Recognition (ICR)
- Context data entry/validation
- Export of data/images from/to legacy applications
- Image-based business workflows

The IDR process identifies the W-2s from within the tax return or wage/withholding report without any additional sorting or prepping. Once classified, the specific data elements are identified, then multiple ICR engines are applied. Voting among best engines is fine tuned to this specific application in order to produce the highest read results.

Specifically for the Commission, seven fields from the W-2 are captured - Tax Year, Federal Identification Number, Employee Social Security Number, State Identification, State Account Number, State Wages and State Withholding - which allows the Commission to create electronic files that they hand off to their tax accounting system, GenTax.

The GenTax Data Warehouse matches employer and employee amounts against each other in the Discovery Module.

The Results

In Fiscal Year 2008, the Idaho State Tax Commission requested funding to image wage and tax statements and use the information from them in their discovery process. As part of the request to the Idaho Legislature for funding, the Commission advised them they expected to increase revenue by some \$600,000 annually from this process. The funding request was approved.

From January 1, 2008 through December 31, 2008, the Commission imaged W-2s submitted by individuals on their tax year 2007 Idaho income tax returns along with the W-2s submitted on paper by employers. Employers are required to file copies with both the federal and state governments.

On January 1, 2009, the Commission implemented a discovery process of the W-2s submitted by these two sources.

As of June 4, 2009, the Commission has identified approximately 7,000 discovery leads. The first 1,000 leads have been reviewed with 111 of these leads resulting in deficiencies in the amount of \$571,000. The Commission anticipates reaching the \$600,000 goal by the end of the first six months. The collection process has begun, and they have received no appeals from with taxpayers or employers.