LEGISLATIVE SERVICES AGENCY

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FISCAL IMPACT STATEMENT

LS 6170	**NOTE PREPARED:** Nov 19, 2012
BILL NUMBER: SB 34	**BILL AMENDED:**

SUBJECT: Income Tax and Use of Fraudulent Identities.

FIRST AUTHOR: Sen. Tomes	**BILL STATUS:** As Introduced
FIRST SPONSOR:	

FUNDS AFFECTED:	X	**GENERAL**	**IMPACT:** State & Local
	X	**DEDICATED**	
		FEDERAL	

Summary of Legislation: *Data Sharing of the Fraudulent Identities:* This bill specifies that all state agencies must cooperate with the Department of State Revenue (DOR) by providing monthly reports identifying the use of a fraudulent identity. The bill requires the information be provided at no charge to the DOR.

Specific Data Sharing Requirements: The bill requires:
- The Department of Correction (DOC) to annually provide an electronic file listing the name and Social Security Number (SSN) of each individual under the jurisdiction of the DOC.
- The State Department of Health (DOH) to annually provide an electronic file listing the name of each individual for whom an Indiana death certificate was issued during the last year.

Proof of Identification for Dependent Claims: This bill prohibits taxpayers from claiming deductions, exemptions, and credits for dependents who are not United States citizens or came into the country illegally. The bill also requires taxpayers to provide the following information to claim an income tax exemption for a dependent:
- The SSN of the individual for whom the taxpayer is claiming the exemption; or
- If the dependent is not eligible for a SSN or is the dependent of a taxpayer who is exempt from obtaining a SSN under federal law; an individual taxpayer identification number (ITIN) and any other proof required by the DOR must be provided to establish that the dependent qualifies as a qualifying child and is not a nonresident alien.

This bill provides a specific civil penalty for intentional noncompliance with the requirements to establish that the taxpayer is entitled to the dependent exemption. It also specifies that the penalty also applies to a paid tax return preparer.

Effective Date: July 1, 2013.

Explanation of State Expenditures: *Data Sharing of the Fraudulent Identities*: All state agencies would incur some cost to provide the DOR with incidences of fraudulent identities in an electronic format. There would be additional expenses in the collection and transmission of the data. The precise cost depends on the format specified by the DOR and the information technology resources of the other state agencies.

Department of Correction - The DOC would incur additional expenses to provide the requested data to the DOR. The DOC should have sufficient resources to implement the provisions of the bill.

State Department of Health - The DOH would incur additional expenses to provide the requested data to the DOR. The DOH should have sufficient resources to implement the provisions of the bill.

Department of State Revenue - The DOR will need to revise tax forms, instructions and computer software to implement this bill. They will be required to review the supplemental documentation submitted by the taxpayer. The DOR's current level of funding and resources should be sufficient to implement the provisions of the bill.

Explanation of State Revenues: *Proof of Identification for Dependent Claims:* This bill disallows deductions, exemptions, and credits for dependents who are not United States citizens or who came into the country illegally. The bill specifically modifies any credit or deduction where the dependent is defined through a reference to the Internal Revenue Code. This provision applies to the standard dependent exemption, dependent child exemption, and private school/homeschool deduction for the Individual Adjusted Gross Income (AGI) Tax. The bill also denies the dependent exemption and the dependent child exemption for Individual AGI Tax filers who fail to provide a Social Security Number (SSN) or any other proof required by the DOR. The required information must be provided for all dependents claimed, and an individual taxpayer identification number (ITIN) alone will not be considered sufficient documentation.

Based on national statistics, this bill has the potential to increase total Indiana taxable income by an estimated \$110.5 M. That would increase revenue deposited to the General Fund by \$3.7 M in FY 2014. This change will increase the overall tax base and be reflected in future years.

Data Sharing of the Fraudulent Identities: The sharing of fraudulent identities will be used by the DOR for tax administration purposes, specifically to identify fraudulent taxpayers. This could lead to an indeterminable increase in revenue, depending on how the DOR uses the information. The bill does not restrict the use of the information to a specific tax type. The increased revenue would be deposited in the fund appropriate for the tax.

Civil Penalty: The amount of revenue collected from the civil penalty in the provision depends on the number of people who fail to provide the appropriate documentation and the willingness of the DOR to issue the penalty. Revenue collected from the civil penalty will be deposited in the General Fund.

<u>Background Information - Proof of Identification:</u> ITINs are issued by the Internal Revenue Service (IRS) to noncitizens who do not have employment authorization but are required to file taxes under federal law. U.S.

citizens, permanent residents, eligible foreign nationals, and individuals who are authorized to work may receive an SSN. ITINs are only used for federal tax filing. A person does not have to earn wages to be issued an ITIN. ITINs can be issued to the spouse and dependents of the person required to file. Research by the U.S. Treasury Inspector General for Tax Administration (TIGTA) sampled ITIN applications and found that 78% of the IRS-approved applications contained errors or did not have sufficient documentation.

DOR reported 36,535 returns were filed in 2011 where a dependent exemption was claimed without providing an SSN. Those returns may contain an estimated 67,000 dependents. Approximately 11,000 of those dependents belong to a religious or conscience-based group who are issued ITINs and will be able to provide the necessary documentation as required by DOR. Applying the findings of the TIGTA study, it is estimated that 43,700 of the remaining dependents could have been issued an ITIN without providing sufficient documentation to the IRS. Based on that estimated population, $109.2 M in exemptions could be denied. That would yield an estimated additional $3.7 M in state Individual Income Tax liability and a permanent expansion of the income tax base.

Nearly all of the additional revenue can be attributed to changing the dependent eligibility of the standard and dependent exemption. The bill also applies to the private school/homeschool deduction. However, the additional revenue from changing the dependent eligibility of that deduction will likely be less than $0.05 M. The Indiana Earned Income Tax Credit (EITC) also references the Internal Revenue Codes's definition of a dependent, but Indiana law requires the taxpayer to be eligible for the federal EITC to claim the Indiana EITC. The federal EITC requires SSNs for all EITC claims. Taxpayers filing with ITINs are prohibited from claiming the federal EITC.

The estimate is contingent on several assumptions:

(1) The results of TIGTA's national ITIN-issuing study being applicable to Indiana since the actual percent of legitimate ITINs used by individuals filing Indiana Income Tax is unknown.

(2) The population of the "religious or conscience-based" group is based on a 2000 survey. The current population will likely be greater because research has found this population is growing at a significantly faster rate than the general population and the survey only included one denomination.

(3) The distribution of dependents claimed on ITIN returns is similar to the distribution of dependents for the general population.

(4) The estimate assumes 95% to 100% enforcement of the provision and validation of the supporting documentation provided by the taxpayer.

Explanation of Local Expenditures:

Explanation of Local Revenues: The bill is estimated to increase state taxable income, so counties with a local option income tax (LOIT) could experience an increase in revenue. Using the median current LOIT rate of 1.45%, this bill has the potential to increase statewide LOIT revenue by $1.6 M in FY 2014. This change would increase the overall base and be reflected in future years.

State Agencies Affected: Department of State Revenue; Department of Correction; State Department of Health; and any other state agency who provides data to the Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax; Trial courts, city and town courts.

Information Sources: LSA Income Tax Database: Tax Year 2010; TIGTA Report, Reference Number 2010-

40-005; TIGTA Report, Reference Number 2012-42-081; Association of Religion Data Archives; Greska, L.P., “Population Growth and Fertility Patterns in an Old Order Amish Settlement”.

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