IRS STATES INDUSTRY

Identity Theft
Tax Refund Fraud
ISAC

2023 Annual Report

Executive Summary

2023 proved to be another exciting and successful year for the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (ISAC). Partners continued to collaborate and share vital information used for detecting and preventing sophisticated fraud schemes ensuring our nation's taxpayers and the revenue system are protected from the disruptive behavior of fraudsters.

This year the partnership celebrated seven years of protecting taxpayer identity through collaboration. That celebration included the 'game changing' addition of new data shared by IRS through the Taxpayer First Act (TFACT). The TFACT files provide a strong feedback loop and have improved conversations among the partners around various fraud schemes and their impact on the tax ecosystem, which has enabled improved models and detection methods and more opportunities to reduce the burden on taxpayers. Analysis of TFACT and other ISAC data helps to lower the risk of identity theft and reduces the false detection rates. This work creates a strong foundation for the long-term value of the ISAC to the participants/stakeholders and taxpayers.

Key ISAC activities in 2023 include:

- Membership in the ISAC remains strong and steady with the number of analysts using the ISAC growing this year from 445 to 498. ISAC member organizations include 48 states, 15 Industry, 4 Financial Service Companies, IRS and 5 endorsing organizations.

- In the third year of an innovative data sharing pilot, the ISAC, two industry partners, and eight states tested enhanced leads data. Leads are near real-time reports of suspicious activity identified by the industry partners and shared in the ISAC. The pilot demonstrated that the enhanced leads helped the states more quickly identify and stop identity theft. This pilot also identified schemes not previously observed in any other process.

- This year, with the sunset of many of the pandemic credits (which spiked identity theft tax refund fraud) and ongoing work to improve data utility, the Security Summit partners re-evaluated the information collected by the lead process and recommended additional sharing opportunities for the partnership.

- Alerts are a real time process that allows ISAC users to share what they see when they see it enabling all partners to act quickly. Interactive work around the mechanics of the alert schemes and detection methods remains strong within the partnership. 221 alerts have been posted YTD for 2023. Engagement remains high at all levels of ISAC membership, including the Analysts' Community of Practice, which is a key forum for the community to share information to protect the ecosystem and prevent revenue loss.

> **ISAC Mission**
>
> The mission of the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center is to provide a secure platform via a sustainable public/private partnership, to facilitate information sharing consistent with applicable law, and analytics necessary to detect, prevent, and deter activities related to stolen identity refund fraud.
>
> **ISAC Vision**
>
> Our vision, as a public/private partnership, is a tax ecosystem where taxpayers can confidently file their taxes safely and securely.

The Identity Theft Tax Refund Fraud Information Sharing and Analysis Center, or ISAC, continues to demonstrate the value of the Security Summit public-private partnership established in 2015 to fight identity fraud and refund theft. Even though this effort has been a remarkable success for taxpayers and the tax system, the cyberthreats faced by the IRS, state tax administration and the nation's tax industry remain a major concern. Even as cybercriminals constantly change their tactics, the ISAC has proven its ability to evolve and adjust to emerging threats, including focusing on evolving areas like artificial intelligence.

– Danny Werfel, Commissioner, Internal Revenue Service

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Our History

The IRS Security Summit

In March 2015, the IRS convened an unprecedented coalition of state tax agencies and private-sector tax industry officials to tackle a difficult task – fighting back against emerging criminal syndicates, based in the U.S. and overseas, that were filing fraudulent returns for refunds. These new cyber gangs were often sophisticated, highly organized, and well-funded. In 2016, Security Summit partners agreed on the need for a formal Public-Private Partnership for sharing data in a collaborative environment based on partner-agreed rules.

Formation of the IDTTRF-ISAC: The Platform and the Partnership

In January 2017, the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (the IDTTRF-ISAC or simply, the ISAC) was formed, governed in equal partnership by the IRS, industry, and states. The ISAC consists of two components: the platform and the partnership.
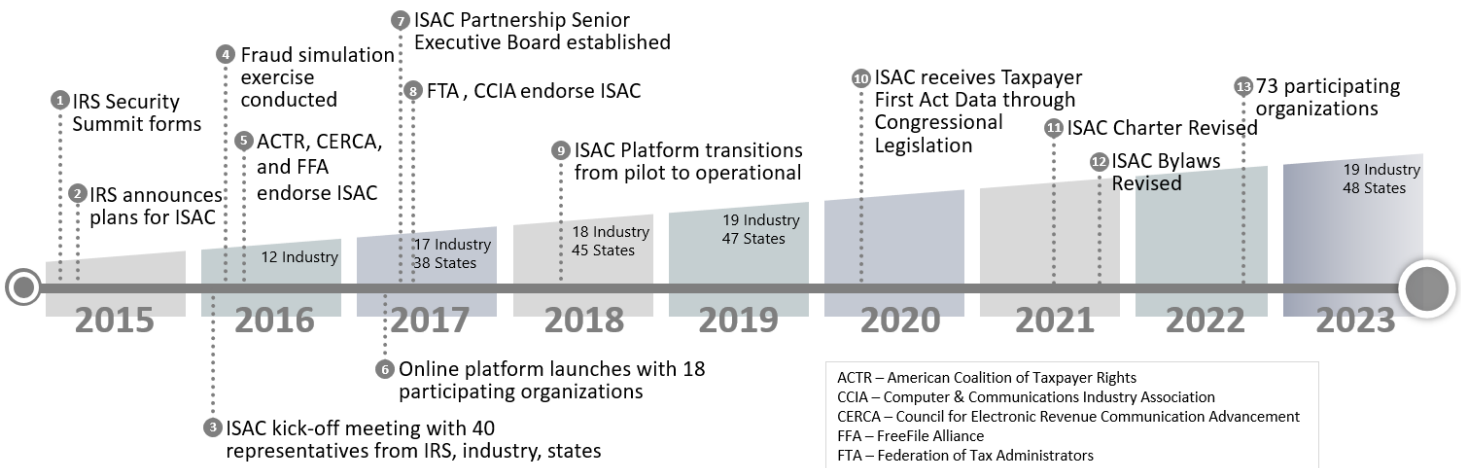
The platform is operated under the direction of the IRS, through a Federally Funded Research and Development Center (FFRDC). The FFRDC serves as the ISAC's Trusted Third Party (TTP) facilitating information sharing among entities that wouldn't otherwise do so. The platform serves as the centralized information-sharing vehicle for the ISAC and includes controls to ensure that sharing is consistent with applicable regulations and laws.

The ISAC partnership today includes 73 organizations – 48 States, 15 Industry partners, 4 Financial Services Companies, the IRS and 5 Endorsing Organizations. This collaboration and data sharing creates a formidable defense against criminals' ongoing attacks on our tax system.

The IDTTRF-ISAC in comparison to other Public Private Partnerships

ISAC 2023 Renewal of Charter and Bylaws (staying current)

All partners are focused on protecting taxpayers

Partners volunteer time and resources to the mission

Analysts Community of Practice provides multi dimensional layers of competence to problem solving

Partner 'potluck' contributions reduce burden and sustain ISAC activities

Trusted Third Party provides data security and partner-specific data anonymity, ensuring trust

Trust is high, communications & threat sharing produces action

In a recent comparative analysis of 29 Information Sharing and Analysis Centers, the Identity Theft Tax Refund Fraud ISAC follows, and in some instances exceeds, operating norms as outlined in these characteristics.

Risk Environment

Overall identity theft continues to remain the primary focus of the ISAC partners because the threat has not changed. The Identity Theft Resource Center (ITRC)[1] reported: The number of data compromises reported in the U.S. in the first half of 2023 is higher than the total compromises reported every year between 2005 and 2020, except for 2017. The ITRC reports that in the third quarter alone 66,658,764 individual identities were compromised due to data breaches. The observations in the ISAC support the findings identified by the ITRC, this is despite the unique tax ecosystem. Often the identity thief incorporates data compromised elsewhere and uses it to prepare high quality false tax returns.

> *Protecting the tax system and the taxpayers we serve continues to be in the forefront of the FTA membership. The work that is done within the ISAC is essential and we value the collaboration, partnerships, and dedication of those who work diligently in the fight against identity theft tax refund fraud.*
>
> **– Peter Barca**
> **Secretary, Wisconsin Department of Revenue and FTA President**

Artificial Intelligence

This year ISAC partners saw some new twists to bad behavior in the form of social media scams and the potential use of Artificial Intelligence (AI) to produce notices that can dupe taxpayers into falling for scams. Social media scammers took to multiple platforms to share 'how to' tips on how to claim various types of rebates – flooding the IRS and states with frivolous and fraudulent filings. AI, through tools such as ChatGPT and others, provided 'tax guidance' that caused taxpayers to be misinformed on seemingly logical new tax information that sounded too good to be true. The ISAC partners remain vigilant in monitoring trends in filing patterns.

In a public statement from Thompson Reuters, "With the tax world exploring how AI can improve practice and administration; firms, the IRS, and taxpayers alike are in the early stages of considering its potential for streamlining tasks, saving time, and improving access to information. Regardless of one's individual optimism or skepticism about the possible future of AI in the tax space . . . practitioners [should] arm themselves with important fundamentals and key technological differences under the broad-stroke term of AI."[2] The ISAC leadership team is focused on identifying the value AND the risks associated with the role of AI and Large Language Models in tax administration.

These threats to our tax ecosystem have not gone unnoticed by the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center in 2023 and partners are sharing best practices and risk solutions to address them. These discussions will establish a baseline on the use of AI as well as potential mitigations to address risk for use of AI to disrupt the tax ecosystem or commission of identity refund fraud.

Social Media Promotions, Promoters and Dark Web

Rumors, misinformation, disinformation, and mal-information are common challenges confronting digital media, especially on social media platforms. Ease of access and use, speed of information diffusion, and difficulty in correcting false information make control of undesirable information a horrid task[3]. Social Media is constantly updated with tutorials and other methods to lure individuals and businesses to file tax returns to claim certain refundable credits. Unfortunately, these same techniques are used by identity thieves to secure large refunds. These methods are blatant and are high risk to the IRS and states. Examples include:

- Aggressive marketing of false claims. This can be seen in countless places, including radio, television and online as well as phone calls and text messages.

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[1] The ITRC Is a non-profit organization established to empower and guide consumers, victims, business, and government to minimize risk and mitigate the impact of identity compromise and crime.

[2] The Potential of AI in Tax Practice Relies on Understanding its Limitations, Experts Say by Tim Shaw, May 15, 2023.

[3] Thai MT, Wu W, Xiong H. *Big Data in Complex and Social Networks.* 1. Boca Raton: CRC Press; 2017. [Google Scholar]

- Direct mailing. Some mills send fake letters to taxpayers from non-existent groups like the "Department of Employee Retention Credit." These letters can be made to look like official IRS correspondence or an official government mailing with language urging immediate action.
- Leaving out key details. Third-party promoters often don't accurately explain eligibility requirements or how the credit is computed. They may make broad arguments suggesting that eligibility without evaluating the taxpayer's circumstance.
- Many of the techniques of tax refund fraud exist in the shadows of the dark web where criminals flock to buy and sell illicit goods (SSNs, bank account information and other personally identifiable information) with total anonymity. The ISAC monitors both social media and the dark web and continues to find key information on scheme methodologies and risks.

Authentication

The ecosystem continuously updates authentication techniques and processes to reduce the risks of revenue loss and/or the risk of a taxpayer being a victim of identity theft. Identity thieves often leverage social engineering tools and techniques to dupe taxpayers into sharing their credentials or other personally identifiable information. The ISAC and partners monitor 'trending' social engineering activities and shares information within the ISAC community.

Financial Risk

As the ISAC learned through the 2023 Data Sharing Pilot, financial organizations also become tools of the identity thieves in relation to tax refund fraud. The targets of identity thieves can include the gambit of the IRS, a state or states, or a financial organization.

In each of these known risks to our tax ecosystem, the ISAC leverages link analysis to monitor the threats and offers mitigations for each ISAC sector.

Year in Review - Evolution of the ISAC

Understanding partners data and information needs, identifying value and building trust have evolved significantly since 2017. This evolution is the result of partner engagement at all levels of the ISAC community and adds value to the tax ecosystem.

Value to IRS and Taxpayers

Whether sharing data via alerts, confirmed fraud, pilot programs, leads or sharing through the Analysts Community of Practice (ACoP) collaboration, the ultimate beneficiary is the taxpayer whose account remains safe at both the federal and state levels. This year, partners saw a social media scam encouraging taxpayers to file a claim for a rarely used tax credit. Frivolous filings spiked, and the IRS was flooded with unnecessary activities to address these claims. Alert ISAC partners shared what they saw and took steps to reduce this rapidly trending scheme preventing large scale abuse limiting the scam to fewer localized situations.

Executive Leadership/Commitment through Actions

ISAC leadership and Endorsing Organizations work together to strengthen sharing and trust – they participate in forums, conferences and meet regularly to share ideas and concerns about the tax ecosystem, discuss ISAC collective findings and search for mutually successful solutions. The ISAC Board members participate in multiple outreach activities with others in the tax ecosystem to build relationships that foster more and better collaboration and information sharing.

In 2023, ISAC leadership revised the ISAC Charter and Bylaws to include Federation of Tax Administrators (FTA) as an ISAC Partner representing the states. This action aligns with the 2022 ISAC Charter revision making CERCA the Industry partner. Both FTA and the Council for Electronic Revenue Communication Advancement (CERCA) bring the sector leadership that ensures continual ISAC participation.

Pilots

Partners shared many ideas and experiences during the year to further understand the continually evolving identity theft landscape. This sharing often occurs through the development of pilot programs. Since the ISAC's inception, the three ISAC sectors (IRS, States, Industry) have worked together to explore, through pilots, additional methods of identifying identity theft – some of these pilots did not become operational programs but did provide valuable lessons learned. Several pilots have become operationalized into the ISAC program. Two such pilots include the Deposit Verification Program (DVP) with our Financial Service Company partners which became operational in 2019.

The pilot identified schemes that could not be identified in any other way. In 2023, more than 1,000 bank accounts at 182 banks were used in high frequencies and across multiple states. Participants are shaping how we will share high-impact, actionable data into the future.

One of the benefits of the data sharing pilot was the automation of data sharing between the ISAC, states, and our organization which greatly reduced burden, increased speed of delivery and ensured security in transmission.

-- ISAC User

More recently, in a data sharing pilot, a few Industry partners tested sharing enhanced leads data with a few states to better identify fraud – as a result of the success of the pilot, this program is slated to become operational in FY 2025.   The value added was the collaboration between ISAC partners and the security summit information sharing working group to recommend enhancements to the Industry Leads to help better identify and confirm fraud.

Taxpayer First Act Data

While Congress enacted the Taxpayer First Act (TFACT) in 2020, the first two years of data sharing in the ISAC involved enhancing the security of the ISAC infrastructure to ensure safeguarding procedures and then helping partners understand the data, how to use the data and how to provide feedback on the value. In 2023, IRS has shared over 5.5 million records with the ISAC partners. These records include Potential Individual Identity Theft, Annual Confirmed Individual Identity Theft and Cumulative Confirmed Individual Identity Theft. The TFACT records for 2023 were enriched by the ISAC and posted as 'reports' that were accessed by authorized partners over 1,800 times through September of 2023.

Partners report real time value from the TFACT files. The data sets have altered partner driven communications with taxpayers and have proven valuable in identifying improvements to system fraud filters. TFACT data shared with the partnership improves detection methods and provides opportunities to reduce taxpayer burden.

The industry specific TFACT files are game changers!

Client-level data enables more detailed forensic review of factors that lead to a taxpayer being identified as problematic or suspicious and allow much better system, software and training evaluation and determinations.

We can proactively reach out to clients to help resolve situations where they may be mistakenly caught up in an identity validation net. Improved customer service, assuring refunds are received and minimizing the press on IRS call centers – win-win-win!

– ISAC User

Metrics

User Activity and Collaboration

Collaboration and information exchange within the ISAC is unprecedented in the tax ecosystem. Each of the 73 partner organizations and 498 users contributes a unique set of skills and valuable insight. The partnership is united on the common goal to address tax refund fraud identity theft and is committed to protecting taxpayers and tax revenue. The Analysts Community of Practice (ACoP) Annual Meeting highlights ISAC collaboration as a value for each partner.

The Partnership-approved metrics provide qualitative and quantitative information to assess and measure progress and performance to reflect the value of the ISAC in the tax ecosystem and provide actionable information to help inform future progress and initiatives.

> *The alerts and the information surrounding them are the lifeblood of the ISAC.*
> *— ISAC User*

The ISAC currently measures its work in three categories:

- Levels of industry, state and IRS <u>participation</u> in the ISAC;
- Volume and quality of alert and information <u>contributions</u> that identify ecosystem threats; and
- Volume and quality of the ISAC's data <u>analysis</u> in identifying suspected identity theft tax refund fraud.
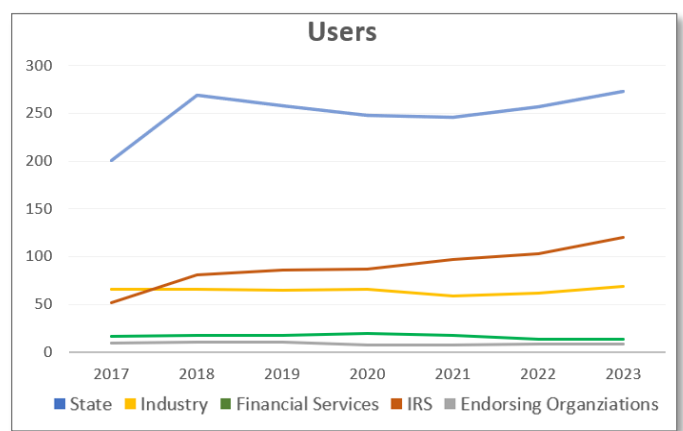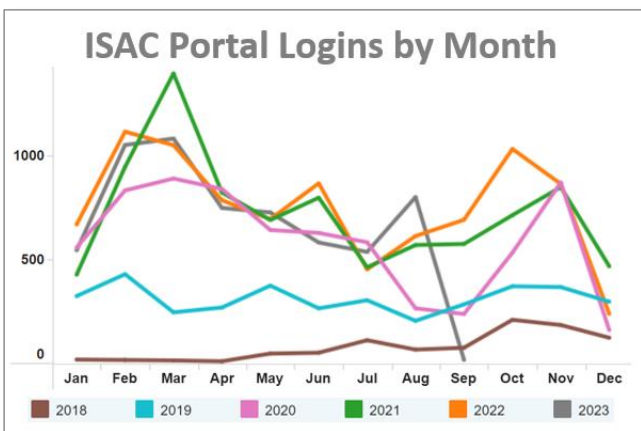
Participation - Each of the 73 partner organizations and 498 users contributes a unique set of skills and valuable insight. Participation through data sharing, leading training sessions, membership on committees, serving on the senior executive board and engaging in the Analysts Community of Practice (ACOP) continues to increase. The number of ISAC analysts joining and using the ISAC increases each year, demonstrating the value each ISAC organization obtains by committing resources to engage in the data sharing process provided in the ISAC. The

Analysts Community of Practice (ACoP) has evolved to an unprecedented model of trust and sharing in the tax ecosystem. The ACOP Annual meeting highlights ISAC collaboration as a value for each partner.

Fraud analysts from partner organizations, who previously had no process to know and/or share threat data, now share best practices, discuss fraud schemes, and share identity theft trends. They build relationships and develop a greater understanding of how identity theft impacts each partner's work. These analysts are the boots on the ground, and they work tirelessly every day to protect the tax ecosystem. In preparation for filing season 2023, ISAC ACoP members gathered virtually for their 7th annual Fall Meeting on October 18-20, 2022.

Collaboration - Data shared by partners includes Industry reports of suspicious activity, called Industry Leads, state confirmed fraud, TFACT data, alerts and partner identified alerts.

The pandemic credits (which spiked identity theft tax refund fraud) saw a dramatic increase in industry leads in 2022.
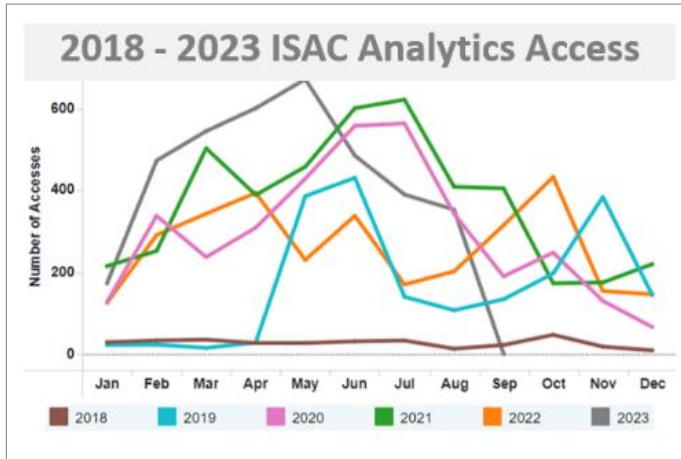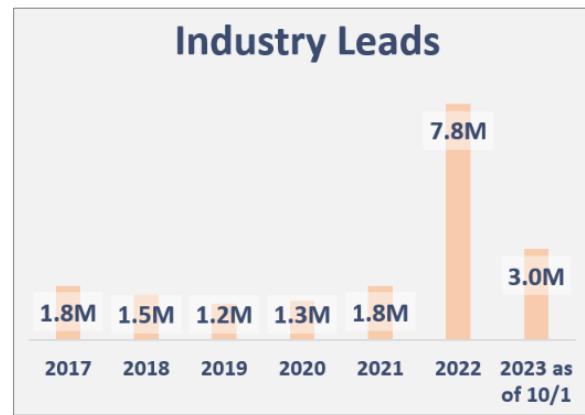
Analysis - Partner leads, alerts, TFACT and other partner-shared data are aggregated, de-identified and analyzed by the ISAC trusted third party. This analysis is shared with partner sectors as appropriate.

ISAC alerts continue to be the key to success for each partner sector in identifying and addressing fraud in near real time. Partners participated in a new process in 2023 to redefine how alerts are shared, searched, viewed, and related to help more quickly identify actionable data.

Between October 1, 2022, and September 30, 2023, ISAC Alerts were viewed over 8,000 times.
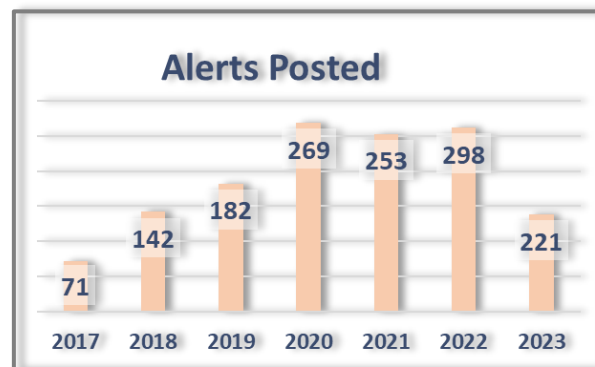
The ISAC is more than just a platform for exchanging information. It is a strategic partnership that enables CERCA members to leverage the collective expertise and resources of the tax industry, the states, and the IRS. Through the ISAC, we can share data in a secure and timely manner, receive real time alerts and guidance on emerging threats, and implement effective countermeasures to protect our systems and customers. The ISAC helps us to align our business processes with the best practices and standards of the tax ecosystem, enhancing our efficiency and quality while protecting taxpayers from victimization. In addition, CERCA sponsors the ISAC Annual Roundtable where members of the ISAC come together to enhance these trusted relationships and to provide a platform for exchanging information.

— Shannon Bond
Chair, Council for Electronic Revenue Communication Advancement (CERCA)

Strategic Accomplishments

Through the 2022 – 2027 ISAC Strategic Plan, the partnership continues to evolve with new data sets, techniques, and improved efficiency to consume data within the partnership. This evolution is necessary to keep pace with the changing environment and to support the needs of the partnership. The Senior Executive Board approved and deployed a five-year strategic plan for 2022-2027. The development of the plan included gathering information and feedback from all participants of the ISAC and conducting an environmental scan of the tax ecosystem, other ISACs and the identity theft threat environment. The objectives and strategies are designed to provide a comprehensive and agile approach to combatting tax refund fraud identity theft.

2022 – 2027 Objectives	Strategies
1. Identify and implement modern solutions that facilitate partner participation, information transfer, and data utilization	A. Help participants operationalize the ISAC within their organization B. Explore new platforms that address user needs
2. Promote a culture of continuous improvement by identifying quality data sets that keep pace with emerging trends and stall the evolution of identity theft tax refund fraud	A. Monitor and discuss trends and potential solutions that facilitate the detection and mitigation of current and future identity theft threats. B. Develop and implement educational opportunities to address analytic findings C. Identify new data sets that help participants detect and prevent IDT
3. Continue to promote a partnership that is transparent, diverse, and sustainable	A. Expand monitoring of ISAC communities and model applicable best practices B. Collaborate with other sectors that can potentially impact the tax ecosystem C. Understand fraud schemes beyond IDT that may migrate into the tax ecosystem
4. Develop metrics that tell the story of the ISAC, create accountability, and help participants understand their return on investment	A. Evaluate existing ISAC metrics to determine usefulness B. Work with participants to identify metrics needs and workable solutions C. Identify and implement new metrics
5. Foster communication and education between and among levels of government, industry, and related associations	A. Establish an ongoing feedback loop about the value of the ISAC operational platform, the partners and the TTP B. Identify, develop, and promote collaborative education and training to strengthen IDT efforts

Strategic Accomplishments in 2023 include:

- **Machine-to-Machine** Through advanced techniques, the ISAC platform connected with multiple partner platforms through machine2machine (M2M) connections, allowing for a more efficient operational workflow, reducing time to discovery & improving decision-making insights.

- **Supply Chain Risk Management Policy** was developed and implemented this year further ensuring the tools, technology and systems used to operate the ISAC are secure and aware of the implications of each 'piece' of technology used for the ISAC portal.

- **ISAC in the Cloud!** The platform upgraded ISAC security and is in the Cloud.

- **Artificial Intelligence** as a tool has evolved the ISAC's ability to use a variation of Large Language Models to better identify fraud through the partner shared alerts and leads.

How the ISAC Works

Information Sharing and Analysis Centers collect, analyze, and disseminate actionable threat information to their members and provide members with tools to mitigate risks and enhance resiliency. ISACs reach deep into their sectors, communicating critical information far and wide and maintaining sector-wide situational awareness. The Identity Theft Tax Refund Fraud Information Sharing and Analysis Center works through the collaboration of members using a secure platform and overseen by an active executive board in partnership with the IRS, states, and Industry to protect the tax ecosystem.

	Post, read, and respond to alerts – reports of any tax ecosystem threats – in near real-time within the ISAC's secure* environment.
Alerts	Alerts serve as something like a neighborhood listserv for the tax ecosystem, with immediate reports of breaches, compromised ID numbers, or other suspect data.

	Share knowledge, best practices, and concerns related to the detection and prevention of IDTTRF through the Analysts' Community of Practice (ACoP).
ACoP	The ACoP is an active forum of analysts from all sectors who meet to share knowledge and best practices to aid in the detection and prevention of IDTTRF.

	Receive data reports and analytics daily – tailored to the partner's organization, delivered in digestible formats, and easily viewed through visualization tools. Now includes Taxpayer First Act data.
Data and Analytics	The ISAC conducts analytics on numerous datasets, looking for suspicious activity. One dataset is industry leads (including reports of IDTTRF patterns, suspicious activity, and suspected fraud) which the ISAC aggregates and anonymizes. Dashboard metrics are updated instantly as data flows into the ISAC.

Leadership

The Partnership's Senior Executive Board and its committees have equal representation and includes 15 senior level representatives (five each from the IRS, State Revenue Agencies, and private sector tax industry). The Senior Executive Board:

- Provides guidance in strategic areas, including recommending operating procedures for the ISAC, membership criteria, vision, and mission.

- Communicates with IRS leadership, state revenue agencies and private sector tax organizations.

- Develops and approves procedures, activities, and communications by Partnership Committees to other parties.

- Shares topics for study and analysis and reviews results of analyses submitted by the TTP.

The Senior Executive Board Co-chairs offer leadership and communication coordination for their respective sectors.

- Gardy LaRochelle, IRS Co-chair; Director, Return Integrity Verification Operations (RIVO), Wage & Investment Division, Internal Revenue Service

- Neena Savage, Esq., State Co-chair; Rhode Island Tax Administrator and Immediate Past President of the Federation of Tax Administrators

- Kathy Pickering, Industry Co-chair; Chief Tax Officer, H&R Block, Inc.

IRS remains the most important US civilian agency cybersecurity target of both foreign nation states and criminal actors. The alliance between the IRS, the private-sector tax industry and the state DORs in the ISAC is a crucial source of planning and secure technical exchange to combat and stop cyber-attacks.

– Steve Ryan, American Coalition of Taxpayer Rights