Millions of Dollars in Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credits Continue to Be Claimed Using Ineligible Vehicles

September 30, 2019

Reference Number: 2019-30-072

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:
1 = Tax Return/Return Information
2 = Law Enforcement Techniques/ Procedures and Guidelines for Law Enforcement Investigations or Prosecutions.

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HIGHLIGHTS

MILLIONS OF DOLLARS IN POTENTIALLY ERRONEOUS QUALIFIED PLUG-IN ELECTRIC DRIVE MOTOR VEHICLE CREDITS CONTINUE TO BE CLAIMED USING INELIGIBLE VEHICLES

Highlights

Final Report issued on September 30, 2019

Highlights of Reference Number: 2019-30-072 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The Energy Improvement and Extension Act of 2008 created the Qualified Plug-In Electric Drive Motor Vehicle Credit (hereafter Plug-In Credit). The American Recovery Act of 2009 later amended the credit for vehicles purchased after December 31, 2009. These credits, of up to $7,500, help taxpayers offset the purchase of a qualifying plug-in electric drive vehicle.

WHY TIGTA DID THE AUDIT

This audit was initiated to assess whether the IRS is adequately considering returns with the Plug-In Credit for examination.

WHAT TIGTA FOUND

The IRS does not have effective processes to identify and prevent erroneous claims for the Plug-In Credit. As a result, taxpayers received millions of dollars in potentially erroneous Plug-In Credits. Based on our analysis of Plug-In Credits claimed and received during Processing Years 2014 through 2018, TIGTA identified:

- 16,510 tax returns for which taxpayers received approximately $73.8 million in Plug-In Credits **********2***************** ****************************2******************* ****************************2******************
- 1,509 tax returns for which taxpayers received more than $8 million in Plug-In Credits ******************2******************* ****************************2******************
- 68 tax returns for which taxpayers received approximately $1 million Plug-In Credits *******************2**********************

Additionally, IRS examiners are generally not reviewing questionable claims for the Plug-In Credit during examination when IRS filtering does not identify the credit.

WHAT TIGTA RECOMMENDED

TIGTA made four recommendations to the IRS to improve the detection and prevention of erroneous Plug-In Credit claims, including that the IRS use the Vehicle Identification Numbers reported by taxpayers to identify improper credit claims.

IRS management agreed with all four recommendations and plans to take appropriate corrective actions. These actions include using data analytics to determine the extent of noncompliance. These results will be used to initiate the appropriate compliance activities. The IRS will also develop a new audit lead sheet to assist examiners with auditing the Plug-in Credit. Lastly, the IRS will initiate a recovery program for potentially erroneous Plug-in Credits identified in TIGTA's report.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 30, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Millions of Dollars in Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credits Continue to Be Claimed Using Ineligible Vehicles (Audit # 201930011)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) is adequately considering returns with the Qualified Plug-In Electric Drive Motor Vehicle Credit for examination. This review is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Improving Tax Reporting and Payment Compliance.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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Abbreviations

I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
PY	Processing Year
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year
VIN	Vehicle Identification Number

Background

On October 3, 2008, the Energy Improvement and Extension Act of 2008 was enacted.[1] The Act extended various tax credits for renewable energy sources that were due to expire as well as created new ones, including the Qualified Plug-In Electric Drive Motor Vehicle Credit (hereafter simply the Plug-In Credit) under Internal Revenue Code (I.R.C.) Section (§) 30D.[2] The American Recovery and Reinvestment Act of 2009 later amended the credit effective for vehicles acquired after December 31, 2009.[3] This credit, of up to $7,500, was created to encourage individuals and businesses to invest in certain motor vehicles that operated on clean renewable sources of energy by providing an energy conservation incentive. In October 2018, the Joint Committee on Taxation estimated that the credit would cost $7.5 billion over a five-year period (Fiscal Years[4] 2018 through 2022).

The Plug-In Credit is a nonrefundable credit, claimed by individual and business taxpayers on Form 8936, *Qualified Plug-In Electric Drive Motor Vehicle Credit*. Form 8936 is attached to the individual taxpayer's Form 1040, *U.S. Individual Income Tax Return*. In order to qualify for the credit, I.R.C. § 30D requires that vehicles:

- Have an electric motor that uses a rechargeable battery to generate at least four kilowatt-hours of capacity.
- Be made by an eligible manufacturer under the Clean Air Act.
- Be acquired for use or lease and not for resale.
- Be appropriate for driving on public streets and highways.
- Have a weight rating of under 14,000 pounds.

Additionally, the original use of the vehicle must have commenced with the taxpayer claiming the credit. This taxpayer must also be the owner of the vehicle. If the vehicle is leased, only the lessor (and not the lessee) is entitled to the credit.

In 2011, the Internal Revenue Service (IRS) completed new programming for Form 8936 to help identify potential compliance risks. Based on a prior Treasury Inspector General for Tax Administration (TIGTA) recommendation, the vehicle years and Vehicle Identification Numbers

[1] Pub. L. No. 110-343, 122 Stat. 3765 (2008).
[2] I.R.C. § 30D provides a credit for Qualified Plug-In Electric Drive Motor Vehicles including passenger vehicles and light trucks
[3] Pub. L. No. 111-5, 123 Stat. 115 (2009).
[4] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

(VIN) are now being transcribed for ********2******* claimed on the form to assist in the identification of errors.[5] Compliance for taxpayers claiming credits on Form 8936 is based on the identification of returns with potential errors, which is accomplished by reviewing returns as they are received against a set of electronic filters. If the electronic filters identify a potential error, the return is reviewed by IRS examiners to determine the reason for the error.

In addition to the returns that are identified as having a potentially erroneous Plug-In Credit by the filters, IRS examiners are required to look for large, unusual, or questionable items as part of the regular examination process, which would include the Plug-In Credit if it meets the large, unusual, or questionable criteria. If the credit is not considered large, unusual, or questionable, it will not be reviewed as part of the examination of the case under this criteria.

According to I.R.C. § 30D, the credit begins to phase out when at least 200,000 qualifying vehicles have been sold for use in the United States (determined on a cumulative basis for sales after December 31, 2009) by each manufacturer. The phase-out begins in the second calendar quarter after the quarter in which the 200,000th vehicle was sold. Once initiated, the phase-out allows 50 percent of the full credit for two quarters, then 25 percent of the full credit for two quarters, then no credit thereafter. ****************1************************ *****************1****************** Tesla was the first to reach the 200,000 vehicle sales mark (during the third quarter of 2018), and General Motors reached this mark in the fourth quarter of 2018. In Tesla's example, the full $7,500 credit for Tesla vehicles will now only be available on those acquired on or by December 31, 2018. Tesla vehicles acquired from January 1 to June 30, 2019, are eligible for a Federal credit of $3,750. Tesla vehicles acquired from July 1 to December 31, 2019, are eligible for a Federal credit of $1,875. After that, no Federal tax credits for Tesla would be available to taxpayers.

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[5] TIGTA, Ref. No. 2011-41-011, *Individuals Received Millions of Dollars in Erroneous Plug-In Electric and Alternative Motor Vehicle Credits* (Jan. 2011).

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This review was performed with information obtained from the Large Business and International Division Headquarters in Washington, D.C.; Small Business/Self-Employed Division Headquarters in Lanham, Maryland; and Wage and Investment Division Headquarters in Atlanta, Georgia, during the period October 2018 through August 2019. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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Results of Review

The Internal Revenue Service Is Allowing Erroneous Claims of the Qualified Plug-In Electric Drive Motor Vehicle Credit

The IRS does not have sufficient processes to identify erroneous claims for the Plug-In Credit. Although the IRS has taken steps to address some of TIGTA's previous recommendations to improve the identification and prevention of erroneous credit claims, many of the deficiencies previously identified still exist. Figure 2 shows the population and amount of Plug-In Credits claimed on individual returns during Processing Years (PY) 2014 through 2018 (which included returns from Tax Years (TY) 2008 through 2017).[9]

Figure 2: Summary of Qualified Plug-In Electric Drive Motor Vehicle Credits Claimed During PYs 2014 Through 2018

Form 8936, Qualified Plug-In Electric Drive Motor Vehicle Credit		
Tax Year	Records	Credit Amount
2012 and Prior	378	$1,831,805
2013	31,839	$186,852,157
2014	38,973	$227,432,734
2015	38,791	$232,138,759
2016	50,802	$312,037,776
2017	78,639	$481,580,904
Total	239,422	$1,441,874,135

Source: TIGTA analysis of the Individual Return Transaction File data for PYs 2014–2018.[10]

[9] PYs 2014–2018 included individual tax returns for TYs 2008–2017. Specifically, 378 TY 2012 and prior returns were filed during PYs 2014–2018, potentially due to late-filed or amended returns. A tax year is a 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year. The processing year is the calendar year in which the tax return or document is processed by the IRS. TY 2017 individual tax returns are generally processed in PY 2018 (for timely filed returns).

[10] The Individual Return Transaction File contains data transcribed form initial input of the original tax returns during return processing.

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Based on our analysis of the 239,422 Plug-In Credits claimed and received during PYs 2014 through 2018, we identified 16,510 taxpayers who received $73.8 million in potentially erroneous credits. Figure 3 shows the number of returns filed for which individual taxpayers received potentially erroneous Plug-In Credits during PYs 2014 through 2018.

Figure 3: Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credits Claimed

Questionable Issue Identified	Potentially Erroneous Claims	
	Number of Returns	Dollar Amount
***************2***************	6,353	$20.1 million
Vehicle Claimed ********2*******	5,152	$27.3 million
***************2***************** and Vehicle Claimed *********2********	309	$1.1 million
********2********	4,696	$25.3 million
Total	16,510	$73.8 million

Source: TIGTA analysis of Plug-In Credits received during PYs 2014–2018.

Taxpayers are claiming ************************2*********************** and receiving the Qualified Plug-In Electric Drive Motor Vehicle Credit

Our analysis indicates that taxpayers with **********2*************** vehicles are claiming and have received the Plug-In Credit. We identified 6,662 tax returns for which taxpayers received almost $21.2 million in credits on vehicles that ********2******** Figure 4 shows the number of *******2******** that received the credit in PYs 2014 through 2018 (TYs 2011 through 2017).

Millions of Dollars in Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credits Continue to Be Claimed Using Ineligible Vehicles

Figure 4: Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credit Claims Identified for ************2**********

Tax Period[11]	VINs Associated to ******2********* *********2*******[12]	Dollar Amount
201112	*1*	****1****
201212	*1*	****1****
201312	1,343	$4,186,798
201412	1,526	$4,765,815
201512	1,565	$4,555,852
201612	1,086	$3,410,166
201712	1,129	$4,209,123
Total	6,662	$21,164,644

Source: TIGTA analysis of Plug-In Credits received during PYs 2014–2018.

In order to qualify for the Plug-In Credit under I.R.C. § 30D, the new vehicle must draw propulsion energy from a battery that has at least four kilowatt-hours of capacity and is capable of recharging from an external source of electricity. The IRS.gov website lists vehicle manufacturers, makes, and models that qualify for the credit.[13]

We verified that the vehicles reported on Forms 8936 were associated with a ****2***** ****2**** by analyzing the vehicle's VIN used to claim the credit (using the Department of Transportation's VIN Decoder website).[14] ***************2******************* *************************************2******************************** **************************************2********************************** ********2******** Figure 5 gives examples of vehicles we identified as having potentially erroneous claims for the Plug-In Credit with ***********2************* reported by individual taxpayers.

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[11] The period of time for which a return is filed. The IRS uses a six-digit code to indicate the end of the tax period for a given return. The first four digits represent the year and the last two digits represent the month.
[12] 309 VINs, totaling $1.1 million, also fall under the category of vehicles ********2*********** Please see Figure 3.
[13] IRS, *IRC 30D New Qualified Plug-In Electric Drive Motor Vehicle Credit*, https://www.irs.gov/businesses/irc-30d-new-qualified-plug-in-electric-drive-motor-vehicle-credit (last visited November 05, 2018).
[14] U.S. Department of Transportation, *National Highway Traffic Safety Administration VIN Decoder website*, https://vpic.nhtsa.dot.gov/decoder (last visited July 17, 2019).

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Source: TIGTA analysis of Plug-In Credits received during PYs 2014–2018.

In response to a prior TIGTA recommendation, the IRS updated Form 8936, in Fiscal Year 2012, to report vehicle VINs used to claim the Plug-In Credit on Form 8936, Line 2. The requirement to report the VIN was made to prevent taxpayers from using *********2***************** **2** to claim the credit. VINs indicate a vehicle's year, make, and model, including the vehicle's engine and fuel type *********************2************************* ************2************. However, since adding this line item, the IRS has not implemented adequate controls or processes to analyze these VINs reported by taxpayers and identify *************2****************** Additionally, there has been no formal reviews of the ********2********* since the IRS started requiring taxpayers to report these VINs.

*******2******** for the Qualified Plug-In Electric Drive Motor Vehicle Credit were allowed ******2****** vehicle

The IRS's current controls do not identify or prevent ***********2******************* We identified 5,461 individual tax returns claiming the Plug-In Credit by reporting a vehicle used ******************************2*********************************** *****************2***************** For example, we identified taxpayers who claimed the*****************2*************************** We also identified taxpayers who ****************2******************** Figure 6 shows the number of credits identified in PYs 2014 through 2018 (TYs 2012 through 2017), totaling more than $28 million.

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Figure 6: Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credit Claims Using Vehicles *************2****************

Tax Period	Vehicles Claimed **2** ****2****[15]	Dollar Amount
2012	3	$13,740
2013	773	$4,423,908
2014	1,016	$5,449,943
2015	1,056	$5,354,744
2016	1,279	$6,324,230
2017	1,334	$6,798,832
Totals	5,461	$28,365,397

Source: TIGTA analysis of Plug-In Credits received during PYs 2014–2018.

According to I.R.C. § 30D, an individual taxpayer must have purchased a new qualifying vehicle in order to qualify for the Plug-In Credit. Therefore, only the original owner of a qualifying vehicle may claim the credit.

IRS controls currently in place are limited. As a result, we identified a number of taxpayers who claimed the Plug-In Credit using ***********2*************** to claim the credit. For example, we found 34 taxpayers ***********2******************* to claim the Plug-In Credit.

Qualified Plug-In Electric Drive Motor Vehicle Credits are being received by taxpayers ***********2***********

The IRS has not implemented controls or processes to prevent *****2****** from receiving the Plug-In Credit. As a result, we identified 4,696 tax returns for which the taxpayers received over $25 million in credits using *****2****** Figure 7 shows the number of potentially erroneous credits using an ***********2********* identified in PYs 2014 through 2018 (TYs 2012 through 2017), totaling more than $25 million.

[15] 309 VINs, totaling $1.1 million, also fall under the category of a *******2******* See Figure 3.

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Figure 7: Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credit Claims Using an ****2****

Tax Period	Credits Claimed Using *****2******	Dollar Amount
2012	4	$17,850
2013	960	$5,270,592
2014	1,020	$5,328,542
2015	816	$4,462,985
2016	873	$4,597,202
2017	1,023	$5,633,394
Total	4,696	$25,310,565

Source: TIGTA analysis of Plug-In Credits received during PYs 2014–2018.

As previously noted above, to qualify for the Plug-In Credit, the taxpayer must have purchased a qualifying vehicle under I.R.C. § 30D and is required to include the vehicle's VIN on Line 2 of Form 8936. A valid VIN is 17 characters in length, made up of numbers and letters. ****2**** ********************************2**************************************

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Although the IRS requires taxpayers to report the vehicle's VIN when claiming the credit, the IRS has not implemented controls to identify and prevent these claims made with *****2****** *********2*********** a determination cannot be made if the vehicle is actually a ****2***** for the credit.

Without effective processes that identify erroneous Plug-In Credit claims using ***2*** ********************2**************************** the IRS is allowing individuals to inappropriately reduce their tax liabilities, resulting in the loss of millions in revenue.

Qualified Plug-In Electric Drive Motor Vehicle Credits are being received by taxpayers on ********************************2***

Individual taxpayers are claiming and receiving the Plug-In Credits on *******2********
*********************2****************************** We identified 1,509 individual tax returns claiming almost $8 million in erroneous credits that *****2******
***********2***************** When a taxpayer leases a qualifying vehicle model or purchases a previously leased vehicle, the entity, and not the taxpayer, is entitled to claim the credit.

Since Fiscal Year 2012, the IRS started requiring taxpayers to include the vehicle's VIN on Form 8936 to claim the Plug-In Credit. However, leasing entities, such as vehicle manufacturers did not always follow this requirement. Instead, they filed a Form 8936 indicating the total credit amount without listing each individual VIN.

************************************2**********************************
*********2*********** However, we identified 21,613 VINs the IRS requested during examination and matched the VIN list to the population of individual taxpayers who claimed the Plug-In Credit for PYs 2014 through 2018. We matched the data to determine if *****2*****
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These taxpayers were not entitled to these credits. Although we were only able to match a small population, our match indicates a potentially large problem **********2*****************
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*********1********* approximately 372,205 electric vehicles were sold in 2018. According to Edmunds, leasing vehicles has been at an all-time high in recent years, making up 30 percent or more of the market share of new vehicle sales.[16] As such, there is a significant potential for erroneous credits going undetected from taxpayers ***********2*********************** *********2************* If controls and processes are not developed, this could result in millions of dollars of improper credits.

*__The IRS does not have controls to prevent taxpayers from claiming Qualified Plug-In Electric Drive Motor Vehicle Credits ***************2*********************__*

The IRS does not have systematic controls in place to identify or prevent the Plug-In Credit *********2****************** According to I.R.C. § 30D, the allowable credit amount ranges from a minimum of $2,500 to a maximum of $7,500 per qualifying vehicle. Additionally, the IRS website lists the qualifying credit amount available for all vehicle makes and models

[16] Edmunds.com Inc. is an American online resource for automotive information, which is gathered from automakers, dealerships, and other industry participants.

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acquired after December 31, 2009.[17] We reviewed a judgmental sample of 50 electronically filed returns with the largest Plug-In Credit claims reported for one vehicle and identified 23 returns claiming a total of over $855,722 in credits ********2*********************[18] *** **1********************************* **1********************************* **1*******************************

We also reviewed a judgmental sample of 50 returns that claimed a Plug-In Credit using a vehicle model where *************************2******************************* for the individual vehicle model. We limited our judgmental sample to the five vehicle models shown in Figure 9 and filtered for only returns for which the credit claim was ****2***** *****2**** that particular vehicle model. Of the 50 returns, we found 45 returns that claimed a credit **2** the vehicle model's ****2*** totaling $170,158. ********2**************** ***********************************2************************************* **************2***************************** Figure 9 below provides an example of the credits below the maximum credit amount, but above the allowed threshold for the particular vehicles.

Figure 9: Returns Reviewed for Credits Under the Maximum Credit Amount but *******************2****************** for the Vehicle**

Vehicle Make and Model	Maximum Credit Allowable*	Number of Returns Reviewed	No. of Returns *******2******* *****2*****
Ford Fusion Energi (2013–2018)	$4,007	10	9
Toyota Prius Prime (2017–2018)	$4,502	10	9
Ford C-Max Energi (2013–2017)	$4,007	10	8
Toyota Prius Plug-In (2012–2015)	$2,500	10	10
Volvo XC-90 T8 Twin Engine Plug-In Hybrid (2016–2017)	$4,585	10	9
Total		50	45

Source: TIGTA analysis of Plug-In Credits received during PYs 2014–2018. * Based on vehicle model.

***********************************2********************************** ***********************************2********************************** ****************2******************** As noted earlier, the Plug-In Credit begins to phase out when vehicle manufacturers reach 200,000 vehicles sold. Phase-out begins in the second calendar quarter after the quarter in which the 200,000th vehicle is sold. Once initiated,

[17] IRS, *IRC 30D New Qualified Plug-In Electric Drive Motor Vehicle Credit*, https://www.irs.gov/businesses/irc-30d-new-qualified-plug-in-electric-drive-motor-vehicle-credit (last visited November 05, 2018).
[18] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

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the phase-out allows 50 percent of the full credit for two quarters, then 25 percent of the full credit for two additional quarters, then no credit thereafter. Tesla and General Motors have already reached this mark in the third and fourth quarters of 2018, respectively. Figure 10 shows the credit phase-out schedule for the two vehicle manufacturers.

Figure 10: Schedule of Maximum Allowable Credits for Tesla and GM Manufacturers (for Which Phase-Out Has Initiated)

Qualifying Vehicles	First Quarter and Prior	Second and Third Quarters	Fourth Quarter	Subsequent to Fourth Quarter
Tesla[19]	Acquired Through 12/31/2018	Acquired 1/1/2019 Through 6/30/2019	Acquired 7/1/2019 Through 12/31/2019	Credit Available Starting 1/1/2020
	$7,500	$3,750	$1,875	$0
GM[20]	Acquired Through 3/31/2019	Acquired 4/1/2019 Through 9/30/2019	Acquired 10/1/2019 Through 3/31/2020	Credit Available Starting 4/1/2020
	$7,500	$3,750	$1,875	$0

Source: IRS website of qualifying vehicles acquired after December 31, 2009.

************************************2*************************************
****************2*************** allowing individuals to inappropriately reduce their tax liabilities and resulting in a loss of revenue. ***************2********************
*********2******* erroneous credit amounts will rise.

Recommendations

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 1**:** Use VINs provided by taxpayers on their tax returns and readily available third-party VIN information to identify taxpayers who are claiming the credit for
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*******************************2***********************

> ***Management's Response:*** The IRS agreed with this recommendation and plans to use data analytics to determine the size and scope of the noncompliance of the Plug-in Credit for Small Business/Self-Employed taxpayers. Results of data analytics will be used to initiate the appropriate compliance activities.

[19] Includes the following qualifying Tesla vehicle models: Tesla Roadster, Model S, Model X, and Model 3.
[20] Includes the following qualifying GM vehicle models: Chevrolet Bolt, Chevrolet Volt, Cadillac CT6, Cadillac ELR, and Chevrolet Spark.

Recommendation 2: Develop a compliance program to address the taxpayers who appear to have erroneously received the Plug-In Credit by using a ***********2*****************
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> **Management's Response:** The IRS agreed with this recommendation. The IRS plans to develop a compliance program and take appropriate enforcement action(s) on the taxpayer returns identified in this report that meet selection threshold criteria and have open statutes.
>
> The IRS disagreed with the measurable impact (outcome measure) that our recommended corrective actions will have on tax administration. IRS management stated that the related outcome measure is overstated and the measure 1) includes some returns with a barred statute and 2) does not account for the opportunity costs associated with redeploying resources away from cases with higher compliance risks and larger potential adjustments.
>
> **Office of Audit Comment:** We believe the outcome measures are valid and reasonable as presented. If controls were in place or the returns had been reviewed, potentially, claims totaling $81.7 million may have been disallowed.

Recommendation 3: Use available vehicle VIN listings submitted by leasing entities to claim a Plug-In Credit to perform a computer analysis to identify individual taxpayers claiming a credit with the **************2**********************

> **Management's Response:** The IRS agreed with this recommendation and plans to obtain readily available VIN listings of previously leased vehicles and use that information in their return selection rules to address the Plug-in Credit.

Questionable Qualified Plug-In Electric Drive Motor Vehicle Credits Were Not Always Reviewed During Examination

IRS examiners are generally not reviewing questionable claims of the Plug-In Credit during examination when IRS filtering does not identify these credits for review. During return processing, the limited IRS controls currently in place identify only the following situations:

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- *****************************2*********************************
- ******************************2********************************

When a return selected for examination is not identified as having one of the issues above, the IRS classifiers and examiners are to use their expertise to identify large, unusual, or questionable claims in the return. Due to the low individual dollar value for this credit, Plug-In Credits generally are not picked up or reviewed during examination if the current IRS controls did not identify an issue.

We reviewed 151 individual return cases that were selected for examination and closed during PYs 2014 through 2018 that included at least one of the questionable issues identified above in Figure 3. Of the 151 cases, we identified:

- 128 (85 percent) cases that did not have filtering for the issue identified. Of those 128 cases, the examiner did not examine the credit appropriately for 99 (77 percent) cases and allowed the credit.
- 23 (15 percent) cases for which IRS filtering had identified the issue. Of those 23 cases, the examiner examined the credit for 18 (78 percent) cases and allowed or disallowed the credit appropriately.

According to the results of our review, if the case had filtering specifically for the Plug-In Credit, the IRS generally examined the credit appropriately. However, **********2**************
**************************2********************************** resulting in the IRS allowing a majority of the erroneous credits to go through. Although the IRS agrees that the questionable issues concerning the credit on examined returns were a concern, the IRS does not agree that expanding the examination to review the credit is warranted due to the generally low dollar amounts. However, the IRS should have stopped the credit during the examination process because the majority of the examined cases with a Plug-In Credit were erroneous and the credit should not have been allowed. Developing a process to systemically identify taxpayers reporting VINs with questionable credit claims, as previously noted, would help prevent a majority of these erroneous claims; however, the IRS should also provide guidance to examiners to review the credit and ensure that the ************************2*******************
**********2*****************

Recommendation

Recommendation 4*:* The Commissioner, Small Business/Self-Employed Division, should update Examiner Lead Sheets to provide guidance to examiners to review the Plug-In Credit along with information on VIN characteristics, including available resources to check and determine the validity of a VIN (such as using the VIN decoder on the Department of Transportation website).

> ***Management's Response:*** The IRS agreed with this recommendation and plans to develop a new lead sheet for the general business credit that will include the Plug-In Credit along with how to find information on the VIN characters.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS is adequately considering returns with the Qualified Plug-In Electric Drive Motor Vehicle Credit (hereafter referred to as the Plug-In Credit) for examination. To accomplish our objective, we:

I. Determined the applicable policies, procedures, and controls that were in place and the status of any ongoing IRS efforts related to the identification, selection, and examination of returns claiming the Plug-In Credit.

II. Determined if the IRS was effectively identifying erroneously claimed credits and what actions the IRS had taken to correct them.

   A. Determined whether potentially erroneous claims for the Plug-In Credit were being appropriately identified by filters by reviewing the population of 239,422 tax returns for which the taxpayer received the Plug-In Credit during PYs 2014 through 2018.

   B. Determined if additional filters were needed to prevent potentially erroneous Plug-In Credits from going undetected. We analyzed the applicable criteria and evaluated whether the filters in place were adequately designed to identify returns that do not meet such criteria.

   C. Reviewed a judgmental sample of 100 returns reporting a Plug-In Credit above allowable amounts based on the make and model of the vehicles.[1]

III. Determined if the Small Business/Self-Employed Examination function ensured that taxpayers and vehicles were qualified and that Plug-In Credit claims were appropriate during examination.

   A. Determined if the IRS had a selection process in place to examine the Plug-In Credit.

   B. Identified a population of 151 cases that had been examined with potentially erroneous Plug-In Credit claims and reviewed all 151 cases. We looked for key criteria such as: ********************2***************************
   ********************************2***************************
   ****************2***************

IV. Identified the issues in the prior review regarding the Plug-In Credit and determined if the IRS had implemented the necessary corrective actions.

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[1] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

V. Evaluated the risk for fraud, waste, and abuse to obtain reasonable assurance that improprieties did not exist by considering actions and trends within our review of returns claiming the Plug-In Credit.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the processes for planning, organizing, directing, and controlling program operations for new tax legislation for the Plug-In Credit. We tested these controls by interviewing IRS management, performing analysis of individual tax return data from the Individual Return Transaction File located on the TIGTA Data Center Warehouse[2], and reviewing and analyzing relevant documents, data, and calculations related to the preparation of these credits.[3]

[2] A collection of IRS databases containing various types of taxpayer account information that is maintained by the TIGTA for the purpose of analyzing data for ongoing audits.
[3] The Individual Return Transaction File contains data transcribed form initial input of the original individual tax returns during return processing.

Appendix II

Major Contributors to This Report

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Glen Rhoades, Director
Michele Jahn, Audit Manager
Antony Shang, Lead Auditor

Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Deputy Commissioner, Small Business/Self-Employed Division
Director, Examination, Small Business/Self-Employed Division
Director, Enterprise Audit Management

Millions of Dollars in Potentially Erroneous

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $81,735,523 ($73,771,234 and $7,964,289) in additional tax revenue by addressing 18,019 (16,510 and 1,509) taxpayer accounts that have erroneously claimed the Qualified Plug-In Electric Drive Motor Vehicle Credit (see page 4).

Methodology Used to Measure the Reported Benefit:

Based on our analysis of the 239,422 Plug-In Credits claimed and received during PYs 2014 through 2018, we identified 16,510 tax returns for which taxpayers received $73.8 million in potentially erroneous Plug-In Credits. Figure 1 shows the number of returns filed with taxpayers receiving potentially erroneous Plug-In Credits during PYs 2014 through 2018.

Figure 1: Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credits Claimed

Questionable Issue Identified	Potentially Erroneous Claims	
	Number of Returns	Dollar Amount
**************2*****************	6,353	$20,095,272
Vehicle Claimed *********2*******	5,152	$27,296,025
**************2**************** and Vehicle Claimed ********2********	309	$1,069,372
*********2*********	4,696	$25,310,565
Total	16,510	$73,771,234

Source: TIGTA analysis of Plug-In Credits received during PYs 2014–2018.

Our analysis indicates that taxpayers are using ********************2**************** ***********2********** to receive the Plug-In Credit. We identified:

- 6,353 tax returns for which the taxpayers received $20,095,272 in credits on vehicles that *********2**********
- 5,152 tax returns for which the taxpayers received $27,296,025 in credits by reporting a vehicle used ***********************2****************************** **********2***********
- 309 tax returns for which the taxpayers received $1,069,372 in credits on vehicles that do ***************************2**********************************
- 4,696 tax returns for which the taxpayers received over $25,310,565 in credits using an *****2*****.

In addition, we requested a listing of 21,613 VINs from the IRS and conducted a match to the population of individual taxpayers that claimed the Plug-In Credit for PYs 2014 through 2018. We matched the data to determine ********************2*********************** **2****************************** ****2**** We found that 1,509 (7 percent) of the 21,613 VINs were ******2********** *******2******* during PYs 2014 through 2018. The taxpayers were not entitled to these credits. The 1,509 tax returns resulted in $7,964,289 in erroneous credits *******2********* **********2**********

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $1,025,880 in additional tax revenue by addressing 68 tax returns for which the taxpayers erroneously claimed the Plug-In Credit (see page 4).

Methodology Used to Measure the Reported Benefit:

Of our analysis of the 239,422 Plug-In Credits claimed and received during PYs 2014 through 2018, we reviewed a judgmental sample of 50 electronically filed returns with the largest credit claims reported for one vehicle.[1] We identified 23 returns claiming a total of over $855,722 in **************2*****************

We also reviewed a judgmental sample of 50 returns claiming a Plug-In Credit using a vehicle model for which ***********************2********************************* for the individual vehicle model. We limited our judgmental sample to five vehicle models and filtered for only returns for which the credit claim was *********2******** for that particular

[1] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

vehicle model.[2] Of the 50 returns, we found that 45 returns claimed a credit ******2********* *******2******** totaling $170,158.

[2] The five vehicle models were the Ford Fusion Energi (2013–2018), Toyota Prius Prime (2017–2018), Ford C-Max Energi (2013–2017), Toyota Prius Plug-In (2012–2015), and Volvo XC-90 T8 Twin Engine Plug-In Hybrid (2016–2017).

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

September 5, 2019

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Eric C. Hylton
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Millions of Dollars in Potentially Erroneous Qualified Plug-in Electric Drive Motor Vehicle Credits Continue to Be Claimed Using Ineligible Vehicle (Audit # 201930011)

Thank you for the opportunity to review and comment on the above subject draft audit report. This credit was enacted in 2008 and was subsequently amended in the American Recovery Act of 2009 for vehicles purchased after December 31, 2009. These credits help taxpayers offset the purchase of a qualifying electric plug-in vehicle up to $7,500.

We appreciate your recognition of our achievements since your last review. We now transcribe the first two Vehicle Identification Numbers (VINs) on Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit*, and we recovered the erroneous credits with an open assessment period you previously identified. We appreciate your acknowledgement that leasing entities are not always following the requirement to individually list each VIN, creating a challenge for enforcement activities. The President's current proposed budget would repeal this credit and, independently, would provide the IRS authority to correct more errors on tax returns before refunds are issued. This authority would permit the IRS to address these compliance issues more efficiently and effectively at filing, rather than through performing examinations. We remain committed to using all available information and authority to prevent erroneous plug in credit claims.

Your report focused on our processes to identify and prevent erroneous claims for the Qualified Plug-in Electric Motor Vehicle Credit, and it includes several recommendations to improve compliance. We will use data analytics to determine the extent of non-compliance and initiate a recovery program for potentially erroneous credits identified in your report. We also will develop a new audit lead sheet to assist examiners with auditing the plug-in credit.

2

We disagree with your increased revenue potential amounts of $81,735,523 and $1,025,880. Both outcome measures assume that the credit is erroneous as reported and would produce tax if removed. Neither of those assumptions can be confirmed without an examination. Some returns included in your outcome measure have barred assessment statutes and legally cannot be recouped if erroneous. Finally, management has to exercise its discretion in allocating finite resources across the filing population and areas of noncompliance. Your outcome measures do not account for the opportunity costs associated with redeploying resources away from cases with higher compliance risks and larger potential adjustments than these 16,578 returns.

Attached is a detailed response to address your recommendations. If you have any questions, please contact me or Brenda Dial, Director, Examination Operations, Small Business/Self-Employed Division.

Attachment

Attachment

Recommendation 1:
The Commissioner, Small Business/Self-Employed Division, should, using VINs provided by taxpayers on their tax returns and readily available third-party VIN information, identify taxpayers who are claiming the credit for ***********************2************************
2
************2***********

Planned Corrective Action:
We agree with this recommendation. We will use data analytics to determine the size and scope of the non-compliance of the Qualified Plug-in Electric Drive Motor Vehicle Credit for SB/SE taxpayers. Based on the results of our data analytics we will initiate the appropriate compliance activities.

Implementation Date:
November 15, 2020

Responsible Official:
Director, Exam Case Selection, Small Business/Self-Employed Division

Corrective Action Monitoring Plan:
IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 2:
The Commissioner, Small Business/Self-Employed Division, should develop a compliance program to address the taxpayers who appear to have erroneously received the Plug-In Credit by using a***********************2***
2
***2**
****************2************************

Planned Corrective Action:
We agree with this recommendation. We will develop a compliance program and take the appropriate enforcement action(s) on the taxpayer returns identified in this report that meet our selection threshold criteria and have open statutes.

Implementation Date:
February 15, 2021

Responsible Official:
Director, Exam Case Selection, Small Business/Self-Employed Division

Corrective Action Monitoring Plan:
IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 3:
The Commissioner, Small Business/Self-Employed Division, should use available vehicle VIN listings submitted by leasing entities to claim a Plug-In Credit to perform a computer analysis to identify individual taxpayers claiming a credit with the************2*************
****************2*******************.

Planned Corrective Action:
We agree and will take the necessary actions to obtain readily available VIN listings of previously leased vehicles and use that information in our return selection rules to address the Qualified Plug-in Electric Drive Motor Vehicle Credit.

Implementation Date:
November 15, 2020

Responsible Official:
Director, Exam Case Selection, Small Business/Self-Employed Division

Corrective Action Monitoring Plan:
IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 4:
The Commissioner, Small Business/Self-Employed Division, should update Examiner Lead Sheets to provide guidance to examiners to review the Plug-In Credit along with information on VIN characteristics, including available resources to check and determine the validity of a VIN (such as using the VIN decoder on the Department of Transportation website).

Planned Corrective Action:
We agree with this recommendation. We will develop a new lead sheet for the general business credit that will include the Qualified Plug-in Electric Drive Motor Vehicle Credit along with how to find information on the VIN characters.

Implementation Date:
November 15, 2020

Responsible Official:
Director, Exam Quality and Technical Support, Small Business/Self-Employed Division

Corrective Action Monitoring Plan:
IRS will monitor this corrective action as part of our internal management system of controls.