



*Unsupported and Potentially Erroneous
Claims for General Business Credits
Are Not Always Identified
When Tax Returns Are Processed*

September 16, 2013

Reference Number: 2013-40-093

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:

2 = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

UNSUPPORTED AND POTENTIALLY ERRONEOUS CLAIMS FOR GENERAL BUSINESS CREDITS ARE NOT ALWAYS IDENTIFIED WHEN TAX RETURNS ARE PROCESSED

Highlights

Final Report issued on September 16, 2013

Highlights of Reference Number: 2013-40-093 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The General Business Credit exists as an incentive for a business to engage in certain kinds of activities considered beneficial to the economy or public at large, such as improving disability access at their business for customers or providing childcare for employees. In Tax Year 2011, the IRS received 455,618 Forms 1040, U.S. Individual Income Tax Return, with General Business Credits offsetting the taxes owed by more than \$2 billion. TIGTA found that ineffective processes result in individuals receiving potentially erroneous General Business Credits.

WHY TIGTA DID THE AUDIT

In Tax Year 2011, individual taxpayers claimed nearly \$7.9 billion in General Business Credits. The General Business Credit reduces the tax liability amount an individual owes. The objective of this review was to assess the effectiveness of IRS controls to detect and prevent questionable claims for the General Business Credit on individual income tax returns.

WHAT TIGTA FOUND

Our review of Tax Year 2011 tax returns with claims for General Business Credits found that the IRS has not established effective processes to identify individuals claiming potentially erroneous General Business Credits at the time tax returns are processed. TIGTA found 3,187 Tax Year 2011 electronically filed tax

returns with General Business Credit claims totaling approximately \$1.2 billion for which. In addition, the IRS did not always ensure that required source credit forms were attached to paper-filed tax returns.

TIGTA also identified individuals claiming potentially erroneous General Business Credits. For example, there were:

- 1,472 tax returns with \$9.9 million in General Business Credits claimed for which
- 3,998 tax returns with \$41 million in General Business Credits claimed for

Finally, the IRS needlessly expended approximately \$76,000 to review 145,583 tax returns for which a programming error incorrectly identified an error in the computation of the General Business Credit.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS develop processes to identify individuals claiming a General Business Credit on tax returns.

The IRS agreed with all of our recommendations and plans to develop a compliance strategy that considers the treatment and resources to address questionable claims. In addition, the IRS plans to use the strategy to determine the need for procedural changes for returns processing, revisions to forms or instructions, and any underlying programming changes to its systems.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 16, 2013

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Unsupported and Potentially Erroneous Claims
for General Business Credits Are Not Always Identified When Tax
Returns Are Processed (Audit # 201240031)

This report presents the results of our review to assess the effectiveness of the Internal Revenue Service (IRS) controls to detect and prevent questionable claims for the General Business Credit on individual income tax returns. This audit is included in our Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper Payments.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me if you have questions or Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).



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 *****2***** Page 10

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Abbreviations

e-file(d)	Electronically file(d)
EIN	Employer Identification Number
IRS	Internal Revenue Service
IRTF	Individual Return Transaction File
TIGTA	Treasury Inspector General for Tax Administration



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Background

The General Business Credit exists as an incentive for a business to engage in certain kinds of activities considered beneficial to the economy or public at large, such as improving disability access for customers at their business or providing childcare for employees. The General Business Credit includes the total amount of current year business credits plus any carryforward¹ amount of unused credits from prior years. The General Business Credit reduces a taxpayer's tax liability amount, *i.e.*, the credit is subtracted directly from taxes the individual owes. The General Business Credit is nonrefundable and is subject to Alternative Minimum Tax limitations.²

As of October 25, 2012, the IRS received 455,618 Tax Year 2011 individual tax returns with General Business Credit claims totaling nearly \$7.9 billion.

To claim the credit, taxpayers must prepare and attach a Form 3800, *General Business Credit*,³ to their Form 1040, *U.S. Individual Income Tax Return*. The Form 3800 is used to summarize all of the various business credits claimed and to calculate the total General Business Credit amount allowed in the current tax year.⁴ Generally, taxpayers must complete and attach a required source credit form⁵ for each of the business credits claimed on Form 3800, *e.g.*, Form 8826, *Disabled Access Credit*. The amount of the General Business Credit actually used for the current year by the taxpayer to offset taxes owed is then reported on the Form 1040, line 53 (Other Credits). The amount used is generally limited by the amount of taxes owed. However, taxpayers can carry any unused General Business Credit amount from the current year back one year by filing an amended tax return or carry it forward for up to 20 years on subsequently filed tax returns.

To be eligible to claim a General Business Credit, a taxpayer must be either the owner of a business or the owner of a pass-through entity. IRS guidance indicates that an owner of a

¹ A carryforward is the amount of the General Business Credit that is unused because of the tax liability limit for claiming the credit.

² The Alternative Minimum Tax attempts to ensure that individuals and corporations that benefit from certain exclusions, deductions, or credits pay at least a minimum amount of tax. The limitation for General Business Credits is calculated based on the taxpayer's net income tax minus the greater of the tentative minimum tax or 25 percent of the net regular tax liability that is more than \$25,000.

³ See Appendix V for an example of the Form 3800.

⁴ 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.

⁵ For Tax Year 2011, there are a total of 32 source credit forms. See Appendix VI for a list of the source credit forms. A source credit form is not required if the taxpayer's only source for a credit listed is from pass-through entities, *i.e.*, partnership, S corporation, estate, trust, or cooperative, or if the amount is for a carryforward or carryback credit amount.



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pass-through entity is a partner, shareholder, beneficiary, or investor. Pass-through entities include partnerships, S corporations, estates, and trusts for which the income, loss, deductions, and credits are passed on to the underlying owners. Illustrated below is an example of how individuals who are owners of a pass-through entity claim General Business Credits (*hypothetically*):

Taxpayer A and Taxpayer B are part owners (partners), with each taxpayer having a 50 percent interest in Partnership XYZ. For Tax Year 2011, Partnership XYZ reports a Low-Income Housing Credit of \$1,000 on Form 1065, U.S. Return of Partnership Income, and reports the credit on Form 1065, Schedule K, Partners' Distributive Share Items, for the year. Partnership XYZ issues a Form 1065, Schedule K-1, Partner's Share of Income, Deductions, Credits, etc., to "pass through" the credit to its two partners (Taxpayer A and Taxpayer B). Each partner receives a Schedule K-1 with a Low-Income Housing Credit amount of \$500 because each had a 50 percent interest. Taxpayer A and Taxpayer B then include their share of the Low-Income Housing Credit and indicate the Employer Identification Number (EIN)⁶ of Partnership XYZ on Form 3800, which is attached to their Form 1040 tax return.

In Tax Year 2011, the Internal Revenue Service (IRS) significantly redesigned Form 3800, including adding a Part III. Part III is used to report any General Business Credits being claimed and identifies the type of credit being reported, *i.e.*, nonpassive activity, passive activity, carryforward, or carryback. Part III also requires taxpayers to include the EIN of the pass-through entity for which they are claiming the credit. Figure 1 shows that in Tax Year 2011, individual taxpayers reported nearly \$7.9 billion on Form 3800 for General Business Credits of which approximately \$1.5 billion was a carryforward amount from a prior year.⁷ The amount of credits actually used, *i.e.*, reported on Forms 1040, line 53, totaled more than \$2 billion, with more than \$5.8 billion remaining for these taxpayers as General Business Credits that can be carried back one tax year or carried forward 20 years.

⁶ An EIN is a nine-digit number assigned by the Internal Revenue Service to identify a business entity.

⁷ We calculated the carryforward amount based on the amounts reported on Part I of Form 3800.



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**Figure 1: Tax Year 2011 Tax Returns Reporting
a General Business Credit on Form 3800**

	Tax Year 2011		
	E-Filed	Paper	Total
Number of Tax Returns Reporting the Credit	406,756	48,862	455,618
Credit Amount Reported	\$5,664,406,535	\$2,186,942,984	\$7,851,349,519

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the Individual Return Transaction File (IRTF),⁸ as of October 25, 2012. E-filed = electronically filed.

This audit included an assessment of taxpayers who claim the General Business Credit on a Form 1040. We have another review planned that will determine whether controls are adequate to identify questionable claims for General Business Credits on business tax returns. This review was performed at the Wage and Investment Division office in Atlanta, Georgia, and the IRS Submission Processing Site in Austin, Texas, during the period December 2012 through April 2013. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁸ The IRS database that contains information originally filed by the taxpayer and transcribed from Forms 1040, 1040A, and 1040EZ, *Income Tax Return for Single and Joint Filers With No Dependents*, and their accompanying forms and schedules.



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Results of Review

**Unsupported Claims for General Business Credits Are Not Always
Identified When Tax Returns Are Processed**

Our review of Tax Year 2011 tax returns with claims for General Business Credits found that the IRS has not established effective processes to identify individuals who claim General Business Credits *****2*****
*****2*****.⁹ Our review of Tax Year 2011 e-filed tax returns identified 3,187 returns with General Business Credit claims totaling approximately \$1.2 billion that resulted in the individuals reducing their income tax by \$4.8 million. The returns filed by these individuals did not have a *****2*****
*****2*****
*****2*****
*****2*****
*****2*****.

The criterion we used to identify the unsupported General Business Credit claims is similar to the criterion the IRS uses to identify potentially erroneous claims for the General Business Disabled Access Credit. The IRS identifies questionable claims for the Disabled Access Credit as those tax returns *****2*****
****2*****. For the tax returns identified, the portion of the refund associated with the Disabled Access Credit is frozen, and the tax return is sent to the IRS’s Examination function for review. This process was put in place in response to a prior TIGTA report¹⁰ which found that taxpayers *****2*****
{*****2*****. Figure 2 provides the examination results for Fiscal Year¹¹ 2012 for those tax returns identified as having a questionable Disabled Access Credit claim.

⁹ *****2*****
*****2*****
*****2*****.

¹⁰ TIGTA, Ref. No. 2001-30-158, *Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans* (Sept. 2001).

¹¹ A 12-consecutive-month period ending on the last day of any month. The Federal Government’s fiscal year begins on October 1 and ends on September 30.



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Figure 2: Fiscal Year 2012 Disabled Access Credit Examination Results

Number of Tax Returns Examined	Number of Examinations Resulting in a Tax Assessment	Percentage of Tax Returns Examined With Additional Tax Assessed	Additional Tax Assessed	Average Amount of Additional Tax Assessed
41	34	83%	\$97,846	\$2,386

Source: IRS examination results for the General Business Credit for Fiscal Year 2012.

These results show that individuals claiming General Business Credits on tax returns listed on the Form 3800 is a reliable indicator of a potentially erroneous claim. However, despite the success of this criterion for identifying potentially erroneous claims, the IRS does not use this criterion to identify other questionable General Business Credit claims. IRS management acknowledges that this criterion is not used. However, IRS management stated that without considerable gathering of facts and data analysis, they cannot ensure that this criterion should be used to identify other potentially erroneous General Business Credit claims.

The majority of unsupported claims relate to the Energy Efficient Home Credit

We found that 1,956 (61 percent) of the 3,187 Tax Year 2011 returns we identified involved General Business Credit claims for the Energy Efficient Home Credit. These 1,956 Energy Efficient Home Credit claims account for all but \$1.1 million of the total \$1.2 billion in potentially erroneous General Business Credits claimed. It should be noted that if the IRS used criterion similar to the one that it uses to identify questionable Disabled Access Credit claims, each of these tax returns would have been identified as potentially erroneous at the time the tax returns were processed.

The Energy Efficient Home Credit is available to eligible *contractors*¹² for each qualified energy efficient home they sold or leased to another person during the tax year for use as a residence. The credit is \$1,000 or \$2,000 per home based on the energy saving requirements of the home. Figure 3 provides an example of the Form 8908, *Energy Efficient Home Credit*, used to report and calculate the credit.

¹² An eligible contractor is the person who constructed a qualified energy efficient home (or produced a qualified energy efficient home that is a manufactured home). A person must own and have a basis in the qualified energy efficient home during its construction to qualify as an eligible contractor with respect to the home.



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Figure 3: Form 8908, Energy Efficient Home Credit

Form 8908 Department of the Treasury Internal Revenue Service	Energy Efficient Home Credit ► Attach to your tax return.	OMB No. 1545-1979 2011 Attachment Sequence No. 153
Name(s) shown on return		Identifying number
1a Enter the total number of qualified energy efficient homes including qualified energy efficient manufactured homes meeting the 50% standard that were sold or leased to another person for use as a residence during the tax year (see instructions)		1a
b Multiply line 1a by \$2,000		1b
2a Enter the total number of qualified energy efficient manufactured homes meeting the 30% standard that were sold or leased to another person for use as a residence during the tax year (see instructions)		2a
b Multiply line 2a by \$1,000		2b
3 Energy efficient home credit from partnerships and S corporations		3
4 Add lines 1b, 2b, and 3. Partnerships and S corporations, report this amount on Schedule K. All others, report this amount on Form 3800, line 1p		4

Source: Form 8908 for Tax Year 2011.

Our review of the 1,956 tax returns found that some individuals seem to be incorrectly claiming the Energy Efficient Home Credit rather than the Residential Energy Credit. The Residential Energy Credit is available to individuals who made energy saving improvements to their residence, e.g., installing energy efficient exterior doors. However, unlike the Energy Efficient Home Credit that has no limit to what can be claimed, the Residential Energy Credit for Tax Year 2011 is limited to \$500. It is likely that individuals were incorrectly claiming the Energy Efficient Home Credit in place of the Residential Energy Credit because only *contractors* are able to take the Energy Efficient Home Credit. For each of the 1,956 tax returns we identified, the individuals filing the tax returns do not seem to be operating as a contractor. For example, the individuals *****2*****
 *****2*****
 *****2*****.

Furthermore, the calculations to determine the credit amount for many of the tax returns are excessively overstated, which may be a result of taxpayer confusion in calculating the credit. For example (*hypothetically – based on characteristics of tax returns we identified as potentially questionable*):

*****2*****
 *****2*****
 *****2*****
 *****2*****
 *****2*****
 *****2*****



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filed their Tax Year 2012 tax return, with 65 taxpayers reporting a General Business Credit carryforward on Form 3800. These 65 taxpayers reported a carryforward amount of nearly \$195 million.

*****2*****
*****2*****

Our review of a statistically valid sample of 142 Tax Year 2011 paper-filed tax returns¹³ with a claim for the General Business Credit found that the required source credit form(s) were not attached for four (18 percent) of 22 tax returns that required a source credit form. We estimate that 1,376 of the 48,862 Tax Year 2011 paper-filed tax returns claiming a General Business Credit on Form 1040, line 53, did not have the required source credit form attached to the tax return.

The IRS systemically rejects e-filed tax returns when the required forms are not attached to the Form 3800 in support of General Business Credits being claimed. For example, to claim the Energy Efficient Home Credit on an e-filed tax return, the taxpayer must include with the Form 3800 a Form 8908 or the tax return will be rejected. *****2*****

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When we brought this to IRS management's attention, *****2*****
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*****2*****. The IRS implemented revised procedures in March 2013. The IRS now requires that source credit forms for all General Business Credits claimed on a paper-filed tax return are attached to the tax return. When a required source credit form is not attached, the IRS will correspond with the taxpayer to obtain the required forms regardless of the amount claimed.

¹³ We used attribute sampling to calculate the minimum sample size for paper-filed tax returns based on a confidence level of 90 percent, an expected rate of occurrence of 5 percent, and a precision rate of ± 3 percent.

¹⁴ The IRS ensures that required source documents are attached to the tax return for the following six credits:
*****2*****
*****2*****
*****2*****.



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Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Develop a process to identify tax returns with claims for General Business Credits that *****2*****
*****2*****
*****2*****.

Management's Response: The IRS agreed with this recommendation. The IRS will evaluate and enhance the compliance strategy to address questionable claims of General Business Credits. The enhancements will address the identification and treatment of returns *****2*****.

Recommendation 2: Determine the validity of the credits claimed for the 1,956 individuals we identified who claimed the Energy Efficient Home Credit *****2*****
*****2*****.

Management's Response: The IRS agreed with this recommendation. The IRS will review the returns identified as claiming the Energy Efficient Home Credit ***2*****
*****2*****. The IRS will use a risk-based approach to determine the appropriate follow-up actions with the taxpayers (e.g., soft notices or examinations).

Office of Audit Comment: IRS management agreed to review these returns; however, they noted that most of the carryforward amount of \$195 million from the 65 taxpayers will likely expire unused after 20 years. We agree that this is solely the carryforward amount that could be used to offset taxes. Based on the taxpayers' incomes, the amount of taxes actually offset will likely be much lower. As such, we have reflected a lower amount in our outcome measure. Assuming there is no significant change in these individuals' income tax reporting, the potential amount of tax avoidance over 20 years totals approximately \$1.4 million.



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Individuals Claimed Potentially Erroneous General Business Credits

*****2*****
*****2*****

Our review of Tax Year 2011 tax returns with claims for General Business Credits found that the IRS has not established effective processes during tax return processing *****2*****
*****2*****. We identified 1,472 Tax Year 2011 tax returns for which taxpayers ***2***
*****2*****.¹⁵ These individuals claimed approximately \$9.9 million in General Business Credits. Although individuals are required to provide the EIN of the pass-through entity on the Form 3800, **2***
*****2*****. Instructions for Form 3800 require taxpayers to enter the valid EIN of the pass-through entity of which they have an ownership interest in column “b” (which is next to the credit amount) when the taxpayer reports the credit. Figure 5 shows where on the Form 3800 that the EIN is required to be listed.

Figure 5: Form 3800, Part III
(General Business Credits or Eligible Small Business Credits)

Form 3800 (2011)		Page 3
Part III General Business Credits or Eligible Small Business Credits (see instructions)		
Complete a separate Part III for each box checked below. (see instructions)		
A <input type="checkbox"/> General Business Credit From a Non-Passive Activity	E <input type="checkbox"/> Eligible Small Business Credit From a Non-Passive Activity	
B <input type="checkbox"/> General Business Credit From a Passive Activity	F <input type="checkbox"/> Eligible Small Business Credit From a Passive Activity	
C <input type="checkbox"/> General Business Credit Carryforwards	G <input type="checkbox"/> Eligible Small Business Credit Carryforwards	
D <input type="checkbox"/> General Business Credit Carrybacks	H <input type="checkbox"/> Eligible Small Business Credit Carrybacks	
I If you are filing more than one Part III with box A, B, E, or F checked, complete and attach first an additional Part III combining amounts from all Parts III with box A, B, E, or F checked. Check here if this is the consolidated Part III <input type="checkbox"/>		
(a) Description of credit	(b) If claiming the credit from a pass-through entity, enter the EIN	(c) Enter the appropriate amount
Note: On any line where the credit is from more than one source, a separate Part III is needed for each pass-through entity.		
1a Investment (Form 3468, Part II only) (attach Form 3468)	1a	
b Reserved for future use	1b	
c Increasing research activities (Form 6765)	1c	
d Low-income housing (Form 8586, Part I only)	1d	

Source: Form 3800 for Tax Year 2011.

The pass-through entity is required to provide the owners a Schedule K-1¹⁶ to report their share of the income, loss, deductions, and credits. The pass-through entity also files the Schedule K-1

¹⁵ *****2*****
*****2*****

¹⁶ This includes Form 1041 (Schedule K-1), *Beneficiary’s Share of Income, Deductions, Credits, etc.*; Form 1065 (Schedule K-1), *Partner’s Share of Income, Deductions, Credits, etc.*; Form 1065-B (Schedule K-1), *Partner’s Share of Income (Loss) From an Electing Large Partnership*; and Form 1120-S (Schedule K-1), *Shareholder’s Share of Income, Deductions, Credits, etc.*



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with the IRS, which the IRS can then use to improve taxpayer compliance by matching what the individual taxpayer reported with what the pass-through entity reported.

*****2*****
*****2*****

Our review identified 3,998 Tax Year 2011 tax returns on which the taxpayers either ***2***
*****2*****
*****2*****.

These individuals claimed potentially erroneous carryforward credits totaling \$41 million. **2**
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*****2*****
*****2*****.

When a taxpayer is unable to claim the entire General Business Credit amount in the current tax year, the taxpayer can carry forward the unused credit amount until the full amount of the credit is offset against income tax or up to 20 years. IRS instructions require a taxpayer who carries forward an amount of unused credit to attach a statement to his or her tax return which provides information regarding the year from which the credit originated, the amount of the original credit, and the years and amounts of credits allowed on subsequent years' tax returns. However, our review of a statistically valid sample of 284¹⁷ Tax Year 2011 tax returns with General Business Credits identified that *****2*****
*****2*****.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 3: *****2*****
*****2*****
*****2*****. This should include programming to reject e-filed tax returns with this condition.

Management's Response: The IRS agreed with this recommendation. The IRS will evaluate and enhance the compliance strategy to address programming or procedural changes needed to identify returns claiming General Business Credits purporting to *****2*****
*****2*****.

¹⁷ We used attribute sampling to calculate the minimum sample size of 142 (284 total) for both e-filed and paper-filed tax returns based on a confidence level of 90 percent, an expected rate of occurrence of 5 percent, and a precision rate of ± 3 percent.



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*****2*****; however, evaluation of the compliance strategy will consider alternative options such as referral for review by the Error Resolution System or by the Compliance function.

Recommendation 4: *****2*****
*****2*****
*****2*****

Management's Response: The IRS agreed with this recommendation. The IRS will evaluate and enhance the compliance strategy to address programming or procedural changes needed to identify and address returns *****2*****
*****2*****.

Recommendation 5: Verify whether the 1,787 individuals we identified as *****2*****
*****2*****.

Management's Response: The IRS agreed with this recommendation. The IRS will review the returns identified as *****2*****
*****2*****. The IRS will use a risk-based approach to determine the appropriate follow-up actions with the taxpayers, e.g., soft notices or examinations.

Recommendation 6: Develop a process to ensure that taxpayers *****2*****
*****2*****
*****2*****.

Management's Response: The IRS agreed with this recommendation. The evaluation of improvements to the overall compliance strategy for General Business Credits will consider and address the continued need for *****2*****
*****2*****
*****2*****.

Recommendation 7: *****2*****
*****2*****
*****2*****
*****2*****.

Management's Response: The IRS agreed with this recommendation. The evaluation of improvements to the overall compliance strategy for General Business Credits will consider the continued need for *****2*****
*****2*****
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*****2*****.



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A Program Error Resulted in Needless Reviews of Tax Returns With General Business Credit Claims

Our review identified 145,583 Tax Year 2011 tax returns that were incorrectly identified by an IRS computer verification program as having a calculation error related to the amount claimed for the General Business Credit. At the time a tax return is processed, IRS computer programs verify the amount of the General Business Credit claimed by the taxpayer. Tax returns identified as having an incorrect calculation are sent to the IRS’s Error Resolution function for review.

We estimate that the IRS wasted nearly 4,500 staff hours at a cost of approximately \$76,000 for the review of these incorrectly identified tax returns. There was no impact on these taxpayers because Error Resolution function reviews are generally completed without delaying the processing of tax returns. Figure 6 provides a breakdown of resources needlessly expended to review these tax returns.

Figure 6: Staff Hour and Cost Calculation to Work Tax Returns With Taxpayer Amount Accepted by the Tax Examiner

Description	Tax Return Filing Method			Total
	Legacy e-File ¹⁸	Modernized e-File ¹⁹	Paper	
Number of Tax Returns	64,202	67,960	13,421	145,583
Error Resolution and Support Hours per Tax Return	0.028	0.0303	0.0448	
Calculated Staff Hours	1,798	2,059	601	4,458
Error Resolution and Support Cost per Tax Return	\$0.47	\$0.52	\$0.74	
Calculated Cost ²⁰	\$30,178	\$35,645	\$9,913	\$75,736

Source: TIGTA analysis of the IRTF, as of October 25, 2012, and IRS Document 6746.

On December 14, 2012, we brought this concern to IRS management’s attention. Based on our observations, IRS management determined that there was a programming error in the calculation of the allowable General Business Credit amount. This error resulted in tax returns being sent to the Error Resolution function. IRS management agreed to submit a work request by May 2013

¹⁸ The Legacy e-File system was the IRS’s prior electronic filing system for accepting individual tax returns electronically.

¹⁹ The Modernized e-File system replaced the Legacy e-File system in Processing Year 2013 as the sole system for accepting all e-filed individual tax returns. The processing year is the calendar year in which the tax return or document is processed by the IRS.

²⁰ Totals do not add due to rounding.



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to correct the programming. The IRS indicated that the corrected programming should be in place by January 2014. Until that time, the IRS will continue to expend resources reviewing General Business Credit claims for which taxpayers actually claimed the correct amount.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the effectiveness of IRS controls to detect and prevent questionable claims for the General Business Credit on individual income tax returns. To accomplish this objective, we:

- I. Determined if the IRS had effective processes and procedures to identify questionable claims for the General Business Credit.
 - A. Reviewed Form 1040, *U.S. Individual Tax Return*, and Form 3800, *General Business Credit*, instructions to identify taxpayer filing requirements to claim the General Business Credit.
 - B. Reviewed the IRS's Internal Revenue Manuals and Publication 1346, *Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns*, to identify taxpayer requirements for attaching supporting schedules and forms to substantiate entitlement to the credit and IRS procedures for processing individual tax returns claiming the General Business Credit.
 - C. Compared the filing requirements between e-filed and paper-filed individual tax returns to identify inconsistencies between the two filing methods.
 - D. Conducted a walkthrough at the Austin Submission Processing Site to observe efforts taken to ensure the completeness of General Business Credit claims and to identify questionable claims during processing.
 - E. Discussed with the Code and Edit and Error Resolution functions the steps taken to ensure the accuracy of General Business Credit claims.
 - F. Interviewed IRS Submission Processing function personnel and reviewed management information reports to identify the volume and cause of error conditions associated with individual tax returns with General Business Credit claims.
 - G. Evaluated IRS post-processing compliance measures for questionable General Business Credit claims.
 1. Reviewed the examination process for individual tax returns with General Business Credit claims.
 2. Reviewed management information reports for examination results for General Business Credit claims.



Unsupported and Potentially Erroneous Claims for General Business Credits Are Not Always Identified When Tax Returns Are Processed

3. Followed up on the implementation of corrective actions by the IRS in response to a prior TIGTA report¹ to develop a compliance approach for taxpayers taking the Disabled Access Credit without qualifying businesses.

II. Assessed the effectiveness of IRS processes to ensure that taxpayers claiming the General Business Credit *****2*****

A. Identified 455,618 Tax Year² 2011 individual tax returns processed through October 25, 2012, claiming \$7,851,349,519 in General Business Credits on Form 3800 from the IRTF.³

B. *****2*****

C. Determined if the General Business Credit claim is based on a pass-through entity arrangement *****2*****⁴ *****2*****⁵

D. Identified 3,187 Tax Year 2011 e-filed returns claiming \$1,212,115,082 in General Business Credits on Form 3800 *****2*****

III. Evaluated the effectiveness of IRS controls to verify the accuracy of the carryforward amount⁶ portion of the General Business Credit claimed by taxpayers on their individual tax return.

A. Reviewed Internal Revenue Manual procedures and met with IRS personnel to identify processing controls to ensure the accuracy of the General Business Credit carryforward amount claimed by the taxpayer.

B. Identified 51,484 Tax Year 2011 tax returns processed through October 25, 2012, claiming a carryforward amount of \$1,479,536,298 on Form 3800 from the IRTF.

¹ TIGTA, Ref. No. 2001-30-158, Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans (Sept. 2001).

² 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.

³ IRS database that contains information originally filed by the taxpayer and transcribed from Forms 1040, 1040A, and 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents, and their accompanying forms and schedules.

⁴ *****2*****

⁵ *****2*****

⁶ A carryforward is the amount of the General Business Credit that is unused because of the tax liability limit for claiming the credit.



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- C. Determined from the IRTF extract whether the taxpayers who claimed a carryforward credit amount on their Tax Year 2011 tax return *****2*****
*****2*****.
 - 1. *****2*****
*****2*****.
 - 2. *****2*****
*****2*****
2. - D. Identified 3,998 Tax Year 2011 tax returns claiming \$40,956,599 ***2*****
*****2*****
*****2*****.
- IV. Determined whether taxpayers met eligibility requirements to claim the General Business Credit when the tax return was processed.
- A. Identified a population of 455,618 Tax Year 2011 tax returns processed through October 25, 2012, claiming a General Business Credit on Form 3800 from the IRTF.
 - B. Reviewed statistically valid random samples of 142 e-filed and 142 paper-filed tax returns from the IRTF extract.⁷ For each sampled tax return, we:
 - 1. Determined if the taxpayer complied with filing and documentation requirements.
 - 2. Determined if the taxpayer was entitled to the *****2*****
****2*****.
 - 3. Determined whether a *****2*****
*****2*****.
 - 4. Identified any adjustments to the General Business Credit claim and determined the cause of the error condition and whether it was correctly resolved.
 - C. Identified 36 Tax Year 2011 tax returns claiming *****2*****
*****2*****
*****2*****
*****2*****.

⁷ We used attribute sampling to calculate the minimum sample size based on a confidence level of 90 percent, an expected rate of occurrence of 5 percent, and a precision rate of ± 3 percent. We selected statistically valid random samples to help quantify the extent of the problem over the entire population.



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Data validation methodology

During this review, we relied on data extracted from the IRTF for Processing Years⁸ 2012 and 2013 and from the Business Master File⁹ through the end of Processing Year 2012 located on the TIGTA Data Center Warehouse. We also relied on data extracts from the IRS's Tax Return Database¹⁰ for Tax Years 2010 and 2011 that were provided by the TIGTA Office of Investigations' Strategic Data Services. To assess the reliability of computer-processed data, programmers within Strategic Data Services validated the data files on the Data Center Warehouse and the data extract files, while we ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed judgmental samples¹¹ of the data extracts and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.¹² In addition, we compared data to the physical tax returns as appropriate to verify that the amounts were supported. As a result of our testing, we determined the data used in our review were reliable.

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 the following internal controls were relevant to our audit objective: processes and procedures to identify questionable claims for the General Business Credit. We evaluated the controls by reviewing the IRS's Internal Revenue Manuals used by Submission Processing function personnel, interviewing IRS management, and evaluating applicable documentation and management information reports.

⁸ The calendar year in which the tax return or document is processed by the IRS.

⁹ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

¹⁰ The database containing tax return source information for e-filed tax returns and tax forms.

¹¹ A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.

¹² IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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Appendix II

Major Contributors to This Report

Augusta R. Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)
Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)
Darryl Roth, Audit Manager
Van Warmke, Senior Auditor
Stephen Elix, Auditor
Nathan Smith, Auditor
Brian Hattery, Information Technology Specialist



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Appendix III

Report Distribution List

Acting Commissioner
Office of the Commissioner – Attn: Chief of Staff C
Office of the Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Operations, Wage and Investment Division SE:W
Deputy Commissioner, Support, Wage and Investment Division SE:W
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division
SE:W:S:PEI



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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:

- Revenue Protection – Potential; \$4,820,232 in erroneous General Business Credits received by 3,187 taxpayers for Tax Year 2011. There was no evidence that these taxpayers ****2*** (see page 4).
- Revenue Protection – Potential; \$1,390,321 in erroneous General Business Credits received by 65 taxpayers claiming the Energy Efficient Home Credit for up to 20 years. There was no evidence that these taxpayers ****2*** (see page 4).

Methodology Used to Measure the Reported Benefit:

We identified 406,756 e-filed Tax Year 2011 returns that claimed the General Business Credit on Form 1040, line 53, as of October 25, 2012. From this population, we identified 10,258 tax returns. From the 10,258 tax returns, we excluded returns that reported an EIN, carryforward amounts,¹ or vehicle credits allowed to be claimed as personal use on Form 3800, *General Business Credit*. After this analysis, we identified 3,187 tax returns. These taxpayers reported \$1,212,115,082 in General Business Credits on Form 3800 and offset their Tax Year 2011 income tax by \$4,820,232 using the credits.

From this analysis, we determined that 1,956 (61 percent) of the 3,187 Tax Year 2011 returns involved claims for the Energy Efficient Home Credit and accounted for all but \$1,115,748 of the \$1,212,115,082 in General Business Credits reported on Form 3800. Our review determined that as of June 9, 2013, 1,661 (85 percent) of the 1,956 taxpayers have filed their Tax Year 2012

¹ We excluded tax returns with carryforward amounts reported on Form 3800, Part I, line 4, and tax returns with credits on Form 3800, Part III, line 3 and lines 4a through 4h. The credits on Part III, line 3 and lines 4a through 4h can also be claimed as carryforward amounts and Part II, lines 22 and 34 identifying the carryforward amount are not transcribed.



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tax return, and 65 of the 1,661 taxpayers reported a General Business Credit carryforward amount on Form 3800 totaling \$194,894,318. These 65 taxpayers offset their Tax Year 2012 income tax by \$108,856 and may continue to offset their income tax with the unused credit amounts until the full amount of the credit is offset against income tax for up to 20 years (including Tax Year 2012). We estimated the amount these taxpayers may offset against future income tax based upon the amount the taxpayers offset against their income tax during Tax Year 2012 and until the credit is fully offset against income tax or 20 years to be \$1,390,321.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$9,916,363 in erroneous General Business Credits received by 1,472 taxpayers *****2*****
*****2***** in a pass-through entity (see page 10).

Methodology Used to Measure the Reported Benefit:

We identified 406,756 e-filed Tax Year 2011 returns that claimed the General Business Credit on Form 1040, line 53, as of October 25, 2012. From this population, we identified 330,260 tax returns that reported a General Business Credit *****2*****
*****2*****
*****2*****
*****2***** and can offset their income tax with the unused credit amounts until the full amount of the credit is offset against income tax for up to 20 years.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$40,956,599 in erroneous General Business Credits received by 3,998 taxpayers *****2***** (see page 10).

Methodology Used to Measure the Reported Benefit:

We identified 455,618 Tax Year 2011 returns that claimed the General Business Credit on Form 1040, line 53, as of October 25, 2012. From this population, we identified 51,484 tax returns reporting \$1,479,536,298 in carryforward General Business Credits on Form 3800, Part I, line 4.³ From the population of taxpayers with *****2*****
*****2*****

² *****2*****.

³ *****2*****
*****2*****.



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*****2*****4 *****
*****2*****
*****2*****
*****2*****
*****2*****
*****2***** General Business Credit by \$40,956,599. These taxpayers can continue to offset their income tax with the unused credit amounts until the full amount of the credit is offset against income tax or for up to 20 years.

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; \$378,680 (\$75,736 over five years) in resources that could be applied to other Submission Processing function programs that was needlessly expended for the review of tax returns with General Business Credit claims (see page 13).

Methodology Used to Measure the Reported Benefit:

As of October 12, 2012, 145,583 Tax Year 2011 tax returns were erroneously identified by IRS computer processing programs as containing a mismatch between what the taxpayers computed as their General Business Credit and the amount the IRS computed. A computer programming error in the IRS calculation of the allowable General Business Credit amount resulted in these tax returns being needlessly sent to the Error Resolution function during Processing Year⁵ 2012. The Error Resolution function used 4,458 staff hours at a cost of \$75,736 for the review of tax returns containing the preventable error condition. We calculated this amount based on the average Error Correction/Resolution and Support Cost as reported in IRS Document 6746, *Cost Estimate Reference*, dated March 2012. If the IRS had not needlessly expended resources reviewing General Business Credit claims for which the taxpayer claimed the correct amount for the credit, \$378,680 could have been used for other Submission Processing function programs over five years (\$75,736 X 5). Figure 1 presents the details of our estimate for inefficient use of resources.

⁴ *****2*****
*****2*****.

⁵ The calendar year in which the tax return or document is processed by the IRS.



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**Figure 1: Staff Hour and Cost Calculation to Work Tax Returns
With Taxpayer Amount Accepted by the Tax Examiner**

Description	Tax Return Filing Method			Total
	Legacy e-File ⁶	Modernized e-File ⁷	Paper	
Number of Tax Returns	64,202	67,960	13,421	145,583
Error Resolution and Support Hours per Tax Return	0.028	0.0303	0.0448	
Calculated Staff Hours	1,798	2,059	601	4,458
Error Resolution and Support Cost per Tax Return	\$0.47	\$0.52	\$0.74	
Calculated Cost ⁸	\$30,178	\$35,645	\$9,913	\$75,736

Source: TIGTA analysis of the IRTF, as of October 25, 2012, and IRS Document 6746.

⁶ The Legacy e-File system was the IRS's prior electronic filing system for accepting individual tax returns electronically.

⁷ The Modernized e-File system replaced the Legacy e-File system in Processing Year 2013 as the sole system for accepting all e-filed individual tax returns.

⁸ Totals do not add due to rounding.



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Appendix V

Form 3800, General Business Credit

Form 3800 Department of the Treasury Internal Revenue Service (99)	General Business Credit ▶ See separate instructions. ▶ Attach to your tax return.	OMB No. 1545-0895 2011 Attachment Sequence No. 22	
Name(s) shown on return		Identifying number	
Part I Current Year Credit for Credits Not Allowed Against Tentative Minimum Tax (TMT) (See instructions and complete Part(s) III before Parts I and II)			
1	General business credit from line 2 of all Parts III with box A checked	1	
2	Passive activity credits from line 2 of all Parts III with box B checked 2		
3	Enter the applicable passive activity credits allowed for 2011 (see instructions)	3	
4	Carryforward of general business credit to 2011. Enter the amount from line 2 of Part III with box C checked. See instructions for schedule to attach	4	
5	Carryback of general business credit from 2012. Enter the amount from line 2 of Part III with box D checked (see instructions)	5	
6	Add lines 1, 3, 4, and 5	6	
Part II Allowable Credit			
7	Regular tax before credits: <ul style="list-style-type: none"> • Individuals. Enter the amount from Form 1040, line 44, or Form 1040NR, line 42 • Corporations. Enter the amount from Form 1120, Schedule J, Part I, line 2; or the applicable line of your return • Estates and trusts. Enter the sum of the amounts from Form 1041, Schedule G, lines 1a and 1b; or the amount from the applicable line of your return 	7	
8	Alternative minimum tax: <ul style="list-style-type: none"> • Individuals. Enter the amount from Form 6251, line 35 • Corporations. Enter the amount from Form 4626, line 14 • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 56 	8	
9	Add lines 7 and 8	9	
10a	Foreign tax credit	10a	
b	Personal credits from Form 1040 or 1040NR (see instructions)	10b	
c	Add lines 10a and 10b	10c	
11	Net income tax. Subtract line 10c from line 9. If zero, skip lines 12 through 15 and enter -0- on line 16a	11	
12	Net regular tax. Subtract line 10c from line 7. If zero or less, enter -0-	12	
13	Enter 25% (.25) of the excess, if any, of line 12 over \$25,000 (see instructions)	13	
14	Tentative minimum tax: <ul style="list-style-type: none"> • Individuals. Enter the amount from Form 6251, line 33 • Corporations. Enter the amount from Form 4626, line 12 • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 54 	14	
15	Enter the greater of line 13 or line 14	15	
16a	Subtract line 15 from line 11. If zero or less, enter -0-	16a	
b	For a corporation electing to accelerate the research credit, enter the bonus depreciation amount attributable to the research credit (see instructions)	16b	
c	Add lines 16a and 16b	16c	
17a	Enter the smaller of line 6 or line 16c C corporations: See the line 17a instructions if there has been an ownership change, acquisition, or reorganization.	17a	
b	Enter the smaller of line 6 or line 16a. If you made an entry on line 16b, go to line 17c; otherwise, skip line 17c (see instructions)	17b	
c	Subtract line 17b from line 17a. This is the refundable amount for a corporation electing to accelerate the research credit. Include this amount on Form 1120, Schedule J, Part II, line 19c (or the applicable line of your return)	17c	
For Paperwork Reduction Act Notice, see separate instructions.			Cat. No. 12392F Form 3800 (2011)



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Form 3800 (2011)		Page 2
Part II Allowable Credit (Continued)		
Note. If you are not required to report any amounts on lines 22 or 24 below, skip lines 18 through 25 and enter -0- on line 26.		
18	Multiply line 14 by 75% (.75) (see instructions)	18
19	Enter the greater of line 13 or line 18	19
20	Subtract line 19 from line 11. If zero or less, enter -0-	20
21	Subtract line 17b from line 20. If zero or less, enter -0-	21
22	Combine the amounts from line 3 of all Parts III with box A, C, or D checked	22
23	Passive activity credit from line 3 of all Parts III with box B checked 23	23
24	Enter the applicable passive activity credit allowed for 2011 (see instructions)	24
25	Add lines 22 and 24	25
26	Empowerment zone and renewal community employment credit allowed. Enter the smaller of line 21 or line 25	26
27	Subtract line 13 from line 11. If zero or less, enter -0-	27
28	Add lines 17b and 26	28
29	Subtract line 28 from line 27. If zero or less, enter -0-	29
30	Enter the general business credit from line 5 of all Parts III with box A checked	30
31	Enter the total eligible small business credit from line 6 of all Parts III with box E checked	31
32	Passive activity credits from line 5 of all Parts III with box B checked and line 6 of all Parts III with box F checked 32	32
33	Enter the applicable passive activity credits allowed for 2011 (see instructions)	33
34	Carryforward of business credit to 2011. Enter the amount from line 5 of Part III with box C checked and line 6 of Part III with box G checked. See instructions for schedule to attach	34
35	Carryback of business credit from 2012. Enter the amount from line 5 of Part III with box D checked and line 6 of Part III with box H checked (see instructions)	35
36	Add lines 30, 31, 33, 34, and 35	36
37	Enter the smaller of line 29 or line 36	37
38	Credit allowed for the current year. Add lines 28 and 37. Report the amount from line 38 (if smaller than the sum of Part I, line 6, and Part II, lines 25 and 36, see instructions) as indicated below or on the applicable line of your return: <ul style="list-style-type: none"> • Individuals. Form 1040, line 53, or Form 1040NR, line 50 • Corporations. Form 1120, Schedule J, Part I, line 5c • Estates and trusts. Form 1041, Schedule G, line 2b 	38



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Form 3800 (2011)	Page 3
Part III General Business Credits or Eligible Small Business Credits (see instructions)	
Complete a separate Part III for each box checked below. (see instructions)	
A <input type="checkbox"/> General Business Credit From a Non-Passive Activity B <input type="checkbox"/> General Business Credit From a Passive Activity C <input type="checkbox"/> General Business Credit Carryforwards D <input type="checkbox"/> General Business Credit Carrybacks	E <input type="checkbox"/> Eligible Small Business Credit From a Non-Passive Activity F <input type="checkbox"/> Eligible Small Business Credit From a Passive Activity G <input type="checkbox"/> Eligible Small Business Credit Carryforwards H <input type="checkbox"/> Eligible Small Business Credit Carrybacks
I If you are filing more than one Part III with box A, B, E, or F checked, complete and attach first an additional Part III combining amounts from all Parts III with box A, B, E, or F checked. Check here if this is the consolidated Part III <input type="checkbox"/>	
(a) Description of credit	(b) If claiming the credit from a pass-through entity, enter the EIN
(c) Enter the appropriate amount	
Note: On any line where the credit is from more than one source, a separate Part III is needed for each pass-through entity.	
1a Investment (Form 3468, Part II only) (attach Form 3468) b Reserved for future use c Increasing research activities (Form 6765) d Low-income housing (Form 8586, Part I only) e Disabled access (Form 8826) (do not enter more than \$5,000 in column (c) of Parts III with box A, B, E, or F checked, combined) f Renewable electricity, refined coal, and Indian coal production (Form 8835) g Indian employment (Form 8845) h Orphan drug (Form 8820) i New markets (Form 8874) j Small employer pension plan startup costs (Form 8881) (do not enter more than \$500 in column (c) of Parts III with box A, B, E, or F checked, combined) k Employer-provided child care facilities and services (Form 8882) l Biodiesel and renewable diesel fuels (attach Form 8864) m Low sulfur diesel fuel production (Form 8896) n Distilled spirits (Form 8906) o Nonconventional source fuel (Form 8907) p Energy efficient home (Form 8908) q Energy efficient appliance (Form 8909) r Alternative motor vehicle (Form 8910) s Alternative fuel vehicle refueling property (Form 8911) t Reserved for future use u Mine rescue team training (Form 8923) v Agricultural chemicals security (Form 8931) (do not enter more than \$2 million in column (c) of Parts III with box A, B, E, or F checked, combined) w Employer differential wage payments (Form 8932) x Carbon dioxide sequestration (Form 8933) y Qualified plug-in electric drive motor vehicle (Form 8936) z Qualified plug-in electric vehicle (Form 8834, Part I only) aa New hire retention (Form 5884-B) bb General credits from an electing large partnership (Schedule K-1 (Form 1065-B)) zz Other	1a 1b 1c 1d 1e 1f 1g 1h 1i 1j 1k 1l 1m 1n 1o 1p 1q 1r 1s 1t 1u 1v 1w 1x 1y 1z 1aa 1bb 1zz 2 3 4a 4b 4c 4d 4e 4f 4g 4h 4i 4j 4z 5 6
2 Add lines 1a through 1zz and enter here 3 Enter the amount from Form 8844 4a Investment (Form 3468, Part III) (attach Form 3468) b Work opportunity (Form 5884) c Alcohol and cellulosic biofuel fuels (Form 6478) d Low-income housing (Form 8586, Part II) e Renewable electricity, refined coal, and Indian coal production (Form 8835) f Employer social security and Medicare taxes paid on certain employee tips (Form 8846) g Qualified railroad track maintenance (Form 8900) h Small employer health insurance premiums (Form 8941) i Reserved for future use j Reserved for future use z Other 5 Add lines 4a through 4z and enter here 6 Add lines 2, 3, and 5	2 3 4a 4b 4c 4d 4e 4f 4g 4h 4i 4j 4z 5 6
Form 3800 (2011)	



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Appendix VI

Source Credit Forms for General Business Credits

1. Form 1065-B, Schedule K-1, Partner's Share of Income (Loss) From an Electing Large Partnership – Credit applies to those credits that are taken by the partnership but not separately reported to partners.
2. Form 3468, Investment Credit – Credit consists of the total of the following credits: rehabilitation credit, energy credit, qualifying advanced coal project credit, qualifying gasification project credit, qualifying advanced energy project credit, and qualifying therapeutic discovery project credit.
3. Form 5884, Work Opportunity Credit – Credit applies to businesses that hire individuals from targeted groups that have a particularly high unemployment rate or other special employment needs.
4. Form 5884-B, New Hire Retention Credit – Credit is available to a business that hires a qualified employee and the employee works for the business at least 52 consecutive weeks.
5. Form 6478, Alcohol and Cellulosic Biofuel Fuels Credit – Credit consists of the alcohol mixture credit, alcohol credit, small ethanol producer credit, and cellulosic biofuel producer credit.
6. Form 6765, Credit for Increasing Research Activities – Credit is designed to encourage business to increase the amounts they spend on research and experimental activities, including energy research.
7. Form 8586, Low-income Housing Credit – Credit generally applies to each new qualified low-income building placed in service after 1986 and is used by owners of qualified residential rental buildings in low-income housing projects.
8. Form 8820, Orphan Drug Credit – Credit applies to qualified clinical testing expenses paid or incurred during the tax year.
9. Form 8826, Disabled Access Credit – Credit applies to amounts paid or incurred by the eligible small business to comply with applicable requirements under the Americans With Disabilities Act of 1990 (Public Law 101-336) as in effect on November 5, 1990.
10. Form 8834, Part I only, Qualified Plug-in Electric and Electric Vehicle Credit – Credit is for certain qualified plug-in electric vehicles.



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11. Form 8835, Renewable Electricity, Refined Coal, and Indian Coal Production Credit – Credit is allowed for the sale of electricity, refined coal, or Indian coal produced in the United States or U.S. possessions from qualified energy resources at a qualified facility.
12. Form 8844, Empowerment Zone and Renewal Community Employment Credit – Credit is available to employers for wages paid to qualified employees residing in an empowerment zone for which the credit is available.
13. Form 8845, Indian Employment Credit – Credit applies to qualified wages and health insurance costs paid or incurred for American Indians who are qualified employees.
14. Form 8846, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips – Credit is generally equal to the employer's portion of Social Security and Medicare taxes paid on tips received by employees of a food and beverage establishment where tipping is customary.
15. Form 8864, Biodiesel and Renewable Diesel Fuels Credit – Credit applies to certain fuel sold or used in business and consists of the following: biodiesel credit, renewable diesel credit, biodiesel mixture credit, renewable diesel mixture credit, and small agri-biodiesel producer credit.
16. Form 8874, New Markets Credit – Credit is for qualified equity investments made in qualified community development entities.
17. Form 8881, Credit for Small Employer Pension Plan Startup Costs – Credit applies to pension plan startup costs of a new qualified defined benefit or defined contribution plan.
18. Form 8882, Credit for Employer-Provided Childcare Facilities and Services – Credit applies to the qualified expenses paid for employee childcare and qualified expenses paid for childcare resource and referral services.
19. Form 8896, Low Sulfur Diesel Fuel Production Credit – Credit is for the production of low sulfur diesel fuel by a qualified small business.
20. Form 8900, Qualified Railroad Track Maintenance Credit – Credit applies to qualified railroad track maintenance expenditures paid or incurred during the tax year.
21. Form 8906, Distilled Spirits Credit – Credit is available to eligible wholesalers of distilled spirits.
22. Form 8907, Nonconventional Source Fuel Credit – Credit is allowed for qualified coke or coke gas produced and sold to an unrelated person during the tax year.
23. Form 8908, Energy Efficient Home Credit – Credit is available for eligible contractors for each qualified energy efficient home sold or leased to another person during the tax year for use as a residence.



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24. Form 8909, *Energy Efficient Appliance Credit* – Credit is available to manufacturers of qualified energy efficient appliances, *i.e.*, eligible dishwashers, clothes washers, and refrigerators.
25. Form 8910, *Alternative Motor Vehicle Credit* – Credit is for the following vehicles placed in service: qualified fuel cell motor vehicle, advanced lean burn technology motor vehicle, qualified hybrid motor vehicle, qualified alternative fuel motor vehicle, and qualified plug-in electric drive motor vehicle conversion.
26. Form 8911, *Alternative Fuel Vehicle Refueling Property Credit* – Credit applies to the cost of any qualified alternative fuel vehicle refueling property placed in service.
27. Form 8923, *Mine Rescue Team Training Credit* – Credit applies to training program costs paid or incurred for certain mine rescue team employees.
28. Form 8931, *Agricultural Chemicals Security Credit* – Credit applies to qualified agricultural chemicals security costs paid or incurred by eligible agricultural businesses.
29. Form 8932, *Credit for Employer Differential Wage Payments* – Credit provides certain small businesses with an incentive to continue to pay wages to an employee performing services on active duty in the uniformed services of the United States for more than 30 days.
30. Form 8933, *Carbon Dioxide Sequestration Credit* – Credit is allowed for qualified carbon dioxide that is captured and disposed of or captured, used, and disposed of by the taxpayer in secure geological storage.
31. Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit* – Credit is for new qualified plug-in electric drive motor vehicles placed in service during the tax year.
32. Form 8941, *Credit for Small Employer Health Insurance Premiums* – Credit applies to the cost of certain health insurance coverage provided to certain employees.



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Appendix VII

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

JUL 29 2013

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Peggy Bogadi 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Unsupported and Potentially Erroneous
Claims for General Business Credits Are Not Always Identified
When Tax Returns Are Processed (Audit # 201240031)

Thank you for the opportunity to review the subject draft report. We agree that procedures should be reviewed to identify improvements in the detection of questionable General Business Credit claims. An evaluation of our compliance strategy will be completed to identify systemic and operational changes to improve detection processes. Treatment streams will be evaluated to determine how we can effectively use available resources to address the risk presented.

The most substantial finding in the report is attributable to claims for the Energy Efficient Home Credit (EEHC). The Treasury Inspector General for Tax Administration (TIGTA) suggests that some of the questionable claims may have been attributable to taxpayers mistakenly claiming the EEHC when they intended to claim the Residential Energy Credit. We agree with that assumption and believe it is supported, as noted in the report, by the finding that of the 1,956 taxpayers whose claims for Tax Year 2011 appear to be erroneous, only 65 of those taxpayers claimed a carryover credit on their 2012 return. We will review those claims, as well as any similar first-time claims made on 2012 returns by taxpayers not included in the 2011 analysis.

We agree with all of the recommendations made in the report; however, we believe it is critical to the success of our corrective actions that the compliance strategy be developed prior to taking specific actions. That strategy will need to consider treatment streams and resources to address the questionable claims, and will determine the procedural changes that should be implemented for return processing, revisions to forms or instructions, and any underlying programming changes to be made to our systems. Since actions identified by the strategy may be dependent on funding and resource prioritization that is beyond the control of the IRS or the Wage and Investment



*Unsupported and Potentially Erroneous Claims
for General Business Credits Are Not Always
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Division, we will identify any stop-gap measures that can be implemented immediately, but will consider completion of the compliance strategy evaluation as the milestone for closing the corrective actions.

We disagree with the outcome measure of \$195 million attributable to the gross EEHC claimed by the 65 taxpayers who initially claimed the credit on their 2011 returns, and continued to claim a carryforward of the credit on their 2012 return. The outcome measure is based on the gross amount the taxpayers calculated on Form 8908, *Energy Efficient Home Credit*. Although the gross credit appears to be substantially inflated, the benefit the taxpayers receive over the 20-year carryforward period is limited to actual tax liability, and may be further reduced by any alternative minimum tax liabilities. We acknowledge that, left unchallenged, the taxpayers could avoid any net tax liability over 20 years; however, the projected harm to the government is not realistic. Using the TIGTA's example¹, the taxpayer, averaging an actual tax liability of \$2,000 per year, would realize a benefit of only \$40,000 over the duration of the 20-year carryforward period. The remaining credit of \$49,960,000 would expire, unused. Assuming a flat 35 percent tax rate, the taxpayer would need to have taxable income in excess of \$7.1 million dollars in each of the 20 years in order to use the full amount of the erroneous credit.²

We do agree with the \$4.8 million outcome measure, which reflects the actual benefit received by the 1,956 taxpayers who were allowed the EEHC on their 2011 returns. The remaining outcome measures are not disputed. It should be noted, however, that programming changes to correct the erroneous referrals of some returns claiming General Business Credits to the Error Resolution System are scheduled to be implemented for the 2014 Filing Season, thus reducing the \$378,680 outcome measure by \$227,208³.

Attached are our comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Steve Klingel, Director, Reporting Compliance, Wage and Investment Division, at (404) 338-9085.

Attachment

¹ Pages 6 and 7 of the subject report.

² (\$50 million divided by 35 percent) divided by 20 years.

³ \$75,736 X 3 years.



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Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1

Develop a process to identify tax returns with claims for General Business Credits that ****2*****
*****2*****
*****2*****
*****2*****.

Corrective Action

The compliance strategy will be evaluated and enhanced to address questionable claims of General Business Credits (GBC). The enhancements will address the identification and treatment of returns*****2*****
***** *****2*****.

Implementation Date

April 15, 2015

Responsible Official

Director, Reporting Compliance, Wage and Investment Division

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.

Recommendation 2

Determine the validity of the credits claimed for the 1,956 individuals we identified who claimed the Energy Efficient Home Credit*****2*****
2***.

Corrective Action

We will review the returns identified as claiming the Energy Efficient Home Credit ***2*****
*****2***** *****2*****. A risk-based approach will be used to determine the appropriate follow-up actions with the taxpayers (e.g. soft notices or examinations).



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Implementation Date

April 15, 2014

Responsible Official

Director, Reporting Compliance, Wage and Investment Division

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 3

*****2*****
*****2*****. This should include programming to
reject e-filed tax returns with this condition.

Corrective Action

The compliance strategy will be evaluated and enhanced to address programming or procedural changes needed
to identify returns claiming GBCs purporting to*****2*****
*****2*****,
however, evaluation of the compliance strategy will consider alternative options such as referral for review by
the Error Resolution System or by the Compliance function.

Implementation Date

April 15, 2015

Responsible Official

Director, Reporting Compliance, Wage and Investment Division

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.

Recommendation 4

*****2*****
*****2*****.

Corrective Action

The compliance strategy will be evaluated and enhanced to address programming or procedural changes needed
to identify and address returns *****2*****.

Implementation Date

April 15, 2015



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Responsible Official

Director, Reporting Compliance, Wage and Investment Division

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.

Recommendation 5

Verify whether the 1,787 individuals we identified as *****2*****
*****2*****.

Corrective Action

We will review the returns identified as *****2*****
*****2*****. A risk-based approach will be used to determine the appropriate follow-up actions with the taxpayers (e.g. soft notices or examinations).

Implementation Date

April 15, 2014

Responsible Official

Director, Reporting Compliance, Wage and Investment Division
Director, Campus Reporting Compliance, Small Business/Self-Employed Division

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.

Recommendation 6

Develop a process to ensure taxpayers *****2*****
*****2*****
*****2*****.

Corrective Action

The evaluation of improvements to the overall compliance strategy for GBCs will consider and address the continued need for *****2*****
*****2*****
*****2*****.

Implementation Date

April 15, 2015



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Responsible Official

Director, Reporting Compliance, Wage and Investment Division

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.

Recommendation 7

*****2*****
*****2*****
*****2*****
*****2*****.

Corrective Action

The evaluation of improvements to the overall compliance strategy for GBCs will consider the continued need
for*****2*****
*****2*****
*****2*****.

Implementation Date

April 15, 2015

Responsible Official

Director, Reporting Compliance, Wage and Investment Division

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.