TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Opportunities Exist to Improve the Audit Selection Process for the Qualified Plug-In Electric Drive Motor Vehicle Credit

September 29, 2023

Report Number: 2023-30-065

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HIGHLIGHTS: Opportunities Exist to Improve the Audit Selection Process for the Qualified Plug-In Electric Drive Motor Vehicle Credit

Final Audit Report issued on September 29, 2023 **Report Number 2023-30-065**

Why TIGTA Did This Audit

This audit was initiated to assess whether the IRS is adequately reviewing the Qualified Plug-In Electric Drive Motor Vehicle Credits claimed by taxpayers. Additionally, TIGTA assessed the IRS's actions in response to past recommendations and sought to review the IRS's plans for addressing the changes made to the credit in the Inflation Reduction Act of 2022.

Impact on Tax Administration

The Energy Improvement and Extension Act of 2008 created the Qualified Plug-In Electric Drive Motor Vehicle Credit. This credit was amended by the American Recovery and Reinvestment Act of 2009, and then modified and extended under the Inflation Reduction Act of 2022 and renamed the Clean Vehicle Credit. The nature of these changes will have an impact on the data available to the IRS and its future controls and compliance strategy.

These credits of up to $7,500 help taxpayers offset the purchase of a qualifying plug-in electric drive motor vehicle. The Joint Committee on Taxation estimated the credits will cost $5 billion from Fiscal Years 2022 through 2026.

What TIGTA Found

In response to TIGTA's recommendations in a prior audit, the IRS developed filters to identify returns with potentially erroneous Qualified Plug-In Electric Drive Motor Vehicle Credit claims. While the IRS has taken steps to address past recommendations, problems with the implementation of some of the filters have made existing issues worse.

TIGTA's analysis found that 74 percent of the tax returns flagged by the filter to identify non-qualifying vehicle models flagged qualifying vehicle models in error, resulting in taxpayer burden and unproductive examinations. In addition, due to issues with the filter, many claims for non-qualified vehicles were not examined. TIGTA identified 13,518 unexamined returns totaling approximately $63 million in credits potentially paid for unqualified vehicles.

Additionally, for vehicles that qualify for a credit less than the maximum of [redacted] In Processing Years 2019 through 2022, TIGTA identified 7,547 returns with credits totaling approximately $23 million that were over the allowable threshold but were not caught by IRS filters. In addition, while the IRS created controls to identify [redacted] these cases were not productive. However, data on invalid VINs could be used to improve the quality of future audit selection.

TIGTA was unable to review the IRS's new compliance strategy to address the changes to the Clean Vehicle Credit, due to the strategy not being finalized at the time of our review.

What TIGTA Recommended

TIGTA made five recommendations. The Commissioner, Small Business/Self-Employed Division, should: 1) review the population of 13,518 claims for non-qualified vehicles identified by TIGTA for potential examination; 2) consider adding a manual review to the filter identifying non-qualifying vehicle models until future controls are in place; 3) expand use of invalid VIN criteria as additional information in examination selection; 4) expand controls to identify partial credits; and 5) review the 7,547 claims that were over the allowed threshold for their vehicle model identified by TIGTA for potential examination.

The IRS agreed with four of the five recommendations and plans to review the identified claims, expand invalid VIN criteria for Tax Year 2023, and update business rules to incorporate the legislative changes from the Inflation Reduction Act related to claims made over the allowable threshold amounts. The IRS disagreed with manually reviewing Qualified Plug-In Electric Drive Motor Vehicle Credit claims when the vehicle is a non-qualifying vehicle.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

September 29, 2023

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

Heather Hill

FROM: Heather M. Hill
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Opportunities Exist to Improve the Audit Selection Process for the Qualified Plug-In Electric Drive Motor Vehicle Credit (Audit # 202330019)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) is adequately reviewing the Qualified Plug-In Electric Drive Motor Vehicle Credits claimed by taxpayers, to follow up on past recommendations, and to identify the IRS's plans for addressing the changes made to the credit in the Inflation Reduction Act. This review is part of our Fiscal Year 2023 Annual Audit Plan and addresses the major management and performance challenge of *Increasing Domestic and International Tax Compliance and Enforcement*.

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

The Qualified Plug-In Electric Drive Motor Vehicle Credit (Plug-In Credit) is a non-refundable credit of up to $7,500 designed to encourage individuals and businesses to invest in certain motor vehicles that operate on clean renewable sources of energy by providing a tax incentive. The credit was first created in 2008 under Internal Revenue Code (I.R.C.) § 30D as part of the Energy Improvement and Extension Act of 2008, then amended under the American Recovery and Reinvestment Act of 2009.[1]

Subsequently, the Inflation Reduction Act of 2022 (IRA) was signed into law on August 16, 2022.[2] The IRA extends and modifies the credit under I.R.C. § 30D, now known as the "Clean Vehicle" credit, while adding additional credits for previously owned vehicles under I.R.C. § 25E and commercial vehicles under I.R.C. § 45W.[3] In December 2022, the Joint Committee on Taxation estimated that the credits would cost $5 billion over a five-year period (Fiscal Years (FY) 2022 through 2026). The changes from the IRA to the Plug-In Credit under I.R.C. § 30D are listed in Figure 1 and include modified requirements for both vehicles and manufacturers.

[1] Pub. L. No. 110-343, 122 Stat. 3765 (2008); Pub. L. No. 111-5, 123 Stat. 115 (2009).

[2] Pub. L. No. 117-169, 136 Stat. 1818 (2022).

[3] I.R.C. § 25E allow qualified taxpayers who acquire a previously owned clean vehicle before January 1, 2033, to claim a Federal tax credit during the tax year the vehicle is placed in service, equal to the lesser of $4,000 or 30 percent of the sales price. I.R.C. § 45W provides a new credit for qualified commercial clean vehicles acquired before January 1, 2033, not to exceed $7,500 for vehicles weighing less than 14,000 pounds and $40,000 for all other vehicles.

Figure 1: Changes Made by the IRA to the Plug-In Credit (I.R.C. § 30D)

	Pre-IRA 2022 Plug-in Electric Vehicle (EV) Credit	Post-IRA 2022 Clean Vehicles Credit (Plug-In EVs only)	Effective Date
Maximum Credit Amount	$7,500 base amount of $2,500 plus $417 for each kilowatt- hours (kWh) of capacity above 5 kWh (up to $5,000)	$7,500 $3,750 for vehicles meeting the critical minerals requirement; $3,750 for vehicles meeting the battery components requirement	1/1/2023; Battery and Mineral requirements eff. 4/18/23
Battery Capacity Requirement	Battery not less than 4 kWh of capacity with external charging	Battery with 7 kWh of capacity with external charging	1/1/2023
Critical Mineral Requirement	N/A	Percentage of the value of the critical minerals contained in the battery to be extracted, processed, or recylced in North America: 2023, 40% 2024, 50% 2025, 60% 2026, 70% 2027+, 80%	4/18/2023
Battery Component Requirement	N/A	Minimum percentage of the value of the battery components must be manufactured or assembled in North America: 2023, 50% 2024-2025, 60% 2026, 70% 2027, 80% 2028, 90% 2029+, 100%	4/18/2023
Qualified Manufacturer	N/A	Plug-in EV must be made by a qualified manufacturer	1/1/2023
Manufacturer Production Limitations	Phaseout after 200,000 plug-in EVs manufactured	N/A	
Vehicle Price Limits	N/A	Manufacturer Suggested Retail Price cannot exceed: $80,000 for vans, sports utility vehicles, and pickup trucks $55,000 for other vehicles	1/1/2023
Taxpayer Income Limits	N/A	No Credit if Modified Adjusted Gross Income (MAGI) is greater than the following thresholds based on tax filing status: $300,000 (married filing jointly); $225,000 (head of household); $150,000 (single); Income thresholds apply to the lesser of current year or prior year MAGI	1/1/2023
Seller Reporting Requirements	N/A	Sellers required to submit Seller Reports by January 15 (including VIN) of the year after the purchase date and to taxpayers not later than the date the vehicle was purchased*	1/1/2023
Manufacturer Reporting Requirements	N/A	Manufacturers must enter in to written agreement with the Secretary of the Treasury to become qualified manufacturers; qualified manufacturers are required to complete monthly reports (including VIN) including any vehicles the manufacturer asserts is eligible for the credit*	1/1/2023
Transferability of Credit	Only for tax-exempt entities	Taxpayers can elect to transfer credit to dealer	1/1/2024
Expiration Date of Credit	12/31/2022	12/31/2032	

**Reporting was broadly required for qualified manufacturers under the IRA, but the procedures and details were defined under Rev. Proc. 2022-42.*

Source: Treasury Inspector General for Tax Administration's (TIGTA) analysis of the American Recovery and Reinvestment Act of 2009 and the IRA.

The nature of these changes will have an impact on the data available to the Internal Revenue Service (IRS) and its future controls and compliance strategy. As noted in Figure 1, some significant changes to the Plug-In Credit from the IRA were: 1) the removal of the credit phase-out after a manufacturer has produced 200,000 electric vehicles and 2) the requirement that a percentage of critical minerals and battery components must be processed and assembled in North America for a manufacturer to be considered "qualified" for the credit.[4] Vehicles placed in service on or after April 18, 2023, will have to meet the following new requirements for critical minerals and battery components to be considered eligible for a tax credit of either $3,750 or $7,500:

- $3,750 if the vehicle only meets the critical mineral requirements.
- $3,750 if the vehicle only meets the battery component requirements.
- $7,500 if the vehicle meets both requirements.

The IRS's current processing and controls

In a 2019 audit, TIGTA found that the IRS did not have effective processes to identify and prevent erroneous claims for the Plug-In Credit.[5] TIGTA identified over 17,000 potentially erroneous Plug-In Credit claims, totaling over $82 million, and recommended that the IRS improve the detection and prevention of erroneous Plug-In Credit claims, including using Vehicle Identification Numbers (VIN) reported by taxpayers to identify improper credit claims. In response, the IRS developed a compliance program and implemented some controls and filters to identify and prevent erroneous Plug-In Credit claims.

Before IRA changes, the Plug-In Credit could be claimed by individuals and business taxpayers for a vehicle meeting the following criteria:

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

[4] A qualified manufacturer is a manufacturer that enters into a written agreement with the IRS to file periodic reports with VINs and other information for each vehicle they manufacture. To see if a vehicle is eligible for the new Clean Vehicle Credit for new vehicles, the IRS directs readers to https://fueleconomy.gov/feg/tax2023.shtml. For used clean vehicles, the IRS maintains a list of qualified vehicles at https://www.irs.gov/credits-deductions/manufacturers-and-models-of-qualified-used-clean-vehicles.

[5] TIGTA, Report No. 2019-30-072, *Millions of Dollars in Potentially Erroneous Qualified Plug-In Electric Drive Motor Vehicle Credits Continue to Be Claimed Using Ineligible Vehicles* (Sept. 2019).

Figure 2 shows the population of Plug-In Credit claims filed for Processing Years (PY) 2017 through 2021.

Figure 2: Summary of Plug-In Credit Claims on Individual Returns in PYs 2017 Through 2021

Processing Year	Returns Filed	Credit Amount Allowed	Average Credit Amount per Return
2017	57,066	$375,124,833	$6,574
2018	91,406	$536,989,427	$5,875
2019	228,909	$1,540,909,232	$6,732
2020	162,686	$642,894,918	$3,952
2021	61,793[6]	$313,118,227	$5,067
Totals	**601,860**	**$3,409,036,637**	**$5,664**

Source: Data provided by the IRS.

The compliance program implemented by the IRS after our 2019 report now systemically evaluates tax returns for potentially erroneous Plug-In Credit claims using filters included in the Discretionary Exam Business Rules (DEBR). DEBR are a subset of workload selection rules and filters built into the IRS's Dependent Database Programming process, with the goal of identifying tax returns with the highest potential for additional tax assessments based on certain return conditions. These filters are programmed annually and applied against all tax returns as they are filed. The IRS developed a set of DEBR post-processing filters specific to Plug-In Credit claims in Calendar Year 2020 in response to recommendations from TIGTA's 2019 audit. The IRS uses six different filters to identify tax returns for characteristics that indicate a Plug-In Credit claim may not qualify based on the [redacted]

In addition to DEBR filters, the IRS has been granted some discretion under Math Error Authority to identify common errors associated with tax returns claiming the Plug-In Credit. Math Error Authority is provided by Congress to allow the IRS to correct certain issues, including calculation and clerical errors, through an abbreviated process, generally during return processing.[7] Currently, the IRS reviews the following conditions to correct the Plug-In Credit using Math Error Authority during return pre-processing:

- Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit (Including Qualified Two-Wheeled Plug-in Electric Vehicles and New Clean Vehicles)*, is incomplete or missing from the return.
- Dates on Form 8936 do not meet criteria for the Plug-In Credit.
- The credit is calculated or transferred from Form 8936 incorrectly.

[6] Many manufacturers no longer qualified for the credit during PY 2020 due to phase-out limitations resulting in the decreased amount of credit claims in PY 2021.

[7] U.S.C. § 6213(b).

The IRA amended the IRS's use of Math Error Authority to include omissions of a correct VIN on returns.[8]

Results of Review

The IRS's Future Controls and Compliance Strategy for the Plug-In Credit Have Not Been Finalized

The IRS's future controls and compliance strategy for the Plug-In Credit are yet to be finalized. The IRS currently plans to issue a draft of its new compliance strategy by September 30, 2023. Once issued, TIGTA will review the Plug-In Credit compliance strategy in more detail as part of a future audit.[9] However, the IRS has issued guidance to manufacturers and sellers on their reporting responsibilities in Revenue Procedure 2022-42, which should provide a consistent basis for VIN matching.[10]

The IRS determined that currently, without further regulations, Math Error Authority procedures can be implemented to identify instances where the VIN supplied by the taxpayer is not on the list of VINs supplied by the manufacturer to the IRS, thus disqualifying these VINs for the Plug-In Credit. For Tax Year (TY) 2023 returns and later, IRA legislation enacted significant changes for clean vehicle credits (including electric plug-in vehicles), which will directly affect how a taxpayer claims the credit, including updated eligibility rules, vehicle qualifications, and new reporting requirements for sellers and manufacturers. The IRS's implementation of these changes includes processes and procedures built into a prefile portal that provides math error validation for eligible VINs at time of filing. Since Math Error Authority exists for VIN matching, the IRS believes this will be the most efficient way to address non-qualifying vehicles starting in TY 2023 (PY 2024).

If the IRS determines that it does not have the data capability to use Math Error Authority for VIN matching, downstream compliance filters will be necessary, such as:

- Additional programming of DEBR filters to identify ineligible vehicles through an anticipated Clean Vehicle Credit portal.
- If the Clean Vehicle Credit portal is not in place, IRS officials noted they would need to develop other selection methods to identify ineligible vehicles.

The IRS plans to educate taxpayers, tax practitioners, and the automobile industry about the requirements of IRA Clean Vehicle Credit provisions through outreach in the form of IRS.gov articles, frequently asked questions, fact sheets, videos, news releases, and the issuance of revenue procedures.

[8] Pub. L. No. 117-169, 136 Stat. 1818 (2022).

[9] TIGTA, Audit No. 202340825, *Inflation Reduction Act: Clean and Previously Owned Vehicle Credits.*

[10] Rev. Proc. 2022-42, I.R.B. 2022-52.

Although IRS Controls Have Identified a Significant Volume of Potentially Erroneous Credit Claims, Improvements to IRS Filters Are Still Needed

For TYs 2019 through 2021, the IRS identified 110,254 returns through its DEBR filtering that flagged specific criteria indicating that the reported vehicle is ineligible for the credit or amount reported. Figure 3 shows the summary count of returns identified (triggered) by each DEBR filter.

Figure 3: Summary of DEBR Filters Triggered for Plug-In Credit Issues for TYs 2019 Through 2021

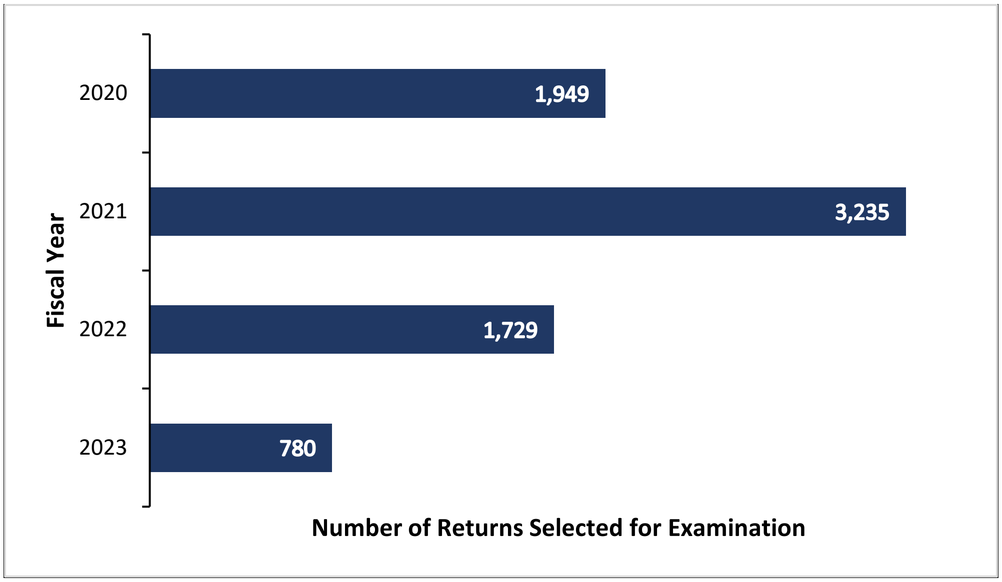
DEBR Filter Triggered	Filter Description	Number of Tax Returns	Percentage of All Filters Triggered
991A	[redacted]	841	0.8%
991B/991G	[redacted][11]	6,671	6.1%
991C	[redacted]	76,309	69.2%
991D	[redacted]	12,142	11.0%
991E	[redacted]	10,294	9.3%
991F	[redacted]	3,997	3.6%
Totals		**110,254**	**100.0%**

Source: Count of DEBR filters triggered for a Plug-In Credit issue for TYs 2019 through 2021 provided by the IRS.

Although the IRS's DEBR filters have identified over 110,000 returns with potentially erroneous Plug-In Credit claims, only a limited number of returns flagged by the filters were selected for review by the IRS. Figure 4 shows that the IRS selected only 7,693 returns for examination during FYs 2020 through 2023.

[11] Filter 991B [redacted] is combined with filter 991G and includes [redacted]

Figure 4: Summary of All Returns Selected for Examination for Plug-In Credit Issues During FYs 2020 Through 2023



Source: List of all returns opened for a Plug-In Credit issue for FYs 2020 through 2023 provided by the IRS.

Figure 5 shows that the productivity of closed examinations of returns identified by DEBR Plug-In Credit filters resulted in an overall no-change rate of approximately 51 percent for FYs 2019 through 2022.

Figure 5: Productivity of Examinations Closed in FYs 2019 Through 2022 for Returns Identified by the IRS's Plug-In Credit DEBR Filters

Filter Triggered	Filter Definition	Count of Records	Total Adjustments	No-Change Rate
991A	[redacted]	137	$1,587,102	5.84%
991B/991G	[redacted]	534	$2,796,105	17.04%
991C	[redacted]	1,585	$2,406,570	75.08%
991D	[redacted]	500	$2,155,444	29.00%
991E	[redacted]	95	$656,543	7.37%
991F	[redacted]	98	$156,351	67.35%
Totals – IRS DEBR Filter-Identified Cases		**2,949**	**$9,758,115**	**51.10%**

Source: TIGTA's analysis of the Audit Information Management System population of returns selected for a Plug-In Credit issue and closed during FYs 2019 through 2022.

The IRS's evaluation of DEBR filtering identified several factors leading to the high no-change rate of some filters, including taxpayer input errors and data issues with DEBR filter 991C [redacted] as discussed subsequently. Starting in FY 2023, the IRS focused its resources on the three DEBR filters with the lowest no-change rates and has no plans to work any additional cases from the following filters:

- [redacted]

[redacted]

TIGTA's review found that while the IRS has taken steps to address past recommendations, problems with the implementation of some filters have made existing issues worse. TIGTA analyzed the IRS's controls and processing for these DEBR filters and found inefficiencies that resulted in qualified vehicles being identified as non-qualifying vehicles by the filters and selected for examination, causing taxpayer burden, while also allowing credit claims for thousands of unqualified vehicles.

[redacted]

DEBR filter 991C [redacted] was created to identify Plug-In Credits claimed for [redacted] This DEBR filter [redacted] The filter flags all returns claiming a Plug-In Credit for a [redacted]

As shown previously in Figure 3, DEBR filter 991C identified the majority (69 percent) of all returns identified by DEBR filters for TYs 2019 through 2021. As shown previously in Figure 5, 75 percent of examinations for returns selected by this filter resulted in a no-change in FYs 2019 through 2022. Figure 6 shows that TIGTA's analysis of returns flagged by DEBR filter 991C found the majority (74 percent) of returns flagged by this filter were for returns reporting a vehicle qualified for the Plug-In Credit for TYs 2019 through 2021. The filter correctly flagged only 13,606 (18 percent) of returns with a valid VIN but claiming the Plug-In Credit for a non-qualified vehicle.[12] Most returns selected for examination from this population were legitimate claims for the Plug-In Credit, leading to a burden on compliant taxpayers who were flagged for examination.

Figure 6: TIGTA's Analysis of Returns Flagged by the IRS's DEBR Filter 991C for [redacted] for TYs 2019 Through 2021

Returns Identified by IRS DEBR Filter 991C		
TIGTA's Analysis	**Number of Returns**	**Percentage**
Valid VIN and Qualified Vehicle	56,315	74%
Valid VIN and Non-Qualified Vehicle	13,606	18%
Invalid VIN or Model Unknown	6,378	8%
Total Vehicles	**76,299**[13]	**100%**

Source: TIGTA's analysis of IRS-provided count of DEBR filters triggered with a Plug-In Credit issue for TYs 2019 through 2021.

We analyzed the returns selected for examination through this filter and identified 1,585 closed examinations for TYs 2019 through 2021. Figure 7 shows only 395 examinations resulted in an adjustment and the overall no-change rate was 75 percent. TIGTA's analysis of this population

[12] An invalid VIN could include fewer than 17 characters, all alpha, or all numeric characters.

[13] While the IRS identified 76,309 returns through DEBR filter 991C shown in Figure 3, TIGTA identified 10 as duplicate records.

showed that 1,390 examinations were for qualified vehicles, with 1,110 (80 percent) of these examinations resulting in a no-change. Only 88 (6 percent) examinations were for a valid VIN and a non-qualified vehicle, which resulted in a 14 percent no-change rate. The remaining 107 examinations were related to either an invalid VIN or an unknown vehicle model, which resulted in a 64 percent no-change rate.

Figure 7: TIGTA's Analysis of Closed Examinations Selected by the IRS's DEBR Filter 991C for [redacted] for TYs 2019 Through 2021

[redacted] Vehicle Filter Examination Results				
TIGTA's Analysis	**No-Change Rate**	**Number of Examinations Closed With Adjustment**	**Number of Examinations Closed as No-Change**	**Total Examinations**
Valid VIN and Qualified Vehicle	80%	280[14]	1,110	**1,390**
Valid VIN and Non-Qualified Vehicle	14%	76	12	**88**
Invalid VIN or Model Unknown	64%	39	68	**107**
Totals	**75%**	**395**	**1,190**	**1,585**

Source: TIGTA's analysis of IRS-provided count of DEBR filters triggered with a Plug-In Credit issue for TYs 2019 through 2021.

On February 1, 2023, TIGTA sent an alert to IRS management about DEBR filter 991C primarily identifying qualified vehicles for examination, resulting in a high no-change rate. We provided the IRS with our analysis of the VINs that were qualified yet triggering the filter, and the IRS stated that the limited effectiveness of this filter was due to the automated nature of identifying and opening audits, a lack of a manual review, and inaccuracies with VIN data lists used to identify non-qualified vehicles. On February 22, 2023, IRS management noted that after an internal review conducted in November 2021, they decided [redacted]

As shown previously in Figure 6, TIGTA identified 13,606 returns flagged by DEBR filter 991C that claimed the Plug-In Credit for a [redacted] As shown in Figure 7, the IRS selected only 88 (less than 1 percent) of these returns for examination. The remaining 13,518 unexamined returns contained a total of approximately $63 million in credits potentially paid for unqualified vehicles. In addition, the IRS selected 1,110 qualified vehicles that properly claimed the Plug-In Credit for examination, resulting in a no-change and causing unnecessary burden for 1,110 taxpayers.

Although the overall no-change rate for DEBR filter 991C was 75 percent, examinations of [redacted] resulted in a no-change rate of 14 percent. This suggests that [redacted] are a productive area for examination when filtered properly.

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[14] TIGTA took a judgmental sample of 20 cases that resulted in an adjustment. Even though the vehicle qualified for the Plug-In Credit, an adjustment was made due to other reasons, such as duplicate claims or no support for the claim provided by the taxpayer. A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

The Commissioner, Small Business/Self-Employed (SB/SE) Division, should:

Recommendation 1: Review the population of 13,518 Plug-In Credit claims for non-qualified vehicles identified by TIGTA for potential examination.

> **Management's Response:** IRS management agreed with this recommendation and will review the 13,518 Plug-In Credit claims for non-qualified vehicles for potential enforcement action.

Recommendation 2: Consider adding a manual review to DEBR filter 991C to identify and select returns with [redacted] for examination until the future controls are in place.

> **Management's Response:** IRS management disagreed with this recommendation. IRS management stated that due to the ineffectiveness of DEBR filter 991C, [redacted] As a result, a manual review is not possible.
>
> > **Office of Audit Comment:** If the IRS can implement its planned VIN-to-VIN matching to identify [redacted] TIGTA agrees this would be the best long-term solution. However, until those controls are in place, alternative approaches to identifying [redacted] such as a manual review of questionable claims, would be a better alternative [redacted]

The Filter for Identifying [redacted] Was Generally Not Productive, but Data Could Be Used to Improve the Quality of Future Audit Selection

DEBR filter 991F [redacted] reviews the population of Plug-In Credit claims and flags VINs reported on Form 8936 for specific characteristics that demonstrate the [redacted] During PYs 2020 through 2022 (TYs 2019 through 2021), the filter flagged 3,997 returns for a Plug-In Credit claimed for an [redacted] This filter identifies situations where the:

[redacted]

As shown previously in Figure 5, the IRS selected and examined 98 returns from this population from FYs 2019 through 2022, resulting in an overall no-change rate of approximately 67 percent. The IRS determined that the examinations of returns flagged by this filter resulted in high no-change rates largely due to taxpayer input errors. The IRS found that most taxpayers selected for examination by this filter had inadvertently entered the wrong VIN, based on the taxpayers later providing support during the examination for the purchase of a vehicle qualifying for the Plug-In Credit, resulting in the IRS examiner accepting the return as filed (*i.e.*, no-change).

Due to the low productivity of DEBR filter 991F, [redacted] While TIGTA believes that examinations of returns identified through this filter should be limited, TIGTA's analysis of returns examined and closed through DEBR filtering showed that the IRS could analyze the validity of VIN data to improve the quality of audit selection.

Figure 8 shows that TIGTA's analysis of the closed examinations identified by DEBR filters found that no-change rates for Plug-In Credit claims with a valid VIN were significantly lower overall in many DEBR filters than claims with an invalid VIN.[15]

Figure 8: Analysis of Closed Examinations Identified by DEBR Filtering During FYs 2019 Through 2022

DEBR Filters Triggered: 991A, 991B, 991D, 991E, 991F	Total Count	Valid VIN			Invalid VIN		
		Valid VIN Count	No-Change Count	No-Change Rate	Invalid VIN Count	No-Change Count	No-Change Rate
Totals	**1,364**	**1,101**	**170**	**15.4%**	**263**	**147**	**55.9%**

Source: TIGTA's analysis of the examination of returns selected for a Plug-In Credit issue and closed from FYs 2019 through 2022.

Additionally, TIGTA identified more than twice the number of Plug-In Credit claims with [redacted] for TYs 2019 through 2021 than were identified by the IRS's DEBR filter 991F. TIGTA identified a total of 8,945 [redacted] used to claim a Plug-In Credit, compared to 3,997 [redacted] identified by the IRS's DEBR filter 991F, by adding the following two additional criteria for identifying [redacted]

- [redacted].[16]
- [redacted].[17]

As noted previously, examinations of Plug-In Credit claims with valid VINs were considerably more productive compared to invalid VINs. With the addition of these criteria, the IRS would be able to identify more invalid VINs through DEBR filter 991F. Additionally, these invalid VINs would be helpful in identifying more productive cases by removing invalid VINs from the other DEBR filter populations, therefore providing a more productive examination selection pool.

[redacted] examinations identified by DEBR filter 991F due to the high no-change rate, [redacted] of invalid VINs is a compliance risk. If the IRS can use Math Error Authority in combination with VIN validation, the instances of invalid VINs would be minimized for TY 2023 returns and future years. Until future controls are put in place, expanding the invalid VIN criteria would help the IRS identify more productive cases.

Recommendation 3: The Commissioner, SB/SE Division, should expand [redacted] and use these data in examination selection until future controls are in place.

> **Management's Response:** IRS management agreed with this recommendation and will work with DEBR programmers to assess expanding [redacted] for TY 2023 DEBR.

[15] DEBR filter 991C was not included in TIGTA's analysis due to the issues discussed previously in which the majority of returns flagged (*i.e.*, [redacted]) were not the filter's intended purpose (*i.e.*, [redacted]).

[16] A VIN check digit is a single digit or the letter X found in position 9 of the VIN used to verify the accuracy of the transcription of the VIN (see 49 Code of Federal Regulations § 565).

[17] A valid VIN does not include the letters I, O, or Q to avoid confusion with numerals 1 and 0.

[redacted]

[redacted]. Under I.R.C. § 30D rules in place prior to the passage of the IRA, the Plug-In Credit for a particular manufacturer began 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 allowed 50 percent of the full credit ($3,750) for the following two quarters, then 25 percent of the full credit ($1,875) for two quarters, then no credit thereafter. TIGTA identified 7,547 returns with a qualifying vehicle that [redacted] resulting in a net difference of approximately $23 million not identified by the IRS during PYs 2019 through 2022. The claims not identified by the IRS's filters included:

- 7,057 returns with a [redacted] that was in the phase-out period in TY 2019, with a net difference of over $21.2 million.
- 490 returns with a [redacted] that was in the phase-out period in TY 2020, with a net difference of over $1.4 million.

[redacted] The new IRA provisions provide some consistency to the Plug-In Credit, such as:

- Simplified credit amounts of either $7,500 or $3,750.
- Reduced number of qualifying vehicle models.
- No credit phase-out periods for vehicle models.

Although IRA changes should reduce the complexity of the threshold levels and phase-out periods for vehicle models, the IRS should address this area of noncompliance until these changes are fully implemented. The IRS could use the additional resources provided by the IRA to expand its controls to ensure that the correct credit amount is allowed.

The Commissioner, SB/SE Division, should:

Recommendation 4: Expand controls to identify Plug-In Credit claims for [redacted]

> **Management's Response:** IRS management agreed with this recommendation. The IRS is evaluating and updating its business rules to incorporate the new legislative requirements of the IRA.

Recommendation 5: Review the 7,547 claims for potential examination that [redacted]

> **Management's Response:** IRS management agreed with this recommendation and reviewed the 7,547 claims (7,057 TY 2019 claims and 490 TY 2020 claims), determining

that they all had either expired or short statutes and enforcement action cannot be taken.

Office of Audit Comment: While IRS management stated that all 7,547 claims had expired or had short periods of time remaining on the assessment statute of limitations, TIGTA's analysis found that as of October 1, 2023, the assessment statute of limitations on 1,158 of these claims will not yet have expired.

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this audit were to determine whether the IRS is adequately reviewing the Qualified Plug-In Electric Drive Motor Vehicle Credits claimed by taxpayers, to follow up on past recommendations, and to identify the IRS's plans for addressing the changes made to the credit in the IRA. To accomplish our objectives, we:

- Determined the applicable policies, procedures, and controls that were in place and the status of any ongoing efforts related to identification, selection, and examination of returns claiming the Qualified Plug-In Electric Drive Motor Vehicle Credit.
- Determined whether potentially erroneous claims for the Qualified Plug-In Electric Drive Motor Vehicle Credit were being appropriately identified by IRS filters by reviewing the population of 598,739 taxpayers that received the credit during PYs 2019 through 2022 against key qualifying criteria such as the credit [redacted]. We obtained a list of all returns identified by the IRS's filters used to identify potentially erroneous credits and compared the IRS list to TIGTA's review.
- Analyzed the IRS's processing of filters for examination selection. We obtained and reviewed a list of 5,180 potential erroneous credits identified by the IRS's filters that were selected for examination and closed for FYs 2019 through 2022.
- Determined the future strategies and controls the IRS plans to have in place to address changes made to the credit due to the IRA related to identifying and examining returns claiming the Clean Vehicle Credit.
- Evaluated the risk for fraud, waste, and abuse to obtain reasonable assurance that improprieties did not exist by considering actions and/or trends within our review of returns claiming the Qualified Plug-In Electric Drive Motor Vehicle Credit.

Performance of This Review

This review was performed with information obtained from the SB/SE Division, located in Lanham, Maryland, and the Large Business and International Division, located in Washington, D.C., during the period October 2022 through July 2023. 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.

Major contributors to the report were Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Robert Jenness, Director; Michele Jahn, Audit Manager; Antony Shang, Lead Auditor; Michael Liu, Auditor; and Jennifer Ragsdale, Auditor.

Data Validation Methodology

We performed tests to assess the reliability of data from the Audit Information Management System and the Individual Return Transaction File. We evaluated the data by: (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

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 the Qualified Plug-in Electric Drive Motor Vehicle Credit, along with the changes related to the new tax legislation. We tested these controls by interviewing IRS management; performing analysis of individual tax return data from the Individual Return Transaction File; and reviewing and analyzing relevant documents, data, and calculations related to the preparation of these credits.

Appendix II

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; $63 million in Qualified Plug-In Electric Drive Motor Vehicle Credits erroneously paid for unqualified vehicles related to 13,518 tax returns (see Recommendation 1).

Methodology Used to Measure the Reported Benefit:

TIGTA's analysis of the 76,299 tax returns for TYs 2019 through 2021 flagged by DEBR filter 991C found that the majority (74 percent) of returns (56,315) flagged by this filter were for returns reporting a vehicle qualified for the Plug-In Credit. The filter correctly flagged only 13,606 (18 percent) returns with a [redacted] Of those 13,606 returns, the IRS selected 88 returns (less than 1 percent) for examination. The 88 returns selected for examination had a no-change rate of 14 percent. The remaining 13,518 (13,606 – 88 = 13,518) unexamined tax returns contained credits that totaled $72,429,584 erroneously paid for [redacted] We considered the 14 percent no-change rate on similar returns and estimate that $62,552,823 was potentially paid for unqualified vehicles.[1]

> **Management's Response:** IRS management disagreed with this outcome measure. The IRS states that previous audits have shown that [redacted] Accordingly, until audits occur, the actual revenue protection amount could be significantly different from the potential revenue protection amount listed in the outcome measure.
>
> > **Office of Audit Comment:** Our analysis of the 13,518 unexamined tax returns were returns claiming the Plug-In Credit with a [redacted] and had a valid VIN. Due to the VINs being valid, the likeliness of [redacted] However, as part of our calculation we did factor in the 14 percent no-change rate and estimate that $62,552,823 was potentially paid for unqualified vehicles.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 1,110 taxpayers unnecessarily examined due to a no-change for qualified vehicles that properly claimed the Plug-In Credit (see Recommendation 2).

[1] The estimate of $62,552,823 was calculated using the no-change rate (12/88 = .13636364) based on TIGTA's analysis of 991C detailed in row 2 of Figure 7 (72,429,584 x (1 - 12/88) = $62,552,823).

Methodology Used to Measure the Reported Benefit:

TIGTA analyzed the tax returns selected for examination through DEBR filter 991C and identified 1,585 closed examinations for TYs 2019 through 2021. TIGTA's analysis of this population showed that 1,390 examinations were for qualified vehicles, with 1,110 examinations (80 percent) resulting in a no-change. The IRS worked 1,110 examinations resulting in a no-change on qualified vehicles that properly claimed the Plug-In credit.

> **Management's Response:** IRS management agreed with this outcome measure and stated that in November 2021, the IRS identified this issue and ceased selecting cases from this filter.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; $23 million in Qualified Plug-In Electric Drive Motor Vehicle Credits paid for a [redacted] for the vehicle model relating to 7,547 tax returns (see Recommendations 4 and 5).

Methodology Used to Measure the Reported Benefit:

TIGTA identified 7,547 tax returns with a [redacted] resulting in a net difference of $22,670,939 in claims not identified by the IRS during PYs 2019 through 2022. The claims not identified by the IRS's filters included:

- 7,057 returns with a [redacted] that was in the phase-out period in TY 2019, with a net difference of $21,223,598.
- 490 returns with a [redacted] that was in the phase-out period in TY 2020, with a net difference of $1,447,341.

Overall, 7,547 tax returns (7,057 + 490) with a [redacted] resulting in a net difference of $22,670,939 ($21,223,598 + $1,447,341).

> **Management's Response:** IRS management disagreed with this outcome measure. The IRS reviewed the 7,547 claims (7,057 TY 2019 claims and 490 TY 2020 claims) and determined they all either had an expired or short statute and enforcement action cannot be taken. Therefore, no action will be taken on any of these cases, and no monetary benefits will be realized.
>
> > **Office of Audit Comment:** As of October 1, 2023, 1,158 claims have not yet expired resulting in $4,182,402 claimed more than the allowable credit and 50 of those claims will not have an expired statute for more than a year with $168,004 claimed more than the allowable credit. Although some of these claims now have expired or have short statutes, if the claims had been selected for examination timely, $22,670,939 would not have been incorrectly paid [redacted]

Appendix III

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 8, 2023

MEMORANDUM FOR HEATHER M. HILL
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Lia Colbert Amalia C. Colbert Digitally signed by Amalia C. Colbert Date: 2023.09.08 14:57:23 -04'00'
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Improvement Opportunities Exist in the Audit Selection Process for the Qualified Plug-In Electric Drive Motor Vehicle Credit (Audit #202330019)

Thank you for the opportunity to review and comment on the subject draft audit report. With enactment of the Inflation Reduction Act of 2022 (IRA), signed into law on August 16, 2022, Congress established expanded clean vehicle credit eligibility requirements to incentivize and accelerate the adoption of electric vehicles. The IRS is working to implement these new provisions for new, previously-owned, and qualified commercial clean vehicles, under IRA provisions 13401, 13402 and 13403, respectively. The IRS relies heavily on available data to identify and select cases in the most efficient manner, and these IRA provisions will allow the IRS to obtain vehicle data to identify noncompliance. For example, these IRA provisions all provide that no credit shall be allowed or determined unless the taxpayer includes the vehicle identification number (VIN) of their vehicle on their tax return. Congress also specifically modified section 6213 of the Internal Revenue Code to provide that an omission of a correct VIN under these provisions constitutes a "mathematical or clerical error." This revision should allow the IRS to address certain additional errors under its math error authority.

IRA provides the IRS with opportunities to review, evaluate and improve processes and procedures related to the administration of these credits, including those related to the validity of credits claimed on filed returns. Throughout the implementation of these provisions, the IRS continues to identify ways to expand the use of systemic checks to verify credit eligibility and the appropriateness of the amount claimed.

In the past, the IRS had limited vehicle information to use when determining credit eligibility. Much of this audit focused on the Discretionary Exam Business Rules (DEBR) and the selection process for examination of qualified plug-in electric drive motor vehicle credits under the law prior to the changes mandated by IRA (i.e., the audit focused on credits associated with new electric vehicles purchased in 2022 or before). However, 2

due to the changes mandated by IRA for new electric vehicles purchased in 2023 and after, the IRS is updating DEBR for clean vehicle credits by evaluating the validity of existing business rules and developing new rules to address legislation requirements. Generally, the existing DEBR will no longer be used for return selection, especially for tax year (TY) 2023 and later returns.

We appreciate TIGTA's work on this audit not only in [redacted] and [redacted] but providing additional data the IRS can use when developing business rules for TY 2023. The IRS remains committed to using the tools available to select the most productive work for examination, while reducing taxpayer burden.

Attached are our comments and proposed actions to your recommendations. If you have any questions, please contact me, or Richard L. Tierney, Director, Examination, Small Business/Self-Employed Division.

Attachment

Attachment

Recommendations

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

RECOMMENDATION 1:
Review the population of 13,518 Plug-In Credit claims for [redacted] identified by TIGTA for potential examination.

CORRECTIVE ACTION:
We agree. We will review the listing of 13,518 Plug-In Credit claims for [redacted] identified by TIGTA and determine if enforcement action can be taken.

IMPLEMENTATION DATE:
July 15, 2024

RESPONSIBLE OFFICIAL:
Director, Examination 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:
Consider adding a manual review to DEBR filter 991C to identify and select returns with [redacted] for examination until the future controls are in place.

CORRECTIVE ACTION:
We disagree. Due to the ineffectiveness of this filter, [redacted]. As a result, a manual review is not possible. However, we are reviewing the 13,518 claims identified in Recommendation 1 for potential enforcement action.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 3:
The Commissioner, SB/SE Division, should expand [redacted] and use these data in examination selection until future controls are in place.

CORRECTIVE ACTION:
We agree. Although the IRS will no longer use DEBR filter 991C, other DEBR filters will be used. We will work with DEBR programmers to assess expanding [redacted] for TY 2023 DEBR.

IMPLEMENTATION DATE:
October 15, 2024

RESPONSIBLE OFFICIAL:
Director, Examination 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.

The Commissioner, SB/SE Division should:

RECOMMENDATION 4:
Expand controls to identify Plug-In Credit claims for [redacted]

CORRECTIVE ACTION:
We agree. We are evaluating and updating our business rules to incorporate the new legislative requirements of the Inflation Reduction Act.

IMPLEMENTATION DATE:
April 15, 2024

RESPONSIBLE OFFICIAL:
Director, Examination 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 5:
Review the 7,547 claims for potential examination that were [redacted]

CORRECTIVE ACTION:
We agree. We reviewed the list of claims provided by TIGTA and determined they consist of 7,057 TY 2019 claims and 490 TY 2020. All of these claims have either expired or short statutes such that enforcement action cannot be taken.

IMPLEMENTATION DATE:
Implemented

RESPONSIBLE OFFICIAL:
Director, Examination Case Selection, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
N/A

OUTCOME MEASURE 1:
Revenue Protection – Potential; $63 million in Qualified Plug-In Electric Drive Motor Vehicle Credits erroneously paid for [redacted] related to 13,518 tax returns (see Recommendation 1).

IRS RESPONSE:
We disagree. Previous audits have shown that taxpayer [redacted] Accordingly, until audits occur, the actual revenue protection amount could be significantly different from the potential revenue protection amount listed in the outcome measure.

OUTCOME MEASURE 2:
Taxpayer Burden – Potential; 1,110 taxpayers unnecessarily examined due to a no-change for qualified vehicles that properly claimed the Plug-In Credit (see Recommendation 2).

IRS RESPONSE:
In November 2021, the IRS identified this issue and ceased selecting cases from this filter.

OUTCOME MEASURE 3:
Revenue Protection – Potential; $23 million in Qualified Plug-In Electric Drive Motor Vehicle Credits paid for a [redacted] for the vehicle model relating to 7,547 tax returns (see Recommendations 4 and 5).

IRS RESPONSE:
We disagree. As noted in our response to Recommendations 4 and 5 above, we will not be taking action on any of these cases. Accordingly, no monetary benefits will be realized.

Appendix IV

Glossary of Terms

Term	Definition
Audit Information Management System	A computer system used by IRS Examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports.
Dependent Database	A rules-based selection application designed to identify potentially ineligible tax returns claiming the Earned Income Tax Credit and other refundable credits.
Discretionary Exam Business Rules	A subset of workload selection rules and filters built into the Dependent Database Programming process, with the goal of identifying tax returns with the highest potential for additional tax assessments based on certain return conditions.
Fiscal Year	A tax year that ends on the last day of any month other than December.
Internal Revenue Code	Congress typically enacts Federal tax law in the Internal Revenue Code of 1986. The sections of the I.R.C. can be found in Title 26 of United States Code (26 U.S.C.).
Math Error Authority	Authority granted to the IRS to bypass normal audit and deficiency procedures in favor of an abbreviated process. This authority was initially designed to allow the IRS to assess a tax liability by quickly resolving simple mathematical or clerical mistakes.
Processing Year	The calendar year in which the tax return or document is filed and processed by the IRS.
Tax Year	The calendar year or fiscal year for which information is reported to the IRS on a return or document.

Appendix V

Abbreviations

DEBR	Discretionary Exam Business Rules
FY	Fiscal Year
IRA	Inflation Reduction Act of 2022
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
Plug-In Credit	Qualified Plug-In Electric Drive Motor Vehicle Credit
PY	Processing Year
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year
VIN	Vehicle Identification Number

To report fraud, waste, or abuse,
contact our hotline on the web at www.tigta.gov or via e-mail at oi.govreports@tigta.treas.gov.

To make suggestions to improve IRS policies, processes, or systems affecting taxpayers, contact us at www.tigta.gov/form/suggestions.

Information you provide is confidential, and you may remain anonymous.