



*The Complexity of the Law Makes  
Administering the Alternative Motor Vehicle  
Credit Difficult*

**May 6, 2008**

**Reference Number 2008-30-107**

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.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

May 6, 2008

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION  
COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Michael R. Phillips*

**FROM:** Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – The Complexity of the Law Makes Administering  
the Alternative Motor Vehicle Credit Difficult (Audit # 200730024)

This report presents the results of our review of the Alternative Motor Vehicle Credit. The overall objective of this review was to determine whether the Internal Revenue Service (IRS) had adequate controls in place to properly implement and ensure taxpayer compliance with the Alternative Motor Vehicle Credit provision of the Energy Policy Act of 2005.<sup>1</sup> The audit was conducted as part of the Treasury Inspector General for Tax Administration annual audit plan.

### *Impact on the Taxpayer*

The Energy Policy Act of 2005 provided an Alternative Motor Vehicle Credit (Credit) for taxpayers purchasing certain energy efficient vehicles. The Joint Committee on Taxation<sup>2</sup> estimated that this provision could save taxpayers who purchase qualified vehicles \$874 million in taxes over the next decade (with the majority of tax savings occurring in the first 3 years of the provision). This law is very complex and could be easily misunderstood by taxpayers. Specific requirements must be met to ensure that taxpayers claim the correct Credit amount. It is important for the IRS to help taxpayers meet their tax responsibilities by clearly informing them of the requirements that must be met to accurately claim the Credit.

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<sup>1</sup> Pub. L. No. 109-58, sec. 1341(a), § 30B, 119 Stat. 594, 1038-39.

<sup>2</sup> Advisory Committee charged with monitoring Federal tax policy and estimating the impact of proposed tax legislation.



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### Synopsis

The complexity of the law that provided for the Credit created administrative difficulties for the IRS. The Credit is not refundable, but it lowers the taxpayer's liability up to the amount of tax owed. The law contains a phase-out provision for the Credit, which reduces the effect of the Credit by calendar quarter after the number of vehicles sold reaches 60,000. Taxpayers may claim 100 percent of the Credit associated with the qualified vehicles until the second calendar quarter after the 60,000<sup>th</sup> vehicle from that manufacturer has been sold. The Credit then is reduced to 50 percent for qualifying vehicles purchased during the second and third calendar quarters following the sale of the 60,000<sup>th</sup> vehicle, reduced to 25 percent for qualifying vehicles purchased during the fourth and fifth calendar quarters, and finally eliminated for vehicles purchased after the fifth calendar quarter. To qualify for the Credit, taxpayers must meet certain requirements including: the qualifying vehicle must be placed in service after December 31, 2005; the original use of the vehicle must begin with the taxpayer claiming the Credit; the vehicle must be used predominantly in the United States; and the Credit may only be claimed by the original owner of a new, qualifying, hybrid vehicle and does not apply to a used hybrid vehicle (if a car is leased, only the lessor may claim the Credit, not the lessee).

The law contained no provision for manufacturers to provide taxpayers with documentation regarding the Credit to which they were entitled (based on sales figures) at the time of the purchase of their vehicle. The onus was placed on taxpayers to research what percentage of the available Credit was still available for the car they purchased on the date they purchased it. This created a significant challenge for the IRS to help taxpayers determine whether their car qualified for the Credit, what the qualifying amount was, and the percentage of the qualifying amount to which the taxpayer was entitled.

The law also contained no provision for manufacturers to provide the IRS with documentation regarding the Credit to which specific taxpayers were entitled. Despite these challenges, the IRS provided adequate information for most taxpayers to properly claim the credit.

We did find that instructions for the Alternative Motor Vehicle Credit (Form 8910) did not clearly inform taxpayers that if they were the lessee of a vehicle, they could not claim the Credit for that vehicle. Based on a sample taken from 3 States' Department of Motor Vehicles records of taxpayers leasing what would have otherwise been qualifying vehicles, we found that 22 percent of the taxpayers erroneously claimed the Credit. We immediately informed the IRS of our concerns and recommended they revise the Form 8910 instructions to clarify the requirements for qualifying for the Credit, specifically regarding leased vehicles. The IRS responded in a timely manner and changed the instructions to explain that only lessors are entitled to claim the Credit.

We also found that the IRS needs to establish additional controls to ensure that egregious claims for the Credit are identified. From a population of 420 electronically filed taxpayer claims for



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Credits of more than \$4,000<sup>3</sup> each, we found that 15 percent of the taxpayers either claimed non-qualifying vehicles, claimed qualifying vehicles at amounts higher than the amount allowed, or did not provide the required data to support their claim, and yet their claims were allowed by the IRS.

### Recommendations

We recommended that the Commissioners, Small Business/Self-Employed Division and Wage and Investment Division, work cooperatively to establish criteria to select questionable claims for review by appropriate examination functions for taxpayers claiming the Credit. Further, if a significant compliance issue in claims for the Credit is found, the Commissioner, Small Business/Self-Employed Division, should consider proposing legislation to require the seller of a qualified vehicle to provide the purchaser and the IRS with an information document, similar to a Form 1099, supporting a claim. If such legislation is passed, a method should be developed aimed at matching the information document against the Credit claimed. Finally, the Director, Submission Processing, Wage and Investment Division, should also establish procedures to correspond with taxpayers for missing Forms 8910 or for missing information on Forms 8910 when appropriate.

### Response

IRS management agreed with the recommendations in this report. Specifically, the IRS agreed to establish dollar criteria for selection of questionable claims for the Credit on all filed returns and will prepare an analysis of the return on investment of examining these returns to determine the cost effectiveness of the screening methodology. If necessary, the screening process will be reassessed based upon the analysis of examination results, and adjustments to the screening criteria, if any, will be reflected in updated procedural guidelines and in the Internal Revenue Manual. The IRS also agreed to review the results of the analysis mentioned above and, if appropriate, initiate actions to support a legislative proposal requiring a seller of a qualified vehicle to provide the purchaser and the IRS with an information document, similar to Form 1099, supporting a claim. IRS actions also include researching additional program costs, creating systemic measures to accommodate the processing and matching of an information document, projecting agency benefits and resource savings, and soliciting outside groups for input focused on reduction of taxpayer and third-party burden. Finally, the IRS agreed to establish procedures to correspond with taxpayers for missing Forms 8910 or for missing

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<sup>3</sup> We selected the \$4,000 amount because it was more than the highest amount allowed for hybrid vehicles. The vast majority of claims for the Credit were for hybrid vehicles. This figure is not an IRS tolerance.



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information on Forms 8910. Management's complete response to the draft report is included as Appendix V.

Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-8510.



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## *Abbreviations*

DMV	Department of Motor Vehicles
IRS	Internal Revenue Service



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## *Background*

The Energy Policy Act of 2005<sup>1</sup> contained several incentives intended to encourage taxpayers to make energy conscious purchases. One such incentive for taxpayers who purchase certain energy efficient vehicles was the Alternative Motor Vehicle Credit (Credit). Internal Revenue Code Section 30B provides for the new Credit and is effective for qualified vehicles<sup>2</sup> placed in service after December 31, 2005. The Joint Committee on Taxation<sup>3</sup> estimated that this provision could save taxpayers who purchase qualified vehicles \$874 million in taxes over the next decade.<sup>4</sup> Generally, taxpayers who have purchased qualifying hybrid vehicles should use the Alternative Motor Vehicle Credit (Form 8910) to calculate the proper amount of the Credit to be claimed. Because Tax Year 2006 was the inaugural year of the Credit and specific details of the provision are complex, we believed that many taxpayers may not fully understand and correctly calculate the Credit.

This review was performed by auditors at the Treasury Inspector General for Tax Administration's post of duty in the Internal Revenue Service (IRS) Ogden Campus<sup>5</sup> during the period December 2006 through December 2007 and included a review of Tax Year 2006 individual income tax returns filed by taxpayers nationwide and discussions with personnel from the IRS Wage and Investment Division's Customer Assistance, Relationships, and Education function and Customer Account Services function. 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.

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<sup>1</sup> Pub. L. No. 109-58, sec. 1341(a), § 30B, 119 Stat. 594, 1038-39.

<sup>2</sup> A qualified vehicle is defined for this purpose as any passenger automobile or light truck that is a new advanced lean-burn technology motor vehicle or a new, qualified, hybrid motor vehicle.

<sup>3</sup> Advisory Committee charged with monitoring Federal tax policy and estimating the impact of proposed tax legislation.

<sup>4</sup> The 10 year period referred to in the estimate dated July 27, 2005 is Fiscal Years 2006 to 2015.

<sup>5</sup> The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to the taxpayer accounts.





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*Results of Review*

***The Complexity of the Law Created Difficulties for the Internal Revenue Service and Taxpayers***

The new legislation allowed a tax Credit<sup>6</sup> for four separate categories of vehicles:

- Fuel cell vehicles, which are motor vehicles propelled by power derived from chemical energy converted directly into electricity.
- Advanced lean-burn technology vehicles, which are passenger automobiles with internal combustion engines designed to operate using more air than is necessary for complete burning of the fuel. The vehicles must also incorporate direct injection and must meet certain fuel economy standards and requirements of the Clean Air Act.
- Hybrid vehicles, which are defined as vehicles that draw propulsion energy from batteries and an internal combustion engine using a consumable fuel such as gasoline. The vehicles must also have received a certificate of conformity under the Clean Air Act. Credits can vary from \$250 to \$3,150.
- Alternative fuel vehicles, which are vehicles using compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid at least 85 percent of the volume of which consists of methanol.

In addition to purchasing a vehicle that qualifies for the Credit, the taxpayer must also meet other requirements to qualify for the Credit. For example:

- The taxpayer's qualified vehicle must be placed in service after December 31, 2005.
- The original use of the vehicle must begin with the taxpayer claiming the Credit.
- The Credit may only be claimed by the original owner of a new, qualifying, hybrid vehicle and does not apply to a used hybrid vehicle. If a qualifying vehicle is leased to a consumer, the leasing company may claim the Credit.
- The vehicle must be used predominantly within the United States.

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<sup>6</sup> A tax credit is subtracted directly from the total amount of Federal tax owed, thus reducing or even eliminating the taxpayer's tax obligation.



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The law also contains a phase-out provision for both hybrid and advanced lean burn technology vehicles. The phase-out period begins with the second calendar quarter following the quarter in which the number of qualified vehicles sold by a manufacturer after December 31, 2005, is at least 60,000. The Credit then is reduced to 50 percent for qualifying vehicles purchased during the second and third calendar quarters following the sale of the 60,000<sup>th</sup> vehicle, reduced to 25 percent for qualifying vehicles purchased during the fourth and fifth calendar quarters, and finally eliminated for vehicles purchased after the fifth calendar quarter. For example, Toyota Motor Sales, U.S.A., Inc., reached the sale of the 60,000<sup>th</sup> qualifying hybrid vehicle during the calendar quarter ending June 30, 2006. Therefore, the phase out for Toyota and Lexus vehicles began October 1, 2006 (the beginning of the second calendar quarter after the quarter in which the 60,000<sup>th</sup> vehicle was sold). See Figure 1.

**Figure 1: Credit Amount and Purchase Date Limitation for Various Models of Toyota and Lexus Vehicles**

Qualifying Vehicle	Full Credit if Purchased by 9/30/06	Half Credit if Purchased From 10/01/06 - 3/31/07	Quarter Credit if Purchased From 4/01/07 – 9/30/07	No Credit if Purchased After 10/01/07
2005, 2006 and 2007 Toyota Prius	\$3,150	\$1,575	\$787.50	\$0
2006 and 2007 Toyota Highlander 2WD and 4WD	\$2,600	\$1,300	\$650	\$0
2007 Toyota Camry Hybrid	\$2,600	\$1,300	\$650	\$0
2006 and 2007 Lexus RX 400h 2WD and 4WD	\$2,200	\$1,100	\$550	\$0
2007 Lexus GS450h	\$1,550	\$775	\$387.50	\$0

Source: IRS Fact Sheet – 2007-9.

The law contained no provision for manufacturers to provide taxpayers with documentation regarding the Credit to which they were entitled (based on sales figures) at the time of the purchase of their vehicle. The onus was placed on taxpayers to research what percentage of the Credit was still available for the car they purchased on the date they purchased it. This created a significant challenge for the IRS to help taxpayers determine whether their car qualified for the Credit, what the qualifying amount was, and the percentage of the qualifying amount to which the taxpayer was entitled.



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The law also contained no provision for manufacturers to provide the IRS with documentation regarding the Credit to which specific taxpayers were entitled. The taxpayer receives no documentation with which to substantiate their claim to the IRS. Further, the IRS has no data sharing process with State Departments of Motor Vehicles (DMV) to help determine when the applicable cars were purchased or placed in service.

During our review, the complexities in the law and the lack of required documentation made it very difficult for us to determine whether some taxpayers qualified for the Credits they claimed. For example, to verify a taxpayer's claim for the Credit, it was necessary for us to determine the date the vehicle was purchased and/or placed in service. This piece of information is critical in the verification of the Credit amount and is not always provided by the taxpayer on Form 8910. In certain instances (discussed later), the taxpayer is not even required to file Form 8910 to obtain the Credit. Instead, the taxpayer files the General Business Credit (Form 3800), which provides only the amount of the Credit, with no data related to the vehicle for which the Credit was claimed or when the vehicle was purchased or placed into service.

The purchase date or placed-in-service date indicates whether the taxpayer is entitled to 100 percent, 50 percent, 25 percent, or none of the Credit. Gathering independent substantiation for this information would require that the IRS negotiate with each of the 50 States, or thousands of different car dealerships, or request the information from taxpayers during an audit of their tax returns. We obtained DMV data from Florida, Texas, and Utah and reviewed a judgmental sample of 283<sup>7</sup> returns to verify the taxpayers' claim for the Credit. Of the 283 returns, we were unable to determine the correctness of the Credit in 60 of the cases (21 percent), even with DMV data. This was due to missing information on the tax return or inadequate data from the DMV.

In addition, we identified 19 cases (7 percent) where the taxpayer or his or her preparer made the following errors when calculating the Credit:

- Six did not claim the Credit as entitled.
- Seven did not appear to be the original owner of the qualified vehicle.
- Four claimed 100 percent of the Credit when they were only entitled to 50 percent of the Credit.
- Two did not claim all of the Credit available.

Although we used State DMV information to try and verify the correctness of the taxpayer claims, it is unlikely that the IRS would be able to use this data on a large scale basis. We requested DMV information from 5 States; however, we were only able to obtain the data (without cost) from 3 of the 5 States, and 1 of the States took more than 3 months to provide the information. In addition, the type of data provided from the three States varied widely. Two of

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<sup>7</sup> We excluded leased vehicles from this sample.



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the three States did not provide enough information to enable us to calculate the Credit independently of the taxpayer data. In our opinion, to effectively administer the Credit, the IRS would need to obtain the necessary information to verify that the claims are valid (e.g., purchase or placed-in-service date, type of vehicle, year, and make of vehicle). Presently, there are no easy ways to obtain this information. However, without this information, the IRS is forced to accept whatever information the taxpayer provides. This makes it impossible, without auditing the return, to determine whether taxpayers are properly claiming the Credit.

### ***The Internal Revenue Service Provided Information for Most Taxpayers to Properly Claim the Credit***

Through the use of the IRS Newswire,<sup>8</sup> news releases, and tax tips published on its web site, the IRS kept taxpayers and preparers apprised of the Credit, which was new for Tax Year 2006. Generally, the information provided through the news releases informed taxpayers and preparers of the following:

- Year, make, and model of vehicles qualifying for the Credit.
- The amount of the Credit available.
- The number of vehicles sold to determine whether the phase out of the Credit for qualifying vehicles had begun.

The IRS published a table that informed taxpayers and preparers of the year, make, model, Credit amount, and the initial news release that acknowledged the vehicle manufactures' certifications of qualified hybrid vehicles. The IRS continued to publish and update the table as additional vehicles were acknowledged. The narrative used in the law to describe the phase out for qualifying hybrid vehicles could be described as difficult to understand. For example, the following narrative describes the phase-out provisions of the Credit:

*The phase-out period for a manufacturer begins with the second calendar quarter after the calendar quarter in which the manufacturer records its 60,000<sup>th</sup> sale. For the second and third calendar quarters after the quarter in which the 60,000<sup>th</sup> vehicle is sold, taxpayers may claim 50 percent of the credit. For the fourth and fifth calendar quarters, taxpayers may claim 25 percent of the credit. For quarters after that fifth quarter, taxpayers may not claim the credit.*

The IRS reduced the difficulty in understanding the narrative by adding to the table--next to the affected year and model of vehicle--the purchase dates that affect the amount of Credit to be claimed and the reduced amount of Credit for the related purchase dates. In addition to the table, they also continue to publish sales information for other manufacturers (e.g., Ford Motor

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<sup>8</sup> News releases from the IRS that cover the entire range of tax administration, including tax law changes, filing season updates, statistics, and more.



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Company, General Motors, Honda, Nissan) that have yet to reach the sales limitation for the phase-out provision of the Credit, as well as new vehicles that meet the Credit qualifications.

In addition to the tables relative to the hybrid automobiles, the IRS also issued tables that show the Credit amount available for the qualified heavy hybrid vehicles and qualified alternative fuel motor vehicles. Through the IRS' efforts, most taxpayers were given the necessary information to properly claim the Credit.

### ***Some Taxpayers Erroneously Claimed the Alternative Motor Vehicle Credit for Leased Vehicles***

The Energy Policy Act of 2005 specifies that a taxpayer obtaining a qualifying vehicle by leasing the vehicle from a dealer or leasing company is precluded from claiming the Credit. The IRS states in published document FS-2007-9 that:

*A consumer that leases a hybrid vehicle is not eligible for the credit. The credit is allowed to the vehicle owner, including the lessor of a vehicle subject to a lease. That means that the lessor (the person who leases the vehicle to the consumer) is the person who can claim a credit for the vehicle.*

From the DMV data we obtained, we identified 94 vehicles that were leased to taxpayers who had filed their 2006 tax returns. We reviewed their tax returns to determine whether the taxpayers had claimed the Credit and found that 21 taxpayers (22 percent) erroneously claimed the Credit. These erroneous claims totaled \$37,731 and resulted in reductions in tax liabilities totaling \$28,631. Not all of the amounts claimed had an effect on tax liability because some taxpayers did not have enough tax liability to use the Credit or, in some cases, the Alternative Minimum Tax reduced the amount of the Credit claimed. Regardless of whether the Credit actually reduced a taxpayer's tax liability, the fact remains that these taxpayers did not understand the law. Of the 21 erroneous claims, 14 were prepared by the taxpayers themselves and 7 were prepared by a paid preparer.

In reviewing the Form 8910 and the related instructions, we found that the form and related instructions did not clearly inform taxpayers that if they were the lessee they were not entitled to the Credit. The instructions contained the following requirements to qualify for the Credit:

- You placed the vehicle in service after 2005.
- The original use of the vehicle began with you.
- You acquired the vehicle for your use or to lease to others and not for resale.
- You use the vehicle primarily in the United States.

The misleading direction begins with the second bullet above. If the taxpayer is the lessee, then the original use may very well have begun with the taxpayer. The third bullet adds to the



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confusion. If the taxpayer acquired the vehicle through a lease, then it was acquired for the taxpayer's use.

Immediately upon discovering this issue, we informed the IRS of our concerns and recommended they revise the instructions for Form 8910 to clarify the requirements for qualifying for the Credit specifically with respect to leased vehicles. The IRS responded in a timely manner and changed the instructions to explain that "if the vehicle is leased, only the lessor and not the lessee, is entitled to claim the credit."

***Additional Controls Are Needed to Ensure That Egregious Claims Are Identified***

We reviewed claims for Alternative Motor Vehicle Credits of more than \$4,000<sup>9</sup> each claimed by 420 taxpayers who filed their returns electronically. We found 15 percent of these taxpayers (61 of the 420) either claimed non-qualifying vehicles, claimed qualifying vehicles at amounts higher than the amount allowed, or did not provide the required data to support their claim. Nevertheless, their claims were allowed by the IRS.

***Claims for non-qualifying vehicles and vehicles with credits exceeding the allowable amount***

We found 27 of the 420 taxpayers claimed vehicles that did not qualify for the Credit. Among the vehicles claimed were two recreational vehicles. These 27 taxpayers claimed Credits totaling more than \$411,000, which resulted in erroneous reductions to their tax liabilities of more than \$90,000 (an average of more than \$3,300 per taxpayer).

We also found that 21 of the 420 taxpayers claimed Credits exceeding the maximum allowable Credit for the qualified vehicle claimed. Among these were claims for Credits of more than \$300,000 for a single vehicle. These 21 taxpayers made claims for approximately \$1.8 million more than they should have, resulting in erroneous reductions to their tax liabilities of more than \$33,000 (an average of more than \$1,500 per taxpayer).

The erroneous claims for these Credits were allowed, at least in part, because the IRS did not establish sufficient controls up-front during the processing of tax returns to ensure that claims were only allowed for qualified vehicles, and that the amounts claimed were correct. Without at least some reasonableness checks in place to identify potentially egregiously overstated amounts, taxpayers could erroneously or purposefully claim amounts to which they are not entitled.

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<sup>9</sup> We selected the \$4,000 amount because it was more than the highest amount allowed for hybrid vehicles. The vast majority of claims for the Credit were for hybrid vehicles. This figure is not an IRS tolerance.



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### **Claims without required supporting data**

To claim the Credit, taxpayers are required to fill out and attach Form 8910 to their tax return (even if they are claiming the Credit on Form 3800) unless the Credit is from a Partnership, S Corporation, estate, or trust. In the latter cases, the claim for the Credit is filed on Form 3800, which requires only the amount of the Credit being claimed, with no data related to the vehicle for which the Credit was claimed or the date the vehicle was placed into service, and a Form 8910 is not required. Taxpayers participating in a Partnership, S Corporation, estate, or trust would also file a Supplemental Income and Loss (Schedule E) with their individual income tax return.

Of the 420 claims for the Credit of more than \$4,000 included in our review, we found that 100 claims did not have the required supporting data. These claims were filed on Form 3800 with no corresponding Form 8910 or were claimed on Form 8910 but without entries on the appropriate lines to establish the qualifying vehicle being claimed and the placed-in-service date of the vehicle. Because the only time that such claims would be appropriate is if the taxpayer participated in a Partnership, S Corporation, estate, or trust, we reviewed these 100 claims to determine if the taxpayer had attached a Schedule E to their return. We found that 13 of these taxpayers (13 out of 100) did not attach a Schedule E and, thus, had most likely not participated in one of these business entities. Therefore, their claims for the Credit were filed inappropriately. These 13 taxpayers made claims for \$489,163 without providing the documentation required.

We were informed that the IRS previously was corresponding with taxpayers any time a Credit was claimed without the Form 8910 being attached to their tax return. Because of concerns by the Taxpayer Advocate that taxpayers who were not required to file Form 8910 were being burdened, the IRS discontinued the practice of corresponding with taxpayers when Forms 8910 were missing.

### **Recommendations**

**Recommendation 1:** The Commissioners, Small Business/Self-Employed Division and Wage and Investment Division, should work cooperatively to establish criteria to select questionable claims for the Alternative Motor Vehicle Credit on both paper and electronically filed returns for review by appropriate examination functions to verify the amount of the credit claimed. This recommendation only applies to taxpayers who claimed the credit using Form 8910 and will not identify any erroneous claims made by taxpayers claiming the credit on Form 3800 without a Form 8910 to support the claim.

**Management's Response:** The Commissioner, Wage and Investment Division, agreed with this recommendation and will work cooperatively with the Small Business/Self-Employed Division Commissioner to establish dollar criteria for selection of questionable claims for the Alternative Motor Vehicle Credit on all filed returns. An



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analysis will be prepared of the return on investment of examining these returns to determine the cost effectiveness of the screening methodology. If necessary, the screening process will be reassessed based upon the analysis of examination results, and adjustments to the screening criteria, if any, will be reflected in updated procedural guidelines and in the Internal Revenue Manual.

**Recommendation 2:** The Commissioner, Small Business/Self-Employed Division, if finding a significant compliance issue in claims for the Alternative Motor Vehicle Credit, should consider: a) proposing legislation to require the seller of a qualified vehicle to provide the purchaser and the IRS with an information document, similar to a Form 1099, supporting a claim, and b) if such legislation is passed, a method should be developed aimed at matching the information document against the Credit claimed.

**Management's Response:** IRS management agreed with this recommendation. The Commissioner, Small Business/Self-Employed Division, will review the results of the analysis from Recommendation 1 and, if appropriate, will initiate actions to support a legislative proposal requiring the seller of a qualified vehicle to provide the purchaser and the IRS with an information document, similar to Form 1099, supporting a claim. IRS actions also include researching additional program costs, creating systemic measures to accommodate the processing and matching of an information document, projecting agency benefits and resource savings, and soliciting outside groups for input focused on reduction of taxpayer and third-party burden.

**Recommendation 3:** The Director, Submission Processing, Wage and Investment Division, should establish procedures to correspond with taxpayers for missing Forms 8910 or for missing information on Forms 8910 when a Schedule E is not attached to the taxpayer return indicating participation in a Partnership, S Corporation, estate, or trust.

**Management's Response:** IRS management agreed with this recommendation. The Director, Submission Processing, Wage and Investment Division, will establish procedures to correspond with taxpayers for missing Forms 8910, or for missing information, when a Schedule E is not attached to the return indicating participation in a Partnership, S Corporation, estate, or trust.





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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to determine whether the IRS had adequate controls in place to properly implement and ensure taxpayer compliance with the Alternative Motor Vehicle Credit (Credit) provision of the Energy Policy Act of 2005.<sup>1</sup> To accomplish our objective, we:

- I. Determined whether forms and instructions had been updated to include the Credit.
  - A. Determined whether the IRS had a coordinated implementation plan for the Credit.
  - B. Reviewed Alternative Motor Vehicle Credit (Form 8910) and related instructions for clarity regarding the requirements to qualify for the Credit.
- II. Determined whether the IRS effectively advertised and communicated to taxpayers and preparers the availability of the Credit.
  - A. Reviewed IRS published articles from the Newswire<sup>2</sup> and Newsroom<sup>3</sup> with information regarding the Credit.
  - B. Contacted IRS management for information regarding outreach efforts made after the Energy Policy Act of 2005 was signed.
- III. Determined whether the IRS properly modified computer programs to account for the Credit.
  - A. Reviewed U.S. Individual Income Tax Return (Form 1040) to determine whether a separate line was used to account for the Credit or whether it was included on the miscellaneous credit line.
  - B. Requested documentation for programming efforts for the Credit.
  - C. Reviewed taxpayer accounts from the sample described in Step V.B. to determine whether the Credit correctly posted to taxpayers' accounts.

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<sup>1</sup> Pub. L. No. 109-58, sec. 1341(a), § 30B, 119 Stat. 594, 1038-39.

<sup>2</sup> News releases from the IRS that cover the entire range of tax administration, including tax law changes, filing season updates, statistics, and more.

<sup>3</sup> A location on the IRS web site that contains articles on a variety of tax topics.



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- IV. Determined whether controls were implemented to identify and prevent fraudulent claims of the Credit.
  - A. Requested information from IRS personnel outlining controls employed to identify and prevent erroneous claims of the Credit.
  - B. Evaluated the effectiveness of current controls over erroneous claims of the Credit.
- V. Determined whether taxpayers claiming the Credit were claiming only qualified vehicles and were claiming appropriate amounts.
  - A. Obtained vehicle registration information from the DMVs for the States of Florida, Texas, and Utah.<sup>4</sup>
  - B. Identified a judgmental sample<sup>5</sup> of 283 returns from the DMV data obtained in Step V.A. for which a tax return had been filed with a claim for the Credit. For this test, we excluded leased vehicles.
  - C. Determined whether the vehicle for which the Credit was claimed was qualified for the Credit under the Energy Policy Act based on the IRS' list of qualified vehicles.
  - D. Determined the amount of the Credit available for the type of vehicle for which the Credit claim was made and whether the amount claimed was correct.
- VI. Determined whether taxpayers were inappropriately claiming leased vehicles as qualifying for the Credit.
  - A. Identified leased vehicles from the DMV records obtained from Florida, Texas, and Utah.
  - B. Reviewed a judgmental sample<sup>6</sup> of 94 taxpayer accounts for which the State DMV data indicated that the taxpayer had leased a qualified vehicle and who had filed a 2006 tax return.

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<sup>4</sup> We were unable to perform tests to determine the reliability of the data received from the DMVs. However, we believe that the inability to perform these tests did not affect the audit results or conclusions.

<sup>5</sup> A judgmental sample was used for this review because we could not obtain vehicle registration information for each State, and because we started the review early in the filing season when many taxpayers qualifying for the Credit had not yet filed their 2006 tax return. In addition, the total population of taxpayers claiming the Credit could not be determined.

<sup>6</sup> A judgmental sample was used for this review because the review was conducted early in the filing season when many taxpayers had not yet filed their 2006 tax return. Additionally, to obtain returns for review, it was necessary to research many taxpayer accounts to find the small number of taxpayers who had filed a return and had a leased vehicle registered in their name on one of the three State DMV databases we obtained.



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- VII. Determined whether egregious claims for the Credit could be identified by reviewing claims for more than \$4,000.
- A. Obtained an extract from the Tax Return Database<sup>7</sup> for all electronically filed individual returns claiming the Credit for more than \$4,000.
  - B. Established the reliability of the data obtained by tracing 30 taxpayer accounts to the data posted in IRS' Integrated Data Retrieval System<sup>8</sup> file to confirm the accuracy of the data.
  - C. Reviewed all 420 accounts from the extract received in Step VII. A. to determine the type and number of erroneous claims contained in the population of electronically filed claims for more than \$4,000.

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<sup>7</sup> The authoritative data store for electronically filed tax returns for Tax Years 1998 and beyond.

<sup>8</sup> IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account record.



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**Appendix II**

*Major Contributors to This Report*

Margaret E. Begg, Acting Assistant Inspector General for Audit, Small Business and Corporate Programs

Kyle R. Andersen, Director

Larry Madsen, Audit Manager

W. George Burleigh, Lead Auditor

Kyle D. Bambrough, Senior Auditor

Douglas C. Barneck, Senior Auditor

Martha Stewart, Information Technology Specialist



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Treasury Assistant Secretary for Tax Policy  
Deputy Commissioner for Services and Enforcement SE  
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS  
Director, Communications, Liaison, and Disclosure Small Business/Self-Employed Division  
SE:S:CLD  
Director, Compliance, Wage and Investment Division SE:W:CP  
Director, Exam Planning and Delivery, Small Business/Self-Employed Division SE:S:E:EPD  
Director, Exam Policy, Small Business/Self-Employed Division SE:S:E:EP  
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 Liaisons:  
    Commissioner, Small Business/Self-Employed Division SE:S  
    Commissioner, Wage and Investment Division SE:W



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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 – Actual; \$28,631 in underpaid taxes due to erroneous claims from 21 taxpayer accounts (see page 6).

#### **Methodology Used to Measure the Reported Benefit:**

We obtained DMV information from three States for qualified hybrid vehicles. We identified 94 vehicles that were leased to taxpayers and for which taxpayers had filed their 2006 tax returns. We reviewed the tax returns of each of the taxpayers leasing the 94 vehicles to determine whether the taxpayers had claimed the Alternative Motor Vehicle Credit (Credit).

We determined that 21 taxpayers (22 percent) of the 94 cases reviewed erroneously claimed the Credit, thereby reducing their tax liabilities by a total of \$28,631.

#### **Type and Value of Outcome Measure:**

Revenue Protection – Actual; \$123,197 in underpaid taxes from erroneous claims from 48 taxpayer accounts (see page 7).

#### **Methodology Used to Measure the Reported Benefit:**

The Treasury Inspector General for Tax Administration Technology unit provided a database containing all 420 electronically filed individual returns that claimed the Credit for more than \$4,000 from the Tax Return Database.<sup>1</sup> We reviewed 100 percent of the electronically filed returns claiming the Credit for more than \$4,000 to determine whether the IRS could identify and correct erroneous claims by reviewing the cases claiming the Credit of more than \$4,000.

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<sup>1</sup> The Tax Return Database is the authoritative data store for electronically filed tax returns for Tax Years 1998 and beyond.



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We determined that 27 of the claims for more than \$4,000 claimed vehicles that did not qualify for the Credit. These 27 taxpayers claimed Credits totaling \$411,189, which resulted in erroneous reductions to their tax liabilities totaling \$90,041.


We also determined that 21 of the 420 taxpayers claimed the Credit for amounts that exceeded the maximum allowable Credit for the qualified vehicle claimed. These 21 taxpayers made claims for \$1,878,675 more than they should have, resulting in erroneous reductions to their tax liabilities totaling \$33,156.



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**Appendix V**

*Management's Response to the Draft Report*

  
COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

APR 04 2008

**RECEIVED**  
APR 4 2008

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. *Richard Byrd*  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Complexity of the Law Makes  
Administering the Alternative Motor Vehicle Credit Difficult  
(Audit # 200730024)

I reviewed the subject draft report and appreciate your suggestions to make the administration of this credit easier and more accurate for the IRS as well as for taxpayers and their preparers. We recognize the difficulty of reporting the Alternative Motor Vehicle Credit and have taken steps to clarify who qualifies for the credit. We are also planning to correspond with taxpayers and request a Form 8910, *Alternative Motor Vehicle Credit*, when it is not attached to their return and one is required to support their claim.

I am pleased with your finding that we do a good job providing information for most taxpayers so they can properly claim the credit. Currently, we publish important information in news releases and tax tips on IRS.gov, to keep taxpayers and their preparers apprised of the rules for the Alternative Motor Vehicle Credit and the types of vehicles eligible for this credit. We educate our frontline employees, who serve taxpayers, by including information in their yearly Continuing Professional Education Document 10288A, *Highlights of Significant Tax Law Issues*. In addition to these efforts, we revised the 2007 instructions for the Form 8910 to clarify the requirements for who qualifies for the credit.

During the course of the audit you found that taxpayers leasing qualified vehicles were incorrectly taking the credit. If the vehicle is leased, only the lessor and not the lessee is entitled to the credit. When we received this information we took immediate action and changed the 2007 Form 8910 instructions to explain that "if the vehicle is leased, only the lessor and not the lessee, is entitled to claim the credit." In addition, two August 2007 news releases, IR-2007-150 and IR-2007-151, regarding Honda and GM hybrids specifically state that "original purchasers" of these vehicles may claim the credit.





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The Wage and Investment (W&I) and Small Business/Self-Employed (SB/SE) Divisions are cooperating to establish dollar criteria for selection of questionable claims for review. If these efforts identify significant compliance issues, SB/SE will consider proposing legislation to require the seller of a qualified vehicle to provide the purchaser and the IRS an information document similar to a Form 1099 supporting the claim.

Attached are our specific comments to your recommendations. We agree with the outcome measures as stated in the report. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Peter J. Stipek, Director, Customer Account Services, at (404) 338-8910.

Attachment



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Attachment

**RECOMMENDATION 1**

The Commissioners, Small Business/Self-Employed Division, and Wage and Investment Division should work cooperatively to establish criteria to select questionable claims for the Alternative Motor Vehicle Credit on both paper and electronically filed returns for review by appropriate examination functions, to verify the amount of the credit claimed. This recommendation only applies to taxpayers that claimed the credit using Form 8910 and will not identify any erroneous claims made by taxpayers claiming the credit on Form 3800 without a Form 8910 to support the claim.

**CORRECTIVE ACTION**

We agree with this recommendation. The SB/SE Division and W&I Division Commissioners will work cooperatively to establish dollar criteria for selection of questionable claims for the Alternative Motor Vehicle Credit on all filed returns. The selection criteria will identify cases for review, and will be classified and screened by the appropriate examination function. Cases selected for examination of the Alternative Motor Vehicle Credit will be assigned a project code for tracking purposes. Listed below are the specific actions and the responsible parties for this corrective action.

1. The SB/SE Director, Examination Policy will be responsible for reviewing business results of the cases examined for this credit.
2. The SB/SE Director(s), Examination Policy and Examination Planning & Delivery will jointly prepare an analysis of the return on investment of examining these returns to determine the cost effectiveness of the screening methodology.
3. The SB/SE Director(s), Examination Policy and Examination Planning & Delivery and W&I, Director, Submission Processing will reassess the screening criteria, if necessary, based upon the analysis of examination results. Adjustments to the screening criteria, if any, will be reflected in updated Submission Processing procedural guidelines and Internal Revenue Manuals.

**IMPLEMENTATION DATE**

October 15, 2009, corrective actions 1 and 2  
January 15, 2011, corrective action 3

**RESPONSIBLE OFFICIAL(S)**

Directors, SB/SE, Examination Policy and Examination Planning & Delivery; W&I, Director, Submission Processing

**CORRECTIVE ACTION MONITORING PLAN**

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



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**RECOMMENDATION 2**

The Commissioner SB/SE Division, if finding a significant compliance issue in claims for the Alternative Motor Vehicle Credit, should consider: a) proposing legislation to require the seller of a qualified vehicle to provide the purchaser and the IRS with an information document, similar to a Form 1099, supporting a claim, and b) if such legislation is passed, a method should be developed aimed to matching the information document against the credit claimed.

**CORRECTIVE ACTION**

We agree with this recommendation. The Commissioner, SB/SE will review the results of the analysis from Recommendation 1, and if appropriate, initiate actions to support a legislative proposal requiring the seller of a qualified vehicle to provide the purchaser and the IRS with an information document, similar to Form 1099, supporting a claim. Actions include, but are not limited to, researching additional program costs, creating systemic measures to accommodate the processing and matching of such an information document, projecting agency benefits and resource savings, and soliciting outside groups for input especially focused on reduction of taxpayer and third party burden.

If justified, a legislative proposal will be submitted and a generalized plan and methodology will be formulated for matching the information document against the credit claimed.

**IMPLEMENTATION DATE**

October 15, 2010

**RESPONSIBLE OFFICIAL(S)**

Director, SB/SE, Examination Policy

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 3**

The Director, Submission Processing, Wage & Investment Division, should establish procedures to correspond with taxpayers for missing Forms 8910 or for missing information on Forms 8910 when a Schedule E is not attached to the taxpayer return indicating participation in a partnership, S corporation, estate or trust.

**CORRECTIVE ACTION**

We agree with this recommendation. Submission Processing will establish procedures to correspond with taxpayers for missing Forms 8910, or for missing information, when



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a Schedule E is not attached to the return indicating participation in a partnership, S corporation, estate or trust.

**IMPLEMENTATION DATE**

January 15, 2009

**RESPONSIBLE OFFICIAL**

Director, Submission Processing, W&I Division

**CORRECTIVE ACTION MONITORING PLAN**

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

TOTAL P.06