



*Increasing Federal and State Cooperation  
and Promoting Electronic Filing Would  
Improve Administration of Taxes Used to  
Maintain the Nation's Highways*

**March 24, 2008**

**Reference Number: 2008-40-089**

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

March 24, 2008

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

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Increasing Federal and State Cooperation and Promoting Electronic Filing Would Improve Administration of Taxes Used to Maintain the Nation’s Highways (Audit #200740016)

This report presents the results of our review to assess the efficiency and effectiveness of the Internal Revenue Service (IRS) processing of the Heavy Highway Vehicle Use Tax Return (Form 2290).<sup>1</sup> This audit was conducted as part of the Treasury Inspector General for Tax Administration Office of Audit Fiscal Year 2007 Annual Audit Plan.

*Impact on the Taxpayer*

The Heavy Vehicle Use Tax is a prepaid tax the IRS collects. Combined with other Federal excise taxes, it is used to provide more than \$1 billion annually in Federal highway transit funds to the States. Expanding the Alternate Proof of Payment Program could reduce taxpayer burden by allowing taxpayers one-stop service when paying the Heavy Vehicle Use Tax and registering their vehicles. The Alternate Proof of Payment Program is based on an agreement between the IRS and State Departments of Motor Vehicles that allows taxpayers to simultaneously file, pay the Heavy Vehicle Use Tax, and register their vehicles. In addition, expanding electronic filing (*e-filing*) of Form 2290 would reduce costs for both taxpayers and the IRS.

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<sup>1</sup> The Heavy Highway Vehicle Use Tax (also referred to as the Heavy Vehicle Use Tax) is a Federal highway use tax paid annually on vehicles with a taxable gross weight of 55,000 or more pounds, designed to carry a load over public highways, and expected to be used more than 5,000 miles (more than 7,500 miles for agricultural uses). See Appendix V.



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*Synopsis*

The IRS is charged with administering the Heavy Vehicle Use Tax, which requires it to provide proof of payment to taxpayers so they can register and operate their vehicles. The Heavy Vehicle Use Tax is reported to the IRS on Form 2290. After a taxpayer files Form 2290 and pays the tax, the IRS stamps the Schedule of Heavy Highway Vehicles (Schedule 1)<sup>2</sup> of Form 2290 to show payment was received and returns it to the taxpayer for use as proof of payment for vehicle registration.

The IRS offers the following assistance options for taxpayers who need to file Form 2290: online at IRS.gov (the IRS public web site), at local offices called Taxpayer Assistance Centers,<sup>3</sup> and via toll-free telephone assistance. The IRS also provides a dedicated call site to handle excise tax inquiries. However, improved cooperation between Federal and State Government agencies is critical to administer the Heavy Vehicle Use Tax needed to maintain the nation's infrastructure.

***The Heavy Vehicle Use Tax places much burden on the trucking community. Processing improvements should reduce the burden associated with filing, paying, and registering vehicles subject to the Tax.***

During Calendar Year 1997, the IRS created the Alternate Proof of Payment Program. Although guidelines for the Program authorize a State Department of Motor Vehicles to accept Forms 2290 with related payments to register vehicles, the IRS has not regularly pursued expansion of this Program. The IRS also needs to track participation and monitor State compliance with the Memorandum of Understanding guidelines.

***The Alternate Proof of Payment Program has existed for 10 years. However, only 11 States participate.***

To improve the administration of the Program and promote taxpayer service, more States should be encouraged to participate. Taxpayers in States not participating in the Alternate Proof of Payment

Program must submit their tax returns and payments to the IRS to receive the stamped Schedules 1. The taxpayers then have to visit a Department of Motor Vehicle office with the stamped Schedules 1 to register their vehicles. Better cooperation between the IRS and the States should reduce this burden. In addition, the Alternate Proof of Payment Program can reduce the risk of noncompliance (falsification of Schedule 1) as the tax return and associated payment are provided at the time of registration.

<sup>2</sup> See Appendix V.

<sup>3</sup> These are IRS offices with employees who answer questions, provide assistance, and resolve account-related issues for taxpayers face to face.



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The IRS has developed a process that enables filers to electronically file (*e-file*) their Forms 2290. As of December 9, 2007, the IRS had received 1,569 *e-filed* Forms 2290. Although *e-filing* benefits both taxpayers and the IRS, costs and unfamiliarity with the *e-filing* option may be limiting participation. Currently, the population of Form 2290 filers is about 600,000. Discussions with IRS management indicated that most tax preparation software companies find the population of filers too low to warrant their offering the option to *e-file* Form 2290. The cost to taxpayers to *e-file* Forms 2290 ranges from approximately \$40 for one vehicle to \$160 for multiple vehicles. Recently, a new company began offering *e-filing* for \$12.50 for an unlimited number of vehicles.

### *Recommendations*

The Commissioner, Small Business/Self-Employed Division, should encourage more State participation in the Alternate Proof of Payment Program, develop a process to identify States participating, and ensure that agreement provisions are followed and promote the benefits of *e-filing* to all Form 2290 filers to increase *e-filing* participation.

### *Response*

IRS management agreed with all our recommendations. They stated that State participants in the Alternative Proof of Payment Program can be identified on the Servicewide Employment Tax Research System database by Governmental Liaison and Disclosure office analysts using "Highway Use Tax Form 2290" as the search criterion. The Governmental Liaison and Disclosure office will solicit additional State office participants and continue to assist State offices in completing standardized Memoranda of Understanding to authorize their participation in the Alternate Proof of Payment Program. IRS management will also verify compliance with Memorandum of Understanding requirements.

The Chief, Excise Tax Operations, will issue news releases regarding the benefits of *e-filing* to all Form 2290 filers; advise all State Departments of Motor Vehicles about how taxpayers may participate in *e-filing*, the benefits of *e-filing*, and how to locate a provider for *e-filing*; and provide information and outreach about the benefits of Form 2290 *e-filing* to the various trucking industry associations. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.



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## *Abbreviations*

*e-file; e-filing*

Electronically file; electronic filing

IRS

Internal Revenue Service



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## *Background*

The Heavy Highway Vehicle Use Tax (also referred to as the Heavy Vehicle Use Tax) is a Federal highway use tax paid annually on vehicles with a taxable gross weight of 55,000 or more pounds, designed to carry a load over public highways, and expected to be used more than 5,000 miles (more than 7,500 miles for agricultural uses). The Heavy Vehicle Use Tax is a prepaid tax collected by the Internal Revenue Service (IRS). The maximum annual tax amount is \$550 per vehicle.<sup>1</sup> Combined with other Federal excise taxes, it is used to provide funds to the States for highway construction, maintenance, and repairs. Proceeds from the Heavy Vehicle Use Tax provide more than \$1 billion annually in Federal highway transit funds to the States.



Two Federal Government agencies are involved in the processing and verification of payment of the Heavy Vehicle Use Tax payments.

- The IRS is responsible for processing the tax returns and associated payments, assisting taxpayers with filing and payment requirements (by telephone and in person), and ensuring taxpayer compliance by conducting Heavy Vehicle Use Tax correspondence and field audits.
- The Federal Highway Administration is responsible for ensuring that State Department of Motor Vehicle offices obtain proof of payment of the Heavy Vehicle Use Tax prior to registering a vehicle. It conducts periodic reviews of each State's compliance and has authority to withhold highway funds in cases of noncompliance.

The law<sup>2</sup> imposes an annual tax on the use of highway vehicles with a taxable gross weight of 55,000 or more pounds. For this purpose, the tax year is from July 1 to the following June 30. For vehicles used in July, the tax is due on August 31. For vehicles first used in later months of the tax year, the tax is prorated. Thus, for example, for a vehicle that is not used in July but is

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<sup>1</sup> Certain vehicles are exempt from the Heavy Vehicle Use Tax, including vehicles used and operated by government entities and qualified blood collector organizations. The Heavy Vehicle Use Tax ranges from \$100 per truck (\$75 for a logging truck) weighing at least 55,000 pounds to \$550 per truck (\$412.50 for a logging truck) weighing 75,000 or more pounds.

<sup>2</sup> Internal Revenue Code Section 4481 (2006).



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used in August, the tax is 11/12 of the full rate and the return is due September 30. The Heavy Vehicle Use Tax is reported using the Heavy Highway Vehicle Use Tax Return (Form 2290).<sup>3</sup>

The law<sup>4</sup> also requires a taxpayer<sup>5</sup> to prove he or she has paid the Heavy Vehicle Use Tax to register a taxable vehicle with a State Department of Motor Vehicles or to enter the United States in a taxable vehicle registered in Canada or Mexico. Treasury Regulations<sup>6</sup> require a State to obtain a stamped Form 2290 Schedule of Heavy Highway Vehicles (Schedule 1)<sup>7</sup> from the taxpayer as proof of payment. The IRS stamps the Schedule 1 to show payment was received and returns it to the taxpayer to use as proof of payment to register the vehicle.

For example:

Company XYZ owns 10 trucks, each with a taxable gross weight in excess of 75,000 pounds. The Company expects these trucks to travel more than 5,000 miles on public highways during the upcoming year. The Company uses the trucks during July 2007. The Company mails a Form 2290 by August 31, 2007, to the IRS, as required. The Form 2290 lists the Vehicle Identification Numbers for 10 trucks and includes a payment of \$5,500 (\$550 per truck). The IRS processes the Form 2290 and payment and mails a stamped copy of Schedule 1 to the Company. Company XYZ takes the Schedule 1 to its State Department of Motor Vehicles office and provides it as proof of payment of the Heavy Vehicle Use Tax, which enables the Company to register the 10 vehicles.

On March 1, 2008, Company XYZ purchases a new truck and uses it. This truck has a gross weight in excess of 75,000 pounds and will travel more than 5,000 miles on public highways before June 30. As required, before April 30, 2008, the Company mails a second Form 2290 to the IRS. The Form 2290 lists the Vehicle Identification Number for the new truck and includes a payment of \$183 (4/12 of the annual amount of tax). The IRS processes the Form 2290 and mails a stamped copy of Schedule 1 to the Company. Company XYZ takes the Schedule 1 to its State Department of Motor Vehicles office and provides it as proof of payment of the Heavy Vehicle Use Tax, which enables the Company to register its new vehicle.

Figure 1 provides Form 2290 filing statistics for the 2005 and 2006 Filing Seasons.<sup>8</sup>

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<sup>3</sup> See Appendix V.

<sup>4</sup> Internal Revenue Code Sections 41.4481-1 (April 2005) and 41.6001-2 (March 2000).

<sup>5</sup> The tax is paid by the person in whose name the vehicle is registered in a State for highway use. If a vehicle is registered both in the name of the owner and another person, then the vehicle is considered to be registered solely in the name of the owner.

<sup>6</sup> Treasury Regulations Section 41.6001-2 (March 2000).

<sup>7</sup> See Appendix V.

<sup>8</sup> The filing season is when most taxpayers file their tax returns. For the 2007 Form 2290, the filing season was deemed to be from July 1, 2006, to June 30, 2007, although most returns are filed during July and August.





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**Figure 1: Form 2290 Volumes and Filers**

Filing Season	Forms 2290 Filed	Unique Taxpayers	Total Tax (thousands)
2005	721,500	553,976	\$1,041,000
2006	785,156	589,339	\$1,082,000

Source: Treasury Inspector General for Tax Administration analysis of IRS Master File<sup>9</sup> Form 2290 data.

Taxpayers have a number of options available for filing Forms 2290 and paying taxes due, including:

- Mailing the Forms and associated payments directly to the IRS Cincinnati Tax Processing Center located in Covington, Kentucky.
- Submitting the Forms and associated payments at any of the 401 IRS Taxpayer Assistance Centers<sup>10</sup> located nationwide. The Taxpayer Assistance Centers mail the Forms 2290 and associated payments to the Cincinnati Tax Processing Center. If full payment is made with the tax return, the Taxpayer Assistance Center will provide the taxpayer with a stamped copy of the Schedule 1.
- Submitting the Forms and associated payments at any Department of Motor Vehicles office located in the 11 States participating in the Alternate Proof of Payment Program. This Program allows States to register a vehicle for a taxpayer who presents a Form 2290 with full payment at the time of registration. The Department of Motor Vehicles office then mails the Forms and payments to the Cincinnati Tax Processing Center.
- Mailing the Forms and full payments to a lockbox<sup>11</sup> bank located in Charlotte, North Carolina. The lockbox site mails the Forms with a record of payments to the Cincinnati Tax Processing Center.
- Transmitting the Forms and associated payments electronically. In October 2004, Congress required taxpayers reporting 25 or more vehicles to electronically file (*e-file*) Forms 2290.<sup>12</sup> Although this requirement was effective during 2004, *e-filing* was not available to taxpayers until July 2007.

<sup>9</sup> The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

<sup>10</sup> These are IRS offices with employees who answer questions, provide assistance, and resolve account-related issues for taxpayers face to face.

<sup>11</sup> A lockbox is a collection and processing service, provided by a network of financial institutions, that accelerates the flow of funds to the United States Treasury. Only a Form 2290 with full payment can be mailed to the lockbox.

<sup>12</sup> American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat 1418.



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The Excise Tax Program office (in the Specialty Programs function within the Small Business/Self-Employed Division) is responsible for taxpayer service and compliance activities related to excise taxes, which include the Heavy Vehicle Use Tax. The Governmental Liaison and Disclosure office (in the Communications, Liaison, and Disclosure function within the Small Business/Self-Employed Division) is responsible for developing and maintaining relationships with State and local governments.

This review was performed at the Centralized Excise Operations function in Covington, Kentucky; the Specialty Programs function and the Communications, Liaison, and Disclosure function in the Small Business/Self-Employed Division, in Washington, D.C.; the IRS Lockbox Operations function in Charlotte, North Carolina; and a Taxpayer Assistance Center in the Wage and Investment Division in Atlanta, Georgia, during the period June through December 2007. 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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## *Results of Review*

### ***Increased Federal and State Cooperation Would Improve Administration of the Heavy Highway Vehicle Use Tax***

The IRS is charged with administering the Heavy Vehicle Use Tax, which requires it to provide proof of payment to taxpayers so they can register and operate their vehicles. This tax places considerable burden on those that must pay it.

Taxpayers residing in States that do not participate in the Alternate Proof of Payment Program must send their Forms 2290 and payments to the IRS, wait to receive stamped Schedules 1, then go to a Department of Motor Vehicles office to register their vehicles. A Taxpayer Assistance Center will provide a taxpayer with a stamped Schedule 1 immediately after the taxpayer provides Form 2290 and full payment, but the taxpayer must still go a Department of Motor Vehicles office.

***Most taxpayers with these types of vehicles must submit Forms 2290 to the IRS and obtain proof of payment before they can register their vehicles.***

Better cooperation between the IRS and the States could reduce this burden. Improving the system could also reduce fraud and expedite the receipt of funds.

### ***The IRS recognizes the unique challenges and complexity related to the Heavy Vehicle Use Tax and offers a number of assistance options for taxpayers***

Taxpayers are provided assistance online at IRS.gov (the IRS public web site), at Taxpayer Assistance Centers, and via toll-free telephone assistance. The IRS also provides a dedicated call site to handle excise tax inquiries. In Fiscal Year 2007, IRS employees answered 90,946 Form 2290 tax telephone calls.

In Fiscal Year 2006, Taxpayer Assistance Center employees assisted 128,531 taxpayers in preparing a Form 2290 and assisted another 232,806 taxpayers with questions about the Heavy Vehicle Use Tax. The IRS also offers taxpayers the option to *e-file* their Forms 2290. To further assist taxpayers, the IRS can expedite the processing of Schedule 1. Taxpayers who are in jeopardy of not registering their vehicles on time can request that the IRS fax the stamped Schedules 1 to them.



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The IRS also conducts correspondence audits<sup>13</sup> to identify taxpayers who are not compliant with Form 2290 filing and payment requirements. Prior to Fiscal Year 2008, the process to identify these taxpayers had been based on extensive data analyses, which included analyzing Form 2290 tax records and at times requesting files from State Departments of Motor Vehicles to match to IRS files. For Fiscal Year 2008, the IRS plans to move away from the data analysis and use a process called “classification,” which involves an IRS employee’s review of tax returns to identify potentially auditable issues. The IRS plans to conduct 2,300 excise tax audits in Fiscal Year 2008. Approximately 1,200 of these audits will include Forms 2290.

Figure 2 provides the volumes of excise tax correspondence audits, along with specific volumes and percentages of Form 2290 audits. The numbers of Form 2290 audits have been decreasing as the IRS has been shifting into other excise tax work (e.g., fuel tax credit).

**Figure 2: Form 2290 Correspondence Audits for Fiscal Years 2005 – 2007**

Fiscal Year	Total Excise Tax Correspondence Audits	Form 2290 <sup>14</sup> Audits	Percentage of Form 2290 Audits
2005	4,264	4,264	100%
2006	3,045	3,025	99%
2007	3,025	1,427	47%

Source: Centralized Excise Operations Planning and Analysis function staff.

**The IRS should solicit State participation in the Alternate Proof of Payment Program**

The Alternate Proof of Payment Program provides Form 2290 filers with one-stop service by providing the ability to file Form 2290 and pay the Heavy Vehicle Use Tax simultaneously when registering a vehicle, which reduces taxpayer burden. During Calendar Year 1997, the IRS created the Alternate Proof of Payment Program. Although guidelines authorize a State’s Department of Motor Vehicles to accept Form 2290 and related payments from taxpayers to register their vehicles, the IRS has not regularly pursued expansion of this Program.

The Alternate Proof of Payment Program has existed for 10 years, but currently only 11 States participate. IRS management advised us that States were solicited when the Program was first

<sup>13</sup> Correspondence audits are important compliance activities focusing on errors and examination issues that typically can be corrected by mail. They are conducted by sending the taxpayer a letter requesting verification of certain items on the tax return. These audits are much more limited in scope than office and field examinations in which examiners meet face to face with taxpayers to verify information.

<sup>14</sup> Form 2290 audits have been reduced from Fiscal Year 2005 to 2007 because the IRS is now working other types of excise tax case work, including audits of taxpayers claiming the Fuel Tax Credit.



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initiated. Liaisons responsible for the Program stated that management has not recently instructed them to promote the Program. Figure 3 provides a list of the 11 States that currently participate in the Program.

**Figure 3: States Participating in the Alternate Proof of Payment Program**

State	Year(s) Agreements Signed	State	Year(s) Agreements Signed
Idaho	1997	Nebraska	2002, 2006 <sup>15</sup>
Indiana	1998	Arkansas	2004
Connecticut	1999	Delaware	2005
North Carolina	1999	Texas	2005
Vermont	2000	South Carolina	2006
Washington	2001		

*Source: Governmental Liaison and Disclosure office.*

Representatives from four participating States advised us they believe the Program requires minimal resources. One State representative noted that the Program expedites the registration process and makes it easier for taxpayers in that State to register their vehicles.

To improve administration of the Program, the IRS should encourage other States to participate, develop a process to track participation, and monitor State compliance with guidelines. When asked for a list of States participating in the Program, the Governmental Liaison and Disclosure office could not identify all States with signed agreements but eventually determined that 11 States are currently participating in the Program.

The Memoranda of Understanding signed between the IRS and participating States detail specific requirements the States must follow. For example, guidelines require the States to transmit Forms 2290 and payments daily. However, limited testing showed that States were not mailing the Forms and payments on time—late mailings ranged from 7 calendar days to 218 calendar days after the Departments of Motor Vehicles had received the Forms 2290. Currently, there is no IRS function responsible for monitoring and/or ensuring compliance with the Memoranda of Understanding.

Management has raised concerns that limited resources affect their ability to solicit participation and/or monitor State compliance. However, liaisons are already in place to coordinate with the States to solicit participation, and the *Standards for Internal Control in the Federal Government*

<sup>15</sup> Two counties and the State Department of Motor Vehicle joined at different times during 2002 and 2006.



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requires internal controls to be designed to assure that ongoing monitoring occurs in the course of normal operations. It is to be performed continually and ingrained in the agency's operations.

During the 2006 Filing Season, 571,936 filers resided in States that do not participate in the Alternate Proof of Payment Program. These taxpayers will be required to wait until they have stamped Schedules 1 before registering their vehicles.

**The IRS does not have data to measure Form 2290 filing and/or payment compliance**

The current process for filing Form 2290 creates the risk that taxpayers can circumvent paying the Heavy Vehicle Use Tax by submitting fraudulent Forms 2290 as proof of payment. The IRS currently has data identifying filers who manipulated Forms 2290. However, to determine the significance of this activity would require the IRS to obtain State Departments of Motor Vehicle data files of vehicles registered by taxpayers and subject to the Heavy Vehicle Use Tax. The IRS noted that efforts have not been undertaken to regularly obtain data files from the States and compare them to its files. Files are obtained on an as-needed basis. During the previous 4 calendar years (2004 to 2007), the IRS has obtained files from at least 8 States.

IRS officials indicated that extensive resources would be needed to establish a process to regularly obtain State files. In addition, there are both legal and technical issues affecting its ability to obtain State files of registered vehicles, including a lack of legal authority to compel the States to provide registration information to the IRS. Each State has its own system of capturing registration information, and there is little consistency in file formats. For example, some States do not capture the taxpayers' Employee Identification Numbers. Without the Employee Identification Number, matching State and IRS files would require extensive resources.

Technical issues include inconsistent data file structures, and some States want to charge the IRS for the files and/or information. Although the IRS notes several barriers that affect its ability to efficiently obtain State files, no documentation was available to support these positions. Federal Highway Administration guidelines<sup>16</sup> require periodic review of States' procedures for complying with documentation requirements, including inspecting documentation and records. The States are to retain a copy of the receipted Schedule 1 or an acceptable substitute, such as an automated record or microfilm, for a period of 1 year for purposes of evaluating State compliance. Representatives from the Federal Highway Administration indicated that the State reviews are performed on a 3-year cycle.

During a Federal Highway Administration review of one State's Department of Motor Vehicle offices, the Federal Highway Administration identified taxpayers who registered their vehicles using fraudulently stamped Schedules 1. To date, the Federal Highway Administration, in

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<sup>16</sup> 23 C.F.R. 669.21 - Procedure for evaluating State compliance.



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coordination with the IRS Criminal Investigation Division, has identified about 2,700 taxpayers who photocopied legitimately stamped Form 2290 Schedules 1 and changed the Vehicle Identification Numbers and taxpayer information to register different vehicles to circumvent paying the Tax. State data files could be used to identify taxpayers who registered vehicles but have not filed a Form 2290 and/or paid the Heavy Vehicle Use Tax.

The IRS has limited funding available to address Form 2290 compliance issues. The amount of revenue collected via the Heavy Vehicle Use Tax is considerably less than that from other taxes it collects—both per tax return and for the Program as a whole. Management has indicated that extensive resources would be needed to establish a process to obtain State data files and perform matches to IRS files to identify compliance problems. Although they were unable to provide any specific data, they do not believe it would be cost effective to pursue compliance issues in this manner.

The IRS stated it will continue to assess the cost/benefit of compliance initiatives when deciding where to focus its limited resources. In doing so, the IRS should consider that providing the ability to file Form 2290 and pay the Heavy Vehicle Use Tax simultaneously when registering a vehicle reduces both taxpayer burden and the risk of noncompliance (falsification of Schedule 1), as the tax return and associated payment are provided at the time of registration.

### ***Recommendation***

***Recommendation 1:*** The Commissioner, Small Business/Self-Employed Division, should encourage more State participation in the Alternate Proof of Payment Program, develop a process to identify States participating in the Program, and ensure that agreement provisions are followed.

***Management's Response:*** IRS management agreed with this recommendation. They stated that State participants in the Alternative Proof of Payment Program can be identified on the Servicewide Employment Tax Research System database by Governmental Liaison and Disclosure office analysts using "Highway Use Tax Form 2290" as the search criterion. The Governmental Liaison and Disclosure office will solicit additional State office participants and continue to assist State offices in completing standardized Memoranda of Understanding to authorize their participation in the Alternate Proof of Payment Program. IRS management will also verify compliance with Memorandum of Understanding requirements.

### ***Promoting the Benefits of Electronic Filing Could Increase Participation***

The IRS has developed a process that enables Form 2290 filers to *e-file* their tax returns. As of December 9, 2007, the IRS had received 1,569 *e-filed* tax returns. Although *e-filing* benefits



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both taxpayers and the IRS, costs and unfamiliarity with this option may be limiting participation.

Currently, the population of Form 2290 filers is about 600,000. Discussions with IRS management indicated that most tax preparation software companies find the population of filers too low to warrant their offering the option to *e-file* Form 2290. The cost to taxpayers to *e-file* Form 2290 ranges from approximately \$40 for one vehicle to \$160 for multiple vehicles. Recently, a new company began offering *e-filing* for \$12.50 for an unlimited number of vehicles.

Current law requires *e-filing* for companies with 25 or more vehicles. However, nearly one-half of all filers have only one vehicle. Figure 4 shows that only 5 percent of Forms 2290 report 25 or more vehicles.

**Figure 4: Stratification of Vehicles Listed on Form 2290 (Fiscal Year 2006)**

Vehicles	Tax Returns	Percentage
1	300,260	48%
2-5	238,787	38%
6-10	34,365	5%
11-24	28,361	4%
25+	29,208	5%
Total	630,981	100%

Source: Treasury Inspector General for Tax Administration analysis of IRS Master File Form 2290 data.

Because the option to *e-file* is new, filers may be unaware of the option and its benefits. Increased promotion of the benefits of *e-filing*, particularly to the majority of one-vehicle filers, could increase participation, which provides the following benefits to both taxpayers and the IRS:

- Annual savings of approximately \$1.5 million to process paper Forms 2290.<sup>17</sup>
- A validation process for *e-filed* tax returns that can identify filing mistakes prior to IRS receipt of the Forms 2290, allowing taxpayers to address the errors before processing.
- Immediate receipt of a watermarked<sup>18</sup> Schedule 1 showing proof of payment upon acceptance of the *e-filed* tax return.

<sup>17</sup> Calculation is based on the cost to process a paper-filed Form 2290 (\$1.90) multiplied by the 785,156 Forms processed in Fiscal Year 2006 (total \$1,491,796).

<sup>18</sup> Paper that has a transparent design or mark that can be seen when the paper is held up to the light.





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- The ability of State Departments of Motor Vehicles to electronically search IRS databases to confirm compliance with filing and payment requirements prior to registering vehicles. For over a decade, the IRS has been meeting with interested organizations such as the American Association of Motor Vehicle Administrators to discuss automating the filing and subsequent verification of the Heavy Vehicle Use Tax payment.

### ***Recommendation***

***Recommendation 2:*** The Commissioner, Small Business/Self-Employed Division, should promote the benefits of *e-filing* to all Form 2290 filers to increase *e-filing* participation.

***Management's Response:*** IRS management agreed with this recommendation. The Chief, Excise Tax Operations, will issue news releases regarding the benefits of *e-filing* to all Form 2290 filers; advise all State Departments of Motor Vehicles about how taxpayers may participate in *e-filing*, the benefits of *e-filing*, and how to locate a provider for *e-filing*; and provide information and outreach about the benefits of Form 2290 *e-filing* to the various trucking industry associations such as the American Trucking Association, Americas Independent Truckers Association, and the American Association of Motor Vehicle Administrators.



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## **Appendix I**

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

The overall objective of this review was to assess the efficiency and effectiveness of the IRS processing of the Heavy Highway Vehicle Use Tax Return (Form 2290). To accomplish this objective, we:

- I. Identified and documented functional areas and associated processes and procedures involved in the prefiling, filing, and postfiling activities related to Form 2290.
  - A. Researched information available to assist taxpayers in meeting their filing and payment responsibilities.
  - B. Performed a walkthrough of the various functional areas at the Cincinnati Tax Processing Center in Covington, Kentucky, responsible for filing and postfiling activities related to Form 2290.
  - C. Observed Form 2290 processing at an IRS Taxpayer Assistance Center in Atlanta, Georgia, and interviewed personnel involved. We chose this Center because it was near the lead auditor's location.
  - D. Interviewed analysts responsible for lockbox operations.<sup>1</sup>
  - E. Interviewed analysts responsible for the IRS partnership with State Departments of Motor Vehicles.
- II. Identified problems with the processing of Form 2290.
  - A. Held discussions with management and analysts in those functional areas responsible for filing and compliance.
  - B. Evaluated operational reviews to identify problems and associated corrective actions relating to the processing of Form 2290.
  - C. Analyzed Tax Years 2005 and 2006 Form 2290 return information to identify potential problems associated with filed Forms 2290.
  - D. Reviewed the design of Form 2290 and related instructions to identify areas that may result in taxpayer errors in completing the Form.

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<sup>1</sup> A lockbox is a collection and processing service, provided by a network of financial institutions, that accelerates the flow of funds to the United States Treasury. Only a Form 2290 with full payment can be mailed to the lockbox.



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- E. Determined the causes and actions that can be taken to reduce any problems identified. We attempted to quantify the potential impact on both taxpayers and the IRS.
- III. Assessed IRS efforts to ensure taxpayer compliance with Form 2290 filing and payment requirements.
- A. Held discussions with responsible compliance management and analysts.
  - B. Interviewed representatives from the Department of Transportation Federal Highway Administration and the Inspector General Office about compliance initiatives to ensure that the States are confirming that excise taxes are paid prior to registering vehicles.
  - C. Identified data sources that may be available to assist the IRS in identifying noncompliant taxpayers.
  - D. Analyzed Tax Years 2005 and 2006 Form 2290 return information to identify trends in compliance activities.
  - E. Assessed the IRS' efforts to implement an electronic program to enable States to determine if taxpayers have paid the tax prior to registering vehicles.
  - F. Determined if improvements can be made in the IRS' efforts to ensure taxpayer compliance with Form 2290 filing and payment requirements, and attempted to quantify the impact on taxpayers and the IRS.
- IV. Assessed the IRS' efforts to reduce taxpayer burden relating to filing Form 2290.
- A. Determined if the processing time period creates taxpayer burden.
  - B. Analyzed the progress of the IRS' plans for *e-filing* and payment of Form 2290.
  - C. Assessed the efficiency with which the toll-free telephone program routes incoming calls from taxpayers.
  - D. Assessed the IRS' efforts to expand State Departments of Motor Vehicles participation in the Form 2290 Alternate Proof of Payment Program.
  - E. Attempted to quantify the impact of any suggested improvements on taxpayers and the IRS.



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**Appendix II**

*Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)  
Augusta R. Cook, Director  
Russell P. Martin, Audit Manager  
Tracy Harper, Lead Auditor  
Mary Keyes, Auditor  
Geraldine Vaughn, Auditor  
Joseph Butler, Information Technology Specialist



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## **Appendix III**

### *Report Distribution List*

Commissioner C

Office of the Commissioner – Attn: Acting Chief of Staff C

Deputy Commissioner for Services and Enforcement SE

Deputy Commissioner, Small Business/Self-Employed Division SE:S

Deputy Commissioner, Wage and Investment Division SE:W

Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS

Director, Campus Filing and Payment Compliance, Small Business/Self-Employed Division  
SE:S:CCS

Director, Customer Assistance, Relationships, and Education, Wage and Investment Division  
SE:W:CAR

Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP

Director, Strategy and Finance, Small Business/Self-Employed Division SE:S:SF

Director, Strategy and Finance, Wage and Investment Division SE:W:S

Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI

Director, Media and Publications, Wage and Investment Division SE:W:CAR:MP

Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP

Director, Tax Forms and Publications, Wage and Investment Division SE:W:CAR:MP:T

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:

Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed  
Division SE:S:CLD

Senior Operations Advisor, Wage and Investment Division SE:W:S



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## Appendix IV

### *Outcome Measure*

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

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

- Taxpayer Burden – Potential; 571,936 taxpayer accounts affected (see page 5).

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

The Alternate Proof of Payment Program enables Heavy Highway Vehicle Use Tax Return (Form 2290) filers to both file and pay this tax at the time they register their vehicles. Taxpayers currently filing Forms 2290 in the 39 States that do not participate in the Program are not afforded the convenience of the one-stop service option for simultaneously filing and paying the Heavy Highway Vehicle Use Tax and registering the vehicle. Expanding the Program to all States would reduce the burden of taxpayers having to file Forms 2290 and register their vehicles separately.

We obtained the number of Form 2290 filers in States that do not participate in the Alternate Proof of Payment Program. We selected State codes<sup>1</sup> for all Form 2290 filers from IRS Master File<sup>2</sup> data for Fiscal Year 2006 and totaled the number of filers in all States (742,057). We then subtracted the total number of Form 2290 filers in the 11 States that participate in the Alternate Proof of Payment Program (170,121). This identified 571,936 filers who reside in States that do not participate.

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<sup>1</sup> These include codes for United States possessions, such as "PR" for Puerto Rico.

<sup>2</sup> The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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**Appendix V**

*Heavy Highway Vehicle Use Tax Return (Form 2290)*

<b>Form 2290</b> (Rev. July 2007) Department of the Treasury Internal Revenue Service	<b>Heavy Highway Vehicle Use Tax Return</b> For the period July 1, 2007, through June 30, 2008 ▶ <b>Attach both copies of Schedule 1 to this return.</b> ▶ <b>See the separate instructions.</b>	Keep a copy of this return for your records.  OMB No. 1545-0143
<b>Type or Print</b>  <b>Check here if:</b> Address change <input type="checkbox"/> Final return <input type="checkbox"/>	Name _____ Employer identification number _____ Address (number, street, and room or suite no.) _____ City, state, and ZIP code (For Canadian or Mexican address, see page 4 of the instructions.) _____	<b>FOR IRS USE ONLY</b>  T _____ FF _____ FP _____ I _____ T _____

**Part I Figuring the Tax**

1 Was the vehicle(s) reported on this return used on public highways during <b>July 2007</b> ? If YES, enter <b>200707</b> in the boxes to the right. If NO, see the table on page 3 of the instructions. ▶	1						
2 <b>Tax.</b> Enter the <b>Total</b> from Form 2290, page 2, column (4) . . . . . ▶	2						
3 <b>Additional tax</b> from increase in taxable gross weight. See page 4 of the instructions . . . . . ▶	3						
4 <b>Total tax.</b> Add lines 2 and 3 . . . . . ▶	4						
5 <b>Credits.</b> See page 5 of the instructions . . . . . ▶	5						
6 <b>Balance due.</b> Subtract line 5 from line 4. This is the amount you owe. If payment through EFTPS, check here <input type="checkbox"/> . . . . . ▶	6						

**Part II Statement in Support of Suspension** (Complete the statements that apply. Attach additional sheets if needed.)

7 I declare that the vehicles listed in Part II of Schedule 1 are expected to be used on public highways (check the boxes that apply):  5,000 miles or less  7,500 miles or less for agricultural vehicles during the period July 1, 2007, through June 30, 2008, and are suspended from the tax. Complete and attach Schedule 1.

8a I declare that the vehicles listed as suspended on the Form 2290 filed for the period July 1, 2006, through June 30, 2007, were not subject to the tax for that period except for any vehicles listed on line 8b. **Check this box if applicable.** ▶

b Vehicle identification numbers \_\_\_\_\_

9 I declare that vehicle identification numbers \_\_\_\_\_ were listed as suspended on the Form 2290 filed for the period July 1, 2006, through June 30, 2007. These vehicles were sold or transferred to \_\_\_\_\_ on \_\_\_\_\_, At the time of the transfer, the vehicles were still eligible for the suspension of the tax. Attach a separate list if needed.

**Third Party Designee** Do you want to allow another person to discuss this return with the IRS (see instructions)?  **Yes.** Complete the following.  **No**

Designee's name \_\_\_\_\_ Phone no. \_\_\_\_\_ ( ) \_\_\_\_\_ Personal identification number (PIN) \_\_\_\_\_

**Sign Here** Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and, to the best of my knowledge and belief, they are true, correct, and complete.

Signature \_\_\_\_\_ Date \_\_\_\_\_  
 Type or print name below signature. Telephone number ( ) \_\_\_\_\_

For Privacy Act and Paperwork Reduction Act Notice, see page 9 of the instructions. Cat. No. 112500 Form **2290** (Rev. 7-2007)

▲ Detach here ▲

<b>Form 2290-V</b> (Rev. July 2007) Department of the Treasury Internal Revenue Service (99)	<b>Payment Voucher</b> For the period July 1, 2007, through June 30, 2008 See <i>How To Make Your Payment</i> on page 6 of the instructions. ▶ <b>Do not staple or attach this voucher or your payment to your return.</b>	OMB No. 1545-0143
1 Employer identification number _____  3 Enter date as shown on line 1 of Form 2290. Y Y Y Y M M Send Form 2290, this voucher, and payment to: Internal Revenue Service P.O. Box 1236 Charlotte, NC 28201-1236	2 Enter the amount of your payment.	Dollars _____ Cents _____
	4 Name _____ Address _____ City, state, and ZIP code (For Canadian or Mexican address, see instructions.) _____	



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Form 2290 (Rev. 7-2007)

Page **2**

**Tax Computation**

Category	Taxable Gross Weight (in pounds)	(1) Annual tax (vehicles used during July)		(2) Partial-period tax (vehicles first used after July) (See the tables on page 10 of the instructions.)		(3) Number of vehicles		(4) Amount of tax (col. (1) or (2) times col. (3))	Category
		(a) Vehicles Except Logging*	(b) Logging Vehicles*	(a) Vehicles Except Logging*	(b) Logging Vehicles*	(a) Vehicles Except Logging*	(b) Logging Vehicles*		
A	55,000	\$100.00	\$75.00	\$	\$			\$	A
B	55,001 – 56,000	122.00	91.50						B
C	56,001 – 57,000	144.00	108.00						C
D	57,001 – 58,000	166.00	124.50						D
E	58,001 – 59,000	188.00	141.00						E
F	59,001 – 60,000	210.00	157.50						F
G	60,001 – 61,000	232.00	174.00						G
H	61,001 – 62,000	254.00	190.50						H
I	62,001 – 63,000	276.00	207.00						I
J	63,001 – 64,000	298.00	223.50						J
K	64,001 – 65,000	320.00	240.00						K
L	65,001 – 66,000	342.00	256.50						L
M	66,001 – 67,000	364.00	273.00						M
N	67,001 – 68,000	386.00	289.50						N
O	68,001 – 69,000	408.00	306.00						O
P	69,001 – 70,000	430.00	322.50						P
Q	70,001 – 71,000	452.00	339.00						Q
R	71,001 – 72,000	474.00	355.50						R
S	72,001 – 73,000	496.00	372.00						S
T	73,001 – 74,000	518.00	388.50						T
U	74,001 – 75,000	540.00	405.00						U
V	Over 75,000	550.00	412.50						V
<b>Totals.</b> Add the number of vehicles in columns (3a) and (3b). Enter the total here and on Schedule 1, Part III, line a. Add the amounts in column (4). Enter the total here and on Form 2290, line 2 . . . . . ▶								\$	
<b>W</b>	Tax-Suspended Vehicles (See Part II on page 6 of the instructions.)								
<b>Complete both copies of Schedule 1 (Form 2290) and attach them to Form 2290.</b>									
* See page 2 of the instructions for information on logging vehicles.									

Form **2290** (Rev. 7-2007)







*Increasing Federal and State Cooperation and Promoting  
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Schedule 1 (Form 2290) (Rev. 7-2007)

Page **2**

**Consent to Disclosure of Tax Information**

For the period July 1, 2007, through June 30, 2008

By signing, dating, and entering my employer identification number below, I hereby consent to the Internal Revenue Service (IRS) disclosing information about my payment of the Heavy Highway Vehicle Use Tax (HVUT) for the tax period listed above to the federal Department of Transportation (DOT), U.S. Customs and Border Protection (CBP), and to state Departments of Motor Vehicles (DMV). The information disclosed to the DOT, CBP, and state DMVs will be my Vehicle Identification Number (VIN) and verification that I have paid the HVUT. The IRS may disclose the information to the DOT, CBP, and to the DMVs of the 50 states and the District of Columbia who have other taxing, registration, or information collecting authority.

I understand that the information to be disclosed is generally confidential under the laws applicable to the IRS and that the agency receiving the HVUT information is not bound by these laws and may use the information for any purpose as permitted by other federal laws and/or state law. To be effective, this consent must be submitted to the IRS within 60 days of the date below.

If signed by a corporate officer or party other than the taxpayer, I certify that I have the authority to execute this consent to disclosure of tax information.

<b>Sign Here</b>	▶ _____ Signature	▶ _____ Date
	Type or print name below signature.	▶ _____ Employer identification number

Schedule 1 (Form 2290) (Rev. 7-2007)



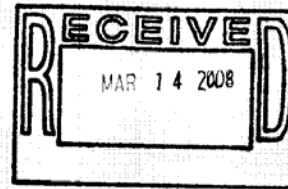
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**Appendix VI**

*Management's Response to the Draft Report*



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



March 14, 2008

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Kathy K. Petronchak  
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – "Increasing Federal and State  
Cooperation and Promoting Electronic Filing Would  
Improve Administration of Taxes Used to Maintain the  
Nation's Highways" (Audit #200740016)

We have reviewed your draft report, "Increasing Federal and State Cooperation and Promoting Electronic Filing Would Improve Administration of Taxes Used to Maintain the Nation's Highways," and agree your recommendations would improve the administration of the Federal Highway Tax program.

We will take the necessary steps to improve coordination with the states to encourage more participation in the Alternate Proof of Payment Program and promote the benefits of e-filing to all 2290 filers.

Attached is a detailed response outlining our corrective actions.

If you have any questions, please contact me or call Kathryn Houston, Acting Director, Office of Specialty Programs, Small Business/Self-Employed Division, at (202) 283-8392.

Attachment



*Increasing Federal and State Cooperation and Promoting  
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**Attachment**

**RECOMMENDATION 1:**

The Commissioner, Small Business/Self-Employed Division, should encourage more State participation in the Alternate Proof of Payment Program, develop a process to identify States participating in the Program, and ensure agreement provisions are followed.

**CORRECTIVE ACTIONS:**

We agree with this recommendation. State participants in the Alternative Proof of Payment Program can be identified on the Servicewide Employment Tax Research System (SWETRS) database by Governmental Liaison analysts using "Highway Use Tax Form 2290" as the search criterion. The Office of Governmental Liaison will solicit additional State office participants and continue to assist State offices in completing standardized Memoranda of Understanding (MOU) to authorize their participation in the Alternate Proof of Payment Program. We will also verify compliance with MOU requirements.

**IMPLEMENTATION DATES:**

March 15, 2009

**RESPONSIBLE OFFICIALS:**

Chief, Excise Tax Operations, Small Business/Self-Employed Division  
Chief, Governmental Liaison, Small Business/Self-Employed Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

Director, Specialty Programs, will advise the Commissioner, Small Business/Self-Employed Division of any delays in implementing this corrective action.

**RECOMMENDATION 2:**

The Commissioner, Small Business/Self-Employed Division, should promote the benefits of *e-filing* to all Form 2290 filers, to increase *e-filing* participation.

**CORRECTIVE ACTIONS:**

We agree with this recommendation. The Chief, Excise Tax Operations will issue news releases regarding the benefits of *e-filing* to all Form 2290 filers; advise all State Departments of Motor Vehicles with information about how taxpayers may participate in electronic filing, the benefits of electronic filing and how to locate a provider for electronic filing; and provide information and outreach about the benefits of Form 2290 electronic filing to the various trucking industry associations such as the American Trucking Association, Americas Independent Truckers Association and the American Association of Motor Vehicle Administrators.

**IMPLEMENTATION DATES:**

June 15, 2008

**RESPONSIBLE OFFICIALS:**

Chief, Excise Tax Operations, Small Business/Self-Employed Division



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**CORRECTIVE ACTION(S) MONITORING PLAN:**

Director, Specialty Programs will advise the Commissioner, Small Business/Self-Employed Division of any delays in implementing this corrective action.