MILLIONS OF DOLLARS IN QUESTIONABLE QUALIFIED MOTOR VEHICLE DEDUCTIONS ARE BEING ALLOWED

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Highlights

Highlights of Report Number: 2011-41-037 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The American Recovery and Reinvestment Act of 2009 (Recovery Act) provides individuals with a Qualified Motor Vehicle (QMV) deduction, which is an additional deduction for State sales tax and excise tax on the purchase of certain motor vehicles. The Internal Revenue Service (IRS) cannot verify whether individuals claiming a QMV deduction are entitled to the deduction at the time their tax returns are processed. Inadequate verification of the QMV deduction increases the risk that taxpayers will be allowed to claim excessive QMV deductions.

WHY TIGTA DID THE AUDIT

This audit was initiated because TIGTA is required to monitor the IRS's implementation of Recovery Act provisions. The objective of our review was to assess the effectiveness of the IRS's efforts to identify individuals erroneously claiming a QMV deduction. The expiration date for the QMV deduction was December 31, 2009.

WHAT TIGTA FOUND

The IRS cannot verify whether individuals claiming a QMV deduction are entitled to the deduction at the time their tax returns are processed. The reason is that individuals do not have to provide any third-party documentation to support that they actually purchased a qualified motor vehicle and, if a qualified vehicle was purchased, the amount paid in sales and excise taxes.

Based on our review of a statistically valid sample of 150 individuals allowed a QMV deduction of less than the amount the IRS considers excessive, it appears that some individuals may have erroneously been allowed QMV deductions for vehicles that were not purchased.

In addition, the process to identify potentially erroneous QMV deductions is not effective. The IRS failed to identify 4,257 individuals claiming what the IRS defines as an excessive QMV deduction during tax return processing so it could hold and prevent the possible issuance of erroneous tax refunds. These individuals claimed a total of more than $151.1 million in QMV deductions. TIGTA also identified 473 cases for which information that the IRS maintains identifies the individuals as ineligible to claim about $1.02 million in QMV deductions they were allowed. These individuals were in prison, deceased, or underage.

Finally, the processes the IRS established to verify the 3,026 QMV deductions the IRS identified as having an excessive claim are also resulting in the erroneous release of tax refunds. Our testing identified that the IRS does not ensure Tax Examiners are taking the necessary steps to verify the QMV deductions.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, ensure Tax Examiners review the 1,324 excessive QMV deduction claims identified by TIGTA. In addition, a review should be conducted of all tax returns identified as a result of an excessive QMV deduction that met examination criteria but were closed with no reduction in the QMV deduction to ensure Tax Examiners are taking correct actions prior to closing cases. Finally, the IRS should review the tax returns of the 473 individuals TIGTA identified as being in prison, deceased, or underage to evaluate whether these individuals qualify for the deduction.

The IRS agreed with all five of the recommendations. The IRS plans to review all of the cases TIGTA identified, and those cases warranting examination will be selected for audit. The IRS also plans to revise the Internal Revenue Manual procedures for the Tax Examiners reviewing QMV deductions.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

http://www.treas.gov/tigta/auditreports/2011reports/201141037fr.pdf.