

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## **Additional Actions Need to Be Taken to Identify and Address Noncompliant Biofuel Tax Credit Claims**

April 24, 2024

Report Number: 2024-300-021

**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**

## HIGHLIGHTS: Additional Actions Need to Be Taken to Identify and Address Noncompliant Biofuel Tax Credit Claims

Final Audit Report issued on April 24, 2024

Report Number 2024-300-021

### Why TIGTA Did This Audit

Since Congress enacted legislation creating biofuel tax credits in Calendar Year 2004, the IRS has been susceptible to significant fraudulent schemes that have resulted in the payment of erroneous refunds. The most egregious scheme (one of the largest fraud schemes in U.S. history) resulted in over \$500 million in erroneous refunds paid to one entity making fraudulent claims. With the passage of additional and expanded clean energy tax credits in the Inflation Reduction Act of 2022, there is even greater incentive to take advantage of biofuel tax credits and make fraudulent claims for biofuel that does not exist or does not qualify for the biofuel tax credits. This audit was initiated to assess the effectiveness of IRS procedures to detect and prevent questionable claims for biofuel tax credits.

### Impact on Tax Administration

The Inflation Reduction Act of 2022 extended biofuel tax credits through December 31, 2024, to encourage the production of cleaner energy sources. This includes tax credits for biodiesel, renewable diesel, alternative fuels, and second-generation biofuels. The Joint Committee on Taxation estimates that taxpayers will claim over \$5.6 billion of these tax credits during Fiscal Years 2023 through 2025.

### What TIGTA Found

The IRS is not using all of the compliance tools to encourage more tax compliance of biofuel tax claims. Internal Revenue Code Section 4101 requires applicable taxpayers to register with the IRS before producing or importing biofuels. Additionally, certain taxpayers claiming biodiesel-related tax credits are not required to be registered but must provide a Certificate of Biodiesel from the producer showing that the biodiesel used to produce the mixture met the Environmental Protection Agency's (EPA) biodiesel specification and registration requirements. TIGTA analysis found that 42 of 124 taxpayers sampled, that claimed biofuel tax credits totaling about

\$30.3 million, did not provide either an approved registration number or a Certificate of Biodiesel;

therefore, these claims would not be allowable. Under current law, the IRS could only address these claims after the returns are filed and examined and it issues notices of deficiency to the taxpayers, as appropriate. The IRS does not have the legal authority to deny biofuel tax credits or otherwise enforce the registration requirements on taxpayers who are not eligible to receive the credits at the time a tax return is filed.

TIGTA found that the IRS's compliance efforts are primarily focused on biofuel tax credit claims made on the Form 8849, *Schedule 3, Certain Fuel Mixtures and the Alternative Fuel Credit*, and Form 720, *Schedule C, Claims*, and more effective efforts could be undertaken to evaluate claims made on the Form 4136, *Credit for Federal Tax Paid on Fuels*.

Taxpayers failed to provide required documentation resulting in over **\$30.3 million** dollars in unallowable biofuel tax credits.



### What TIGTA Recommended

TIGTA recommended that the IRS: 1) engage with the Department of the Treasury's Office of Tax Policy to develop a legislative proposal to ensure taxpayers claiming biofuel tax credits are entitled to the biofuel credit claims and are properly registered or provide the required Certificate of Biodiesel with income tax returns; 2) conduct examinations of the 42 taxpayers we identified to ensure the validity of the credits claimed; 3) examine more Forms 4136, involving biofuel tax credit claims; and 4) partner with the EPA to use the agency's expertise and data involving taxpayers that claimed biofuel tax credits.

IRS management agreed with recommendations 1, 3 and 4 and partially agreed with recommendation 2.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

**U.S. DEPARTMENT OF THE TREASURY**  
**WASHINGTON, D.C. 20024**

April 24, 2024

**MEMORANDUM FOR:** COMMISSIONER OF INTERNAL REVENUE

**FROM:**

Matthew A. Weir  
Acting Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Additional Actions Need to Be Taken to Identify  
and Address Noncompliant Biofuel Tax Credit Claims  
(Audit No. 202330023)

This report presents the results of our review to assess the effectiveness of Internal Revenue Service (IRS) procedures to detect and prevent questionable claims for biofuel tax credits. This review is part of our Fiscal Year 2024 Annual Audit Plan and addresses the major management and performance challenge of *Tax Fraud and Improper Payments*.

Management's complete response to the draft report is included as Appendix VI. If you have any questions, please contact me or Phyllis Heald London, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).

# Table of Contents

|                                  |        |
|----------------------------------|--------|
| <a href="#">Background</a> ..... | Page 1 |
|----------------------------------|--------|

|                                         |        |
|-----------------------------------------|--------|
| <a href="#">Results of Review</a> ..... | Page 6 |
|-----------------------------------------|--------|

|                                                                                                                                                                    |        |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <a href="#">Biofuel Tax Credit Claims Were Allowed for Taxpayers That Were Not Properly Registered or Did Not Provide Proper Certification Documentation</a> ..... | Page 6 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|

|                                         |        |
|-----------------------------------------|--------|
| <a href="#">Recommendation 1:</a> ..... | Page 9 |
|-----------------------------------------|--------|

|                                         |         |
|-----------------------------------------|---------|
| <a href="#">Recommendation 2:</a> ..... | Page 10 |
|-----------------------------------------|---------|

|                                                                                                              |         |
|--------------------------------------------------------------------------------------------------------------|---------|
| <a href="#">Steps Can Be Taken to More Effectively Identify Noncompliant Biofuel Tax Credit Claims</a> ..... | Page 10 |
|--------------------------------------------------------------------------------------------------------------|---------|

|                                         |         |
|-----------------------------------------|---------|
| <a href="#">Recommendation 3:</a> ..... | Page 13 |
|-----------------------------------------|---------|

|                                                                                                                                                |         |
|------------------------------------------------------------------------------------------------------------------------------------------------|---------|
| <a href="#">Data Obtained From the Environmental Protection Agency Could Help Identify Noncompliant Taxpayers and Fraudulent Schemes</a> ..... | Page 13 |
|------------------------------------------------------------------------------------------------------------------------------------------------|---------|

|                                         |         |
|-----------------------------------------|---------|
| <a href="#">Recommendation 4:</a> ..... | Page 18 |
|-----------------------------------------|---------|

## Appendices

|                                                                               |         |
|-------------------------------------------------------------------------------|---------|
| <a href="#">Appendix I – Detailed Objective, Scope, and Methodology</a> ..... | Page 19 |
|-------------------------------------------------------------------------------|---------|

|                                                     |         |
|-----------------------------------------------------|---------|
| <a href="#">Appendix II – Outcome Measure</a> ..... | Page 21 |
|-----------------------------------------------------|---------|

|                                                                                                       |         |
|-------------------------------------------------------------------------------------------------------|---------|
| <a href="#">Appendix III – Internal Revenue Code Sections Related to the Biofuel Tax Credit</a> ..... | Page 23 |
|-------------------------------------------------------------------------------------------------------|---------|

|                                                                                 |         |
|---------------------------------------------------------------------------------|---------|
| <a href="#">Appendix IV – Tax Forms Related to the Biofuel Tax Credit</a> ..... | Page 24 |
|---------------------------------------------------------------------------------|---------|

|                                                                                                      |         |
|------------------------------------------------------------------------------------------------------|---------|
| <a href="#">Appendix V – Current Examination Initiatives Related to the Biofuel Tax Credit</a> ..... | Page 25 |
|------------------------------------------------------------------------------------------------------|---------|

|                                                                               |         |
|-------------------------------------------------------------------------------|---------|
| <a href="#">Appendix VI – Management’s Response to the Draft Report</a> ..... | Page 27 |
|-------------------------------------------------------------------------------|---------|

|                                                        |         |
|--------------------------------------------------------|---------|
| <a href="#">Appendix VII – Glossary of Terms</a> ..... | Page 32 |
|--------------------------------------------------------|---------|

|                                                     |         |
|-----------------------------------------------------|---------|
| <a href="#">Appendix VIII – Abbreviations</a> ..... | Page 34 |
|-----------------------------------------------------|---------|

## Background

### History of biofuel tax credits

The Internal Revenue Code (I.R.C.) allows several tax credits for the production, blending, or use of biofuels.<sup>1</sup> These credits impact a relatively small number of taxpayers compared to other tax credits. For instance, individuals filed approximately 1.2 million claims for the Fuel Tax Credit on the Form 1040, *U.S. Individual Income Tax Return*, during Processing Years 2018 through 2021.<sup>2</sup> During a similar period, taxpayers filed a fraction of that amount in biofuel tax credit claims.

The biodiesel tax credit (the most prevalent biofuel credit) was first established with the American Jobs Creation Act of 2004, and the renewable diesel tax credit was established a year later with the passage of the Energy Policy Act of 2005.<sup>3</sup> The alternative fuel tax credits were first established with the passage of the Safe, Accountable, Flexible, Efficient Transportation Equity Act in 2005.<sup>4</sup> Since then, these fuel tax credits have been extended through legislation numerous times. Most recently, the Inflation Reduction Act of 2022 (IRA), signed into law on August 16, 2022, extended these credits through December 31, 2024.<sup>5</sup> The Joint Committee on Taxation estimates that for Fiscal Years 2023 through 2025, taxpayers will claim \$5.6 billion in these credits.

The second generation biofuel producer credit was first established with the Food Conservation and Energy Act of 2008.<sup>6</sup> Since then, it has been extended several times, most recently, with the IRA extending these credits through December 31, 2024.<sup>7</sup> The Joint Committee on Taxation estimates that for Fiscal Years 2023 through 2025 taxpayers will claim \$54 million in these credits.

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<sup>1</sup> For purposes of this audit, the term biofuels will encompass biodiesel (one of the most common), renewable diesel, alternative fuels, and second generation biofuels. See Appendix VI for a glossary of terms.

<sup>2</sup> Treasury Inspector General for Tax Administration, Report No. 2023-30-053, *Actions Have Been Taken to Enhance Fuel Tax Credit Screening and Examination Processes; However, Improvements Are Still Needed* (Sept. 2023).

<sup>3</sup> H.R. 4520, P.L. 108-357 and H.R. 6, P.L. 109-58.

<sup>4</sup> H.R. 3, P.L. 109-59. See Appendix IV for the various credits and forms.

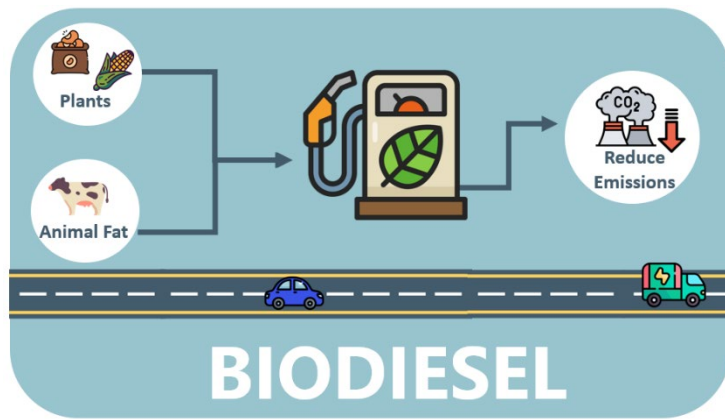
<sup>5</sup> Inflation Reduction Act (IRA), Pub. L. No. 117-169, 136 Stat. 1818 *Extension of Incentives for Biodiesel, Renewable Diesel, and Alternative Fuels* (Section 13201) (2022).

<sup>6</sup> H.R. 6124, P.L. 110-246. This tax credit was introduced as the cellulosic biofuel producer credit but was renamed second generation biofuel with the American Taxpayer Relief Act of 2012, H.R. 8, P.L. 112-240, 126 Stat. 2313.

<sup>7</sup> IRA, Pub. L. No. 117-169, 136 Stat. 1818, *Extension of Second Generation Biofuel Incentives* (Section 13202) (2022).

## **Biodiesel and renewable diesel credits**

Biodiesel fuel is considered an alternative to petroleum-based transportation fuel. In the United States, biodiesel is typically made from soybeans and other plant oils, animal fats, and recycled cooking oils. The use of biodiesel instead of conventional diesel fuel is believed to reduce particulate matter and hydrocarbon emissions. Renewable diesel is a fuel made from fats and oils, such as soybean oil or canola oil, and is processed to be chemically the same as petroleum diesel.



I.R.C. § 6426(a) and (c) allows a \$1.00 per gallon credit against a taxpayer's excise tax liability on taxable fuel under I.R.C. § 4081 for blended biodiesel, renewable diesel, and agri-biodiesel. The taxpayers that typically pay excise taxes are those blenders of biodiesel that purchased the diesel to create the qualifying biodiesel mixtures.

Pursuant to I.R.C. § 6427(e), a payment is allowable to the blender of the mixture to the extent the tax credits exceed the blender's excise tax liability under I.R.C. § 4081. Under I.R.C. § 34, the biodiesel mixture credit described in I.R.C. § 6426 exceeds a person's I.R.C. § 4081 liability for the quarter of a tax year, an income tax credit is allowable to the producer of the mixture.<sup>8</sup>

I.R.C. § 40A provides a nonrefundable credit for:

- A biodiesel mixture tax credit for the production of a qualified biodiesel mixture sold for use as a fuel or used as a fuel in the taxpayer's trade or business.
- A biodiesel tax credit used by the taxpayer in a trade or business or sold by the taxpayer for fuel in a buyer's vehicle.<sup>9</sup>

The biodiesel tax credit for any tax year is \$1.00 for each gallon of biodiesel or qualified biodiesel mixture.

## **Alternative fuel credit**

Alternative fuels include liquefied petroleum gas, compressed or liquefied natural gas, compressed or liquefied gas derived from biomass, and liquid fuel derived from biomass.<sup>10</sup>

I.R.C. § 6426(d) provides an alternative fuel credit of \$0.50 for each gallon of alternative fuel or gasoline gallon equivalents of a nonliquid alternative fuel sold by the taxpayer for use as a fuel in a motor vehicle or motorboat. Like biodiesel and agri-biodiesel mixtures, any excess over the tax liability may be claimed as a payment under I.R.C. § 6427(e) or under I.R.C. § 34.

<sup>8</sup> Notice 2020-8, *Biodiesel and Alternative Fuels; Claims for 2018-2019*.

<sup>9</sup> I.R.C. § 40A(b)(1) and I.R.C. § 40A(b)(2).

<sup>10</sup> The IRA removed liquefied hydrogen from the definition of alternative fuel under I.R.C. § 6426(d)(2) for the purposes of the alternative fuel credit and alternative fuel mixture credit for fuel sold or used after December 31, 2022.

### **Tax forms used to claim biodiesel and alternative fuel credits**

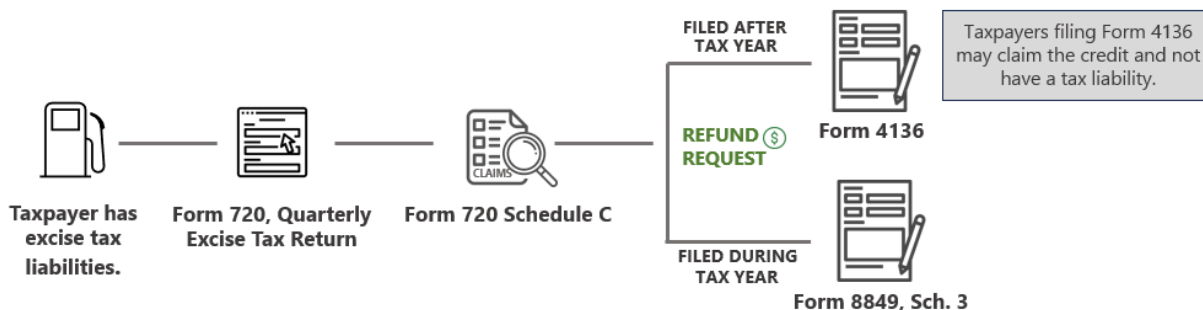
There are several different tax forms that may be used to claim the diesel-related and alternative fuel tax credits:

1. Form 720, *Quarterly Federal Excise Tax Return*, must be filed if the taxpayer claiming the tax credit is liable for fuel excise taxes. The blender of the biodiesel is liable for the excise tax upon sale or removal of blended taxable fuel or the alternative fuel mixture. The person that sells or uses alternative fuel in a motor vehicle or motorboat is liable for excise tax on the sale or use of the alternative fuel.
2. Form 720, Schedule C, *Claims*, is filed by the taxpayer to offset any alternative fuel credit, alternative fuel mixture credit, biodiesel or renewable diesel mixture credit, or sustainable aviation fuel credit against taxable liabilities reported on Form 720. The Form 720, Schedule C, cannot be used to claim tax credits unless the buyer has an excise tax liability.
3. Form 8849, *Claim for Refund of Excise Taxes*, Schedule 3, *Certain Fuel Mixtures and the Alternative Fuel Credit*, is submitted by the taxpayer to request a refund for any credits in excess of the excise taxes paid. These claims can be filed quarterly or even weekly during the tax year. The excess can also be claimed on Form 720, Schedule C.
4. Form 4136, *Credit for Federal Tax Paid on Fuels*, is used to claim biodiesel, renewable diesel, and alternative fuel credits as refundable income tax credits on the taxpayer's Federal income tax return when any amount of biodiesel, renewable diesel, or alternative fuel have not been claimed on the Form 8849, Schedule 3, or Form 720, Schedule C.

In addition, the taxpayer can use Form 8864, *Biodiesel and Renewable Diesel, or Sustainable Aviation Fuels Credit*, to offset income tax liability, but the credit is otherwise nonrefundable. The credits claimed on Form 8864 are recorded on the Form 3800, *General Business Credit*. Form 3800 is used to summarize all the various business credits and to calculate the total General Business Credit amount allowed in the current tax year. The amount is also reported on the main income tax form such as the Form 1040 or Form 1120, *U.S. Corporation Income Tax Return*, to offset tax liability.

Only one credit may be claimed for any one gallon of biodiesel or renewable diesel. If any amount is claimed (or will be claimed) of biodiesel or renewable diesel on Form 720, Schedule C; Form 8849, Schedule 3; or Form 4136, a claim cannot be made on Form 8864 for that amount of biodiesel or renewable diesel. Figure 1 illustrates the process of paying excise taxes and claiming the credits for the excise taxes paid, including claiming refundable excise tax credits.

**Figure 1: The Process for Taxpayers to Claim Excise Tax Credits**



Source: Treasury Inspector General for Tax Administration (TIGTA) created graphic.

While these credits can be used only to offset tax liability and are not otherwise refundable, taxpayers can carry any unused General Business Credit back or forward on subsequently filed returns. A TIGTA audit found that only about 23 percent of the total amount claimed by business taxpayers on the Form 3800 was used to offset tax. The remaining unused credits were available to carryback or carryforward.<sup>11</sup> Figure 2 illustrates the process for claiming the nonrefundable biodiesel credit.

**Figure 2: The Process for Claiming the Nonrefundable Biodiesel Income Tax Credit**



Source: TIGTA-created graphic.

### Second generation biofuel producer credit (or otherwise termed Cellulosic)

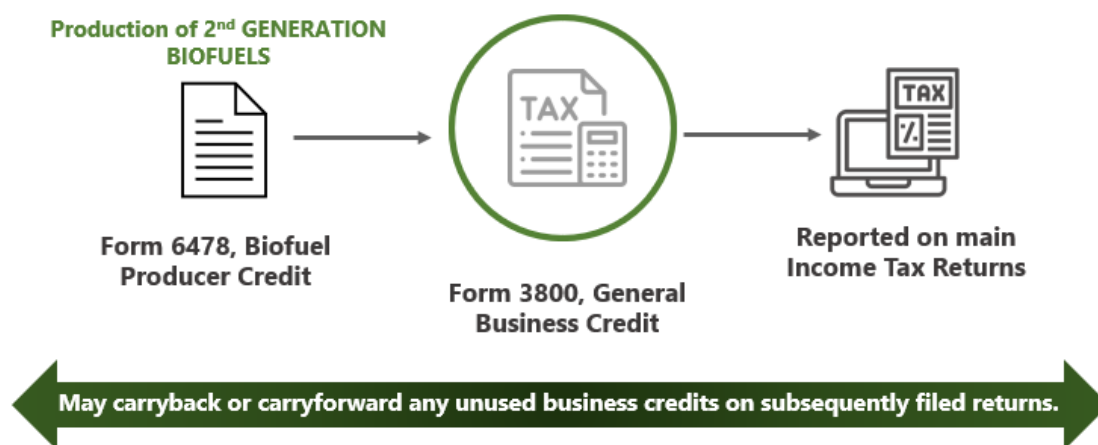
Second generation biofuel is produced from feedstocks such as wood crops, grass, or non-edible parts of plants. As with biodiesel and renewable diesel production, second generation biofuel is produced through specialized processes. The tax credit for production of

<sup>11</sup> TIGTA, Report No. 2015-40-012, *Processes Do Not Ensure That Corporations Accurately Claim Carryforward General Business Credits* (Feb. 2015).

second generation biofuels allows qualified taxpayers a \$1.01 per gallon tax credit.<sup>12</sup> The taxpayers that claim this credit are the producers of second generation biofuels.

This nonrefundable tax credit is calculated and claimed on Form 6478, *Biofuel Producer Credit*. Like the biodiesel tax credits, these calculated tax credits are then recorded on the Form 3800. As stated previously, the Form 3800 is used to summarize all the various business credits and to calculate the total General Business Credit amount allowed in the current tax year. The amount used for the current year by the taxpayer to offset taxes owed is then reported on the parent income tax form such as the Form 1040 or Form 1120. The amount used is generally limited to the amount of tax owed. Taxpayers can carry any unused General Business Credit back or forward on subsequent filed income tax returns. Figure 3 illustrates the process for claiming the credit.

**Figure 3: The Process for Claiming the Nonrefundable Second Generation Biofuel Producer Credit**



Source: TIGTA-created graphic.

### **Most biofuel tax credits are claimed on Form 8849, Schedule 3**

To gain perspective on the number and amounts of biofuel tax credit claims, we requested statistical information from the Internal Revenue Service (IRS) on the number claimed in recent years, and the IRS referred us to Statistics of Income Division data. However, the Statistics of Income data did not contain Form 8849, Schedule 3, data. We therefore relied on data from the Modernized Tax Return Database to identify biofuel tax credit claims made during Processing Years 2020 through 2023 (Tax Years 2019 through 2022) on the Form 8849, Schedule 3; Form 4136; Form 8864; and Form 6478. However, this only provided us with information from tax returns that were filed electronically.

Our analysis of data from the Modernized Tax Return Database found that the highest biofuel tax credit claims are made using the Form 8849, Schedule 3.<sup>13</sup> Specifically, from Tax Years 2019 through 2022 almost 1,500 claims were made for over \$3.5 billion using the Form 8849,

<sup>12</sup> I.R.C. § 40(a)(4) and (b)(6).

<sup>13</sup> The numbers in this paragraph are approximations from our analysis.

Schedule 3. Over the same period, more than 16,000 claims totaling over \$600 million were made on the Form 4136. Almost 12,000 claims were made for about \$100 million on the Form 8864 and just over 2,000 claims for about \$33 million were made on the Form 6478.

The most prevalent refundable biofuel tax credits claimed on the Form 8849, Schedule 3, and Form 4136 include agri-biodiesel mixtures, biodiesel mixtures, and renewable diesel mixtures. Among the alternative fuel credits claimed, the liquefied petroleum gas and compressed natural gas were claimed the most.<sup>14</sup>

### **IRS biofuel tax credit responsibilities**

The IRS is responsible for the administration of biofuel tax credits. While these credits might be questioned by any revenue agent during an examination, overall responsibility for the Federal Fuel Tax Program areas falls under the Excise Tax Program of the Small Business/Self-Employed (SB/SE) Division. The SB/SE Division Excise Tax Program is the responsibility of the Specialty Examination Director. This program is responsible for conducting a wide variety of fuel-related examinations, inspections, and compliance reviews for the taxes related to biofuels.

The SB/SE Division, Excise Tax Policy, is responsible for the administration, procedures, and updates related to the Fuel Tax Program. The SB/SE Division Excise Case Selection (ECS) function is responsible for following policy guidance on the selection of cases and delivery of inventory for examination, and SB/SE Division Specialty Examination – Field is responsible for conducting those examinations. Criminal Investigation (CI) is responsible for conducting criminal investigations involving fraudulent biofuel tax credit claims.

## **Results of Review**

### **Biofuel Tax Credit Claims Were Allowed for Taxpayers That Were Not Properly Registered or Did Not Provide Proper Certification Documentation**

Our review found that the IRS does not address improper biofuel tax credit claims during filing because it lacks legal authority to do so and can only address these claims during examinations. I.R.C. § 4101 and Treasury Regulation § 48.4101-1 require taxpayers to register with the IRS before engaging in certain excise tax activities, and in other situations, a taxpayer must be registered in order to file a claim for refund or credit. These activities include producing or importing biodiesel and renewable diesel, producing second generation biofuels, and creating a blended taxable fuel.

According to the SB/SE Division, Specialty Examination Policy, claimants of the biodiesel and renewable diesel tax credits are not required to be registered under I.R.C. § 4101. However, claimants must provide a certificate from the importer or producer showing that the biodiesel or renewable diesel used to produce the mixture met the registration requirements. Taxpayers

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<sup>14</sup> IRS management opined that our calculations of biofuel tax credit claims may be understated because we only analyzed claims made on electronically filed tax returns and most biofuel tax credit claims made on the Form 8849, Schedule 3, are made using paper returns. However, IRS management was unable to provide data on the total amount of Form 8849, Schedule 3, biofuel tax credit claims made in recent years.

apply for registration by filing Form 637, *Application for Registration (For Certain Excise Tax Activities)*, with the IRS. The SB/SE Division indicated that claims for biodiesel or renewable diesel should not be paid unless the original importer or producer had an approved Form 637. In the case of second generation biofuel, the producer must be registered. Figure 4 provides the registration and certification documentation requirements for those taxpayers claiming biofuel tax credits.

**Figure 4: Biofuel Tax Credit Registration and Certification Requirements**

| Type of Tax Credit Claim                      | Requirements                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|-----------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Alternative Fuel Credit                       | <ul style="list-style-type: none"> <li>➤ The alternative fueler (of unmixed fuel) must be registered with a Form 637 registration in order to file a claim for the alternative fuel credit.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| Biodiesel and Renewable Diesel Mixture Credit | <ul style="list-style-type: none"> <li>➤ Producers and importers of agri-biodiesel must be registered with a Form 637 registration.</li> <li>➤ Producers and importers of biodiesel (other than agri-biodiesel) are required to be registered with a Form 637 registration.</li> <li>➤ Producers and importers of renewable diesel must be registered with a Form 637 registration.</li> <li>➤ Blenders are required to be registered with a Form 637 registration if the blender produces a blended taxable fuel outside the bulk transfer/terminal system. <b>A certificate from the producer/importer is required to be included with the claim for the tax credit.</b></li> </ul> |
| Second Generation Biofuel Tax Credit          | <ul style="list-style-type: none"> <li>➤ Producers of second generation biofuel are required to register with Form 637 registration.</li> <li>➤ Registration is required to file a claim for the second generation biofuel tax credit.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                     |

Source: SB/SE Division, *Excise Revenue Agent Basic Recruit Training – Phase 2*.

We selected a judgmental sample of 124 taxpayers that claimed biofuel tax credits during Processing Year 2022 to determine if they were properly registered or if they provided the Certificate of Biodiesel indicating that the producer of the biodiesel is registered with the IRS.<sup>15</sup> This included 75 business taxpayers that claimed the biodiesel or renewable diesel mixture credits on the Form 8849, Schedule 3; Form 4136; and Form 8864, 24 business taxpayers that claimed alternative fuel credits on the Form 4136, and 25 business taxpayers that claimed second generation biofuel tax credits on the Form 6478.

For the 124 sample cases, we reviewed the IRS Integrated Data Retrieval System (IDRS) data and tax return information. We found that all 25 taxpayers that made claims for biodiesel or renewable diesel mixture credits on the Form 8849, Schedule 3, were either properly registered with the IRS or provided the Certificate of Biodiesel. However, we found that most of the remaining taxpayers either did not provide a valid registration number or did not provide the Certificate of Biodiesel. Specifically, we found that taxpayers did not provide the following:

- A Certificate of Biodiesel for 10 of the 25 claims for refundable biodiesel or renewable diesel mixture credits totaling almost \$1 million made on the Form 4136. We provided

<sup>15</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

three of the 10 claims to the SB/SE Division for review. It responded that the claimants should have attached the Certificate of Biodiesel from the producer showing that the biodiesel used to produce the mixture met the Environmental Protection Agency's (EPA) registration requirements for fuels and fuel additives. Without the Certificate of Biodiesel, these claims are not allowable.

- The required valid registration for 13 of the 24 claims for refundable alternative fuel credits totaling more than \$25 million made on the Form 4136.
- A Certificate of Biodiesel for 19 of the 25 claims for nonrefundable biodiesel or renewable diesel mixture credits totaling more than \$3.6 million made on the Form 8864.

[REDACTED]

- The required valid registration for 22 of the 25 claims for nonrefundable second generation biofuel credits totaling almost \$1.3 million made on the Form 6478.

[REDACTED]

All 22 cases were flow-throughs from either partnerships, S corporations, cooperatives, estates, or trusts claimed on Line 3 of the form.

Figure 5 shows the samples selected and the results of our testing to determine if taxpayers were properly registered or provided a valid Certificate of Biodiesel.

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<sup>16</sup> ASTM D6751 is the U.S. specification that defines biodiesel as mono-alkyl esters of long chain fatty acids derived from vegetable oils and animal fats.

**Figure 5: Biofuel Tax Credit Registration and Certification Testing**

| Tax Form      | Type of Credits Tested                        | Sample Tested | Sample Amount of Biofuel Tax Credits Claimed | No Proper Registration or Certification Provided Claims | Amount of Erroneous Biofuel Tax Credits Claimed |
|---------------|-----------------------------------------------|---------------|----------------------------------------------|---------------------------------------------------------|-------------------------------------------------|
| 8849, Sch. 3  | Biodiesel or Renewable Diesel Mixture Credits | 25            | \$180,071,190                                | 0                                                       | \$0                                             |
| 4136          | Biodiesel or Renewable Diesel Mixture Credits | 25            | \$11,520,489                                 | 10                                                      | \$908,126                                       |
| 4136          | Alternative Fuel Credits                      | 24            | \$44,134,575                                 | 13                                                      | \$25,750,247                                    |
| 8864          | Biodiesel or Renewable Diesel Mixture Credits | 25            | \$8,251,942                                  | 19                                                      | \$3,611,883                                     |
| 6478          | Second Generation Biofuel Credit              | 25            | \$8,645,919                                  | 0                                                       | \$0                                             |
| <b>Totals</b> |                                               | <b>124</b>    | <b>\$252,624,115</b>                         | <b>42</b>                                               | <b>\$30,270,256</b>                             |

*Source: TIGTA analysis of the Modernized Tax Return Database, the IDRS, and the Employee User Portal.*

We discussed with the Wage and Investment Division, Submission Processing, conducting compliance checks when the tax returns are received and processed to ensure that applicable taxpayers are properly registered, are attaching the required certificates, and that any attached certificates contain a valid registration number. These checks could have prevented the IRS from allowing the 42 biofuel tax credit claims totaling \$30,270,256 that were made on the Forms 4136 and 8864.

However, IRS management stated that the IRS cannot deny biofuel tax credits when income tax returns are filed without an examination subject to deficiency procedures.<sup>17</sup> IRS management stated they are unable to use so-called “math error authority” to deny biofuel tax credits even though the taxpayers may have failed to obtain the certifications and registrations required by law.<sup>18</sup> The IRS’s math error authority is limited to specific categories of mathematical or clerical errors, and while the omission of information from a form or schedule can constitute a math error under the law, it is the IRS’s position that the law must require the inclusion of that information on a taxpayer’s return for math error authority to be applicable. Accordingly, the ability to address these claims when they are filed would require a change to the biofuel tax credit provision discussed in this report to require that registration and certification be evidenced on the tax return. Under current law, the IRS could only address these claims after the returns are filed and examined and it issues notices of deficiency to the taxpayers, as appropriate. The IRS would need to engage with the Department of the Treasury’s Office of Tax

<sup>17</sup> I.R.C. §§ 6211 through 6215.

<sup>18</sup> I.R.C. § 6213(g)(2)(D) defines math error authority to include “an omission of information which is required to be supplied on the return to substantiate an entry on the return.” However, IRS management states that the certification and registration information referenced in this report is not currently required to be provided on the tax return.

Policy to proceed with a legislative proposal to obtain the legal authority to ensure that taxpayers meet the requirements.

**Recommendation 1:** The Commissioner, Wage and Investment Division, should engage with the Department of the Treasury's Office of Tax Policy to develop a legislative proposal to require that taxpayers claiming biofuel tax credits provide information that they are properly registered (if applicable) or that they provided the required Certificate of Biodiesel when income tax returns are filed.

**Management's Response:** IRS management agreed with this recommendation and will share this report with the Department of the Treasury's Office of Tax Policy, explain the current law and compliance constraints during filing, and support the Department of the Treasury if it determines to proceed with a legislative proposal to address this issue.

**Recommendation 2:** The Commissioner, SB/SE Division, should establish a Compliance Initiative Project to conduct examinations of the 42 taxpayers reported in Figure 5 to ensure the validity of the biofuel tax credits that were claimed and that these taxpayers are properly registered and have the required certificates (that contain a valid registration number).

**Management's Response:** IRS management partially agreed with this recommendation stating it will review the 42 tax returns identified by TIGTA and determine if compliance activity is warranted.

**Office of Audit Comment:** We disagree with IRS management's proposed alternate corrective action. We believe that compliance activity is warranted given these 42 taxpayers were allowed over \$30 million in biofuel tax credits while not providing a valid registration number or not providing the Certificate of Biodiesel. Compliance Initiative Projects involve contact with specific taxpayers to identify potential areas of noncompliance for the purpose of correcting the noncompliance. For these 42 cases, the Compliance Initiative Project approach is ideal in that the results of the examinations will be closely tracked with project codes and provide IRS management with additional support in discussions with the Department of the Treasury's Office of Tax Policy (recommendation 1).

## Steps Can Be Taken to More Effectively Identify Noncompliant Biofuel Tax Credit Claims

The IRS's compliance efforts are primarily focused on excise tax-related biofuel tax credit claims made on the Form 8849, Schedule 3, and the Form 720, Schedule C.<sup>19</sup> All Form 8849, Schedule 3, biofuel tax credit claims are received and processed by its Centralized Specialty Tax Operations at the Cincinnati Campus. Claims exceeding a certain dollar threshold are classified by a revenue agent, and all remaining claims are screened by a tax specialist to determine if the claim is allowable or should be referred for examination. If large, unusual, or questionable

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<sup>19</sup> Specifically, the biofuel tax credit claims are made on the Form 8849, Schedule 3.

issues are identified during processing of the unpaid claims, they are referred to Field Examination.<sup>20</sup>

SB/SE Division management stated that after the refund has been issued, all claims made on the Form 8849, Schedule 3, and the Form 720, Schedule C, are screened for examination using filters designed by various examination initiatives to identify claims that require further review. The SB/SE Division reviews the claims for certain attributes or indicators and will consider sending them to the field for examination if the claims contain some of these attributes, *e.g.*, if the taxpayer making the claim did not file a related income tax return.

The Form 720, Schedule C, is received and processed by the Wage and Investment Division's Submission Processing function at the Ogden Campus. A tax compliance officer reviews the forms to determine if the claim is allowable or if additional review is required. If further scrutinization is warranted, the forms are referred and reviewed by a revenue agent in the Excise Tax function. If large, unusual, or questionable issues exist, they are referred to Field Examination.

The SB/SE Division has 14 ongoing examination initiatives related to biofuel tax credit claims. These initiatives tend to be related to excise tax claims and focus on those claims made on the Form 8849, Schedule 3, and the Form 720, Schedule C. Only one of these initiatives appears to address biofuel-related claims made by businesses on the Form 4136, and none appear to address those nonrefundable credit claims made on the Forms 8864 or 6478. Appendix V contains a more detailed description of each initiative along with initiation dates and tracking codes.

Some of the initiatives dedicated solely to biofuel tax credits tend to have relatively high no-change rates. This may indicate that the taxpayers claiming these credits are largely compliant or that the methods to identify or conduct these examinations can be improved. The IRS's primary objective in selecting returns for examination is to promote the highest degree of voluntary compliance on the part of taxpayers while making the most efficient use of finite examination staffing and other resources.<sup>21</sup> Having a higher no-change rate for examinations means that more compliant taxpayers are being subject to examinations and noncompliant taxpayers are not being identified, thereby negatively impacting taxpayer compliance. For some of these examination initiatives, it may be too early to form conclusions about the no-change rates.

The SB/SE Division recently started two of the initiatives. One is designed to compare biofuel claims to the data received from the EPA Renewable Identification Numbers (RIN) data. The other is designed to analyze biodiesel mixture and renewable diesel mixture claims made on the Form 720, Schedule C, and the Form 8849, Schedule 3, using various filters. The SB/SE Division has completed only a small number of examinations for these initiatives, if any, and it is too soon to evaluate their effectiveness. Figure 6 lists the 14 ongoing SB/SE Division examination

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<sup>20</sup> On February 21, 2020, the Director, SB/SE Division, Examination, Specialty Policy, issued a memorandum to the Director, Examination, Cincinnati Campus, providing guidance regarding criteria for the disallowance, examination selection, and payment of biofuel tax credit claims that were retroactively reinstated for Tax Years 2018 and 2019 as part of the budget agreement.

<sup>21</sup> Internal Revenue Manual, 4.1.26.2.2(1), *SB/SE Campus Examination Guidance for Fairness in Case Selection* (Aug. 29, 2017).

initiatives along with the no-change percentages for the number of examinations closed during Fiscal Years 2018 through 2023 (as of March 31, 2023).

**Figure 6: Ongoing Examination Initiatives Related to Biofuel Tax Credits and No-Change Rates for Closed Examinations**

| Title of Initiative                                                           | Biofuel Specific | Number Closed <sup>22</sup> | No-Change Percentage <sup>23</sup> | Total Adjustment Amount | Adjustments Per Hour <sup>24</sup> |
|-------------------------------------------------------------------------------|------------------|-----------------------------|------------------------------------|-------------------------|------------------------------------|
| Biofuel Claims for Credit Reference Numbers 307, 388, and 390                 | X                | 0                           | Not Applicable                     | \$0                     | Not Applicable                     |
| Biodiesel Blenders Below the Rack                                             | X                | 44                          | 77                                 | \$83,165                | \$78                               |
| Workload Return System                                                        |                  | 2,803                       | 63                                 | \$70,691,222            | \$929                              |
| Form 637, M Registrant Nonfilers                                              |                  | 60                          | 78                                 | \$19,723                | \$13                               |
| Nontaxable Use Claims for Alternative Fuels                                   | X                | 13                          | 38                                 | \$28,859                | \$385                              |
| Alternative Fuel Mixture Credits for Butane and Gasoline Blends <sup>25</sup> | X                | 52                          | 89                                 | (\$472,609)             | (\$1,136)                          |
| Alternative Fuels and Alternative Fuels Mixture Credits                       | X                | 130                         | 55                                 | \$1,981,136             | \$519                              |
| Propane and Butane Mixture Claims <sup>26</sup>                               | X                | 12                          | 42                                 | (\$79,757,718)          | (\$839,555)                        |
| Tax Year 2018 Form 1040 Excise Referral Returns Compliance Initiative Project |                  | 471                         | 1                                  | \$16,708,359            | \$3,254                            |
| Volume Comparison 720TO vs. 720 <sup>27</sup>                                 |                  | 203                         | 48                                 | \$16,132,470            | \$3,043                            |
| Biodiesel Blenders Below the Rack - Claims                                    | X                | 35                          | 77                                 | \$68,208                | \$67                               |
| Biofuel Claims vs EPA RIN Data                                                | X                | 3                           | 33                                 | \$2,691                 | \$14                               |
| 2018 – 2019 Retroactive Biofuel Credits                                       | X                | 307                         | 51                                 | \$59,818,724            | \$3,997                            |
| Fuel Summit Project                                                           |                  | 100                         | 76                                 | \$122,485               | \$34                               |

*Source: TIGTA analysis of Data Center Warehouse Audit Information Management System data. The initiative title was provided by the SB/SE Division.*

<sup>22</sup> Total number of tax returns examined and closed. A taxpayer may have more than one tax return examined.

<sup>23</sup> When an examination results in no adjustment, it will be disposed of as no-change and closed.

<sup>24</sup> The total adjustments made on the tax returns examined divided by the total time spent by examiners on all tax returns examined.

<sup>25</sup> Per the SB/SE Division, alternative fuel mixture credits for the butane and gasoline blends initiative are unpaid claim examinations. A no-change on an unpaid claim examination reflects that the claim was disallowed in full; therefore, this would be revenue protection. The negative adjustment amounts in these columns show the amount of disallowed unpaid claims, revenue protected, and not a no-change examination as traditionally viewed.

<sup>26</sup> Per the SB/SE Division, the propane and butane mixture claims are unpaid claim examinations. See the prior footnote for an explanation of a no-change on an unpaid claim examination.

<sup>27</sup> Form 720-TO, *Terminal Operator Report*.

ECS personnel stated that adding additional reporting requirements for taxpayers making biodiesel and renewable diesel mixtures, alternative fuel, and alternative fuel mixture tax credit claims could help the IRS identify noncompliance. Additional reporting requirements that would be helpful include: a list of sales to include the customer's name, Employer Identification Number, and summary of gallons sold to each customer. Taxpayers could enter that information into the Excise Summary Terminal Activity Reporting System, commonly referred to as ExSTARS.<sup>28</sup> SB/SE Division Excise Tax Policy indicated that this would require a legislative change to classify biodiesel as a taxable fuel and has been pursuing that change but has thus far been unsuccessful.

**Recommendation 3:** The Commissioner, SB/SE Division, should evaluate if there are opportunities to include biofuel tax credit claims made on the Form 4136 into ongoing examination initiatives involving biofuel.

**Management's Response:** IRS management agreed with this recommendation and will evaluate its biofuel initiatives and determine if Form 4136 data will add value to case selection.

### Data Obtained From the Environmental Protection Agency Could Help Identify Noncompliant Taxpayers and Fraudulent Schemes

Congress adopted the Renewable Fuel Standard (RFS) program to reduce the Nation's dependence on foreign oil, help grow the U.S. renewable energy industry, and achieve significant greenhouse emissions reductions. The EPA is responsible for implementing the RFS program and enforcing its requirements. The RFS program requires a certain amount of renewable fuel to replace or reduce the quantity of petroleum-based transportation fuel, heating oil, or jet fuel. Congress set targets for the total amount of renewable fuel to replace petroleum-based fuels each year through Calendar Year 2022. The EPA translates these targets into individual compliance obligations that each blender or importer must meet every year. These blenders and importers generate RINs to meet their renewable fuel obligations.<sup>29</sup>

RINs are self-generated by producers of a renewable fuel pursuant to EPA guidelines and registered in the EPA's Moderated Transaction System. To be eligible to generate RINs, the producers of renewable fuel must register and receive approval from the EPA and show annual compliance and obey mandated recordkeeping requirements. The RIN code structure makes it possible to tie a RIN to both a specific company and a specific facility. This information is part of the EPA's Moderated Transaction System in which the business activities at each facility location are also tracked. Each batch of fuel produced each year has a unique batch number.<sup>30</sup> The number of RINs generated can be voluminous. For instance, during Calendar Year 2021 alone, nearly 20 billion RINs were generated.<sup>31</sup>

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<sup>28</sup> This system requires a monthly information document from fuel terminal operators and carriers detailing the receipts and disbursements of liquid products passing through a taxable fuel storage and distribution facility.

<sup>29</sup> U.S. EPA, Office of Inspector General, Report No. 23-P-0032, *The EPA Must Improve Controls and Integrate Its Information System to Manage Fraud Potential in the Renewable Fuel Standard Program* (Sept. 2023).

<sup>30</sup> The International Council on Clean Transportation, *A Conversational Guide to...Renewable Identification Numbers (RINs) in the U.S. Renewable Fuel Standard* (May 2014).

<sup>31</sup> EPA: 19.86 billion RINs generated under the RFS in 2021, <https://biomassmagazine.com>, January 21, 2022.

The EPA pursues enforcement actions (both civil and criminal) against renewable fuel producers and importers that generated invalid RINs to protect the program's integrity and maintain a level playing field for regulated companies. The fraudulent generation of RINs for fuel that was not produced can be used to claim fraudulent biofuel tax credits from the IRS.

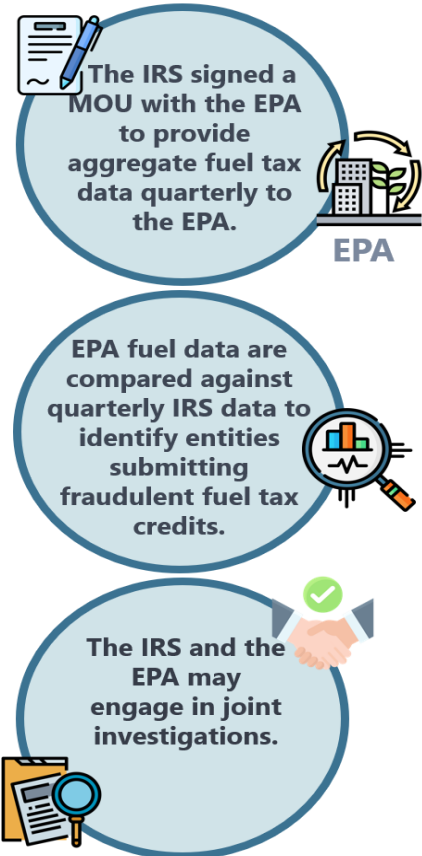
In July 2019, the IRS signed a Memorandum of Understanding (MOU) with the EPA to share information about fuel production facilities and fuel program compliance. The purpose of the MOU was to facilitate policy development, market understanding, verify data for renewable fuel credits, identify and reduce RIN fraud in support of RFS program administration, and identify and reduce fuel tax credit fraud in support of Federal tax administration.<sup>32</sup> According to the MOU, there is a residual compliance effect that occurs when entities considering dishonest or illegal practices realize the IRS is involved with joint enforcement efforts with the EPA. In addition, the IRS can make requests for information on a case-by-case basis.

During Fiscal Year 2021, the SB/SE Division obtained data files which included aggregate RIN data such as buy and sell transaction data. The SB/SE Division's Excise Tax Program personnel analyzed this data by comparing biodiesel tax credit claims made on the Form 8849, Schedule 3, and identified companies that claimed biofuel tax credits that may not have been justified based on taxpayer behavior in the industry. The resulting SB/SE Division internal report concluded that some entities filed claims on the Form 8849, Schedule 3, that did not have any corresponding RIN data, which may be indicative of noncompliance with the tax laws.<sup>33</sup>

The internal IRS report also indicated that the analysis found the data to be complex and transactionally rich and could be useful in identifying noncompliance. The report recommended that the SB/SE Division conduct examinations on those entities that had Form 8849, Schedule 3, claims but did not have any related activity transaction data according to EPA information.

The SB/SE Division began an initiative during Calendar Year 2022 to conduct examinations with this information to identify noncompliance with credits and payments allowable for biodiesel mixtures and renewable diesel mixtures. The IRS assigned tracking codes to monitor the results, but it does not have a planned number of examinations and explained that plans are not built for specific tracking codes. ECS personnel stated there are significant challenges to comparing EPA RIN data to biofuel tax credits claimed to identify noncompliance, including:

- Buying and selling RINs like a commodity without the biofuel ever changing hands.



<sup>32</sup> *Memorandum of Understanding Between the Internal Revenue Service and the United States Environmental Protection Agency*, July 30, 2019.

<sup>33</sup> *Environmental Protection Agency and IRS Data Analysis to Identify Potentially Inflated Form 8849 Claims*. Joint Operations Center, Excise Tax, Internal Revenue Service, December 16, 2021.

- Being eligible to claim the tax credit but not processing the RIN. For example, a RIN is created when the pure biodiesel is created by a producer and a third party blends the pure biodiesel with diesel to create a new blend. The third-party blender would be eligible for the tax credit.

Since the initiative began, only three examinations have been conducted and [REDACTED]

### **Significant fraudulent schemes targeting biofuel tax credits have resulted in the payment of erroneous refunds**

This audit was initiated due to concerns of fraud raised to TIGTA regarding the IRS's efforts to ensure the compliance of those taxpayers claiming biofuel tax credits. In March 2023, the IRS included fuel tax credit scams on its annual list of "Dirty Dozen" tax scams warning taxpayers to watch out for promoters pushing improper fuel tax credit claims that taxpayers are not qualified to receive.<sup>34</sup>

There have also been a number of high-profile fraudulent schemes involving biofuel tax credits in which the IRS did not disallow the fraudulent claims until after millions in erroneous refunds were paid.<sup>35</sup> For instance, in one scheme, individuals from multiple companies conspired to claim and receive over \$15 million in fraudulent biofuel tax credits from 2010 through 2014. The conspirators fraudulently generated RINs but did not produce renewable fuel in accordance with specifications. Most of the biofuel claimed was either never produced or was reprocessed.<sup>36</sup>

In another scheme, a taxpayer received over \$7 million in fraudulent biofuel tax credits claimed on the Form 8849, Schedule 3, and the Form 4136 with some claims being made after the company was evicted from the facility and for renewable fuel that was never produced. There was also no indication from our review of the court documents that the RINs had been falsely generated. In addition, the taxpayer did not file corporate tax returns during the period of the fraudulent claims.<sup>37</sup> SB/SE Division personnel indicated that they now include the nonfiling of tax returns as a filter when identifying taxpayers claiming biofuel tax credits for possible examination.

One of the most egregious biofuel tax credit frauds discovered to date involved the entity Washakie Renewable Energy (hereafter referred to as "Washakie") when the IRS paid over \$500 million in fraudulent biofuel tax credit claims over several years. The fraud occurred during Calendar Years 2010 through 2016 using the Form 8849, Schedule 3, and involved the fraudulent generation of RINs. The Washakie case study provides useful insight into the challenges and opportunities of biofuel tax credit compliance.

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<sup>34</sup> This warning did not specifically reference biofuel tax credits.

<sup>35</sup> IRS Criminal Investigation (CI) special agents indicated that several of these frauds may have been connected but were treated as separate conspiracies.

<sup>36</sup> *U.S. v. Bernard*, Case No. 2:17-cr-00061-SPC-KCD (D. FL 2019), Plea Agreement.

<sup>37</sup> *U.S. v. Glover*, Criminal Action No. 18-cr-346-RM (D. UT 2019), Plea Agreement.

## **IRS CI and Department of Justice prosecution of Washakie**

As one of the ringleader's plea agreements reflects, the Washakie case involved a complex fuel tax credit scheme in which the defendants sought to obtain over \$1 billion in fraudulent biofuel credits from the IRS.<sup>38</sup> The fraud was primarily accomplished through the filing of false Forms 8849, Schedule 3, with the IRS. The defendants claimed RINs for fuel that they did not produce or sell. False highway toll processing agreements and fake paperwork were established to create a false paper trail to make it appear that fuel had been produced, sold, and transported. The fraud began with Tax Year 2010 and defendants continued to claim biofuel tax credits for larger and larger amounts as the IRS continued to issue refunds based on the false claims. As the IRS continued to issue more refunds, the defendant's scheme became more elaborate by entering into rental agreements for large storage tanks for fuel which would be rotated back and forth, imported, and then reimported all to support double filing of false claims on both the import and export of the same product.

According to IRS CI special agents involved with the criminal investigation, the EPA suspected that Washakie was not in compliance with the RFS program in Calendar Year 2011. Specifically, the fuel being produced did not meet the specifications for qualifying biodiesel under EPA standards. EPA expertise was an important factor towards CI's investigation of the scheme. The EPA notified CI of its concerns, and CI initiated an investigation on March 19, 2012. Approximately \$37 million of the fraudulent claims had been paid through Calendar Year 2012.<sup>39</sup>

CI special agents requested a search warrant be issued by the U.S. Attorney's Office for the District of Utah.<sup>40</sup> However, the Assistant U.S. Attorney from the Criminal Division would not issue the search warrant, and the initial investigation was closed. The investigation of Washakie was then reopened in Calendar Year 2015 based on additional information received from an informant. The conspirators eventually pled guilty or were found guilty in this biofuel tax conspiracy. By the time the conspiracy ended, the IRS had paid out more than \$500 million in fraudulent refund claims and is one of the largest fraud schemes in U.S. history.

In response to the Washakie fraud, CI's Nationally Coordinated Investigation Unit developed data analytic models in 2018 to identify similar cases. CI's Nationally Coordinated Investigation Unit personnel stated that these data analytic models focused on Form 8849, Schedule 3, claims and identified six potential criminal cases. However, none of the six resulted in a prosecution recommendation or an indictment. Because these cases did not result in viable prosecutions, CI has not conducted additional analysis, although the biofuels project is not considered to be discontinued. CI is not confident that a similar fraud could be identified systemically because it is not actively engaged in identifying these fraudulent claims and has redirected its resources to focus on other criminal investigations. However, CI management stated that special agents will always investigate if a fraudulent claim is identified through other sources.

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<sup>38</sup> *U.S. v. Kingston*, Case No. 2:18-CR-365-JNP-CMR (D. UT 2019), Plea Agreement.

<sup>39</sup> *U.S. v. Kingston*, Case No. 2:18-CR-365-JNP-BCW (D. UT 2019), Indictment.

<sup>40</sup> The Offices of the U.S. Attorneys are part of the U.S. Department of Justice. They are charged with ensuring "that the laws be faithfully executed." The 93 U.S. Attorneys work to enforce Federal laws throughout the country. The U.S. Attorney is the chief Federal law enforcement office in its district.

## **IRS civil actions related to Washakie**

The SB/SE Division, ECS function, noted that it initially identified the Washakie false claims through one of its examination initiatives and selected for field examination the claims made during TYs 2010 and 2011 [REDACTED]. These examinations were initiated in September 2012 and were later expanded to include subsequent claims. According to SB/SE Division Specialty Examination, the revenue agent conducting the examinations encountered obstacles such [REDACTED]

[REDACTED] The Examination function made fraud referrals to CI on related tax returns in October 2012, but the referrals did not result in new investigations.

We also inquired as to whether the SB/SE Division can systemically identify this type of fraud and were informed that the ECS will continue to run data analytics on paid claims to identify potentially noncompliant taxpayers, which could include potentially fraudulent claims. SB/SE Division management added that the Office of Fraud Enforcement is devoting resources to identifying ways to proactively deter and detect fraud related to the “green credits” established within the IRA.<sup>41</sup>

## **Coordination with the EPA could help identify fraud**

The technical complexity in the biofuel tax credit area warrants coordination with the EPA. We concluded from discussions with CI special agents involved with biofuel fraud criminal investigations that the IRS should coordinate with EPA personnel on examinations and investigations because they have the expertise that is more likely to identify noncompliant taxpayers. For instance, EPA engineers can help determine if the fuel produced meets specifications. CI special agents believed the EPA was stronger in its enforcement of biofuel-related fraud because of its expertise.

The EPA Office of Inspector General recently issued a report on its review of the EPA’s enforcement of the RFS program finding that the EPA has strengthened controls over the RFS program since its inception, primarily in response to several instances of companies generating or selling fraudulent RINs. For instance, the EPA established a quality assurance program to mitigate fraud that was primarily occurring at small biodiesel facilities and to provide renewable fuel producers with the way to demonstrate the validity of their RINs.<sup>42</sup>

During our audit, the SB/SE Division stated that it has an interagency agreement with the Pacific Northwest National Laboratory for its scientists to determine if fuel produced meets specifications as well as to assist with tax credit claim issues and registrations involving biofuels. According to the Internal Revenue Manual, during the course of an IRS inspection of a fuel distribution system, fuel compliance officers conduct interviews and tours, review records, and obtain fuel samples. The fuel samples are shipped to and tested by the Pacific Northwest

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<sup>41</sup> The mission of the Office of Fraud Enforcement is to promote compliance by strengthening the IRS’s response to fraud and mitigating emerging threats. This includes improving fraud detection and development to address areas of high fraud/risk noncompliance and cultivating internal and external partnerships to identify new treatment streams to enhance enforcement.

<sup>42</sup> U.S. EPA, Office of Inspector General, Report No. 23-P-0032, *The EPA Must Improve Controls and Integrate Its Information System to Manage Fraud Potential in the Renewable Fuel Standard Program* (Sept. 2023).

National Laboratory.<sup>43</sup> Fuel compliance officers also conduct inspections in support of excise tax examinations and registration reviews. However, we believe that the IRS should evaluate if there are opportunities to use the EPA's expertise when conducting examinations and investigations relating to biofuels, including taxpayers that claimed alternative fuel tax credits such as credits for liquefied petroleum gas. This could be useful because several examination initiatives involving biofuel tax credits have higher no-change rates (as noted previously) and this could help identify noncompliance.

From our analysis of the IRS's fraud detection efforts, including methodologies to identify questionable biofuel credit claims and our review of specific fraud cases, including the Washakie case, it is clear that the IRS's procedures for identifying and stopping fraudulent claims can be improved. With the passage of additional and expanded clean energy tax credits in the IRA, there is even greater incentive to take advantage of biofuel tax credits and make fraudulent claims for biofuel that does not exist or does not qualify for the biofuel tax credits. We believe that by implementing the recommendations in this report, the IRS can take steps to better ensure that fraudulent claims for biofuel tax credits are identified and stopped prior to the issuance of erroneous refunds.

**Recommendation 4:** The Commissioner, SB/SE Division, and Chief, Criminal Investigation, should identify opportunities to partner with the EPA to use the agency's expertise and data when selecting, conducting examinations and investigations involving taxpayers that claimed biofuel tax credits and revise the MOU as needed.

**Management's Response:** IRS management agreed with this recommendation and is working with the EPA to identify opportunities to use the agency's expertise and data when selecting, conducting examinations and investigations involving taxpayers that claimed biofuel tax credits. If it identifies additional opportunities, it will notify the EPA that it would like to update the MOU.

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<sup>43</sup> Internal Revenue Manual 4.24.13, Excise Tax, Overview of Excise Fuel Compliance Program. (Feb. 11, 2021).

## **Appendix I**

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

The overall objective of this audit was to assess the effectiveness of IRS procedures to detect and prevent questionable claims for biofuel tax credits. To accomplish our objective, we:

- Evaluated the status of the MOU with the EPA by interviewing applicable SB/SE Division personnel and reviewing SB/SE Division analysis of the data provided by the EPA.
- Determined the current procedures used for screening tax returns claiming biofuel tax credits and identifying questionable claims for examination. We interviewed personnel from the SB/SE and Wage and Investment Divisions and obtained information on the current examination initiatives related to biofuel tax credits. We also analyzed Audit Information Management System data identified from TIGTA's Data Center Warehouse related to the examination initiatives related to biofuel tax credits.
- Assessed CI's efforts to identify and conduct criminal investigations involving fraudulent claims for biofuel tax credits. We (1) obtained and analyzed information from the CI Management Information System on criminal investigations closed from October 2017, through March 2023 that involved biofuels; (2) interviewed two special agents who participated in the Washakie Renewable Energy criminal investigations; and (3) interviewed CI personnel from the Nationally Coordinated Investigations Unit on their efforts to identify biofuel tax credit fraud using data analytics.
- Determined the number and amount of biofuel tax credits claimed by obtaining data extracts containing Form 4136; Form 6478; Form 8849, Schedule 3; and Form 8864 data from the Modernized Tax Return Database. This identified returns that were filed electronically.
- Analyzed IDRS and tax return information on the Employee User Portal for a judgmental sample of 124 taxpayers from a population of 6,597 that made biofuel tax credit claims on either the Form 4136; Form 6478; Form 8849, Schedule 3; or Form 8864 filed during Processing Year 2022 to determine if they were properly registered or provided a Certificate of Biodiesel.<sup>1</sup>

### **Performance of This Review**

This review was performed with information obtained from the Criminal Investigation Headquarters in Washington, DC; the SB/SE Division Headquarters in Lanham, Maryland; and the Wage and Investment Division Headquarters in Atlanta, Georgia during the period August 2022 through November 2023. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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<sup>1</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

Major contributors to the report were Matthew A. Weir, Acting Deputy Inspector General for Audit; Phyllis Heald London, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations); Tim Greiner, Director; Eugenia Smoak, Audit Manager; Jeff K. Jones, Lead Auditor; Victor Taylor, Senior Auditor; Ismael Hernandez-Rosario, Information Technology Specialist; and Laura Christoffersen, Data Analyst, Applied Research and Technology Division.

### **Data Validation Methodology**

During this review, we relied on Form 4136; Form 6478; Form 8849, Schedule 3; and Form 8864 data from the Modernized Tax Return Database. We compared the amount of biofuel tax credit claimed according to the data extract to the amount claimed on the tax return found on the Employee User Portal and determined that the data were sufficiently reliable for purposes of this audit.

We also relied on Audit Information Management System data obtained from TIGTA's Data Center Warehouse. We compared the accuracy of 10 taxpayer records to information on the IDRS and determined that the data were sufficiently reliable for purposes of this audit.

### **Internal Controls Methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: controls that identify taxpayers (tax returns) claiming questionable biofuel tax credits for examination. We evaluated these controls by interviewing and corresponding with key personnel and analyzing Audit Information Management System data obtained from TIGTA's Data Center Warehouse.

## Appendix II

### 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:**

- Revenue Protection – Potential; 42 biofuel tax credit claims totaling \$30,270,256 in which the taxpayers did not provide a valid registration number or did not provide the Certificate of Biodiesel (see Recommendation 2).

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

We selected a judgmental sample of 124 taxpayers that claimed biofuel tax credits during Processing Year 2022 to determine if they were properly registered or if they provided the Certificate of Biodiesel indicating that the producer of the biodiesel is registered with the IRS.<sup>1</sup> This included 75 business taxpayers that claimed the biodiesel or renewable diesel mixture Credits on the Form 8849, Schedule 3; Form 4136; and Form 8864, 24 business taxpayers that claimed alternative fuel credits on the Form 4136, and 25 business taxpayers that claimed second generation biofuel tax credits on the Form 6478.

For the 124 sample cases, we reviewed IDRS data and tax return information on the Employee User Portal. We found that all 25 taxpayers that made claims for biodiesel or renewable diesel mixture credits on the Form 8849, Schedule 3, were either properly registered with the IRS or provided the Certificate of Biodiesel. However, we found that most of the remaining taxpayers either did not provide a valid registration number or did not provide the Certificate of Biodiesel. Without the proper registration or the Certificate of Biodiesel, these claims would not be allowable. Specifically, we found that taxpayers did not provide:

- The required valid registration for 13 of the 24 claims for refundable alternative fuel credits totaling \$25,750,247 made on the Form 4136.
- A Certificate of Biodiesel for 10 of the 25 claims for refundable biodiesel or renewable diesel mixture credits totaling \$908,126 made on the Form 4136.
- A Certificate of Biodiesel for 19 of the 25 claims for nonrefundable biodiesel or renewable diesel mixture credits totaling \$3,611,883 made on the Form 8864.

Overall, a total of 42 (13 + 10 + 19) biofuel tax credit claims totaling \$30,270,256 (\$25,750,247 + \$908,126 + \$3,611,883) involved taxpayers not providing a valid registration number or a Certificate of Biodiesel.

**Management's Response:** IRS management disagreed with this outcome measure, stating it lacks the legal authority to deny or otherwise effectively enforce the registration and certificate requirements at the time of filing. To measure the outcome,

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<sup>1</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

the IRS would have to conduct a full examination of these returns to potentially disallow these claims.

**Office of Audit Comment:** In recommendation 2, we ask the IRS to establish a Compliance Initiative Project of the 42 taxpayers in order to conduct an examination of these returns to potentially disallow these claims. While IRS management partially agreed to recommendation 2, we disagree with IRS management's proposed alternate corrective action. We believe that compliance activity is warranted given these 42 taxpayers were allowed over \$30 million in biofuel tax credits while not providing a valid registration number or not providing the Certificate of Biodiesel. Compliance Initiative Projects involve contact with specific taxpayers to identify potential areas of noncompliance for the purpose of correcting the noncompliance. For these 42 cases, the Compliance Initiative Project approach is ideal in that the results of the examinations will be closely tracked with project codes and provide IRS management with additional support in discussions with the Department of Treasury's Office of Tax Policy (recommendation 1).

## Appendix III

### Internal Revenue Code Sections Related to the Biofuel Tax Credit

| I.R.C. § | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 34       | Provides a refundable income tax credit for the alternative fuel credit, biodiesel and renewable diesel mixture credit, and sustainable aviation fuel credit in an amount equal to the sum of the credit under I.R.C. § 6427(e). Credit is not allowed for any amount that was paid under I.R.C. § 6427.                                                                                                                                                                                                                                |
| 40       | Provides that a nonrefundable credit is claimed on the Form 6478, <i>Biofuel Producer Credit</i> , and consists of the second generation biofuel producer credit.                                                                                                                                                                                                                                                                                                                                                                       |
| 40A      | Provides a nonrefundable credit for biodiesel or renewable diesel that is sold for use as a fuel or used as a fuel in the taxpayer's trade or business.                                                                                                                                                                                                                                                                                                                                                                                 |
| 4041     | Imposes tax on any liquid other than gasoline that is sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle or train or used by any such person as a fuel in a diesel-powered train. It also imposes tax on any liquid (other than gasoline) and compressed natural gas that is sold by any person to an owner, lessee, or other operator of a motor vehicle or motorboat for use as a fuel in such motor vehicle or motorboat or used by any person as a fuel in a motor vehicle or motorboat. |
| 4081     | Tax is imposed on the sale or removal of blended taxable fuel by the blender thereof.                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| 4101     | Provides the IRS with the authority to require businesses to register with the IRS before engaging in certain excise activities.                                                                                                                                                                                                                                                                                                                                                                                                        |
| 6426     | Provides a credit against tax imposed by I.R.C. § 4081 for the alternative fuel mixture credit, biodiesel and renewable diesel mixture credit, and sustainable aviation fuel credit. It also provides a credit against tax imposed by I.R.C. § 4041 for the alternative fuel credit.                                                                                                                                                                                                                                                    |
| 6427(e)  | To the extent that the biodiesel or renewable diesel mixture credit or sustainable aviation fuel mixture credit described in I.R.C. § 6426(c) and (k) exceeds a person's I.R.C. § 4081 liability, payment is allowable to the producer of the mixture. To the extent that the alternative fuel credit described in I.R.C. § 6426(d) exceeds a person's I.R.C. § 4041 liability for a quarter, payment is allowable to the alternative fueler.                                                                                           |

*Source: SB/SE Division Biodiesel Help Guide and Excise Revenue Agent Basic Recruit Training – Phase 2 with revisions provided by the SB/SE Division.*

## Appendix IV

### Tax Forms Related to the Biofuel Tax Credit

| Tax Form     | Description and Purpose                                                                                                                                                                                                                                                                                                                    |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3800         | <b>General Business Credit</b> summarizes all of the various credits claimed and calculates the total General Business Credit amount allowed in the current year.                                                                                                                                                                          |
| 4136         | <b>Credit for Federal Tax Paid on Fuels</b> claims biodiesel, renewable diesel, and alternative fuel credits as refundable income tax credits on the taxpayer's Federal income tax return when any amount of biodiesel, renewable diesel, or alternative fuel have not been claimed on the Form 8849, Schedule 3, or Form 720, Schedule C. |
| 637          | <b>Application for Registration (For Certain Excise Tax Activities)</b> registers a business with the IRS before it engages in certain excise activities.                                                                                                                                                                                  |
| 6478         | <b>Biofuel Producer Credit</b> claims the I.R.C. § 40 nonrefundable credit consisting of the second generation biofuel producer credit.                                                                                                                                                                                                    |
| 720          | <b>Quarterly Federal Excise Tax Return</b> reports liability by IRS number, pays the excise taxes on the form, and makes claims against the liability.                                                                                                                                                                                     |
| 8864         | <b>Biodiesel and Renewable Diesel, or Sustainable Aviation Fuels Credit</b> claims the I.R.C. § 40A nonrefundable credit for biodiesel and renewable diesel sold for use as a fuel or used as a fuel in the taxpayer's trade or business.                                                                                                  |
| 8849, Sch. 3 | <b>Certain Fuel Mixtures and the Alternative Fuel Credit</b> requests a payment for the excess amount of the credits in lieu of claiming the refundable income tax credit on a Federal income tax return.                                                                                                                                  |

Source: IRS.gov.

## Appendix V

### Current Examination Initiatives Related to the Biofuel Tax Credit

| Title                                                         | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Tracking Code | Month/Year Initiated                                                      |
|---------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------------------------------------------------------------------------|
| Biofuel Claims for Credit Reference Numbers 307, 388, and 390 | Addresses biofuel claims made on the Form 720, Schedule C, or the Form 8849, Schedule 3. Created to address compliance issues related to these types of excise tax claims. These are selected based on certain criteria such as no related income tax return filed or credit reference number dissonance from the business name.                                                                                                                                                                                                                                                                                                                             | 4220          | May 2022                                                                  |
| Biodiesel Blenders Below the Rack                             | Position holders of disbursed nontaxable biodiesel blends, who are also identified as a fuel wholesaler or retailer, should be reporting tax on Form 720 sufficient for the volume of the disbursed product. These cases are selected when the estimated tax is \$1,000 or more than the estimated liability.                                                                                                                                                                                                                                                                                                                                                | 6300          | November 2009;<br>Revised in March 2014 and September 2017                |
| Workload Return System                                        | <p>Workload Return System provides a "snapshot view" of each excise taxpayer's filings based on summary statistics for filed Form 720; Form 8849, Schedule 3; Form 2290; and Form 637 and the Anomaly Integration Model for Form 720 Returns score for Form 720 returns. This score reflects the overall likelihood of an assessment based on prior audit results.</p> <p>The Workload Return System will be used to identify taxpayers for examination based on ranking of filing habits, Anomaly Integration Model scores, total tax reported, and total claim amount. Fairness in case selection criteria will be used to select the best case first.</p> | 6569          | Initiated in 2005;<br>Chartered in June 2014, December 2017, and May 2021 |
| Form 637, M Registrant Nonfilers                              | <p>The "M" activity letter signifies a blender of gasoline, diesel fuel (including a diesel-water fuel emulsion), or kerosene producing a taxable fuel outside the bulk transfer/terminal system, including blenders of alcohol fuel mixtures, alternative fuel mixtures, biodiesel mixtures, and renewable diesel mixtures.</p> <p>"M" registrants should have a Form 720 filing requirement, because the "M" activity letter signifies producing a taxable fuel outside the bulk transfer/terminal system. The "M" 637 registrant list is compared to Form 720 filings to select nonfilers.</p>                                                            | 6608          | August 2020                                                               |
| Nontaxable Use Claims for Alternative Fuels                   | Identifies entities that file nontaxable use of alternative fuel claims on the Form 720, Schedule C, and Form 8849, Schedule 1. Generally, nontaxable use claims for alternative fuels should not occur due to the excise tax on alternative fuels not being imposed until the time of sale or use. Therefore, it would be unlikely that a claim for refund of the excise tax paid for the nontaxable use of alternative fuels would be allowable. Analyst will run a query of all Form 8849 and Form 720, Schedule C nontaxable use of alternative fuel claims.                                                                                             | 6696          | April 2022                                                                |

## Additional Actions Need to Be Taken to Identify and Address Noncompliant Biofuel Tax Credit Claims

| Title                                                                         | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Tracking Code | Month/Year Initiated                                                                                        |
|-------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------------------------------------------------------------------------------------------------------|
| Alternative Fuel Mixture Credits for Butane and Gasoline Blends               | The IRS outlined in Revenue Ruling 2018-2, butane is not an alternative fuel listed under I.R.C. § 6426(d). Therefore, butane and gasoline (or any other gasoline blendstock) mixtures are not alternative fuel mixtures for purposes of the alternative fuel mixture credit.                                                                                                                                                                                                                                                                                                                                                                        | 6763          | May 2017                                                                                                    |
| Alternative Fuels and Alternative Fuels Mixture Credits                       | Identifies entities that may be underreporting or not reporting Fuel Tax liability on Form 720 for abstracts corresponding to the Credit Reference Number of fuel credits claimed on Form 8849, Schedule 3, or Form 720, Schedule C. Alternative fuel and alternative fuel mixture credit gallons are compared to the corresponding Form 720 fuel abstract gallons.                                                                                                                                                                                                                                                                                  | 6771          | November 2010,<br>Updated:<br>September 2017 and August 2020                                                |
| Propane and Butane Mixture Claims                                             | Monitors cases involving claims for propane and butane mixes.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | 6774          | March 2018                                                                                                  |
| Tax Year 2018 Form 1040 Excise Referral Returns Compliance Initiative Project | Identifies potential areas of noncompliance with excise fuel credits through data analysis. There is currently no specific excise tax fuel credit initiative within the SB/SE Division Excise Tax Program or SB/SE Division Income Tax Examination to address fuel credits filed with income tax returns. These examinations are focused on individual taxpayers.                                                                                                                                                                                                                                                                                    | 7635          | September 2020                                                                                              |
| Volume Comparison 720-TO vs. 720                                              | Identifies entities that may be underreporting or not reporting fuel taxes imposed on disbursements from terminals. This initiative may also identify terminals that have incorrectly reported information on Form 720-TO. Leads are identified by comparing the volume of taxable fuel products disbursed from terminals (per Form 720-TO) for each position holder versus their corresponding Form 720. Consideration is given to Form 720-TO reporting errors, e.g., related entity should have been listed as the position holder. The remaining nonfilers and underreporters are selected. Referrals are made for Form 720-TO reporting errors. | 7663          | March 2009,<br>Updated:<br>June 2010,<br>November 2013,<br>January 2017,<br>September 2017, and August 2020 |
| Biodiesel Blenders Below the Rack - Claims                                    | Claim anomalies are generated if the total tax-reported gallons on the Form 720 are lower than the total amount of biodiesel gallons claimed on the Form 720 or on the Form 8849, Schedule 3, during a given calendar quarter. If the shortfall is greater than \$1,000 in any calendar quarter, the lead is output.                                                                                                                                                                                                                                                                                                                                 | 7721          | November 2009,<br>Updated:<br>March 2014 and September 2017                                                 |
| Biofuel Claims vs EPA RIN Data                                                | Identifies leads when the gallons claimed on Form 720, Schedule C, and Form 8849, Schedule 3, are more than the RIN activity of fuel generated. Further investigation is necessary to determine if the biodiesel or renewable diesel claim is potentially overstated.                                                                                                                                                                                                                                                                                                                                                                                | 8398          | December 2021                                                                                               |
| Retroactive Fuel Claims                                                       | Identifies noncompliance on one-time claims for credits and payments allowable under I.R.C. §§ 6426(c), 6426(d), and 6427(e) for biodiesel mixtures and alternative fuels sold or used.                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 9971          | March 2016,<br>Updated:<br>October 2017 and August 2020                                                     |
| Fuel Summit Project                                                           | Excise led compliance project that developed strategies that are used by the fuel summit tracking code.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 9973          | May 2020                                                                                                    |

Source: SB/SE Division.

## Appendix VI

### Management's Response to the Draft Report



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

March 26, 2024

MEMORANDUM FOR MATTHEW A. WEIR  
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT  
Amalia C. Colbert  
FROM: Lia Colbert      Colbert  
Commissioner, Small Business/Self-Employed Division  
SUBJECT: Draft Audit Report – Additional Actions Need to Be Taken to  
Identify and Address Noncompliant Biofuel Tax Credit Claims.  
(Audit # 202330023)

Digitally signed by Amalia  
C. Colbert  
Date: 2024.03.26  
08:25:38 -0400

Thank you for the opportunity to review and comment on TIGTA's draft report entitled, *Additional Actions Need to Be Taken to Identify and Address Noncompliant Biofuel Tax Credit Claims*. Improper biofuel claims are an important area of focus for the IRS. The credit is intended to encourage the production of cleaner energy sources. This includes tax credits for biodiesel, renewable diesel, alternative fuels, and second-generation biofuels and, as such, is not available to most taxpayers.

While we agree with TIGTA that compliance checks at the time of filing could prevent potential erroneous claims, we are unable to identify biofuel claims that lack a valid registration number or certificate of biodiesel because the provisions governing this credit lack the requirement that registration and certification be evidenced on the tax return. See Internal Revenue Code sections 40A(b)(3) and 6426(a). In addition, we lack the math error authority under Internal Revenue Code section 6213(b)(1) to disallow these returns at time of filing. To bring taxpayers into compliance, we are required to conduct full examinations of potentially erroneous returns and we select returns that reflect the most efficient use of our resources.

We review our initiatives and evaluate their effectiveness periodically. Several of the initiatives with high no-change rates have been discontinued and are no longer used to select cases.

We are currently working with the Environmental Protection Agency (EPA) to determine if there is additional information that can be provided to the IRS to assist us with our compliance efforts. We currently use the EPA data for compliance purposes; however,

this data does not correspond well with the data required to be provided by the taxpayer. For this reason, we use other data to develop filters that provide more productive results for case selection while using the EPA data during examinations. We look forward to continued collaboration with the EPA to ensure we are using all of the information available for tax compliance.

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

Attachment

Attachment

**RECOMMENDATION 1:**

The Commissioner, Wage and Investment Division, should engage with the Department of Treasury's Office of Tax Policy to develop a legislative proposal to require that taxpayers claiming biofuel tax credits provide information that they are properly registered (if applicable) or that they provided the required Certificate of Biodiesel when income tax returns are filed.

**CORRECTIVE ACTION:**

We agree to share TIGTA's report with the Department of Treasury's Office of Tax Policy, explain the current law and compliance constraints during filing, and support Treasury if it determines to proceed with a legislative proposal to address this issue.

**IMPLEMENTATION DATE:**

October 15, 2024

**RESPONSIBLE OFFICIAL:**

Director, Specialty Exam Policy, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 2:**

The Commissioner, SB/SE Division, should establish a Compliance Initiative Project to conduct examinations of the 42 taxpayers reported in Figure 5 to ensure the validity of the biofuel tax credits that were claimed and that these taxpayers are properly registered and have the required certificates (that contain a valid registration number).

**CORRECTIVE ACTION:**

We agree, in part. We will review the 42 tax returns identified by TIGTA and determine if compliance activity is warranted.

**IMPLEMENTATION DATE:**

December 15, 2024

**RESPONSIBLE OFFICIAL:**

Director, Exam Case Selection, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 3:**

The Commissioner, SB/SE Division, should evaluate if there are opportunities to include biofuel tax credit claims made on the Form 4136 into ongoing examination initiatives involving biofuel.

**CORRECTIVE ACTION:**

We agree. We will evaluate our biofuel initiatives and determine if Form 4136 data will add value to case selection.

**IMPLEMENTATION DATE:**

December 15, 2024

**RESPONSIBLE OFFICIAL:**

Director, Exam Case Selection, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 4:**

The Commissioner, SB/SE Division, and Chief, Criminal Investigation, should identify opportunities to partner with the EPA to use the agency's expertise and data when selecting, conducting examinations and investigations involving taxpayers that claimed biofuel tax credits and revise the MOU as needed.

**CORRECTIVE ACTION:**

We agree. We are working with the EPA to identify opportunities to use the agency's expertise and data when selecting, conducting examinations and investigations involving taxpayers that claimed biofuel tax credits. If additional opportunities are identified, we will notify the EPA that we would like to update the MOU.

**IMPLEMENTATION DATE:**

July 15, 2025

**RESPONSIBLE OFFICIAL:**

Director, Exam Case Selection, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**Type and Value of Outcome Measure:**

Revenue Protection – Potential; 42 biofuel tax credit claims totaling \$30,270,256 in which the taxpayers did not provide a valid registration number or did not provide the Certificate of Biodiesel (see Recommendation 2).

**IRS Response**

We disagree with your outcome measure. The IRS lacks the legal authority to deny or otherwise effectively enforce the registration and certificate requirements at the time of filing. To measure the outcome, the IRS would have to conduct a full examination of these returns to potentially disallow these claims.

## Appendix VII

### Glossary of Terms

| Term                                       | Definition                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|--------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Agri-biodiesel                             | Biodiesel derived solely from virgin oils, and animal fats.                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| Campus                                     | 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 taxpayer accounts.                                                                                                                                                                                                                                                                                                    |
| Employee User Portal                       | Internal IRS portal that allows IRS employee users to access data systems, such as tax administration processing systems, financial information systems, and other data and applications, including mission-critical applications. TIGTA auditors can also request access to this information.                                                                                                                                                                                                         |
| Environmental Protection Agency (EPA)      | A Federal agency with the mission to protect human health and the environment. The EPA develops and implements policies and regulations to reduce air pollution and emissions from mobile sources and the fuels that power them, including advancing clean fuels and technology. In this role, the EPA collects data from regulated parties on gasoline, diesel, renewable fuels, and other transportation fuels to assess program implementation and compliance with fuels standards and regulations. |
| Excise Tax                                 | Excise taxes are levied on a variety of goods, services, and activities. The tax may be imposed at the time of sale (by the manufacturer or retailer) or use (by the consumer). Excise taxes are independent of income taxes. <sup>1</sup>                                                                                                                                                                                                                                                             |
| Fiscal Year                                | Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.                                                                                                                                                                                                                                                                                                                                    |
| Internal Revenue Code                      | The body of law that codifies all Federal tax laws. These laws constitute Title 26 of the United States Code, which is a consolidation and codification by subject matter of the general and permanent laws of the United States.                                                                                                                                                                                                                                                                      |
| Internal Revenue Manual                    | Primary source of instructions to employees relating to the administration and operation of the IRS. It contains the directions employees need to carry out their operational responsibilities.                                                                                                                                                                                                                                                                                                        |
| Large, Unusual, or Questionable Issues     | Items that include income, deductions, balance sheet, and credit items. Issues that appear on the return, which if left unexplained, might raise doubt or cause confusion to a reviewer of the closed examination.                                                                                                                                                                                                                                                                                     |
| Modernized Tax Return Database             | The official repository of all electronic returns processed through the Modernized e-file system.                                                                                                                                                                                                                                                                                                                                                                                                      |
| Nationally Coordinated Investigations Unit | Formed by IRS Criminal Investigation during Calendar Year 2017 to partner with internal and external stakeholders using a data-driven approach to deliver high-impact investigations and address emerging threats to advance CI's mission.                                                                                                                                                                                                                                                             |
| No-Change Rate                             | A no-change is where all examined issues are accepted as reported.                                                                                                                                                                                                                                                                                                                                                                                                                                     |

<sup>1</sup> Internal Revenue Manual, *Excise Taxes- General Information*, 4.24.1.3 (Mar. 17, 2023).

## Additional Actions Need to Be Taken to Identify and Address Noncompliant Biofuel Tax Credit Claims

| Term                           | Definition                                                                                                                                                                                                                                                                                                        |
|--------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Statistics of Income Division  | Collects, analyzes, and disseminates information on Federal taxation for the Department of the Treasury's Office of Tax Analysis, congressional committees, IRS business units in its administration of the tax laws, other organizations engaged in economic and financial analysis, and for the general public. |
| Submission Processing Function | The data processing arm of the IRS that processes paper and electronic submissions, corrects errors, and forwards data to the Computing Centers for analysis and posting to taxpayer accounts.                                                                                                                    |
| Tax Year                       | The 12-month period for which tax is calculated.                                                                                                                                                                                                                                                                  |

## Appendix VIII

### Abbreviations

|        |                                                   |
|--------|---------------------------------------------------|
| CI     | Criminal Investigation                            |
| ECS    | Excise Case Selection                             |
| EPA    | Environmental Protection Agency                   |
| IDRS   | Integrated Data Retrieval System                  |
| IRA    | Inflation Reduction Act                           |
| I.R.C. | Internal Revenue Code                             |
| IRS    | Internal Revenue Service                          |
| MOU    | Memorandum of Understanding                       |
| RFS    | Renewable Fuel Standard                           |
| RIN    | Renewable Identification Number                   |
| SB/SE  | Small Business/Self-Employed                      |
| TIGTA  | Treasury Inspector General for Tax Administration |



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contact our hotline on the web at [www.tigta.gov](http://www.tigta.gov) or via e-mail at  
[oi.govreports@tigta.treas.gov](mailto:oi.govreports@tigta.treas.gov).**

**To make suggestions to improve IRS policies, processes, or systems  
affecting taxpayers, contact us at [www.tigta.gov/form/suggestions](http://www.tigta.gov/form/suggestions).**

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