INTERNAL REVENUE SERVICE

IRS News Release

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Excessive Claims for Business Credits Makes the IRS "Dirty Dozen" List of Tax Scams

IRS YouTube Videos:
Dirty Dozen – English | Spanish | ASL

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WASHINGTON — The Internal Revenue Service today warned that taxpayers should watch for improper claims for business credits, which is on the "Dirty Dozen" list of tax scams for the 2017 filing season.

Compiled annually, the "Dirty Dozen" lists a variety of common scams that taxpayers may encounter any time but many of these schemes peak during filing season as people prepare their returns or hire people to help with their taxes.

Fuel Tax Credit Scams

Fraud involving the fuel tax credit is considered a frivolous tax claim and can result in a penalty of $5,000. Furthermore, illegal scams can lead to significant penalties and interest and possible criminal prosecution. IRS Criminal Investigation works closely with the Department of Justice (DOJ) to shutdown scams and prosecute the criminals behind them.

The fuel tax credit is generally limited to off-highway business use or use in farming. Consequently, the credit is not available to most taxpayers. Still, the IRS routinely finds unscrupulous preparers who have enticed sizable groups of taxpayers to erroneously claim the credit to inflate their refunds.

The federal government taxes gasoline, diesel fuel, kerosene, alternative fuels and certain other types of fuel. Certain commercial uses of these fuels are nontaxable. Individuals and businesses that purchase fuel for one of those purposes can claim a tax credit by filing Form 4136, Credit for Federal Tax Paid on Fuels.

The tax is on fuels used to power vehicles and equipment on roads and highways. Taxes paid for fuel to power vehicles and equipment used off-road may qualify for the tax credit and may include farm equipment, certain boats, trains and airplanes.

Improper claims for the fuel tax credit generally come in two forms. An individual or business may make an erroneous claim on their otherwise legitimate tax return. Or an identity thief may claim the credit in a broader fraudulent scheme.

The IRS has taken a number of steps to improve compliance processes involving fuel tax credits. IRS compliance filters are preventing a significant number of questionable fuel tax credit claims from being processed. For example, new identity theft screening filters have also improved the IRS's ability to identify questionable fuel tax credit claims during return processing.

The IRS has taken additional steps to identify returns for review that claim fuel tax credits, including broadening the identification criteria to ensure a more comprehensive compliance approach in selecting questionable tax returns.

Research Credit Scams

The research credit is an important feature in the tax code to encourage research and experimentation by the private sector.

The IRS continues to see significant misuse of the research credit. Improper claims for this credit generally involve a failure to participate in or substantiate qualified research activities and/or a failure to satisfy the requirements related to qualified research expenses.

To qualify for the credit, a taxpayer's research activities must, among other things, involve a process of experimentation using science that is intended to improve a product or process the taxpayer holds for sale or lease. However, there are certain activities, including research after commercial production, adaptation of an existing business product or process, foreign research and research that is funded by the customer that are specifically excluded from the credit. Qualified activities also do not include activities where there is no uncertainty about the taxpayer's method or capability to achieve a desired result.

The IRS often sees expenses from non-qualified activities included in claims for the research credit. In addition, qualified research expenses include only in-house research expenses and contract research. Qualified research expenses do not include expenses without a proven nexus between the claimed expenses and the qualified research activity.

Section 41 of the Internal Revenue Code provides a credit for increasing research activities, commonly known as the "research credit." Congress enacted the research credit in 1981 to provide an incentive for American industry to invest in research and experimentation. Since its enactment, the research credit has been extended 16 times, until it became permanent in December 2015 for amounts paid after Dec. 31, 2014.

Taxpayers who qualify for the credit may claim up to 20 percent of qualified expenses above a base amount by completing and attaching Form 6765, Credit for Increasing Research Activities, to their tax return. For tax years beginning in 2016, eligible small businesses may use the research credit to offset the alternative minimum tax. Also for tax years beginning in 2016, qualified small businesses may elect to use a portion of the research credit as a payroll tax credit against the employer's portion of the Social Security tax. Qualified small businesses make this election on Form 6765 and must complete and attach Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities, to their Form 941, Employer's Quarterly Federal Tax Return.

To claim a research credit, taxpayers must evaluate and document their research activities over a period of time to establish the amount of qualified research expenses paid for each qualified research activity. While taxpayers may estimate some research expenses, taxpayers must have a factual basis for the assumptions used to create the estimates.

Unsupported claims for the research credit may subject taxpayers to penalties. Taxpayers should carefully review reports or studies prepared by third parties to ensure they accurately reflect the taxpayer's activities. Third parties who are involved in the preparation of improper claims or research credit studies also may be subject to penalties.