



INSPECTOR GENERAL
FOR TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20005

April 15, 2020

The Honorable Robert Menendez
United States Senate
528 Senate Hart Office Building
Washington, DC 20510

Dear Senator Menendez:

This is in response to your November 19, 2019, request for my office to undertake a review of the discrepancies between the amount of Internal Revenue Code (I.R.C.) Section (§) 45Q tax credits that have been claimed and the amount of sequestered carbon reported to the Environmental Protection Agency (EPA). You asked us to respond to the questions set out below. We have answered those questions using information obtained from the Internal Revenue Service's (IRS) Large Business and International (LB&I) Division during the period of January through March 2020.

Question 1: What is the reason for the discrepancy between the amount of sequestered carbon cited by claimants of the I.R.C. § 45Q tax credit versus the amount of sequestered carbon reported to the EPA under Subpart RR?

The reason for the discrepancy is that some taxpayers have claimed the I.R.C. § 45Q credit on tax returns without complying with the EPA's monitoring, reporting, and verification (MRV) requirements.¹

Question 2: What is the value of the I.R.C. § 45Q tax credits claimed for sequestered carbon that was not in compliance with the EPA's Subpart RR monitoring, reporting, and verification requirements?

For Tax Years (TYs) 2010 through 2019, we identified a total of 672 taxpayers who claimed the I.R.C. § 45Q credit on their tax returns, with credits totaling over \$1 billion. We identified the following number of taxpayers and I.R.C. § 45Q credits claimed:

¹ Under subpart RR, facilities that conduct geologic sequestration by injecting CO₂ for long-term containment in subsurface geologic formations are required to: report basic information on carbon dioxide received for injection, develop and implement an EPA-approved site-specific MRV plan, and report the amount of carbon dioxide geologically sequestered using a mass balance approach and annual monitoring activities.

Figure 1: TY 2010-2019 Taxpayers Who Claimed § 45Q Credits

Range of Total Credits Claimed	Number of Taxpayers	Percent of Taxpayers	Credits Claimed	Percent of Credits Claimed
\$0 - \$1,000	592	88.10%	\$39,656	0.00%
\$1,000 - \$10,000	56	8.33%	\$212,749	0.02%
\$10,000 - \$1 million	14	2.08%	\$1,213,397	0.12%
Over \$1 million	10	1.49%	\$1,024,900,044	99.86%
Total	672	100.00%	\$1,026,365,846	100.00%

Source: Business Returns Transaction File data as of February 13, 2020.

Of the 672 taxpayers that reported carbon dioxide sequestration to the IRS, 10 taxpayers (one and a half percent) claimed over \$1 million each, with their claims totaling over \$1 billion (99.9 percent) of all of the I.R.C. § 45Q credits. We reviewed these 10 taxpayers and determined that three currently have an approved MRV plan with the EPA.

We determined that for TYs 2010 through 2019, a total of \$893,935,025 (87 percent) worth of I.R.C. § 45Q credits were claimed by these 10 taxpayers when they were not in compliance with the EPA (*i.e.*, they did not have an approved MRV Plan in place at the time the credit was claimed).

Question 3: What enforcement actions should the IRS take to ensure that in the future, all claimants of the I.R.C. § 45Q tax credit are complying with the required monitoring, reporting, and verification requirements?

To ensure that all claimants of the I.R.C. § 45Q credit are in compliance with the MRV requirements, the IRS Examination functions would have to consider a campaign or special project to examine every taxpayer that claimed the credit. IRS management informed us that a campaign or special project to verify that all taxpayers are compliant when claiming the credit would have to be initiated. LB&I uses risk analysis techniques to determine which issues to examine if a return is selected for audit. Taxpayers then have the right to go to the Office of Appeals if they properly protest the examiner's findings.

Question 4: What actions should the IRS take against previous claimants of the I.R.C. § 45Q tax credit that have not complied with the required EPA monitoring, reporting, and verification requirements?

The IRS has already focused audit resources on taxpayers who claimed over \$1 million of the I.R.C. § 45Q credit and should continue to do so. The IRS has taken action against four of the 10 taxpayers who improperly claimed over \$1 million of I.R.C. § 45Q

credits. In the cases where the I.R.C. § 45Q credit was examined, examiners have consistently denied the credit when taxpayers failed to comply with MRV requirements.²

We determined that the 10 taxpayers who claimed over \$1 million of I.R.C. § 45Q credits between TY 2010 and 2019 (including the four that were examined by the IRS) had a total of 30 tax modules with credits claimed. Of these, 25 (83 percent) modules had credits claimed with no approved MRV plan in place.

The IRS has examined 17 (68 percent) of these 25 modules and disallowed the credit in full for 14 (82 percent) of the cases. These disallowed credits total approximately \$531 million (59 percent of the noncompliant credits claimed).

Question 5: The IRS notes there may be a temporary discrepancy between the amount of tax credits claimed and the amount reported to the EPA due to ongoing audits. What percentage of the current claimants of the I.R.C. § 45Q tax credit are currently under an audit that may have created such a discrepancy?

Based on our review, the discrepancy between the amounts of carbon dioxide sequestration reported to the IRS and the amounts reported to the EPA is not based on ongoing audits. Taxpayers were reporting carbon dioxide sequestration to the IRS to claim I.R.C. § 45Q credits without having an approved MRV Plan in place and without complying with the EPA's reporting requirements. Therefore, the discrepancy is based on taxpayers reporting amounts of carbon dioxide sequestration to the IRS without reporting the amounts to the EPA as required. The EPA has all currently-approved MRV plans posted on its website, which can be used to reconcile claims for the I.R.C. § 45Q credit with volumes reported to EPA.

Neither the IRS nor the EPA have a requirement or agreement that the IRS will inform the EPA of information related to I.R.C. § 45Q credits (e.g., claimants, volumes of CO₂, and dollars claimed). In addition, there is no requirement for the taxpayer to amend what was reported to the EPA in prior years. Therefore, audit results would not affect what was reported to the EPA in prior years.

Three taxpayers still have open audits related to the I.R.C. § 45Q credit as of February 14, 2020, but the audit results will not have an impact on what was reported to the EPA in prior years.

Question 6: What is the IRS process for coordinating with EPA when it assesses an I.R.C. § 45Q claimant's eligibility for the tax credit? Should that process be altered in any manner to ensure full compliance with the law?

Neither the Internal Revenue Manual (IRM) nor the instructions to Form 8933 direct or suggest that IRS examiners coordinate with EPA personnel.³ The MRV plans posted by

² IRS examines cases based on tax module, which means a unique taxpayer, tax return type, and tax period. Examinations may include one or more modules per taxpayer.

³ IRM 4.41.1.3.5 *IRC 45Q Credit – Sequestration of Carbon Dioxide in Enhanced Oil or Natural Gas Project* (Dec. 12, 2013). Form 8933 *Carbon Oxide Sequestration Credit*.

the EPA on its website provide a very detailed description of the scope of the subject project and allows LB&I examiners to reconcile claims for the I.R.C. § 45Q credit with volumes reported to EPA. If an examiner needed to speak with EPA personnel, the examiner would need to abide by the Third-Party Contact Program.⁴ In addition, IRS examiners have the ability to coordinate with other governmental agencies via the IRS's Privacy, Governmental Liaison, and Disclosure Office.

In consultation with the Department of Energy and the EPA, the IRS and Treasury have been working on a proposed regulation and other guidance for I.R.C. § 45Q. An important step in this process is the IRS's issuance of Notice 2019-32, *Request for Comments on Credit for Carbon Oxide Sequestration*, to seek general comments on issues arising under § 45Q, as well as other related issues. Many stakeholders have submitted written comments requesting that the IRS approve a method other than the EPA's MRV process to substantiate secure geologic storage of carbon dioxide and to account for the volume of carbon dioxide that has been securely stored. If the new regulations adopt a different method, it could improve the IRS's ability to monitor compliance with the statute.

If you have any questions or require further information regarding this matter, please do not hesitate to call me at (202) 622-6500, or have a member of your staff contact Michael McKenney, Deputy Inspector General for Audit, at (202) 622-6510.

Sincerely,



J. Russell George
Inspector General

⁴ IRM 25.27.1 *Third Party Contact Program* (Oct. 19, 2017).