



July 2016

# INLAND WATERWAYS FUEL TAX

## Additional Data Could Enhance IRS's Efforts to Ensure Taxpayer Compliance

# GAO Highlights

Highlights of [GAO-16-682](#), a report to congressional committees

## Why GAO Did This Study

The inland waterways are a critical component of the nation's freight transportation system—moving over \$230 billion of coal and other bulk commodities in 2014. Vessel operators that transport these products via barge pay a \$0.29 per-gallon fuel excise tax, which provides partial funding for new construction and major rehabilitation of navigation infrastructure, such as locks and dams, on the waterways. From 2005 through 2014, the fuel tax generated about \$83 million per year. Any non-compliance, such as not filing or under-reporting the tax, would reduce available funding.

The Water Resources Reform and Development Act of 2014 included a provision for GAO to evaluate the efficiency of collecting the fuel tax and assess alternative collection methods. This report describes: (1) the results of IRS's efforts to ensure compliance from 2005–2014; (2) challenges IRS and inland waterways operators report in determining taxes owed; and (3) alternative methods of collecting the fuel tax under existing law, and their advantages and disadvantages. GAO analyzed IRS audit data from 2005–2014, the most recent available data; reviewed relevant tax policy papers and reports; and interviewed Corps, IRS, and Treasury officials, as well as a non-generalizable sample of 10 vessel operators to obtain perspectives on fuel tax compliance.

## What GAO Recommends

IRS should consult with the Corps to explore options to obtain relevant proprietary data to enhance IRS's efforts to ensure compliance with the inland waterways fuel tax. IRS agreed with the recommendation.

View [GAO-16-682](#). For more information, contact Rebecca Shea at (202) 512-2834 or [SheaR@gao.gov](mailto:SheaR@gao.gov).

July 2016

## INLAND WATERWAYS FUEL TAX

### Additional Data Could Enhance IRS's Efforts to Ensure Taxpayer Compliance

## What GAO Found

Based on results of audits, the Internal Revenue Service (IRS) views vessel operators to be substantially in compliance with requirements to report and pay the Inland Waterways Fuel Tax (fuel tax). IRS seeks to ensure compliance by auditing quarterly excise-tax returns filed by these operators, as well as identifying operators that failed to file (nonfilers).

- **Audits of filed returns:** IRS data show that IRS generally audited a higher percentage of fuel tax returns compared to all excise-tax returns from 2005 through 2014. Moreover, the percentage of tax returns examined that IRS accepted as filed exceeded 50 percent in 8 of the 10 years. According to IRS officials, this figure is a relatively high percentage of tax returns examined with no change, which suggests that vessel operators are generally properly reporting their fuel taxes. Where IRS determined additional taxes were owed, the average amount assessed per audit for each year varied, ranging from \$194 to \$7,192.
- **Non-filer audits:** In 2010, IRS began an effort to identify potential nonfilers and increase the number of non-filer audits. To identify nonfilers, IRS obtains vessel operator information published by the U.S. Army Corps of Engineers (Corps) and compares that information with tax filings. The average amount assessed per non-filer audit for each year from 2005 to 2014 varied, ranging from \$592 to \$12,550.

IRS and vessel operators face some challenges determining fuel taxes owed because, for example, only fuel used for propulsion purposes is taxed. Vessel operators may overstate or understate the gallons of fuel claimed for non-propulsion purposes, especially when the fuel is drawn from the same tank as the vessel's propulsion engines. The IRS also does not have access to proprietary Corps data, such as vessel identification and route data that may be useful in evaluating whether taxpayers are under-reporting their fuel taxes. According to federal internal control standards, management should design the agency's information system (i.e., the people, processes, data, and technology) and related control activities, such as audits, to achieve objectives and respond to risk. Even though IRS is using the Corps' public waterborne commerce and lock performance data, obtaining the proprietary data could help enhance IRS efforts to ensure compliance and potentially increase fuel tax revenues for navigation-infrastructure construction projects.

GAO identified a potential alternative collection method. Taxing the fuel at the wholesale or vendor level effectively removes the operators' tax-filing burden. This method could increase compliance, according to Department of the Treasury officials, as there would likely be fewer taxpayers responsible for reporting the fuel tax, but there could be increased administrative costs for operators seeking to file refunds for taxes paid on fuel used on nontaxable waterways or for non-propulsion purposes. Fuel-monitoring systems and Global Positioning System-enabled software could facilitate accurate fuel consumption readings and thus tax reporting under the current system, but according to vessel operators, the cost to equip vessels, such as towboats and tugboats, may be high, especially for smaller operators.

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**Abbreviations**

1978 Act	Inland Waterways Revenue Act of 1978
1986 Act	Water Resources Development Act of 1986
Corps	U.S. Army Corps of Engineers
GPS	Global Positioning System
IRS	Internal Revenue Service

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July 29, 2016

The Honorable James M. Inhofe  
Chairman  
The Honorable Barbara Boxer  
Ranking Member  
Committee on Environment and Public Works  
United States Senate

The Honorable Bill Shuster  
Chairman  
The Honorable Peter A. DeFazio  
Ranking Member  
Committee on Transportation and Infrastructure  
House of Representatives

The inland waterways of the United States are a critical component of the nation's freight transportation system. They are especially important in the transportation of heavy, bulk commodities such as coal, petroleum, chemicals, construction materials, and grain. These products are transported on barges—typically three abreast—and pushed by towboats, or by tugboats that maneuver individual barges within harbors and river ports. The inland waterways fuel tax (fuel tax)—an excise tax on diesel fuel used for propulsion purposes by towboats, tugboats, and other vessels in commercial waterway transportation—typically provides half of all funding for new construction and major rehabilitation of navigation infrastructure, such as locks and dams, on the inland waterways system, as authorized.<sup>1</sup> This fuel tax is self-reported by vessel operators on a quarterly basis to the Internal Revenue Service (IRS). The other half of funding for constructing and rehabilitating navigation infrastructure is

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<sup>1</sup>The U.S. inland waterway system is comprised of the navigable waterways of the Mississippi River and its tributaries, the Ohio River basin, the Gulf and Atlantic Intracoastal Waterways, and the Columbia River, among others. Navigation on this system is made possible by locks and dams. Locks provide navigation access through dams, by which vessels are lifted or lowered depending on the direction of travel.

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provided by general revenues from the U.S. Treasury.<sup>2</sup> The U.S. Army Corps of Engineers (Corps) is responsible for managing water resources, including the design, construction, operation, and maintenance of inland waterways for commercial navigation purposes.

From 2005 through 2014, the fuel tax generated approximately \$83 million per year in average revenues, which go into the Inland Waterways Trust Fund. The revenues were largely flat or declining in real terms over that period. Concerned with the amount of funding available for the nation's inland waterways' navigation infrastructure, a coalition of commercial barge, agricultural, and labor interests recently successfully pressed for an increase in the fuel tax from \$0.20 to \$0.29 per gallon, applicable for fuel used after March 31, 2015.<sup>3</sup> The Corps expects the \$0.09 increase in the fuel tax to result in an additional \$30 to \$35 million per year in the Inland Waterways Trust Fund, plus additional general revenue funds from the U.S. Treasury, to be used for navigation infrastructure projects.

Given that the fuel tax generates a significant share of all funds used for new construction and major rehabilitation of inland waterway infrastructure, non-compliance, such as not filing or under-reporting a tax liability would reduce available resources that could be used by the Corps to rehabilitate or modernize this infrastructure. The Water Resources Reform and Development Act of 2014 included a provision for us to evaluate the efficiency of collecting the quarterly, self-reported fuel tax and evaluate any alternatives.<sup>4</sup> This report describes (1) steps that the

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<sup>2</sup>Congress authorizes inland waterways navigation projects to be funded by fuel tax revenues and general revenues from the U.S. Treasury, although the costs for certain new construction and major rehabilitation projects may not always be evenly shared between these two sources. For example, the Water Resources Reform and Development Act of 2014 reduced the cost-sharing requirement of the industry on the Olmsted Locks and Dam project on the Ohio River from 50 to 15 percent. Pub. L. No. 113-121, title II, subtitle A, § 2006, 128 Stat 1193, 1267 (2014).

<sup>3</sup>Pub. L. No. 113-295 div. B. title II. § 205, 128 Stat. 4010, 4065 (2014), codified at 26 U.S.C. § 4042(b)(2)(A). The inland waterways industry has offered alternative proposals for funding the inland waterways system, including altering the current cost sharing practices between the industry and federal government. For a brief summary, see Kentucky Transportation Center, *Inland Waterways Funding Mechanisms Synthesis*, KTC-14-14/MTIC4-14-1F (Lexington, KY: Nov. 21, 2014).

<sup>4</sup>Pub. L. No. 113-121, title II, subtitle A, § 2003, 128 Stat. 1193, 1264.

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Internal Revenue Service (IRS) takes to help ensure compliance with the fuel tax and what the results of IRS's efforts from 2005 through 2014 show in terms of compliance; (2) challenges the IRS and selected inland-waterways operators report in determining taxes owed; and (3) potential alternative methods of collecting the inland-waterways fuel tax under existing tax law and regulations, and these methods' advantages and disadvantages.

To describe the steps IRS takes to help ensure compliance and determine the results of those efforts, we reviewed IRS publications and documentation made available to taxpayers, including tax forms, instructional material, and the audit techniques guide related to the fuel tax. We also reviewed IRS documentation describing the priorities and processes for identifying cases for audit and examination. In addition, we analyzed IRS audit data for the 10-year period from 2005 through 2014 (the most recent year data are available), including data on the overall number of individual taxpayers reporting a fuel tax liability and the overall number of tax filings each year. We also analyzed IRS statistics during this time period on: (1) the number of audits covering the fuel tax; (2) the number of audits focusing on nonfilers (i.e., vessel operators that may be liable for the fuel tax, but have not filed a tax return); (3) the percentage of IRS audits that resulted in no change to the filed tax return; and (4) other fuel tax audit data, including the additional tax, penalties, and interest assessed and collected. For purposes of our analysis, we calculated audit yield from the audit base (i.e., tax assessment), not the amount collected, which can be less. Also, we did not obtain access to individual taxpayer data. IRS also provided and we assessed labor cost data for IRS employees working directly on inland waterways fuel tax audits. Our data reliability assessment included reviewing relevant documentation, examining the data for obvious errors and outliers, and interviewing knowledgeable IRS officials. We determined that the data used in our analysis were sufficiently reliable for purposes of our reporting objectives.

To determine the challenges that IRS and selected inland waterways operators report in determining fuel tax owed, we reviewed IRS documentation used to guide inland waterways fuel tax audits. We also reviewed publicly available Corps data, such as lock performance statistics and waterborne commerce data, along with Corps' vessel characteristic and ownership publications. We assessed the extent to which the IRS and Corps have established communication channels to facilitate the sharing of proprietary versions of these data based on federal standards for internal control, which state that management should design the agency's information system and related control

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activities, such as audits, to achieve objectives and respond to risk.<sup>5</sup> An information system includes the people, processes, data, and technology that management organizes to obtain, communicate, or dispose of information. In addition, we reviewed our prior reports on tax compliance, including IRS audit selection and the impact of budget uncertainty on IRS.<sup>6</sup> We also interviewed Corps officials responsible for inland navigation issues, IRS officials responsible for excise tax issues, and a non-generalizable sample of 10 vessel operators to obtain perspectives on challenges users may face in determining the taxes owed. To select these operators, we first categorized all operators based on several criteria, including the size of the company, diversity of geographic location, and type of cargo transported.<sup>7</sup> We obtained this vessel operator information from a Corps publication summarizing companies involved in domestic waterborne commerce.<sup>8</sup> To identify specific operators to interview from each category, we employed a nonprobability technique in which we conducted initial interviews with industry stakeholders and sought information about other inland waterways operators we might speak with during interviews. The operators' views cannot be used to make generalizations about the views of all industry stakeholders, but do provide a range of perspectives on issues affecting the industry.

To assess potential alternative methods of collecting the fuel tax under existing tax law and regulations and their advantages and disadvantages, we reviewed academic articles, tax policy papers, and our prior work on efforts to curtail excise tax evasion. We also interviewed officials at the Department of the Treasury, a tax policy group, and technology companies with products that could be used for fuel-tax-reporting purposes. Our work focused on alternative tax collection methods that

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<sup>5</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

<sup>6</sup>GAO, *IRS Case Selection: Collection Process is Largely Automated, but Lacks Adequate Internal Controls*, [GAO-15-647](#) (Washington, D.C.: July 29, 2015) and *IRS 2016 Budget: IRS is Scaling Back Activities and Using Budget Flexibilities to Absorb Funding Cuts*, [GAO-15-624](#) (Washington, D.C.: June 24, 2015).

<sup>7</sup>We interviewed 10 vessel operators—two large, three medium, and five smaller companies.

<sup>8</sup>U.S. Army Corps of Engineers, *Waterborne Transportation Lines of the United States: Vessel Company Summary, Volume 2* (Alexandria, VA: 2014).

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could be available under existing tax laws and regulations. As such, we did not assess alternative means of funding the inland waterways system, such as lockage fees and other user-fee proposals, as those were beyond the scope of this review.

For all objectives, we interviewed the current chairman<sup>9</sup> of the Inland Waterways User Board, a federal advisory group established to make recommendations on industry investment priorities; representatives from the Waterways Council, Inc., an industry advocacy group; and academic researchers from two university transportation research centers. See appendix I for a listing of the inland waterways stakeholders we interviewed.

We conducted this performance audit from November 2015 through July 2016 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

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### The Inland Waterways System

Approximately 12,000 miles of inland and intracoastal waterways and channels in the United States are commercially navigable; however, not all such waterways are taxed. The approximately 11,000 miles that are part of the fuel-taxed portion of the system are shown in figure 1 below. The remaining approximately 1,000 miles of inland and intracoastal waterways and channels are not part of the taxable system and contain very few significant lock and dam structures. They also account for a small portion of total commercial inland waterways traffic, according to the

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<sup>9</sup>In addition, 4 of the 10 vessel operators we spoke to were members of the Inland Waterways User Board.

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Corps.<sup>10</sup> Some operators, especially those on the Upper Mississippi and Ohio Rivers, may never leave the taxable portion of the system, but other vessel operators may navigate through taxable and non-taxable waterways, including connecting deep draft waterways. All of these waterways, like highways, operate as a system, and much of the commerce moves on multiple segments.<sup>11</sup>

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<sup>10</sup>The 27 fuel-taxed waterways segments are defined at 33 U.S.C. § 1804. Recent administration proposals have recommended expanding the inland waterways system to include an additional 40 segments, although minimal additional fuel tax revenue would be expected, according to the Corps.

<sup>11</sup>Waterways are operated by the Corps to achieve multiple objectives. According to the Corps, the waterways not only serve commercial navigation, but in many cases also provide hydropower, flood protection, municipal water supply, agricultural irrigation, recreation, and regional development.

**Figure 1: Fuel-Taxed Inland Waterways System**



Source: U.S. Army Corps of Engineers and GAO. | GAO-16-682

The inland waterways system makes a relatively small, but important contribution to the overall U.S. economy. For example, although less visible than other transportation modes, inland waterways allow shippers to transport bulk commodities in a relatively cheap and environmentally friendly method, according to the Kentucky Transportation Center.<sup>12</sup> Inland and intracoastal waterways are particularly well suited for moving a

<sup>12</sup>Kentucky Transportation Center, *Inland Waterways Funding Mechanisms Synthesis*, KTC-14-14/MTIC4-14-1F (Lexington, KY: Nov. 11, 2014).

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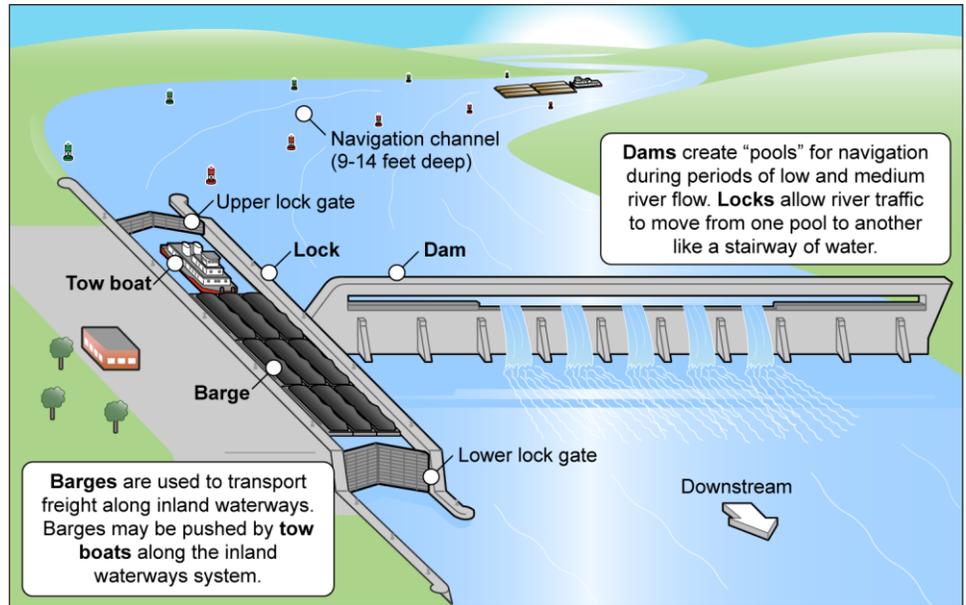
variety of bulk commodities, including coal; petroleum products; chemicals; aggregate construction materials such as sand, gravel and stone; as well as grain, soybeans, and other agricultural products, according to the Waterways Council, Inc. These commodities are transported by commercial barge operators, many of which have been in business for generations. The industry includes large operators that own hundreds of towboats and thousands of barges, as well as smaller operators that may provide marine services within harbors or river ports. According to the Waterways Council, Inc., in 2014, commercial operators transported approximately 600 million tons of cargo valued at over \$230 billion throughout the inland waterways system. The transportation of freight on this system represents approximately 4 to 5 percent of total commercial tonnage shipped or about 6 to 7 percent of all domestic cargo ton-miles in the United States, according to the Transportation Research Board.<sup>13</sup>

Navigation on this system is made possible by locks and dams, navigation structures and aids, and landside terminals, as well as channel maintenance and dredging where necessary to maintain a minimum channel depth of 9 feet to support commercial barge traffic. The dams constructed on the inland rivers form the foundation of the inland waterways system and create “pools” for navigation during periods of low and medium river flow. Locks at dam sites allow river traffic to move up or down from one pool to another much like a stairway of water. See figure 2 below. The Corps operates and maintains 228 lock chambers at 186 sites on the inland waterways system, of which 214 lock chambers are located on fuel-taxed waterways at 172 sites.

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<sup>13</sup>Ton-miles are determined by multiplying the aggregate weight of freight by the distance that weight is carried.

**Figure 2: Illustration of Inland Waterways Barge Traffic Descending through a Lock at Dam Site**



Source: GAO. | GAO-16-682

Many of the locks and dams that support commercial navigation on the inland waterways system are aging and over 60 percent of the locks and dams have exceeded their 50-year service life, requiring increased maintenance to keep them functioning, according to the Corps. In addition to the age of this system, some lock infrastructure, such as lock gates, are experiencing mechanical failures, which can also slow freight flows on the system, according to the Corps. The Corps' *Capital Investment Strategy* identifies \$4.9 billion in capital investments to inland navigation infrastructure needed over the next 20 years with a maximum of \$250 million any one year.<sup>14</sup>

<sup>14</sup>U.S. Army Corps of Engineers, *Inland and Intracoastal Waterways Twenty-Year Capital Investment Strategy* (Washington, D.C.: Mar. 24, 2016).

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## Process for Reporting Inland Waterways Fuel Tax Obligations

Vessel operators use IRS Form 720 to report and pay applicable federal excise tax obligations to the IRS, including the fuel tax. Excise taxes are taxes paid on specific activities or when purchases are made on a specific good. Excise taxes are often included in the price of the product, as is the case with highway motor fuels. Other excise taxes, such as the inland waterways fuel tax, are not included in the price of the good. For those excise taxes, the federal excise tax return form must be filed each quarter of the calendar year in which a tax liability accrued; in the case of the fuel tax, for each quarter commercial operators consume fuel used for propulsion purposes on the fuel-taxed inland waterways system. The IRS expects vessel operators to have a reasonable process for estimating the fuel used for propulsion purposes. According to an IRS publication, all operators of vessels used in commercial waterways transportation that acquire fuel must keep adequate records of all fuel used for taxable purposes.<sup>15</sup> Records should include information related to the purchase date and quantity of fuel purchased, the identification number or name of the vessel using the fuel, and the departure time, departure point, route traveled, destination, and arrival time for each vessel according to the IRS publication. Operators may record this information manually or electronically.

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## Funding the Inland Waterways System

The federal government has invested in the inland waterways since the early 1800s largely because of the value those investments have had in terms of economic development for the nation. For decades, the federal government provided the Corps with 100 percent of the funding to construct, operate, and maintain the system. However, the federal policy for funding the system changed in the late 1970s and early 1980s, and commercial users of the system began to pay more of the cost associated with using it. For instance, the Inland Waterways Revenue Act of 1978 (1978 Act) imposed the fuel tax on fuel consumed for propulsion purposes by commercial towboats, tugboats, and other vessels that typically move barges.<sup>16</sup> Fuel used to provide power for non-propulsion purposes—such as on-board lighting, cooling, or heating commodities like

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<sup>15</sup>Department of the Treasury, IRS, *Publication 510, Excise Taxes* (Washington, D.C.: Feb. 19, 2016), accessed May 2016, <https://www.irs.gov/pub/irs-pdf/p510.pdf>.

<sup>16</sup>Pub. L. No. 95-502, title II, § 202, 92 Stat. 1693, 1697 (1978) codified at 26 U.S.C. § 4042.

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asphalt—is not taxed. The 1978 Act also created the Inland Waterways Trust Fund and established those waterways that are subject to the fuel tax.<sup>17</sup> The Water Resources Development Act of 1986 (1986 Act) increased the initial 1978 Act’s fuel tax rate per gallon from \$0.04 to \$0.10 per gallon before 1990 (up to \$0.20 per gallon after 1994) and established a cost-sharing process for inland waterways expenditures.<sup>18</sup> Together, the 1978 Act and the 1986 Act established a means for the inland waterways industry to provide economic support for inland waterways’ infrastructure development.

The Inland Waterways Trust Fund receives revenues from the fuel tax. Under the 1986 Act, expenditures for new construction and major rehabilitation from the Trust Fund must first be authorized by Congress and then funded in annual discretionary appropriations to the Corps. As mentioned, from 2005 through 2014, the fuel tax has generated average revenues of approximately \$83 million per year. The balance of the Inland Waterways Trust Fund fell sharply from 2005 through 2010 as Congress appropriated more from the Trust Fund than the amount of revenue collected, construction projects incurred cost overruns, and tax revenues decreased, according to the Congressional Research Service (see fig. 3).<sup>19</sup>

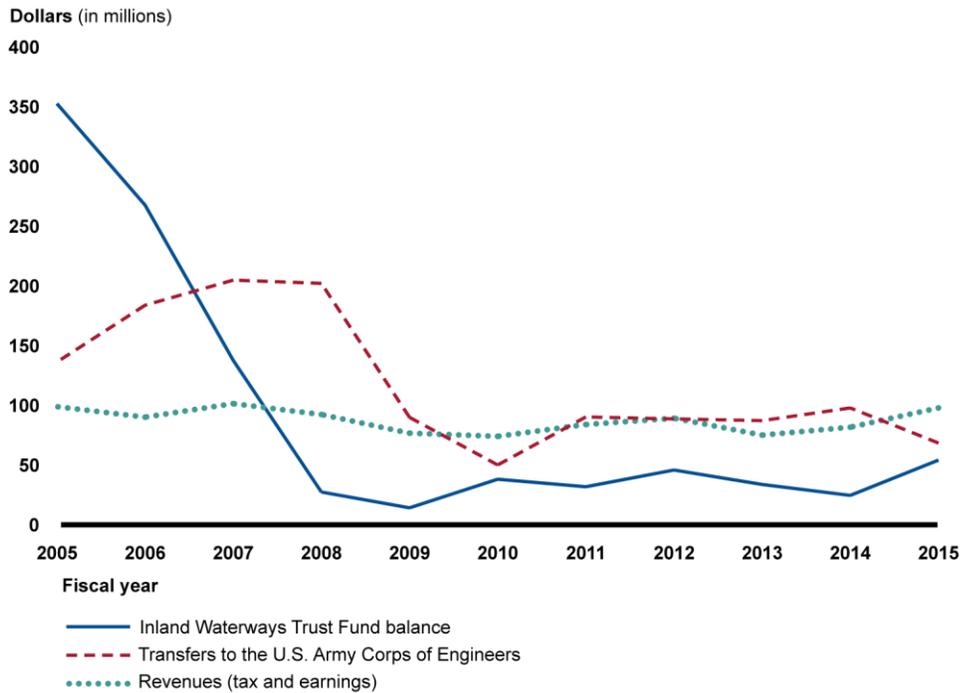
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<sup>17</sup>Pub. L. No. 95-502, title II, §§ 203 and 206, 92 Stat. 1693, 1697-1702 (1978), codified at 26 U.S.C. § 9506 and 33 U.S.C. § 1804. See appendix II for a list of all the fuel-taxed inland and intracoastal waterways.

<sup>18</sup>Pub. L. No. 99-662, title I, § 102, 100 Stat. 4092,4094 (1986), established that inland waterways construction and major rehabilitation projects would be funded on a 50/50 basis, with 50 percent of the funds from the Inland Waterways Trust Fund and 50 percent from general revenues from the U.S. Treasury. Operation and maintenance costs (which typically exceed construction and major rehabilitation costs) were established as a 100 percent federal responsibility. 26 U.S.C. § 9506 and 33 U.S.C. § 2212.

<sup>19</sup>Congressional Research Service, *In Focus: Inland Waterways Trust Fund* (Washington, D.C.: Nov. 5, 2015) and *Inland Waterways: Recent Proposals and Issues for Congress* (Washington, D.C.: May 3, 2013).

**Figure 3: Fuel Tax Revenues, Trust Fund Balance, and Transfers to Corps, Fiscal Years 2005 through 2015 (Millions of Dollars)**



Source: GAO analysis of U.S. Army Corps of Engineers data. | GAO-16-682

## Federal Agency Roles Related to the Fuel Tax

The IRS, Treasury, and Corps are involved with different aspects of the fuel tax. IRS's Small Business Self-Employed Division is responsible for enforcing payment of excise taxes, including the fuel tax. According to IRS, the mission of this IRS division is to help small business and self-employed taxpayers understand and meet their tax obligations, while applying the tax law with integrity and fairness. Within the Small Business Self-Employed Division, the Specialty Taxes organization has responsibility for excise tax issues. This includes identifying returns for audit. The Department of the Treasury is responsible for estimating and investing tax receipts, and administration of the Inland Waterways Trust Fund. Congress appropriates revenues from the collection of the fuel tax from the Trust Fund. Treasury transfers these amounts quarterly from general revenues based on its revenue estimates, subject to adjustments in later transfers to the amounts of actual tax receipts. Treasury also invests the portion of the Trust Fund that is not required to meet current withdrawal requirements. In addition, Treasury prepares a forecast for the

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Inland Waterways Trust Fund's tax receipts. The Corps uses the Trust Fund's revenue forecast to prepare the Corps' annual budget submission for the President's budget to Congress. The Corps also collects and uses a variety of statistics, including data on lock performance and waterborne commerce, to analyze the feasibility of new water transportation projects, set priorities for new investment and rehabilitation, and manage the operations and maintenance of existing projects.<sup>20</sup>

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## Results of Audits— IRS's Primary Means of Ensuring Taxpayer Compliance—Do Not Indicate Major Compliance Issues, according to IRS Officials

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### Audits Are the Primary Focus of IRS's Inland Waterways Fuel Tax Enforcement Efforts

IRS ensures compliance with the fuel tax by auditing Form 720 tax returns reporting a fuel tax liability and focusing on identifying potential taxpayers that may not be filing tax returns. An IRS audit is an examination of a taxpayer's accounts and financial information to ensure that information—including the amount of tax owed—is being reported correctly on the return, in compliance with federal income tax laws. According to IRS officials, its Small Business Self-Employed Division determines what resources it has available and how they are to be directed during the annual audit-planning process for the overall excise tax program. As part of the annual-planning process, IRS develops its strategy for selecting cases to audit for each specific excise tax, including the inland waterways fuel tax. After potential audit leads have been identified, IRS selects individual fuel-tax returns to audit based on several

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<sup>20</sup>River and Harbor Act of 1922, Pub. L. No. 67-362, ch. 427 § 11, 42 Stat. 1038 (1922). 33 C.F.R. Part 207.

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criteria, according to IRS officials. These criteria may include the taxpayer's recent audit history, an annual tax liability greater than a certain filing threshold, and IRS location. The work of auditing the Form 720 tax returns is performed by IRS revenue agents located in designated field offices.

IRS established its current strategy for identifying fuel tax audit leads, called Initiative 103, in 2010, but fully implementing the strategy depends on the availability of proprietary Corps and other data. The strategy defines an approach to identify audit leads for (1) taxpayers that may be underreporting their tax liability; and (2) non-filing taxpayers. As discussed later in this report, the IRS does not have access to certain proprietary data, which are collected by the Corps, and access to these data would help to identify taxpayers that may be under-reporting a tax liability, according to IRS officials. Instead, IRS has focused recent enforcement efforts on the non-filing taxpayer population and specifically those that are liable for paying the tax, but are not doing so. Non-filing taxpayers may fail to understand filing requirements or may willfully choose not to file in an attempt to avoid paying taxes. To implement its strategy for identifying potential non-filers, IRS obtains data and information on vessel operators published by the Corps and compares that information with tax filings. If IRS finds a discrepancy—for example, if a vessel operator shows up in Corps data, but not in IRS tax filing data—the strategy calls for IRS to follow up with the vessel operator to determine whether the operator should have filed a return for that quarter or other quarters.

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## IRS Makes Basic Information Available to Support Taxpayer Compliance

IRS has a number of resources available to help the inland waterways industry understand and meet its tax obligations. Most of these resources are available online at [www.irs.gov](http://www.irs.gov).

- **Publications describing excise taxes and instructions for completing Form 720:** IRS publication 510 covers excise taxes that taxpayers may be liable for and which are reported on Form 720.<sup>21</sup> IRS publication 510 defines all the different types of fuels that are taxed, not just fuel used for commercial operations on the inland

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<sup>21</sup>Department of the Treasury, IRS, *Publication 510, Excise Taxes* (Washington, D.C.: Feb. 19, 2016), accessed May 2016, <https://www.irs.gov/pub/irs-pdf/p510.pdf>.

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waterways, and explains the exemptions to the fuel taxes, among other things. One section in publication 510 covers the inland waterways fuel tax and defines how the tax is applied. In addition to this publication, IRS makes available instructions for completing Form 720.<sup>22</sup> This publication explains how and when to file, describes record-keeping responsibilities, and discusses requirements for filing.

- **Audit Techniques Guide:** The *Inland Waterways Audit Techniques Guide* is intended for IRS auditors, but it is also a useful resource for taxpayers, according to IRS.<sup>23</sup> The purpose of this document is to provide guidance for IRS examiners when conducting fuel tax audits. The document can also be useful in terms of clarifying the techniques that IRS uses when conducting an audit, such as interviews, examination of records, and common inland waterways issues that may lead to filing inaccuracies.
- **Toll-Free Number:** IRS offers a toll-free telephone number specifically for excise taxes, including the inland waterways fuel tax, to provide taxpayers with information on filing requirements.

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### Audit Results Do Not Suggest a Major Compliance Problem, according to IRS Officials

Based on key indicators that can be used to assess overall compliance, IRS views vessel operators to be substantially in compliance with requirements to report and pay the fuel tax. The key indicators IRS identified include:

1. the audit rate;
2. the percentage of returns examined with no change; and
3. the average yield (i.e., tax dollars assessed) per audit.

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<sup>22</sup>Department of the Treasury, IRS, *Instructions for Form 720, Quarterly Federal Excise Tax Return*, (Washington, D.C.: May, 7, 2015), accessed November 2015, <https://www.irs.gov/pub/irs-pdf/i720.pdf>.

<sup>23</sup>IRS, *Inland Waterways Audit Techniques Guide*, accessed November 2015, <https://www.irs.gov/Businesses/Small-Businesses-%26-Self-Employed/Inland-Waterways-Audit-Techniques-Guide>.

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IRS Audit Data of Filed Tax Returns Indicate No Major Compliance Issues, according to IRS Officials

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In addition, we reviewed: (1) IRS data on filed Form 720 tax returns reporting a fuel tax liability; (2) IRS data on non-filer audits; and (3) direct revenue per direct dollar of audit cost.<sup>24</sup>

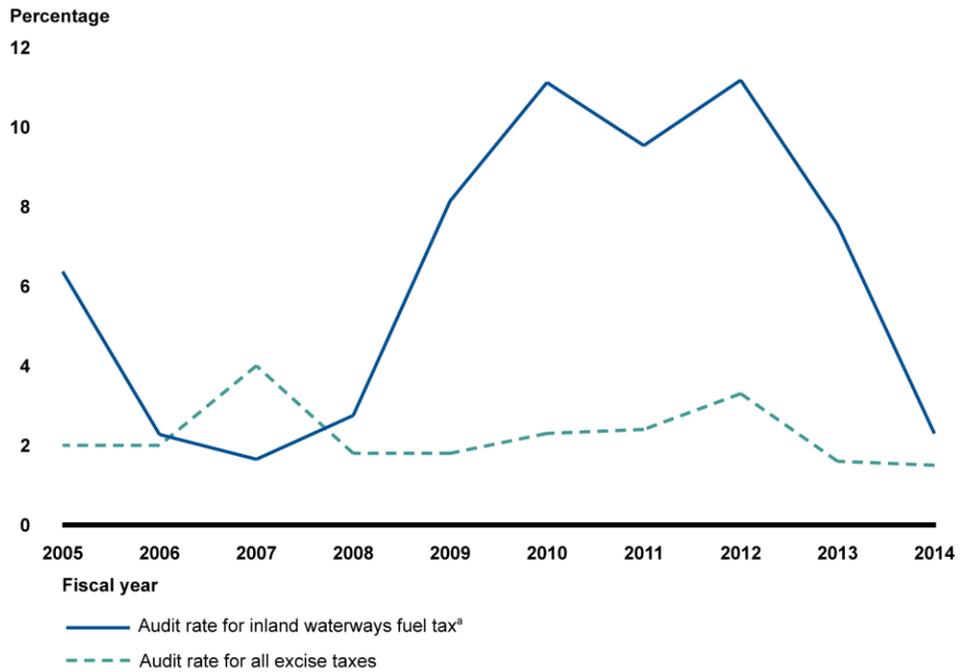
**Audit rate:** From 2005 through 2014, IRS data show that the fuel tax audit rate for filed tax returns generally exceeded the audit rate for all excise taxes. However, because the number of inland waterways quarterly tax filings is so small, even a handful of additional audits can increase the fuel tax audit rate substantially. In figure 4 below, IRS data show that the audit rate ranged from a minimum of 1.6 percent of filed fuel tax returns to a maximum of 11.2 percent of tax returns from 2005 through 2014. The highest audit rates occurred from 2009 through 2013. By comparison, the audit rate for all excise taxes ranged between a minimum of 1.5 percent and a high of 4 percent, indicating greater fuel tax audit coverage relative to all excise taxes.<sup>25</sup> See appendix III for complete IRS data on the results of their activities examining the fuel tax.

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<sup>24</sup>In our analysis, the term “audit” refers to audits of a filed tax return. These are separate from non-filer audits.

<sup>25</sup>IRS reported data for the audit rate of all excise taxes from 2005 through 2014 is the Department of the Treasury, *Internal Revenue Service Data Book*, Publication 55B (Washington, D.C.), accessed May 2016, <https://www.irs.gov/uac/soi-tax-stats-prior-year-irs-data-books>.

**Figure 4: Inland Waterways' Fuel-Tax Audit Rate for Audits of Filed Tax Returns Compared to Audit Rate for All Excise Taxes, Fiscal Years 2005 through 2014**



Source: GAO analysis of Internal Revenue Service data. | GAO-16-682

<sup>a</sup>The audit rate is the proportion of tax returns that IRS audits each year.

According to IRS officials, the relatively high rate of fuel tax audits may deter taxpayers from not complying with requirements to report and pay the fuel tax. Although not representative of the entire inland waterways industry, 7 of 10 industry representatives that we spoke to said that their company had been audited by the IRS in the past 5 to 10 years. According to an IRS publication, the facts and circumstances of each taxpayer are unique, and therefore, the strategy and procedures applied, such as the initial interview and examination of records, are dynamic.<sup>26</sup> There are many variables that affect the audit, including the size of the business, type and condition of the books and records, cooperation of the taxpayer, and various other factors. According to IRS officials, the time

<sup>26</sup>IRS, *Inland Waterways Audit Techniques Guide*.

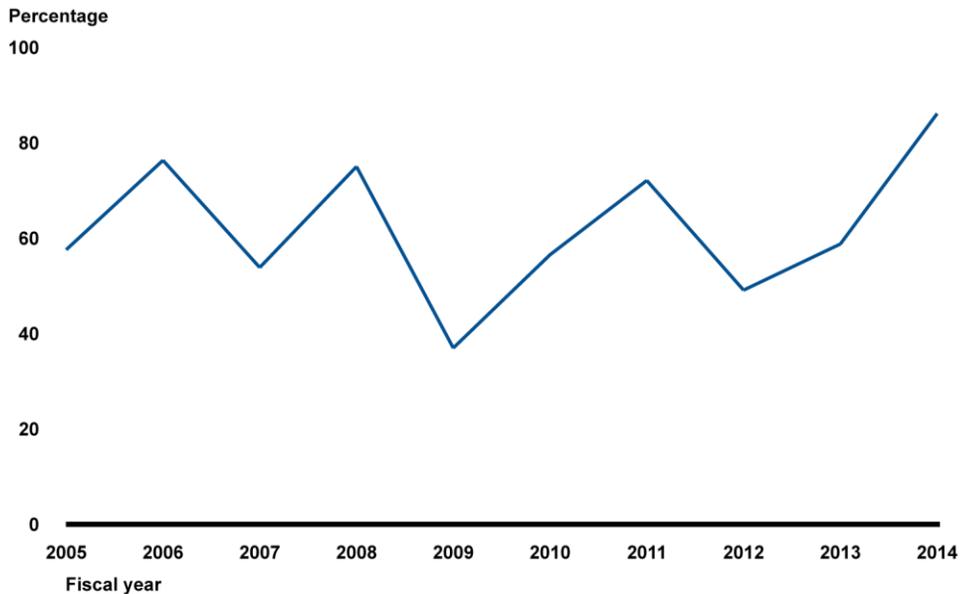
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span and scope of the audit are commensurate with the complexity of the case.

**Percentage of returns examined with no change:** IRS data show that the percentage of fuel tax returns examined with no change exceeded 50 percent in 8 of 10 years for which we reviewed data. A “no change” is defined as an audit recommending the taxpayer’s filing be accepted as filed. According to IRS officials, while there is no exact number indicating “good” compliance, this number represents a relatively high percentage of fuel tax returns examined with “no change,” suggesting that vessel operators are properly reporting their fuel taxes, and that there does not seem to be major noncompliance. Moreover, according to IRS officials, taking this indicator along with others, such as a low average yield (i.e., tax dollars assessed) per audit suggests that there are no major compliance problems.

Specifically, from 2005 through 2014, IRS data show that the no-change percent (i.e., the percent of audited tax returns accepted as filed) ranged from a low of 37 percent to a high of 86 percent. For 8 of these 10 years, at least 54 percent of returns audited were accepted as filed—and in 4 years, the number of accepted returns exceeded 72 percent, as shown in figure 5.

**Figure 5: Percentage of Inland Waterways Fuel Tax Audits Accepted as Filed, Fiscal Years 2005 through 2014**



Source: GAO analysis of Internal Revenue Service data. | GAO-16-682

Further, for those returns IRS did not accept as filed and where the audit resulted in a change, the change could have been in favor of the operator (i.e., an overpayment). According to IRS, an audit in favor of the taxpayer is considered a changed filing. One industry operator we spoke to said that this filed tax return was changed because the company had paid taxes on fuel used in a generator, which should not have been taxed. According to the vessel operator, a refund was provided.

The Treasury Inspector General for Tax Administration has raised concerns that a high no-change rate may burden compliant taxpayers.<sup>27</sup> It may also indicate some concerns with the process in which tax returns are selected and audited. According to the Treasury Inspector General for Tax Administration, IRS has associated a high percentage of audited

<sup>27</sup>Treasury Inspector General for Tax Administration, *The Recommended Adjustments From S Corporation Audits are Substantial, but the Number of No-Change Audits is a Concern*, 2012-30-062 (Washington, D.C.: June 21, 2012).

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returns that result in adjustments with greater audit productivity, while audits that result in no-change are considered to be unproductive. Nevertheless, IRS officials told us that regardless of the no-change rate, they aim to provide coverage as a deterrent to under-reporting and in order to promote voluntary self-compliance.

**Average yield per audit:** IRS officials consider the average yield per fuel tax audit to be relatively low, and a low yield likely also indicates no major taxpayer compliance issues. The yield is the annual amount of tax assessed by IRS per audit.<sup>28</sup> IRS data show that the average yield per audit from fiscal years 2005 through 2014 varies substantially from year to year. During this period, the lowest average amount assessed per audit was \$194 in 2014 and highest was \$7,192 in 2008. For the 10-year period we reviewed, IRS assessed a total of \$1.9 million and collected a total of \$1.7 million based on audits of filed tax returns.<sup>29</sup> See table 3 in appendix III for further details on audit yields, including the average tax amount assessed and collected per audit.

IRS Data on Non-Filer Audits Indicate No Major Compliance Issues Either, according to IRS Officials

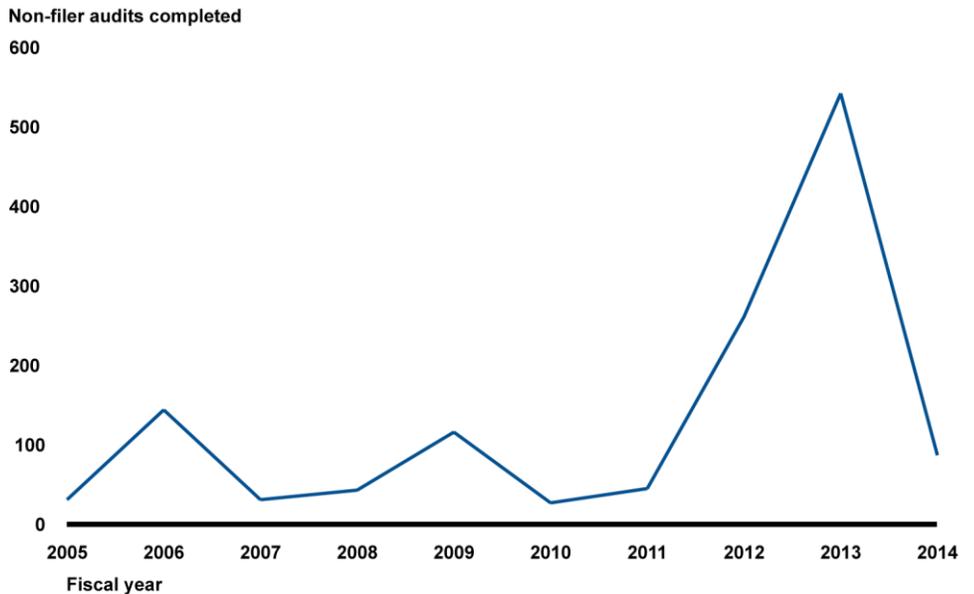
**Number of non-filer audits:** As mentioned above, a primary focus of IRS's inland waterways fuel tax enforcement efforts have been related to potential nonfilers. In our review of IRS data, we found that the number of non-filer audits varied substantially over the 10-year period. During this period, the lowest number of such audits was 27 in 2010 and the highest was 542 in 2013, as shown in figure 6 below. The substantial increase in the number of non-filer audits in 2012 and 2013 reflects IRS's strategy to evaluate nonfilers through Initiative 103, according to IRS officials.

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<sup>28</sup>For purposes of our analysis, we calculated audit yield from the tax assessment, not the amount of tax collected, which can be less.

<sup>29</sup>IRS can also assess and collect penalties, but those funds do not benefit the Inland Waterways Trust Fund. Instead, these penalties go into the General Fund of the U.S. Treasury. 26 U.S.C. § 9506(b) provides that taxes deposited in the U.S. Treasury under 26 U.S.C. § 4042 are appropriated to the Inland Waterways Trust Fund. Penalties are not included in the provision.

**Figure 6: Number of Inland Waterways Fuel Tax Non-Filer Audits, Fiscal Years 2005 through 2014**



Source: GAO analysis of Internal Revenue Service data. | GAO-16-682

According to IRS, during a non-filer audit, if the agent finds that the operator had a legitimate reason for not filing a return in a particular quarter, IRS does not count that audit as a “no-change” result. Instead, the audit is simply closed.

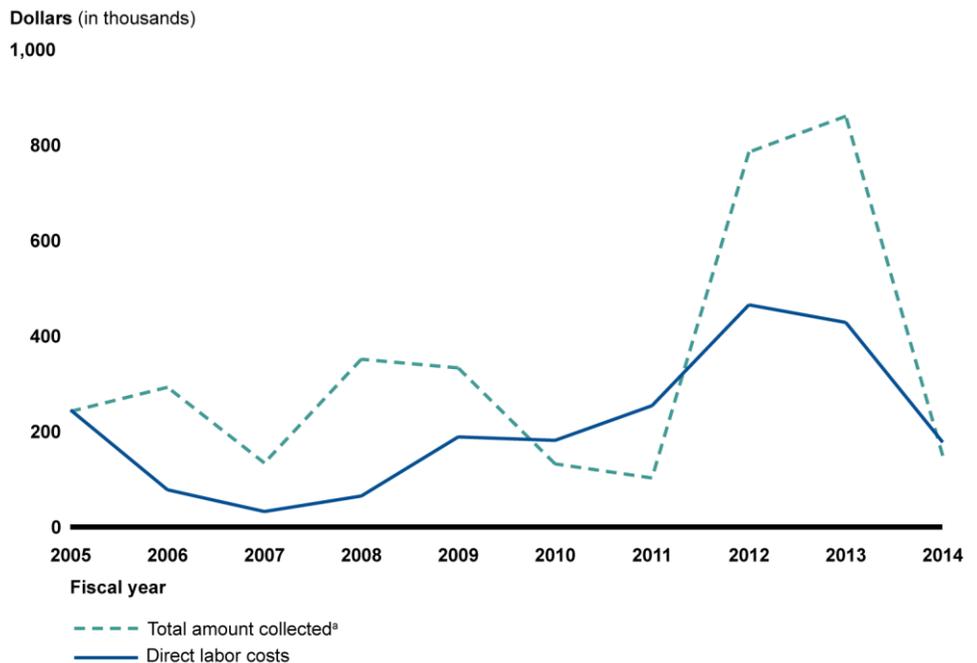
**Average yield per non-filer audit:** The average yield per non-filer audit is consistent with the results from IRS audits of filed tax returns, suggesting no major compliance issues, according to IRS officials. From fiscal years 2005 through 2014, IRS data show that the average annual amount of tax assessed per non-filer audit was lowest, at \$592 per audit, in 2011, and highest, at \$12,550 per audit, in 2010. IRS’s efforts to target nonfilers correspond with an increase in total tax assessments in 2012 and 2013. For the 10-year period we reviewed, as a result of its non-filer audits, IRS assessed a total of \$2.2 million and collected \$1.3 million in additional revenue. According to IRS, the agency initiates non-filer audits when it has identified vessel operators that should have filed returns for particular quarters, but did not. In some of those cases, the operator being audited will have filed returns for other quarters, and IRS may look at some of those returns.

**IRS Collected More in Revenue Than It Directly Spent on Audit Labor for Most Years; However, Costs and Revenue Benefits May Be Understated**

As a result of its audits of filed tax returns and focus on the non-filing population, IRS collected approximately \$3 million of additional revenue for the Inland Waterways Trust Fund from 2005 through 2014. This additional revenue represents funding that could be used to pay for Corps' inland navigation projects, such as a small portion of construction work planned for Olmsted Locks and Dam, currently the largest and costliest modernization project on the inland waterways system at an estimated \$3 billion.

We compared direct labor costs to the total tax amount collected as one measure of the cost effectiveness of enforcement efforts related to the fuel tax. For 6 out of the 10 years of IRS cost data we reviewed, IRS collected more in taxes, interest, and penalties than it directly spent on audit activities for the fuel tax. For instance, in 2008, for every dollar IRS spent directly on enforcement, including audits, it returned more than \$5 to the Inland Waterways Trust Fund. However in 4 of the 10 years, IRS spent more than it collected and in one year (2011), for every dollar IRS directly spent on enforcement, it collected only 40 cents. See figure 7 below.

**Figure 7: Direct Labor Costs and Total Amount Collected Comparison, Inland Waterways Fuel Tax Audits, Fiscal Years 2005 through 2014**



Source: GAO analysis of Internal Revenue Service data. | GAO-16-682

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<sup>a</sup>The total collected amount includes interest and penalties, although only the tax and interest collected is transferred to the Inland Waterways Trust Fund.

The direct costs and benefits described above may understate both costs and benefits of IRS enforcement efforts. For example, on the cost side, according to IRS, the cost data above do not include a 35 percent overhead rate for IRS facilities, communications infrastructure, and other fundamental supervisory and support services. On the benefit side, IRS has long believed that its enforcement activities have a positive impact on voluntary compliance.<sup>30</sup> According to IRS officials, maintaining an audit presence, in general, is a potential deterrent against future noncompliance although it is difficult to quantify and it helps ensure equity, i.e., that all vessel operators are paying their fair share of the tax. Because very few empirical studies have attempted to estimate the indirect effects on revenue of an enforcement presence, it is possible that certain benefits are not captured. For instance, an IRS audit focus on nonfilers may improve future compliance by bringing in taxpayers that may begin to regularly report and pay their taxes, resulting in greater tax revenue overall in the future.

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## IRS and Selected Operators Identified Some Challenges in Determining Taxes Owed, but Opportunities Exist for IRS to Better Determine Compliance

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<sup>30</sup>For additional discussion of the impact that IRS activities have on voluntary tax compliance, see Alan H. Plumley, "The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results," *Proceedings, Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association*, Vol. 95 (2002): 355-363.

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## Some Challenges Exist in Determining and Documenting Fuel Taxes Owed, but Selected Operators' Established Processes Support Compliance

IRS and selected vessel operators we spoke to identified several challenges related to determining the inland waterways fuel taxes owed. Some of these challenges are outlined in the Inland Waterways Audit Techniques Guide.<sup>31</sup> These challenges generally relate to how the tax is designed, i.e., special provisions for the imposition of the tax. In addition, operators described challenges related to keeping records to document the tax owed. Despite these challenges, the vessel operators we spoke to indicated that they are not enough to affect compliance.

### Determining Tax

As discussed, current tax law requires vessel operators to pay tax on commercial operations on certain inland and intracoastal waterways.<sup>32</sup> These taxpayers may operate towboats that push barges on and off taxable inland and intracoastal waterways, and as a result, it may be a challenge to accurately keep track of the fuel consumed on the taxable inland waterways. For instance, vessel operators moving petroleum products do not pay the fuel tax when operating in the Houston Ship Channel where many refineries and chemical plants are located, but do pay the tax when operating in the Gulf Intracoastal Waterway. Similarly, according to one vessel operator, fuel consumed on operations upriver from The Dalles Dam on the Columbia and Snake Rivers is taxed, whereas, fuel consumed downriver from The Dalles, Oregon, to Portland, Oregon, is not. The 10 operators that we spoke with did not consider calculating fuel consumed on taxable waterways separate from that consumed on non-taxable waterways to be a major challenge, but one vessel operator said it requires time to do so.

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<sup>31</sup>IRS, *Inland Waterways Audit Techniques Guide*, accessed November 2015, <https://www.irs.gov/Businesses/Small-Businesses-%26-Self-Employed/Inland-Waterways-Audit-Techniques-Guide>. Other challenges listed in this guide include: (1) overstated or understated fuel usage claimed when generator and propulsion fuel are from the same tank; (2) incorrect classification of vessel usage: over or underreporting of vessel usage on taxable waterways; (3) overstated or understated motor-fuel tax credit: user may overstate or understate claim for tax refund for fuels used for propulsion on taxable waterways; and (4) failure to file: taxpayer does not file the Form 720.

<sup>32</sup>According to IRS, the operator may calculate the amount of fuel consumed while on a taxable waterway by multiplying total fuel consumed in the propulsion engine by the percentage of time spent on the taxable waterway, unless there is better evidence of fuel consumed or there is a substantial discrepancy between the rate of fuel consumed on taxable and nontaxable waterways.

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Determining the correct vessel operator that is subject to the tax can be challenging. Under the current tax requirements, the lessee (i.e., the actual vessel operator), not the lessor (i.e., the owner of the vessel), is responsible for paying the fuel tax. This challenge seems to be most common when contracting agreements are in place. In such situations, the lessee is liable for the tax, even though the lessor may exercise the scope of control and direction of the vessel's movements, according to IRS. One vessel operator that we spoke to described a situation where there was confusion about which entity owed the fuel tax when the boat was leased to another company. Further, an IRS official indicated that information about who operates a vessel, not who owns the vessel, would be helpful, but such information is not publicly available. For example, according to this IRS official, not having access to vessel-operator information delays IRS's ability to identify potential nonfilers because the initial entity that IRS staff contact when following up on audit leads is often the vessel owner, not the operator. In the absence of such data, IRS staff must rely on vessel owners to help the agency identify vessel operators, according to IRS officials. Furthermore, IRS officials stated that proprietary Corps data that identify vessel operators could help them identify potential nonfilers.

Another challenge is determining the tax due for propulsion versus non-propulsion purposes (e.g., on-board lighting, cooling, or heating). According to IRS documentation, vessel operators may overstate or understate the gallons of fuel claimed for non-propulsion purposes, especially in cases where the generators are supplied from the same fuel tank as the vessel's propulsion engines. One operator we spoke to also described this challenge and said that most of the complexity in determining fuel used and taxes owed involves properly allocating fuel used for non-propulsion, or generator-consumed fuel.

While these issues may present challenges to inland waterways operators, none of the 10 vessel operators we spoke to stated that they were significant enough to affect compliance. Five of the 10 vessel operators we spoke to told us that they face no challenges in determining their fuel tax obligation, while two vessel operators acknowledged that in certain cases, they faced one or more of the challenges described above. The remaining three vessel operators mentioned other challenges, such as with record keeping, which are described below. Notwithstanding the challenges that operators cited above, each of the 10 operators, along with other representatives of the inland waterways industry that we spoke with, said they were generally satisfied with the current fuel tax reporting method.

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## Recordkeeping

The challenges of determining the tax can be compounded if an operator does not keep accurate records. Of the 10 operators we spoke with, 6 told us that they keep handwritten fuel records and manually record and calculate fuel consumption data. Although most of these operators said they were comfortable with their recordkeeping processes and do not face any challenges with the manual system, one company said it has occasionally faced some challenges in determining the amount of fuel tax owed because its accounting department can find it difficult to read the handwritten fuel logs and because boat logs can be unclear about the number of miles traveled on taxable inland waterways. Furthermore, the operator explained that it can be difficult to seek clarification from boat captains in a timely manner, especially when a boat captain may work a schedule in which he is on duty for 15 days and then off for 15 days.

Similarly, IRS officials told us that during an audit, the agency may be unable to determine the accuracy of the tax filing—and thus the tax owed—if the operator does not keep clear and accurate records.

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## IRS Identified Some Challenges with the Data It Uses and May Be Missing Opportunities to Use Additional Data for Enforcement

The absence of independent, third-party data to verify the fuel consumption information that vessel operators report represents a challenge for IRS in terms of ensuring compliance with the fuel tax. We have previously reported that the extent to which individual taxpayers accurately report their income is correlated to the extent to which third parties report income to individual taxpayers and IRS.<sup>33</sup> For example, according to 2006 IRS data, for types of income with little or no third-party information reporting, such as business income, over half of these were misreported. For individual income tax returns, IRS is able to compare taxpayer returns to a variety of third-party data, such as information reported from employers via W-2 forms and from financial institutions on

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<sup>33</sup>GAO, *Fiscal Outlook: Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position*, [GAO-16-92T](#) (Washington, D.C.: Oct. 1, 2015).

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1099-MISC forms.<sup>34</sup> Similar third-party information is not currently available to the IRS for purposes of ensuring fuel tax compliance. Nevertheless, IRS can, and to some extent does, use Corps data to help identify taxpayers that may not be filing their taxes. For example, according to IRS officials, IRS uses the two following publicly available data sources from the Corps to help identify potential nonfilers for audit:

- **Waterborne commerce statistics:** These data reflect movement of goods from one location to another.
- **Lock performance data:** These data provide a listing of vessel movements through locks and an estimate of the weight of commodities transported through a lock at a particular point in time.

Through Initiative 103, IRS uses publicly available waterborne commerce and lock performance data from the Corps to evaluate nonfilers. However, the agency has not obtained proprietary versions of these data. The proprietary, or non-public, versions of these data include information that could be used to identify individual operators and estimate their fuel consumption on taxable inland waterways. For example, the proprietary waterborne commerce statistics include vessel identification numbers, as well as the waterway segments traversed, cargo, tonnage, horsepower, and vessel dimensions. Similarly, the proprietary lock performance data contain information about the vessels' passing through locks and the size of the vessel. According to IRS, the proprietary, or non-public, versions of these data are needed to fully implement the part of its strategy designed to evaluate taxpayers that may be potentially under-reporting their fuel taxes. According to IRS officials, the agency has not identified the appropriate Corps personnel that can provide the proprietary information because IRS has been focusing efforts on nonfilers and key contacts at the Corps retired or moved to other agencies.

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<sup>34</sup>Wages paid to employees must be reported on a form W-2. Third-party payers, including businesses, governmental units, and other organizations that make payments to other business or individuals must submit a 1099-MISC form to IRS for a variety of payments made in the course of a trade or business. By matching information from payers reported on these forms with what taxpayers report on tax returns, IRS can detect underreporting of income, including failure to file a tax return. See GAO, *Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements*, [GAO-09-283](#) (Washington, D.C.: Jan 28, 2009).

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Standards for internal controls in the federal government specify that management should design the entity's information system (i.e., the people, processes, data and technology) and related control activities, such as audits, to achieve objectives and respond to risk.<sup>35</sup> Furthermore, management should design the agency's information system to obtain and process information to meet each operational process's information requirements and to respond to the agency's objectives and risks. The Corps' proprietary waterborne-commerce statistics and lock performance data, which contain information that could be used to estimate fuel consumption and identify vessel operators, are two such sources of information that could enable IRS to achieve its objectives of ensuring compliance with requirements for operators to report and pay the inland waterways fuel tax. According to IRS officials, the first step to sharing this information is to identify the appropriate personnel at the Corps and begin a dialogue.<sup>36</sup> Corps officials stated that they are amenable to having a conversation and sharing this information with IRS. Without obtaining these data, IRS cannot fully implement Initiative 103, a key element of its internal control activity for the fuel tax. As a result, IRS may be missing opportunities to further enhance compliance and to potentially increase revenues for the Inland Waterways Trust Fund—revenues that are critically important to improve and rehabilitate navigation infrastructure.

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<sup>35</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 2014).

<sup>36</sup>In commenting on a draft of this report, IRS officials mentioned that the IRS is part of the Federal Initiative for Navigation Data Enhancement group. According to IRS, this group promotes interagency data sharing and is a joint effort between a number of federal agencies, including the IRS and the Corps. According to IRS, through this venue it has established a dialogue with multiple federal agencies that could be beneficial in enhancing compliance with tax laws.

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## An Alternative Collection Method or Greater Use of Technologies Could Improve Compliance but Comes with Costs

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### A “Pay at the Pump” Approach Might Increase Compliance, but Would Pose Additional Costs

Based on our audit work that included a review of relevant studies, interviews with key stakeholders, selected vessel operators, and officials from the Department of the Treasury, IRS, and the Corps, we identified one potential alternative method for collecting the fuel tax—a “pay at the pump” approach—which might increase compliance, although it would likely also increase the administrative burden associated with paying this tax for some operators and thus their costs.<sup>37</sup> Using this method, either a refinery or terminal would add the fuel tax to wholesale fuel purchases or a fuel vendor would add the fuel tax to retail purchases. The refinery, terminal, or fuel vendor would then pay the fuel taxes to the IRS by filing the Form 720, instead of the operators. In either approach, the fuel tax would likely be passed down to the vessel operator, who would pay the cost of the tax as part of its fuel purchase—similar to how owners of private vehicles pay fuel taxes at gas stations. Vessel operators would then file for refunds from the IRS for fuel exempt from the tax, such as fuel that is used on non-taxable waterways or for non-propulsion purposes. Moving the collection method to the refinery, terminal, or fuel vendor would remove the Form 720 filing burden from operators and could increase compliance as there are fewer refineries, terminals, or fuel vendors than vessel operators, according to some industry stakeholders we spoke to. A Treasury official stated that inland waterways fuel-tax

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<sup>37</sup>The scope of our work focused on alternative methods of collecting the fuel tax and not alternative funding mechanisms. Various proposals—such as lock user fees and annual license fees—have been made to change the funding mechanism as well as proposals to change requirements regarding who should pay the tax and how much tax is paid. For a recent overview of these proposals, see Congressional Research Service, *Inland Waterways: Recent Proposals and Issues for Congress* R41430 (Washington, D.C.: May 3, 2013). See also Congressional Budget Office, *Paying for Highways, Airways, and Waterways: How Can Users be Charged?* (Washington, D.C.: May 1992).

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compliance could potentially improve under this approach since the tax would be paid at the time the fuel is purchased, and there would be fewer tax payers to audit.

In 1993, Congress passed legislation to require the point of highway diesel excise-tax collection be moved to the terminal level and required that any diesel fuel removed from the terminal for tax-free use be dyed.<sup>38</sup> These changes were made in an effort to curtail diesel fuel tax evasion schemes that were estimated to have cost the federal government several hundred million dollars per year. In 1996, we found that changing the point of collection of this tax to “pay at the pump” significantly increased compliance.<sup>39</sup> Specifically, IRS’s diesel excise-tax collections increased from \$600 million in 1993 to \$700 million in 1994.

Two of the five smaller operators we spoke to indicated that such a change in collection could be good for them because it would reduce the upfront administrative burden of figuring out the tax. For example, according to one smaller operator, this approach would eliminate its need to check boat logs to verify the amount of taxable fuel consumed and eliminate the paperwork involved in filing quarterly taxes. However, one small operator noted that if this approach were taken, getting rid of the exemptions such as for generator use and reducing the rate of the fuel tax would make this even more feasible. While operators acknowledged that the “pay at the pump” approach is feasible, 6 out of 10 operators we spoke to stated that there are a number of potential costs associated with this approach. For example, two large, two medium, and two smaller operators stated that a “pay at the pump” approach could increase their administrative burden due to filing for refunds for fuel use that is exempt from the tax such as fuel used on non-taxable waterways or used by generators. This administrative burden could include filing for refunds and providing documentation to support refunds. Operators that move cargo on taxable waterways would file for refunds only for generator use and thus would have less administrative burden than those operating on non-taxable waterways. According to one operator, the company’s

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<sup>38</sup>Pub. L. No. 103-66, title VIII, § 13242, 107 Stat. 312, 517 (1993), codified at 26 U.S.C. § 4081.

<sup>39</sup>GAO, *Tax Administration: Diesel Fuel Excise Tax Change*, [GAO/GGD-96-53](#) (Washington, D.C.: Jan. 16, 1996).

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administrative burden increased substantially after the imposition of a 1987 diesel fuel tax that required filing for refunds for fuel use not subject to taxation.<sup>40</sup> In addition, an operator stated that waiting for refunds from the IRS would have impacts on the company's balance sheet, and thus it would want compensation such as interest on the money held by the government. Regarding any impact on administrative burden for the IRS with the "pay at the pump" approach, a Treasury official noted that the approach might result in the IRS's having to process fewer refund requests and in turn increase compliance since the tax would be paid at fuel purchase.

Nonetheless, 7 out of 10 operators with whom we spoke said that the current tax collection method is preferred. Operators gave several reasons for this including that the current collection method is well-established, known, and fair. According to one operator, the collection method for the entire industry should not be changed due to companies that are not fully paying their taxes.

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### Although the Current Collection Method Is Well Established and Known, Technologies Could Improve Accuracy of Reporting

Although most industry stakeholders and the Corps told us that the current collection should not be changed, 7 out of 10 operators we spoke with stated that technologies such as newer engines with fuel monitoring capabilities or independent fuel monitoring systems applied to propulsion engines could improve the accuracy of fuel use estimates. This in turn, could result in more accurate reporting of the fuel taxes, and tax compliance could be enhanced. Newer engines with electronic fuel-monitoring capabilities enable operators to estimate the actual amount of fuel used. Independent fuel-monitoring systems attached to propulsion engines can provide direct and accurate readings of fuel used for propulsion. In addition, Global Positioning System (GPS)-enabled software on vessels could be used to estimate fuel used on taxable waterways for those operating on taxable and non-taxable waterways as GPS coordinates could provide direct and detailed vessel location readings. The use of electronic fuel monitoring technologies and GPS-enabled software combined could determine fuel used only for propulsion on taxable waterways. Results from readings could be downloaded into a

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<sup>40</sup>Pub. L. No. 100-203, title X, § 10502, 101 Stat. 1330, 1438 (1987). The diesel fuel tax was repealed one year later by Pub. L. No. 100-647, title III, § 3003, 102 Stat. 3342, 3616 (1988).

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spreadsheet and provided to (1) the person responsible for a company's tax filing and (2) the IRS as documentation of evidence of appropriate fuel use as part of tax filings. These detailed records could assist IRS in conducting audits. Some vessel operators we spoke to stated that newer engines with fuel-monitoring capabilities or independent fuel-monitoring systems can provide benefits to operators in managing their vessel engines' fuel efficiency in real time, a technology that can assist in minimizing fuel use and costs.

All the large operators with which we spoke said that they have already equipped some of their vessels with many of these technologies. Most of the medium operators and smaller operators said that they have not equipped their vessels with these technologies. Of those that did not use these technologies, four said it was due to costs while another said that their current method of measuring fuel use is sufficient as it is done multiple times a day. One manufacturer of fuel-monitoring systems said that equipage costs of its system are about \$2,000 to \$4,000 per engine and operators told us that they can have more than one engine on their vessels. For operators that have that manufacturer's system in place, tax estimating software could be installed for \$500. In order to improve taxpayer compliance, the federal government could require operators to use a standard electronic fuel-monitoring system or some form of such a system to estimate and report taxes. All operators we interviewed and which responded to our question regarding any requirement to use a standard fuel-monitoring system did not support this requirement. Representatives from large companies told us that they already have equipped their vessels with electronic fuel-monitoring capabilities, which are integrated into their business and operations processes, and would not want to re-equip with a standard system. Medium and smaller operator representatives we spoke to told us that the costs of purchasing these systems could be cost-prohibitive. IRS officials told us that the agency would need to implement compatible software to collect and process the data and would need to conduct a cost benefit assessment to see if the benefits of implementing the technology would be greater than its initial and ongoing costs.

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## Conclusions

The fuel tax typically generates half of the funds used for new construction and major rehabilitation projects on the nation's inland waterways system. Any noncompliance, such as non-filing or under-reporting a tax liability, may reduce available resources that the Corps could use to improve navigation infrastructure on these waterways. While the IRS has developed a strategy to identify fuel-tax audit leads, the

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agency is implementing part of this strategy, largely because the IRS has not established a dialogue with the Corps and obtained the relevant proprietary Corps data that could be used to estimate fuel consumption and identify inland-waterways vessel operators. Given constrained federal resources, as well as the lack of independent third-party data to verify vessel operators' fuel consumption, IRS could potentially benefit from obtaining data that the Corps collects to determine if the data could be used to verify fuel consumption. Without initiating communication and obtaining these data, IRS may be missing opportunities to enhance compliance and potentially increase revenues for the Inland Waterways Trust Fund—revenues that are critically important to improve and rehabilitate navigation infrastructure.

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## Recommendation for Executive Action

To maximize resources for the Inland Waterways Trust Fund, we recommend that the Commissioner of Internal Revenue consult with the U.S. Army Corps of Engineers to explore options to obtain proprietary data to enhance IRS's efforts to ensure taxpayer compliance with the inland waterways fuel tax.

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## Agency Comments

We provided a draft of this report for review and comment to the Commissioner of Internal Revenue and the Secretary of Defense.

In its written comments, reproduced in appendix IV, the IRS agreed with the recommendation and indicated it would renew efforts with the U.S. Army Corps of Engineers to explore options for overcoming previously encountered barriers.

In its written comments, reproduced in appendix V, the Department of Defense did not have any comments on the draft and had no comment on the recommendation to the IRS.

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We are sending copies of this report to appropriate congressional committees and the Secretary of the Treasury, the Commissioner of IRS, the Secretary of Defense, as well as the Chief of Engineers and the Commanding General of the U.S. Army Corps of Engineers. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

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If you or your staff have any questions about this report, please contact me at (202) 512-2834 or [SheaR@gao.gov](mailto:SheaR@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made key contributions to this report are listed in appendix VI.

A handwritten signature in cursive script that reads "Rebecca Shea".

Rebecca Shea  
Acting Director, Physical Infrastructure Issues

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# Appendix I: Inland Waterways Stakeholders GAO Interviewed

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**Table 1: Inland Waterways Stakeholders GAO Interviewed**

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**Federal Agencies**

Department of the Treasury

- Internal Revenue Service
- Office of Tax Policy

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U.S. Army Corps of Engineers

**Federal Advisory Committee**

Inland Waterways User Board

**Industry Trade Association**

Waterways Council, Inc.

**Vessel Operators**

Bernert Barge Lines

Campbell Transportation Company, Inc.

Hanson Material Services

Hunter Marine Transport, Inc.

Industry Terminal and Salvage Company

Ingram Barge Company

Kirby Corporation

Murray American Transportation, Inc.

Tidewater Barge Company

Vidalia Dock and Storage

**Tax Policy Think-Tank**

Taxpayers for Common Sense

**Technology Companies**

FloScan Instrument Company, Inc.

Barge America

**Academics and Expert Researchers**

Bryan Gibson, Kentucky Transportation Center, University of Kentucky

Jim Kruse, Center for Ports and Waterways, Texas A&M Transportation

Chris Dager, retired

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Source: GAO-16-682.

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# Appendix II: Inland and Intracoastal Fuel-Taxed Waterways of the United States

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1. Alabama-Coosa Rivers: From junction with the Tombigbee River at river mile (hereinafter referred to as RM) 0 to junction with Coosa River at RM 314.
2. Allegheny River: From confluence with the Monongahela River to form the Ohio River at RM 0 to the head of the existing project at East Brady, Pennsylvania, RM 72.
3. Apalachicola-Chattahoochee and Flint Rivers (ACF): Apalachicola River from mouth at Apalachicola Bay (intersection with the Gulf Intracoastal Waterway) RM 0 to junction with Chattahoochee and Flint Rivers at RM 107.8. Chattahoochee River from junction with Apalachicola and Flint Rivers at RM 0 to Columbus, Georgia at RM 155 and Flint River, from junction with Apalachicola and Chattahoochee Rivers at RM 0 to Bainbridge, Georgia, at RM 28.
4. Arkansas River (McClellan-Kerr Arkansas River Navigation System): From junction with Mississippi River at RM 0 to Port of Catoosa, Oklahoma, at RM 448.2.
5. Atchafalaya River: From RM 0 at its intersection with the Gulf Intracoastal Waterway at Morgan City, Louisiana, upstream to junction with Red River at RM 116.8.
6. Atlantic Intracoastal Waterway: Two inland waterway routes approximately paralleling the Atlantic coast between Norfolk, Virginia, and Miami, Florida, for 1,192 miles via both the Albermarle and Chesapeake Canal and Great Dismal Swamp Canal routes.
7. Black Warrior-Tombigbee-Mobile Rivers: Black Warrior River System from RM 2.9, Mobile River (at Chickasaw Creek) to confluence with Tombigbee River at RM 45. Tombigbee River (to Demopolis at RM 215.4) to port of Birmingham, RM's 374-411 and upstream to head of navigation on Mulberry Fork (RM 429.6), Locust Fork (RM 407.8), and Sipsey Fork (RM 430.4).
8. Columbia River (Columbia-Snake Rivers Inland Waterways): From the Dalles at RM 191.5 to Pasco, Washington (McNary Pool), at RM 330, Snake River from RM 0 at the mouth to RM 231.5 at Johnson Bar Landing, Idaho.
9. Cumberland River: Junction with Ohio River at RM 0 to head of navigation, upstream to Carthage, Tennessee, at RM 313.5.
10. Green and Barren Rivers: Green River from junction with the Ohio River at RM 0 to head of navigation at RM 149.1.
11. Gulf Intracoastal Waterway: From St. Mark's River, Florida, to Brownsville, Texas, 1,134.5 miles.

12. Illinois Waterway (Calumet-Sag Channel): From the junction of the Illinois River with the Mississippi River RM 0 to Chicago Harbor at Lake Michigan, approximately RM 350.
13. Kanawha River: From junction with Ohio River at RM 0 to RM 90.6 at Deepwater, West Virginia.
14. Kaskaskia River: From junction with Mississippi River at RM 0 to RM 36.2 at Fayetteville, Illinois.
15. Kentucky River: From junction with Ohio River at RM 0 to confluence of Middle and North Forks at RM 258.6.
16. Lower Mississippi River: From Baton Rouge, Louisiana, RM 233.9 to Cairo, Illinois, RM 953.8.
17. Upper Mississippi River: From Cairo, Illinois, RM 953.8 to Minneapolis, Minnesota, RM 1,811.4.
18. Missouri River: From junction with Mississippi River at RM 0 to Sioux City, Iowa, at RM 734.8.
19. Monongahela River: From junction with Allegheny River to form the Ohio River at RM 0 to junction of the Tygart and West Fork Rivers, Fairmont, West Virginia, at RM 128.7.
20. Ohio River: From junction with the Mississippi River at RM 0 to junction of the Allegheny and Monongahela Rivers at Pittsburgh, Pennsylvania, at RM 981.
21. Ouachita-Black Rivers: From the mouth of the Black River at its junction with the Red River at RM 0 to RM 351 at Camden, Arkansas.
22. Pearl River: From junction of West Pearl River with the Rigolets at RM 0 to Bogalusa, Louisiana, RM 58.
23. Red River: From RM 0 to the mouth of Cypress Bayou at RM 236.
24. Tennessee River: From junction with Ohio River at RM 0 to confluence with Holstein and French Rivers at RM 652.
25. White River: From RM 9.8 to RM 255 at Newport, Arkansas.
26. Willamette River: From RM 21 upstream of Portland, Oregon, to Harrisburg, Oregon, at RM 194.
27. Tennessee-Tombigbee Waterway: From its confluence with the Tennessee River to the Warrior River at Demopolis, Alabama.

# Appendix III: Inland Waterways Fuel Tax Audit Results, Fiscal Years 2005 through 2014

This appendix presents Internal Revenue Service (IRS) data on the results of its activities examining the inland waterways fuel tax (fuel tax). In table 2 below, the number of taxpayers reporting a fuel tax liability is presented along with the total number of quarterly Form 720 tax returns filed per fiscal year. Taxpayers are required to file on a quarterly basis, so one taxpayer could potentially file four tax returns in a given year.

**Table 2: Number of Taxpayers Reporting Fuel Tax Liability to the Internal Revenue Service (IRS) on Form 720, Fiscal Years 2005 through 2014**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Number of taxpayers filing a Form 720 and reporting a fuel tax liability	443	456	442	411	418	402	399	412	435	442
Number of Form 720 returns filed with a fuel tax liability	1,555	1,671	1,576	1,454	1,462	1,448	1,353	1,494	1,511	1,566

Source: GAO analysis of Internal Revenue Service data. | GAO-16-682

Note: Taxpayers, such as vessel operators, that consume fuel used for propulsion purposes on the fuel taxed inland waterways system must file a federal excise tax return Form 720 each quarter of the year in which a tax liability accrued.

**Table 3: Internal Revenue Service's (IRS) Reported Audit Data for Inland Waterways Fuel Tax Audits Other Than Nonfilers, Fiscal Years 2005 through 2014**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Number of audits	99	38	26	40	119	161	129	167	114	36	<b>929</b>
No change (percentage)	57.6	76.3	53.9	75.0	37.0	56.5	72.1	49.1	59.8	86.1	<b>N/A</b>
Number of no-change audits	57	29	14	30	44	91	93	82	67	31	<b>538</b>
Audit rate <sup>a</sup>	6.4	2.3	1.6	2.8	8.1	11.1	9.5	11.2	7.5	2.3	<b>N/A</b>
Total tax assessment	\$201,805	\$198,870	\$62,631	\$287,695	\$109,392	\$90,027	\$231,708	\$502,204	\$188,742	\$6,994	<b>\$1,880,068</b>
Total tax collected	\$201,442	\$198,870	\$62,631	\$287,695	\$109,391	\$89,951	\$69,425	\$502,203	\$188,742	\$1,646	<b>\$1,711,996</b>
Average tax amount assessed per audit	\$2,038	\$5,233	\$2,409	\$7,192	\$919	\$599	\$1,796	\$3,007	\$1,656	\$194	<b>\$2,024</b>
Average tax collected per audit	\$2,035	\$5,233	\$2,409	\$7,192	\$919	\$559	\$538	\$3,007	\$1,656	\$46	<b>\$1,843</b>

Source: GAO analysis of Internal Revenue Service data. | GAO-16-682

**Appendix III: Inland Waterways Fuel Tax Audit  
Results, Fiscal Years 2005 through 2014**

Note: This table does not include interest and penalties assessed. Only inland waterways fuel tax collected goes to the Inland Waterways Trust Fund. Revenue from interest and penalties remains in the General Fund of the U.S. Treasury.

<sup>a</sup>The audit rate is the proportion of tax returns that IRS audits each year.

**Table 4: Internal Revenue Service's (IRS) Reported Audit Data for Non-Filer Inland Waterways Fuel Tax Audits, Fiscal Years 2005 through 2014**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Number of non-filer audits	31	144	31	43	116	27	45	261	542	87	<b>1,327</b>
Total tax assessment	\$23,602	\$332,220	\$53,243	\$43,022	\$184,457	\$338,861	\$26,643	\$318,176	\$696,904	\$212,122	<b>\$2,229,250</b>
Total tax collected	\$23,602	\$62,019	\$53,243	\$26,816	\$172,858	\$34,461	\$26,643	\$210,443	\$569,604	\$137,502	<b>\$1,317,191</b>
Average tax amount assessed per audit	\$761	\$2,307	\$1,718	\$1,001	\$1,590	\$12,550	\$592	\$1,219	\$1,286	\$2,438	<b>\$1,680</b>
Average tax collected per audit	\$761	\$431	\$1,718	\$624	\$1,490	\$1,276	\$592	\$806	\$1,051	\$1,580	<b>\$993</b>

Source: GAO analysis of Internal Revenue Service data. | GAO-16-682

Note: This table does not include interest and penalties assessed. Only inland waterways fuel tax collected goes to the Inland Waterways Trust Fund. Revenue from interest and penalties remains in the General Fund of the U.S. Treasury.

# Appendix IV: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

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

July 1, 2016

Rebecca Shea  
Acting Director, Physical Infrastructure Issues  
United States Government Accountability Office  
Washington, DC 20548

Dear Mrs. Shea:

Thank you for the opportunity to review your draft report entitled, "Inland Waterways Fuel Tax - Additional Data Could Enhance IRS Efforts to Ensure Taxpayer Compliance (GAO-16-682). As your report notes, the inland waterways system makes a relatively small, but important contribution to the overall U.S. economy. The inland waterways are a critical component of the nation's freight transportation system.

We appreciate your acknowledgement of the work the IRS has done to help ensure compliance with the inland waterways fuel excise tax. This tax generates a significant share of all funds used for new construction and major rehabilitation of waterways navigation infrastructure, such as locks and dams. The IRS promotes compliance with the inland waterways fuel excise tax through enforcement efforts and through educational resources designed to assist the inland waterways industry in understanding and complying with its tax obligations.

Your report indicated that IRS had not established a dialogue with the U.S. Army Corps of Engineers (Corps) to obtain proprietary data that could be used in compliance efforts. However, the IRS has been part of the Federal Initiative for Navigational Data Enhancement group. This group is a joint Federal effort between the IRS and the Corps, the U.S. Coast Guard, and the U.S. Customs and Border Protection, to promote interagency data sharing and leveraging of expertise, data, and services. Through this collaboration, IRS has established a dialogue with multiple Federal agencies that could be beneficial in enhancing compliance efforts with tax laws. Although there has been dialogue with these Federal agencies, strict disclosure laws have inhibited the successful execution of a nondisclosure agreement with the Corps. We agree that IRS compliance efforts in estimating fuel consumption and identifying inland waterways vessel operators could potentially be enhanced by obtaining additional proprietary data collected by the Corps.

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We appreciate the valuable feedback you have provided. Response to your specific recommendation is enclosed. If you have questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self-Employed Division at (240) 613-2849.

Sincerely,



John M. Dalrymple  
Deputy Commissioner for Services and Enforcement

Enclosure

Enclosure

**GAO Recommendations and IRS Responses to GAO Draft Report  
Inland Waterways Fuel Tax - Additional Data Could Enhance IRS Efforts to Ensure  
Taxpayer Compliance (GAO-16-682)**

**Recommendation:**

To maximize resources for the Inland Waterways Trust Fund, we recommend that the Commissioner of the Internal Revenue consult with the U.S. Army Corps of Engineers to explore options to obtain proprietary data to enhance IRS efforts to ensure taxpayer compliance with the inland waterways fuel tax.

**Comment:**

IRS agrees with this recommendation. Achieving an agreement to obtain this data will further enhance IRS' enforcement activities and ensure future compliance with the inland waterways fuel tax. The IRS will renew efforts with the U.S. Army Corps of Engineers to explore options for overcoming the previously encountered disclosure barrier.

# Appendix V: Comments from the Department of Defense



DEPARTMENT OF THE ARMY  
OFFICE OF THE ASSISTANT SECRETARY  
CIVIL WORKS  
108 ARMY PENTAGON  
WASHINGTON DC 20310-0108

30 JUN 2016

Ms. Anne-Marie Fennell  
Director  
Natural Resources and Environment  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Ms. Fennell:

This is the Department of Defense (DoD) response to the GAO Draft Report, GAO-16-682, "ARMY CORPS OF ENGINEERS: INLAND WATERWAYS FUEL TAX: Additional Data Could Enhance IRS Efforts to Ensure Taxpayer Compliance," dated June 10, 2016 (GAO Code 100421).

The Department appreciates this opportunity to review the report. There are no recommendations for DoD and the Department has no comments to add to the draft report.

Very truly yours,

A handwritten signature in black ink, reading "Jo-Ellen Darcy", is written over a faint, larger version of the signature.

Jo-Ellen Darcy  
Assistant Secretary of the Army  
(Civil Works)

Printed on  Recycled Paper

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# Appendix VI: GAO Contact and Staff Acknowledgments

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## GAO Contact

Rebecca Shea, (202) 512-2834 or [SheaR@gao.gov](mailto:SheaR@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, the following individuals made important contributions to this report: Cathy Colwell, Assistant Director; Jon Carver; Jennifer Clayborne; Vondalee Hunt; Delwen Jones; Maureen Luna-Long; Josh Ormond; Cheryl Peterson; John Sawyer; Anne Stevens; Elizabeth Wood; and Jim Wozny.

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