



*Improved Procedures Are Needed to Identify  
Noncompliance With the Reporting  
Requirements for Contributions of Motor  
Vehicles*

**September 17, 2007**

**Reference Number: 2007-30-171**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 17, 2007

**MEMORANDUM FOR** DEPUTY COMMISSIONER FOR SERVICES AND  
ENFORCEMENT

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Improved Procedures Are Needed to Identify  
Noncompliance With the Reporting Requirements for  
Contributions of Motor Vehicles (Audit # 200730025)

This report presents the results of our review of Provision 884 (Donations of Motor Vehicles, Boats, and Airplanes) of the American Jobs Creation Act of 2004.<sup>1</sup> The overall objective of this review was to evaluate the implementation of Provision 884 and the processing of individual income tax returns reporting deductions for donated motor vehicles. We performed this audit as part of our coverage of the implementation of tax bill legislation.

*Impact on the Taxpayer*

In recent years, the legitimacy of the values placed on gifts of donated property, clothing, vehicles, and other noncash items has been questioned by the Internal Revenue Service (IRS) and Congress. Due to concerns about taxpayers deducting amounts for motor vehicles that did not represent the accurate fair market values<sup>2</sup> of the donations, Congress passed legislation limiting the deductions and adding reporting requirements. Currently, taxpayers who may not be entitled to deductions for charitable contributions of motor vehicles are reducing their tax liabilities, which could result in a loss of revenue to the Federal Government and inequitable treatment of taxpayers.

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<sup>1</sup> Pub. L. No. 108-357, 118 Stat. 1418 (2004).

<sup>2</sup> Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.



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### Synopsis

Individual taxpayers are required to file Noncash Charitable Contributions (Form 8283) if their charitable deductions claimed for noncash contributions exceed \$500. Provision 884 of the American Jobs Creation Act of 2004 added information and reporting requirements for charitable contributions of motor vehicles. Individual taxpayers are required to file Contributions of Motor Vehicles, Boats, and Airplanes (Form 1098-C) or a written acknowledgement from the charity, in addition to Form 8283, if their charitable deductions claimed for donated motor vehicles exceed \$500. The allowable deduction depends on what the charity does with the vehicle. If the charity sells the vehicle without significantly using or improving it, the deduction is limited to the smaller of the gross proceeds received by the charity from the sale, or the vehicle's fair market value on the date of the contribution. However, if the charity (1) makes a significant intervening use of the vehicle before transferring it, (2) makes a material improvement to the vehicle before transferring it, or (3) gives or sells the vehicle to a needy individual for a price significantly below fair market value, the deduction is generally the vehicle's fair market value on the date of the contribution.

The IRS revised tax forms and publications and provided training and information to employees to facilitate implementation of the new requirements for claiming deductions for charitable contributions of motor vehicles. However, taxpayers and tax practitioners still need to be better educated concerning requirements for claiming deductions for donated motor vehicles. Also, additional procedures need to be established to identify noncompliance with motor vehicle donation requirements during returns processing. Better education of taxpayers and preparers and additional returns processing procedures will enable the IRS to address potential noncompliance, as Congress intended in its legislation. We estimate 104,846 taxpayers claimed unsubstantiated motor vehicle donations totaling approximately \$209 million for the tax year ending December 31, 2005.<sup>3</sup>

### Recommendations

We recommended the Commissioner, Wage and Investment Division, coordinate with the other responsible operating divisions to develop a comprehensive outreach plan on the reporting requirements for motor vehicle donations for affected taxpayers and tax practitioners. We also recommended the Commissioner, Small Business/Self-Employed Division, and the Commissioner, Wage and Investment Division, lower the dollar threshold to ensure most of the returns claiming unsubstantiated deductions are addressed and develop procedures to correspond with taxpayers to obtain missing Forms 8283 and supporting documentation. Taxpayers failing

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<sup>3</sup> The actual tax losses cannot be determined because the IRS is unable to identify these taxpayers. See page 4 of this report for additional details on our estimates.



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to provide missing Forms and substantiation should have a specific audit code input on their tax returns to alert the Examination function of returns without required substantiation for charitable contributions of motor vehicles.

### *Response*

IRS management disagreed with one of our recommendations and partially agreed with the other. The IRS did not agree that a comprehensive outreach program was needed and, in fact, stated the timing of our review was a factor in the high noncompliance rate we found. Management believes that the actions they are taking as a result of recommendations in a previous audit report<sup>4</sup> will also address the new reporting requirements for motor vehicle deductions. Management considers motor vehicles as only a small subset of the overall population of noncash contributions and, therefore, did not agree to adjust the dollar threshold addressing unsubstantiated motor vehicle donations. However, they agreed to explore alternative ways to address lower-dollar motor vehicle donation compliance issues. The IRS will continue to correspond with taxpayers claiming motor vehicle deductions over a specific dollar threshold and with no Forms 8283 attached to their returns. In addition, the IRS agreed to assign a specific audit indicator to alert the Examination function of returns claiming motor vehicle deductions over a threshold dollar amount and with no Forms 8283 attached. Management's complete response to the draft report is included in Appendix IV.

### *Office of Audit Comment*

We disagree with the IRS. The law was passed in 2004 and was effective for donations made beginning in 2005. Tax returns reflecting those donations were filed in 2006. The IRS had more than a year to make taxpayers and preparers aware of the change in the law and yet there was still an 80 percent noncompliance rate. The deficient cases in our samples were all filed after the IRS outreach was already available. Further, because the IRS is taking no action when taxpayers file returns without required documentation (except in very extreme and unlikely instances) taxpayers' and preparers' knowledge of the new requirements may not improve very rapidly.

We agree that additional actions taken to publicize the increased reporting requirements for noncash contributions may also address the new reporting requirements for motor vehicle deductions. However, these outreach efforts must specifically emphasize that the documentation requirements for donation of a motor vehicle are different than those for other noncash contributions.

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<sup>4</sup> *The Internal Revenue Service Needs to Improve Procedures to Identify Noncompliance With the Reporting Requirements for Noncash Charitable Contributions* (Reference Number 2007-30-049, dated March 5, 2007).



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We also disagree with the IRS' policy of treating motor vehicles as a small subset of the overall population of noncash contributions. Congress specifically provided different substantiation levels for motor vehicles and, in our opinion, to ignore that fact in administering the tax law is not in keeping with Congress' intent. In addition, we believe the IRS' plan for taking action only when the deduction exceeds the high threshold established for other noncash donations and only when the Form 8283 is missing (rather than incomplete) will result in virtually no action by the IRS. None of the returns with inadequate documentation in our samples would receive followup under the IRS planned corrective actions. We plan to perform a followup audit to determine if the compliance rate significantly improves.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit, (Small Business and Corporate Programs), at (202) 622-5894.



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*Abbreviations*

AJCA	American Jobs Creation Act of 2004
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration



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## *Background*

The Tax Code allows individuals and businesses to make noncash contributions (e.g., vehicles, paintings, used clothing, and household goods) to qualifying charities and to claim deductions for these contributions on their tax returns. Gifts of donated property, clothing, vehicles, and other noncash items have long been a source of revenue for many charitable organizations and a popular deduction for taxpayers. In recent years, the legitimacy of the values placed on some of these noncash donations has been questioned by the Internal Revenue Service (IRS) and Congress. There were concerns about taxpayers deducting amounts for used vehicles that did not represent the accurate fair market value<sup>1</sup> of the donation as required by the tax laws and, as a result, taxpayers were benefiting by the deduction more than the charities were benefiting from the donations. As a result, Congress passed legislation limiting the deduction to the gross amount of the sale, if sold, and adding additional reporting requirements to substantiate the value of some of these donations. In Tax Year 2003,<sup>2</sup> individuals reported 14.3 million noncash donations valued at about \$36.9 billion. Of these, approximately 857,000 were vehicle donations valued at about \$2.3 billion.<sup>3</sup>

On October 22, 2004, President Bush signed the American Jobs Creation Act of 2004 (AJCA).<sup>4</sup> AJCA Provision 884 (Donations of Motor Vehicles, Boats, and Airplanes) added reporting requirements for individual taxpayers making charitable contributions of motor vehicles valued at more than \$500. The IRS Wage and Investment Division was assigned primary responsibility for implementation of Provision 884. The implementation of this Provision involved multiple actions, including providing training and guidance to IRS employees, creating and revising tax forms and publications, and coordinating extensively with various IRS functions.

This review was performed in the Submission Processing function of the Wage and Investment Division and the Small Business/Self-Employed Division during the period February through May 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>1</sup> Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.

<sup>2</sup> Tax Year 2003 was the most current year for which complete data were available.

<sup>3</sup> IR-2006-113, July 18, 2006.

<sup>4</sup> Pub. L. No. 108-357, 118 Stat. 1418 (2004).



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*Results of Review*

***Tax Forms and Publications Were Revised, and Training and Information Were Provided to Employees to Facilitate Implementation of the New Requirements for Motor Vehicle Donations***

To facilitate implementation of the new requirements for claiming motor vehicle donations, the Large and Mid-Size Business Division created on its web site an AJCA webpage that contained links to notices, news releases, fact sheets, and other existing technical guidance related to the Act. Tax forms and publications related to motor vehicle donations were properly updated in accordance with the new law. In addition, training covering the new law was provided to IRS employees.

The Large and Mid-Size Business Division used the Legislative Implementation Tracking System, which is an IRS Intranet-based planning and monitoring system, to monitor implementation of the legislation. This System lists the required actions with estimated due dates and the functions responsible for taking the necessary actions.

***Taxpayers and Tax Practitioners Need to Be Better Educated Concerning Requirements for Claiming Motor Vehicle Donations***

Individual taxpayers are required to file Noncash Charitable Contributions (Form 8283) if their charitable deductions claimed for noncash contributions exceed \$500. Provision 884 of the AJCA added additional information and reporting requirements for charitable contributions of motor vehicles. In addition to Form 8283, individual taxpayers are required to file Contributions of Motor Vehicles, Boats, and Airplanes (Form 1098-C) or a written acknowledgement from the charity if their charitable deductions claimed for donated motor vehicles exceed \$500.<sup>5</sup> Taxpayers filing electronic returns are required to file U.S. Individual Income Tax Declaration for an IRS *e-file* Return (Form 8453) to submit Form 1098-C or any required paper forms.<sup>6</sup> The Provision limits the deductions for vehicle donations of more than \$500 to the sale price obtained by the charity; however, in some limited circumstances, the donor may claim fair market value. The allowable deduction depends on what the charity does with the vehicle. If the charity sells

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<sup>5</sup> Although the Provision was effective for donations made after December 31, 2004, the Form 1098-C was not completed until September 13, 2005.

<sup>6</sup> Form 8453 is used to authenticate the electronic portion of U.S. Individual Income Tax Return (Form 1040) and to send any required paper forms, such as Forms 1098-C. All electronically transmitted returns with required paper forms will not be considered complete, and therefore filed, unless and until a Form 8453 signed by the taxpayer or an authorized agent is received by the IRS.



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the vehicle without significantly using or improving it, the deduction is limited to the smaller of the gross proceeds received by the charity from the sale, or the vehicle's fair market value on the date of the contribution. However, if the charity (1) makes a significant intervening use of the vehicle before transferring it, (2) makes a material improvement to the vehicle before transferring it, or (3) gives or sells the vehicle to a needy individual for a price significantly below fair market value, the deduction is generally the vehicle's fair market value on the date of the contribution.

The Provision also requires a written appraisal from a qualified appraiser for motor vehicle donations of more than \$5,000 if the deduction is not limited to the gross proceeds from the sale of the vehicle. Provision 884 is effective for donations made after December 31, 2004.

We reviewed statistically valid samples of Tax Year 2005 individual income tax returns on which the deductions claimed for noncash charitable contributions were greater than \$500. In 140 (80 percent) of 176 sample cases claiming deductions for contributions of motor vehicles, taxpayers failed to provide the required substantiation for deductions of approximately \$300,000.<sup>7</sup> Paid preparers prepared 123 (70 percent) of the returns in our samples and prepared 100 (71 percent) of the 140 error cases.

Normally, the onus is on taxpayers and their preparers to stay abreast of existing and new tax law provisions. However, the IRS also has a responsibility to help taxpayers understand and meet their tax responsibilities. The fact that in 80 percent of our sample cases taxpayers and/or preparers were not complying with the specific requirements for claiming deductions for charitable contributions of motor vehicles indicates the need for further action by the IRS. Figure 1 contains additional details regarding our samples and our sample results.

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<sup>7</sup> The actual tax losses cannot be determined because the IRS did not identify these returns and, therefore, took no actions to determine whether the taxpayers could provide the required documentation.



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**Figure 1: Tax Returns Filed Without Substantiation for Motor Vehicle Donations**

	Returns Sampled	Form 8453 Missing <sup>8</sup>	Form 1098-C Missing	Form 1098-C Incomplete	Totals <sup>9</sup>	Percentage With Missing Documentation
<b>Paper Returns</b>	26	N/A	15	1	16	62%
<b>Electronic Returns</b>	150	90	28	6	124	83%
<b>Totals</b>	<b>176</b>	<b>90</b>	<b>43</b>	<b>7<sup>10</sup></b>	<b>140<sup>11</sup></b>	<b>80%</b>

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of cases in which the deductions for motor vehicle donations were greater than \$500.

Although the IRS has taken steps to ensure taxpayers and tax practitioners are aware of the reporting requirements for charitable contributions of motor vehicles through news releases and other communications, additional actions are needed. For instance, a draft of new regulations under Internal Revenue Code Section 170<sup>12</sup> with more formal guidance on increased reporting for charitable contributions of motor vehicles is not scheduled for release until 2007, more than 2 years after enactment of the legislation. Our samples were identified from returns processed during the tax year ending Dec. 31, 2005. Based on the results of our samples, we estimate 104,846 taxpayers claimed unsubstantiated deductions for charitable contributions of motor

<sup>8</sup> Form 8453 is used to transmit Form 1098-C as well as other documents. If Form 8453 was missing, it followed that Form 1098-C was missing as well. However, the presence of Form 8453 did not guarantee that a Form 1098-C was present.

<sup>9</sup> In four other cases, the taxpayer failed to file Form 8453 and/or attach Form 1098-C as required; however, we did not include these cases as errors because there was no tax effect.

<sup>10</sup> We considered Form 1098-C incomplete if the following information was missing: (1) vehicle identification number or (2) gross proceeds from sale of the vehicle.

<sup>11</sup> Subsequent to our review, the IRS was able to obtain documentation for 31 of the 140 error cases. Their analysis of the documentation found that 26 of the 31 taxpayers had deducted the correct value for their motor vehicle donation. However, these 31 taxpayers had not filed the required documentation with their tax return to substantiate their claimed deductions and thus, had not complied with the requirements of the tax law.

<sup>12</sup> 26 U.S.C. Section 170 (2005).



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vehicles of approximately \$209 million on Tax Year 2005 returns processed in 2006.<sup>13</sup> Without proper documentation, these taxpayers, by law, are not entitled to these deductions.

## **Recommendation**

**Recommendation 1:** The Commissioner, Wage and Investment Division, should coordinate with the other responsible operating divisions to develop a comprehensive outreach plan on the reporting requirements for motor vehicle donations for affected taxpayers and tax practitioners.

**Management's Response:** IRS management did not agree with our recommendation. Management did not believe a comprehensive outreach plan was needed at this time and, in fact, stated the timing of our review was a factor in the high noncompliance rate we found because we included returns filed during the first year in which the legislative change took effect. IRS management believes the actions they are taking as a result of recommendations in a previous audit report<sup>14</sup> regarding noncash charitable contributions will also address the new reporting requirements for motor vehicle deductions.

**Office of Audit Comment:** We disagree with the IRS. The law was passed in 2004 and was effective for donations made beginning in 2005. Tax returns reflecting those donations were filed in 2006. The IRS had more than a year to make taxpayers and preparers aware of the change in the law and yet there was still an 80 percent noncompliance rate. The deficient cases in our samples were all filed after the IRS outreach was already available. Further, because the IRS is taking no action when taxpayers file returns without required documentation (except in very extreme and unlikely instances) taxpayers' and preparers' knowledge of the new requirements may not improve very rapidly.

We agree that additional actions taken to publicize the increased reporting requirements for noncash contributions may also address the new reporting requirements for motor vehicle deductions. However, these outreach efforts must specifically emphasize that the documentation requirements for donation of a motor vehicle are different than those for

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<sup>13</sup> These estimates were determined using the two samples described in Figure 1 and on Page 3. For the sample of paper returns with motor vehicle donations greater than \$500, we estimate 45,567 taxpayers could have claimed unsubstantiated motor vehicle contributions totaling \$87 million. The number of taxpayers range from 23,429 to 67,706 totaling approximately \$39 million to \$136 million. For the sample of electronic returns with motor vehicle donations greater than \$500, we estimate 59,279 taxpayers could have claimed unsubstantiated motor vehicle contributions totaling \$122 million. The number of taxpayers range from 54,926 to 63,633 totaling approximately \$105 million to \$138 million.

<sup>14</sup> *The Internal Revenue Service Needs to Improve Procedures to Identify Noncompliance With the Reporting Requirements for Noncash Charitable Contributions* (Reference Number 2007-30-049, dated March 5, 2007).



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other noncash contributions. We plan to perform a followup audit to determine if the compliance rate significantly improves.

***Additional Procedures Need to Be Established to Identify  
Noncompliance With Motor Vehicle Donation Requirements During  
Returns Processing***

The procedures used by the IRS Submission Processing function were not adequate to ensure taxpayers met requirements for deducting charitable contributions of motor vehicles. Tax laws related to noncash charitable contributions state that no deduction shall be allowed for various noncash charitable contributions unless taxpayers provide specific substantiating information with their tax returns. Individuals who claim deductions for donated motor vehicles exceeding \$500 must provide the following with their returns:

- Form 8283 containing a description of the donated property.<sup>15</sup>
- Form 1098-C or a written acknowledgement from the charity.<sup>16</sup>

Instructions for Form 8283 inform the taxpayer that his or her deduction generally will be disallowed if he or she fails to attach Form 8283 or get a required appraisal. The instructions also state taxpayers cannot claim deductions for donated motor vehicles greater than \$500 if they fail to file Form 1098-C (or other statement). However, the IRS Submission Processing function did not adjust or stop these returns during processing or implement any type of review of these returns. Submission Processing function guidelines allow returns with such deductions to be processed except in the most egregious cases in which the deductions are of a very significant amount and Form 8283 is missing. All other income tax returns filed without substantiation for the claimed deductions for donated motor vehicles are processed as filed by the taxpayers.

Further, the IRS indicated the Examination function would be responsible for any review of information related to these returns; however, the returns were not coded or processed in any way to alert the Examination function of the unsubstantiated deductions. Instead, the returns go through the same Examination function selection criteria as any other tax returns. The Examination function generally audits fewer than 1 percent of the individual income tax returns filed each year.

By not identifying returns filed without the required substantiation for donated motor vehicles, the IRS is not addressing the Congressional intent of this legislation. Taxpayers who are not entitled to deductions for donated motor vehicles are reducing their tax liabilities and may receive refunds regardless of whether they provide the required substantiation. This could result in a loss of revenue to the Federal Government and inequitable treatment of taxpayers.

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<sup>15</sup> For a donated vehicle, taxpayers are required to enter the year, make, model, condition, and mileage.

<sup>16</sup> The written acknowledgement from the charity must contain the same information as Form 1098-C.



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## **Recommendation**

**Recommendation 2:** The Commissioner, Wage and Investment Division, and the Commissioner, Small Business/Self-Employed Division, should take the following actions to address returns without required substantiation for charitable contributions of motor vehicles:

- a) Lower the dollar threshold to ensure most of the returns claiming unsubstantiated deductions are addressed.
- b) Correspond with taxpayers to obtain missing Forms 8283 and supporting documentation.
- c) Input a specific audit code on tax returns that fail to provide missing Forms and substantiation to alert the Examination function of returns without required substantiation for charitable contributions of motor vehicles.

**Management's Response:** IRS management partially agreed with our recommendation. IRS management considers motor vehicles as only a small subset of the overall population of noncash contributions. Therefore, the current dollar threshold for addressing unsubstantiated motor vehicle donations will not be adjusted. The IRS is exploring alternative ways to address lower-dollar motor vehicle donation compliance issues. The IRS will continue to correspond with taxpayers claiming noncash contributions over a specific dollar threshold and with no Forms 8283 attached to their returns. It also plans to assign a specific audit indicator to alert the Examination function of returns claiming charitable contributions of donated vehicles over a specific threshold dollar amount and with no Forms 8283.

**Office of Audit Comment:** We disagree with the IRS' policy of treating motor vehicles as a small subset of the overall population of noncash contributions. Congress specifically provided different substantiation levels for motor vehicles and, in our opinion, to ignore that fact in administering the tax law is not in keeping with Congress' intent. In addition, we believe the IRS' plan for taking action only when the deduction exceeds the high threshold established for other noncash donations and only when the Form 8283 is missing (rather than incomplete) will result in virtually no action by the IRS. None of the returns with inadequate documentation in our samples would receive followup under the IRS planned corrective actions. We plan to perform a followup audit to determine if the compliance rate significantly improves.



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## **Appendix I**

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

The overall objective of this review was to evaluate the implementation of Provision 884 (Donations of Motor Vehicles, Boats, and Airplanes) of the AJCA of 2004<sup>1</sup> and the processing of individual income tax returns reporting deductions for donated motor vehicles. To accomplish our objective, we:

- I. Evaluated the IRS' implementation of Provision 884.
  - A. Reviewed the requirements for deductions of donated motor vehicles and identified the new requirements under Provision 884.
    1. Performed a risk assessment to identify any internal control weaknesses that needed to be included in our audit tests.
  - B. Determined what actions have been taken by the IRS to implement Provision 884.
    1. Reviewed and monitored the Legislative Implementation Tracking System<sup>2</sup> to identify planned actions to implement Provision 884.
    2. Determined whether the IRS timely developed and revised tax forms, schedules, instructions, and/or publications when necessary. We also determined whether IRS employees received training and whether taxpayers and tax practitioners were informed adequately concerning the requirements of the law.
    3. Determined whether the Internal Revenue Manual instructions regarding the processing of individual income tax returns reporting a deduction for donated motor vehicles have been addressed to successfully implement this provision.
- II. Evaluated controls over the processing of deductions for donated motor vehicles reported on individual income tax returns by reviewing samples of tax returns.
  - A. Extracted a file with 2,588,793 tax returns from the Individual Master File<sup>3</sup> Return Transaction File,<sup>4</sup> which is stored at the TIGTA Data Center

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<sup>1</sup> Pub. L. No. 108-357, 118 Stat. 1418 (2004).

<sup>2</sup> This is an IRS Intranet-based planning and monitoring system to monitor implementation of the legislation. This System lists the required actions with estimated due dates and the functions responsible for taking the necessary actions.

<sup>3</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>4</sup> The Return Transaction File contains line items transcribed during return processing and other fields such as math calculations.



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- Warehouse.<sup>5</sup> We used the criterion of paper-filed individual income tax returns with noncash contributions in excess of \$500 for the tax year ending December 31, 2005.<sup>6</sup>
- B. Selected a random and statistically valid sample of paper-filed tax returns (see audit Step II.C.) from the population based on a 95 percent confidence level and a confidence interval of  $\pm 3.25$  percent. A statistical sampling method was used to make a projection about the population from which the sample was selected. We provided the numbers to the statistician contracted by TIGTA to validate our statistical sampling methodology. We validated the tax return data against the data on the Individual Master File Return Transaction File.
- C. Reviewed a random statistically valid sample of 909<sup>7</sup> paper-filed tax returns with a Form 8283 to determine whether (1) the deductions were for vehicles donated to charitable organizations,<sup>8</sup> and (2) Forms 1098-C (or acknowledgements from the donee) were attached to the returns.
- D. Extracted a file with 71,709 tax returns from the Tax Return Database,<sup>9</sup> which is stored at the TIGTA Data Center Warehouse. We used the criterion of:
- 1) Electronically filed individual income tax returns with noncash contributions in excess of \$500 for the tax year ending December 31, 2005.
  - 2) Motor vehicles with model years from 1900 through 2006 noted in the Property Description field of Form 8283.
- E. Selected a random and statistically valid sample of electronically filed tax returns (see audit Step II.F.) from the population based on a 95 percent confidence level and a confidence interval of  $\pm 8$  percent.<sup>10</sup> A statistical sampling method was used to make a projection about the population from which the sample was selected. We provided the numbers to the statistician contracted by TIGTA to validate our statistical sampling methodology. We validated the tax return data against the data on the Tax Return Database.

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<sup>5</sup> The TIGTA Data Center Warehouse provides data and data access services; centralizes storage, security, and administration of files; and develops uniform and user-friendly interfaces for users to access data.

<sup>6</sup> We selected this tax period so any deductions for noncash charitable contributions would be subject to AJCA Provision 884.

<sup>7</sup> We selected a random sample of 1,200 paper filed returns to ensure that we received the required 909 sampled cases.

<sup>8</sup> From the 909 tax returns, we identified 26 paper filed tax returns with a vehicle donation greater than \$500 listed on the Form 8283.

<sup>9</sup> The Tax Return Database contains all electronically filed original tax return information for individual and business filers for Tax Years 1998 and beyond.

<sup>10</sup> We adjusted the precision levels to arrive at workable sample sizes. We used a Statistical Sample Size Calculator to determine the confidence intervals and sample sizes.



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- F. Reviewed a random statistically valid sample of 150 electronically filed tax returns to determine whether (1) a motor vehicle was reported on Form 8283, and (2) Form 8453 (with Form 1098-C or an acknowledgement from the donee attached) was filed.
- G. Determined whether the IRS took steps to obtain the documentation and what steps it took if no documentation was ever provided by the taxpayer.



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**Appendix II**

*Major Contributors to This Report*

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)  
Kyle R. Andersen, Director  
Bernard F. Kelly, Audit Manager  
Philip W. Peyser, Lead Auditor  
Dolores M. Castoro, Senior Auditor  
Stephen A. Wybaillie, Senior Auditor  
Layne Powell, Information Technology Specialist



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**Appendix III**

*Report Distribution List*

Acting Commissioner C  
Office of the Commissioner – Attn: Acting Chief of Staff C  
Assistant Deputy Commissioner for Services and Enforcement SE  
Commissioner, Large and Mid-Size Business Division SE:LM  
Commissioner, Small Business/Self-Employed Division SE:S  
Commissioner, Wage and Investment Division SE:W  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Commissioner, Large and Mid-Size Business Division SE:LM  
    Commissioner, Small Business/Self-Employed Division SE:S  
    Commissioner, Wage and Investment Division SE:W



*Improved Procedures Are Needed to Identify Noncompliance  
With the Reporting Requirements for Contributions of  
Motor Vehicles*

**Appendix IV**

*Management's Response to the Draft Report*



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

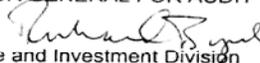
DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

**RECEIVED**

AUG 24 2007

AUG 23 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard J. Morgante   
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Improved Procedures Are Needed to Identify  
Noncompliance With the Reporting Requirements for  
Contributions of Motor Vehicles (Audit # 200730025)

I reviewed the draft report and appreciate your feedback regarding the implementation of Provision 884 of the American Jobs Creation Act of 2004, and the processing of returns with deductions for donated motor vehicles. While I agree there were issues noted during your review, we believe that some of the problems were due to the timing of your audit. The scope of your audit included returns filed during the first year in which this legislative change took effect.

The IRS has already taken numerous steps to ensure taxpayers and practitioners are aware of the new reporting requirements. Numerous publications, forms, notices and instructions were developed or revised to address the legislative changes. The revised guidance is currently available on IRS.gov. As noted in our response to your prior report, "The Internal Revenue Service Needs to Improve Procedures to Identify Noncompliance With the Reporting Requirements for Noncash Charitable Contributions," issued March 5, 2007, the IRS agreed to take actions to promote the increased reporting requirements for noncash charitable contributions. We believe some of the actions resulting from this effort will also address the new reporting requirements for motor vehicle donations. Due to these reasons, we do not believe a comprehensive outreach plan on the reporting requirements for motor vehicle donations is needed at this time.

In response to your prior report, we also agreed to continue to correspond with taxpayers to obtain missing Forms 8283, Noncash Charitable Contributions, and supporting documentation in situations involving significant noncash charitable contributions. This includes missing forms and documentation involving donated motor vehicles. In response to your prior report we also agreed, effective January 2008, to



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begin assigning an audit indicator to returns claiming a noncash charitable contribution over a specific threshold dollar amount and missing Forms 8283.

With regard to the sample results in Figure 1 on page 4 in your current report, Form 8453 (U.S Individual Income Tax Declaration for an IRS e-file return) is being revised to include checkboxes reflecting attachments for electronically-filed returns including Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes (or equivalent contemporaneous written acknowledgement). The revised form will be made available for the 2008 filing season. We believe this will help alleviate the issue of missing Forms 1098-Cs that was noted in your report.

Attached are our specific comments to your recommendations. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Julie Rushin, Director, Strategy and Finance, at (404) 338-8800.

Attachment



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Attachment

**RECOMMENDATION 1**

The Commissioner, Wage and Investment Division, should coordinate with the other responsible operating divisions to develop a comprehensive outreach plan on the reporting requirements for motor vehicle donations for affected taxpayers and tax practitioners.

**CORRECTIVE ACTION**

We do not agree that a comprehensive outreach plan is needed at this time. We believe the timing of the audit contributed to the issues noted in your report, since the scope included returns filed during the first year in which this legislative change took effect.

Numerous publications, forms, notices and instructions were developed or revised to address the legislative changes required by Provision 884. The IRS issued Notice 2005-44, Charitable Contributions of Certain Motor Vehicles, Boats, and Airplanes, and Notice 2006-1, Information Reporting by Organizations that Receive Charitable Contributions of Certain Motor Vehicles, Boats, and Airplanes to provide guidance and interim rules. Revised publications included Publication 526 (Charitable Contributions), Publication 553 (Highlights of 2005 Tax Changes), Publication 561 (Determining the Value of Donated Property) and Publication 17 (Your Federal Income Tax For Individuals). After the legislation was passed, alerts were also attached to Publication 4302 (A Charity's Guide to Vehicle Donations) and Publication 4303 (A Donor's Guide to Vehicle Donations) to ensure that tax-exempt organizations and donors were aware of the new rules while the publications were being updated. Four news releases related to Provision 884 have also been released to the public, and instructions for Form 8283 were revised and instructions for the new Form 1098-C were developed.

Finally, in response to your prior report, "The Internal Revenue Service Needs to Improve Procedures to Identify Noncompliance With the Reporting Requirements for Noncash Charitable Contributions," issued March 5, 2007, the IRS agreed to take actions to promote the increased reporting requirements for noncash charitable contributions. We believe actions resulting from this effort will also address the new reporting requirements for motor vehicle donations.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A



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**RECOMMENDATION 2**

The Commissioner, Wage and Investment Division, and the Commissioner, Small Business/Self-Employed Division, should take the following actions to address returns without required substantiation for charitable contributions of motor vehicles:

- a) Lower the dollar threshold to ensure most of the returns claiming unsubstantiated deductions are addressed.
- b) Correspond with taxpayers to obtain missing Forms 8283 and supporting documentation.
- c) Input a specific audit code on tax returns that fail to provide missing Forms and substantiation to alert the Examination function of returns without required substantiation for charitable contributions of motor vehicles.

**CORRECTIVE ACTION**

- a) At this time, we do not agree to lower the dollar threshold. Donated motor vehicles are only a small subset of the overall population of noncash charitable contributions that was the focus of your prior audit. The current dollar threshold for motor vehicle donations allows us to balance the application of resources while maintaining appropriate coverage of all noncash charitable contribution issues. While we do not plan to lower the threshold at this time, we are currently exploring alternative ways to address lower-dollar motor vehicle donation compliance issues.
- b) As agreed in response to your prior audit, the Submission Processing function will continue to correspond with taxpayers claiming a noncash charitable contribution over a specific threshold dollar amount and missing Forms 8283.
- c) As agreed in response to your prior audit, in January 2008, Submission Processing will begin assigning an audit indicator to returns claiming a charitable contribution of donated vehicles over a specific threshold dollar amount and missing Forms 8283.

**IMPLEMENTATION DATE**

- a) N/A
- b) N/A
- c) January 15, 2008

**RESPONSIBLE OFFICIAL**

- a) N/A
- b) N/A
- c) Director, Submission Processing, Customer Account Services, Wage and Investment (W&I) Division



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**CORRECTIVE ACTION MONITORING PLAN**

- a) N/A
- b) N/A
- c) The Director, Submission Processing, W&I Customer Account Services, will advise the W&I Commissioner of any delays in implementing this corrective action.