



*Procedures to Address Noncompliance
With the Reporting Requirements for
Contributions of Motor Vehicles Continue
to Be Inadequate*

September 11, 2009

Reference Number: 2009-30-116

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



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 11, 2009

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

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Procedures to Address Noncompliance
With the Reporting Requirements for Contributions of Motor Vehicles
Continue to Be Inadequate (Audit # 200830050)

This report presents the results of our review of the American Jobs Creation Act of 2004, Provision 884 (Donation of Motor Vehicles, Boats, and Airplanes).¹ The overall objective of this review was to evaluate the effectiveness of the continuing implementation of Provision 884 and the effectiveness of the processing of reported deductions for donations of motor vehicles to charitable organizations 2 years after its enactment. We also evaluated whether the charities receiving the donated vehicles provided the required documentation to the Internal Revenue Service (IRS). This review was conducted as part of our Fiscal Year 2009 Annual Audit Plan under the major management challenge of Processing Returns and Implementing Tax Law Changes.

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 IRS and Congress. Due to concerns about taxpayers deducting amounts for motor vehicles that did not represent the accurate fair market values² 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.

¹ Pub. L. No. 108-357, 118 Stat. 1418 (2004).

² See Appendix VII for a glossary of the terms.



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Synopsis

Although the IRS issued additional guidance and developed a plan to improve awareness of the current requirements for claiming deductions for charitable contributions of motor vehicles, taxpayer noncompliance continues to be significant. The procedures used by the IRS Submission Processing function are currently inadequate to ensure taxpayers meet the 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. Taxpayers are required to file Noncash Charitable Contributions (Form 8283) if their charitable deductions claimed for noncash contributions exceed \$500. Taxpayers are also 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 IRS' plan for taking action only when the deduction exceeds the high threshold established for other noncash donations and when the Form 8283 is missing (rather than incomplete) has resulted in virtually no action by the IRS. Additional procedures need to be established to identify noncompliance with motor vehicle donation requirements during returns processing. Additional returns processing procedures will enable the IRS to address potential noncompliance, as Congress intended in its legislation.

Charitable organizations are required to file Form 1098-C with the IRS for each contribution of a motor vehicle with a claimed value more than \$500; however, there was no record of Form 1098-C being filed in a significant number of cases.

The IRS captures information from Form 1098-C on the Information Return Processing System; however, it does not match the Form 1098-C information with the information on taxpayers' returns. Matching Form 1098-C with information provided on taxpayers' returns would address potential underreporting by taxpayers claiming deductions for motor vehicle donations. We estimate 92,037 taxpayers claimed unsubstantiated motor vehicle donations totaling \$204 million for the tax year ending December 31, 2007.³ In addition, we estimate 63,972 taxpayers may have avoided paying approximately \$17 million in taxes for the Tax Year 2007.⁴

³ The actual tax losses cannot be determined because the IRS is unable to identify these taxpayers and, therefore, took no actions to determine whether the taxpayers could provide the required documentation. See Appendix V for the statistical methodology.

⁴ See Appendix IV for details.



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Recommendations

We recommended that the Commissioner, Wage and Investment Division, ensure returns without required substantiation for charitable contributions of motor vehicles (including those with missing or incomplete documentation) are processed pursuant to math error authority. The Commissioner, Wage and Investment Division, should also coordinate with the other responsible operating divisions to ensure all Forms 1098-C are transcribed and develop procedures to match the information reported by charities on Forms 1098-C with the information reported on taxpayers' returns. We also recommended that the Commissioner, Tax Exempt and Government Entities Division, use outreach, educational material, and other methods to ensure charitable organizations comply with the requirement to file Form 1098-C with the IRS for each donated motor vehicle with a value in excess of \$500.

Response

IRS management agreed with one of our recommendations and disagreed with the other two. Management agreed to use math error authority to deny claims for charitable contributions of motor vehicles when the supporting documentation is not submitted with the return.

IRS management disagreed that matching the information reported by charities on Form 1098-C with the information on taxpayers' returns would yield good results. Management stated that motor vehicle deductions are one of many noncash charitable contributions reported on Itemized Deductions (Schedule A) of the U.S. Individual Income Tax Return (Form 1040), with no separate line to report it; therefore, the quality of any match would be poor. In addition, the IRS believes this noncash contribution review is better suited for the Correspondence Examination Program.

IRS management disagreed that additional outreach, educational material, and other methods were needed. Management believes they already have a substantial outreach program for motor vehicle donations and have already completed what is being recommended. Management's complete response to the draft report is included in Appendix VIII.

Office of Audit Comment

We disagree that matching the information reported by charities on Form 1098-C with the information on taxpayers' returns would not yield good results and that the noncash contribution review is better suited for the Correspondence Examination Program. The Correspondence Examination Program would review only a small number of tax returns reflecting motor vehicle donations. We believe matching the information reported by charities with the information on taxpayers' returns would more effectively identify potential underreporting by taxpayers



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claiming undue deductions for motor vehicle donations and could facilitate the imposition of penalties on charities that do not provide the required documentation to donors and the IRS.

We also disagree with the IRS' response regarding outreach to charitable organizations. Effective January 2006, charities were required to submit Form 1098-C to the IRS. The IRS has had more than 2 years to make charities aware of the change in the law but our analysis still identified an approximately 60 percent noncompliance rate. The deficient cases in our samples were all filed after the IRS outreach was already available. Further, because the IRS is not identifying noncompliant charities and imposing penalties when the charities fail to submit the required documentation, compliance by charities may not improve.

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 Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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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 Internal Revenue 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 value¹ of the donation as required by the tax laws and, as a result, taxpayers were benefiting from 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 2003,² 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.³

On October 22, 2004, President Bush signed the American Jobs Creation Act of 2004 (AJCA).⁴ 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.

We conducted this review to follow up on recommendations made in our prior audit report.⁵ This review was also conducted to evaluate the continuing implementation of AJCA Provision 884 and processing of returns reporting deductions for donations of motor vehicles to charitable organizations.

This review was performed at the IRS Brookhaven Campus in Holtsville, New York, during the period October 2008 through April 2009, and included a review of tax returns filed nationwide and discussions with personnel in the Submission Processing function of the Wage and

¹ See Appendix VII for a glossary of the terms.

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

³ IR-2006-113, dated July 18, 2006.

⁴ Pub. L. No. 108-357, 118 Stat. 1418 (2004).

⁵ *Improved Procedures Are Needed to Identify Noncompliance With the Reporting Requirements for Contributions of Motor Vehicles* (Reference Number 2007-30-171, dated September 17, 2007).



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Investment Division and the Small Business/Self-Employed Division. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. 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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Results of Review

Additional Guidance Has Been Issued Concerning Requirements for Claiming Motor Vehicle Donations

Our prior audit report recommended the IRS develop a comprehensive outreach plan on the reporting requirements for motor vehicle donations for affected taxpayers and tax practitioners. Although the IRS did not agree a comprehensive outreach plan was needed, on August 7, 2008, the IRS published a notice of proposed rulemaking and proposed regulations in the Federal Register on the substantiation and reporting requirements for cash and noncash charitable contributions under Internal Revenue Code Section 170.⁶ Substantiation for contributions of motor vehicles is specifically addressed in the proposed regulations. The IRS has plans to finalize the regulations by June 30, 2009.

In addition, the IRS partnered with external stakeholder groups to gather suggestions to promote awareness of the increased reporting requirements for noncash charitable contributions and for claiming deductions for charitable contributions of motor vehicles. As a result, an implementation plan was developed with recommendations to improve awareness of the current requirements. One of the proposed recommendations included the creation of a link on the public IRS Internet web site (IRS.gov) for taxpayers and external stakeholders to access a Charitable Contribution and Appraisal/Appraiser Requirements web site. The Charitable Contribution and Appraisal/Appraiser Requirements web site would highlight reporting and appraisal requirements and provide links to relevant materials, notices, a summary of AJCA provisions, and also important forms, instructions, and publications. The IRS would like the public web site to be accessed by outside stakeholders and allow for the creation of links from the outside stakeholders' individual organization web sites directly to the IRS public web site for their constituents. Once the implementation plan is finalized and approved by all vested organizations, the IRS plans to conference with the external stakeholders to present the plan and to gain their commitment to keep their constituents informed of reporting requirements.

We believe the IRS' additional guidance and the proposed recommendation made in its implementation plan, once complete, will provide taxpayers and external stakeholders with information needed to comply with charitable contribution and appraisal/appraiser requirements.

⁶ 26 U.S.C. Section 170 (2005).



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Taxpayer Noncompliance With the Requirements for Claiming Motor Vehicle Donations Continues to Be Significant

We previously recommended that the IRS take the following corrective actions in regard to Submission Processing function procedures:

- Lower the dollar threshold used by the Submission Processing function to identify returns without the required substantiation that require followup actions.
- Correspond with taxpayers to obtain missing Noncash Charitable Contributions (Form 8283) and supporting documentation.
- Assign a specific audit indicator to tax returns claiming a charitable contribution of donated motor vehicles more than a specific threshold dollar amount and missing Forms 8283.

We received from the IRS only a partial agreement to these recommendations. Overall, the IRS did not agree to a reduction in the dollar threshold that would trigger corrective actions on incomplete/erroneous returns, but it agreed to explore alternative ways to address lower dollar motor vehicle compliance issues. Effective January 2008, the IRS began assigning a specific audit indicator to tax returns claiming a charitable contribution of donated motor vehicles and missing Forms 8283. However, we determined that due to the high dollar threshold used, this indicator would only alert the Examination function to tax returns in which the deductions are of a significant amount and Form 8283 is missing and would not trigger an audit. The Examination function would review the deduction only in the course of an audit undertaken for other reasons. The indicator has been programmed and is currently working; however, we found that there have been no returns coded for audit by the IRS.

As a result, the number of taxpayers claiming unsubstantiated deductions for motor vehicle donations continues to be significant. We reviewed statistically valid samples of Tax Year 2007 individual income tax returns on which the deductions claimed for noncash charitable contributions were greater than \$500. Figure 1 contains details regarding our sample results.



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

Return Type Filed	Returns Sampled	U.S. Individual Income Tax Transmittal for an IRS e-file Return (Form 8453) Missing ⁷	Contributions of Motor Vehicles, Boats, and Airplanes (Form 1098-C) Missing	Form 1098-C Incomplete ⁸	Totals ⁹	Percentage With Missing Documentation	Unsubstantiated Deductions
Paper	32	N/A	19	1	21	66%	\$ 55,436
Electronic	223	133	28	4	165	74%	\$307,659
Totals	255				186		\$363,095

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

We determined tax practitioners prepared 166 (65 percent) of the returns in our sample and 121 (65 percent) of the 186 error cases. Our sample identified returns filed during the tax year ending December 31, 2007. Based on the results of our samples, we estimate 92,037 taxpayers claimed unsubstantiated deductions for charitable contributions of motor vehicles of \$204 million for the tax year ending December 31, 2007.¹⁰ Without proper documentation, these taxpayers, by law, are not entitled to the deductions. We estimate 63,972 taxpayers may have avoided paying approximately \$17 million in taxes for the Tax Year 2007.¹¹

Returns processing procedures continue to be inadequate to identify noncompliance with motor vehicle donation requirements

Tax laws related to noncash charitable contributions state that no deduction shall be allowed for various noncash charitable contributions unless taxpayers provide specific substantiating

⁷ Form 8453 is used to transmit Contributions of Motor Vehicles, Boats, and Airplanes (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.

⁸ 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.

⁹ In 15 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.

¹⁰ The actual tax losses cannot be determined because the IRS is unable to identify these taxpayers and, therefore, took no actions to determine whether the taxpayers could provide the required documentation. See Appendix V for the statistical methodology.

¹¹ See Appendix IV for details.



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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 (make, model, condition, and mileage) of the donated property.
- Contributions of Motor Vehicles, Boats, and Airplanes (Form 1098-C) or a written acknowledgement from the charity.¹²

Instructions for Form 8283 inform the taxpayer that his or her deduction generally will be disallowed if Form 8283 or a required appraisal is not attached to the return. The instructions also state that 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, stop processing, or implement any type of review of these returns. Submission Processing function guidelines continue to allow returns with deductions exceeding \$500 without substantiation for the claimed deduction for the donated motor vehicle to be processed as filed by the taxpayer except in the most egregious cases in which deductions are of a very significant amount and Form 8283 is missing.

The IRS Submission Processing function's procedures continue to be inadequate to ensure taxpayers meet requirements for deducting charitable contributions of motor vehicles. Additional procedures need to be established to identify noncompliance with motor vehicle donation requirements during returns processing. Additional returns processing procedures will enable the IRS to address potential noncompliance. None of our sampled returns with inadequate documentation would be identified and reviewed under the IRS' current procedures.

The IRS is not addressing the Congressional intent of this legislation by not identifying returns filed without the required substantiation for donated motor vehicles. 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 condition could potentially result in a loss of revenue to the Federal Government and inequitable treatment of taxpayers.

Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should ensure returns without required substantiation for charitable contributions of motor vehicles (including those with missing or incomplete documentation) are processed pursuant to math error authority.

Management's Response: The Commissioner, Wage and Investment Division, agreed with this recommendation and plans to use math error authority to deny claims for

¹² The written acknowledgement from the charity must contain the same information as Form 1098-C.



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charitable contributions of motor vehicles when the supporting documentation is not submitted with the return. If the taxpayer provides the required substantiation later, the deduction will be recredited to his or her account.

Procedures Need to Be Established to Match Information Reported by Charitable Organizations to Taxpayers' Returns

AJCA Provision 884 requires charitable organizations to file Form 1098-C with the IRS for each contribution of a motor vehicle with a claimed value more than \$500.¹³ In addition, the charities must furnish Form 1098-C (or a written acknowledgment containing the same information) to donors of motor vehicles when the claimed value is more than \$500.

Internal Revenue Code Section 6720¹⁴ allows penalties to be imposed on any donee organization that is required to furnish an acknowledgment to a donor or an information report with the IRS if the donee organization knowingly furnishes false or fraudulent information or knowingly fails to furnish the documents and show the required information.

To determine whether there was a record of Form 1098-C filed with the IRS, we reviewed Information Return Processing System Transcript Reports for samples of Tax Year 2007 individual income tax returns where taxpayers claimed motor vehicle deductions greater than \$500. In 19 (59 percent) of 32 paper-filed tax returns and in 157 (64 percent) of 245 electronically filed tax returns where charitable organizations received contributions of motor vehicles, there was no record of Form 1098-C filed with the IRS. Figure 2 contains details regarding our samples and our sample results.

Figure 2: Charitable Organizations Filing of Forms 1098-C With the IRS

	Returns Sampled	Form 1098-C Filed	No Record of Form 1098-C	Percentage With No Record of Form 1098-C Filed With the IRS
Paper Returns	32	13	19	59%
Electronic Returns	245 ¹⁵	88	157	64%

Source: TIGTA analysis of cases in which the deductions for motor vehicle donations were greater than \$500.

The IRS captures information from Form 1098-C on the Information Return Processing System; however, the IRS Automated Underreporter Program is not being utilized to match the

¹³ For Calendar Year 2007 donations, the charity is required to submit Form 1098-C to the IRS by February 28, 2008 (March 31, 2008, if filed electronically).

¹⁴ 26 U.S.C. Section 6720 (2005).

¹⁵ The returns sampled include 22 cases where we were unable to obtain the tax return or Form 8453.



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information from the Forms 1098-C with the corresponding information provided on taxpayers' returns. As a result, the IRS is not identifying potential underreporting by taxpayers claiming undue deductions for motor vehicle donations. Taxpayers who may not be entitled to deductions for donated motor vehicles may be reducing their tax liabilities. In addition, the IRS is unable to determine which charities should be penalized for not submitting the required documentation which could result in a loss of revenue to the Federal Government and inequitable treatment of taxpayers.

Recommendations

Recommendation 2: The Commissioner, Wage and Investment Division, should coordinate with the other responsible operating divisions to ensure all Forms 1098-C are transcribed and to develop procedures to match the information reported by charities on Forms 1098-C with the information reported on taxpayers' returns.

Management's Response: IRS management disagreed with our recommendation. Management did not believe matching the information reported by charities on Form 1098-C with the information on taxpayers' returns would yield good results. IRS management stated motor vehicle deductions are one of many noncash charitable contributions reported on Itemized Deductions (Schedule A) of the U.S. Individual Income Tax Return (Form 1040), with no separate line to report it; therefore, the quality of any match would be poor. IRS management believes this noncash contribution review is better suited for the Correspondence Examination Program.

Office of Audit Comment: We disagree that matching the information reported by charities on Form 1098-C with the information on taxpayers' returns would not yield good results and that the noncash contribution review is better suited for the Correspondence Examination Program. The Correspondence Examination Program would review only a small number of tax returns reflecting motor vehicle donations. We believe matching the information reported by charities with the information on taxpayers' returns would more effectively identify potential underreporting by taxpayers claiming undue deductions for motor vehicle donations and would facilitate the imposition of penalties on charities that do not provide the required documentation to donors and the IRS.

Recommendation 3: The Commissioner, Tax Exempt and Government Entities Division, should use outreach, educational material, and other methods to ensure that charitable organizations comply with the requirement to file Form 1098-C with the IRS for each donated motor vehicle with a value in excess of \$500.

Management's Response: IRS management disagreed with our recommendation. Management did not believe additional outreach, educational material, and other methods were needed. IRS management believes they already have a substantial outreach



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program for motor vehicle donations and have already completed what is being recommended.

Office of Audit Comment: We disagree with the IRS' response regarding outreach to charitable organizations. Effective January 2006, charities were required to submit Form 1098-C to the IRS. The IRS has had more than 2 years to make charities aware of the change in the law and yet there was still an approximately 60 percent noncompliance rate. The deficient cases in our samples were all filed after the IRS outreach was already available. Further, because the IRS is not identifying noncompliant charities and imposing penalties when the charities fail to submit the required documentation, charities compliance may not improve.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the effectiveness of the continuing implementation of the AJCA, Provision 884,¹ and the effectiveness of the processing of reported deductions for donations of motor vehicles to charitable organizations 2 years after its enactment. We also evaluated whether the charities receiving the donated vehicles are providing the required documentation to the IRS. To accomplish the objective, we:

- I. Evaluated the effectiveness of the IRS' continuing implementation of Provision 884.
 - A. Reviewed Provision 884 regarding any revisions to the requirements for deductions of donated vehicles to charitable organizations.
 1. Reviewed Commerce Clearing House Incorporated and the Research Institute of America Federal Tax Handbook for any new information on Provision 884.
 2. Identified any current Congressional concerns with the legitimacy of taxpayers' deductions for motor vehicle contributions.
 3. Performed a risk assessment to identify any internal control weaknesses that needed to be included in our audit tests.
 - B. Determined what actions the IRS has taken since our September 2007 report² was issued.
 1. Determined whether the IRS has implemented the corrective actions in our September 2007 report.
 2. Reviewed and monitored the Legislative Implementation Tracking System³ to identify any planned actions that were never completed.
 3. Determined whether the Internal Revenue Manual instructions were revised to address additional requirements regarding the processing of individual income tax returns reporting a deduction for donated vehicles.
 4. Issued a questionnaire to the appropriate IRS management to identify actions taken since our previous report was issued.

¹ Pub. L. No. 108-357, 118 Stat. 1418 (2004).

² *Improved Procedures Are Needed to Identify Noncompliance With the Reporting Requirements for Contributions of Motor Vehicles* (Reference Number 2007-30-171, dated September 17, 2007).

³ See Appendix VII for a glossary of the terms.



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5. Compared the error rates on Tax Years 2005 and 2007 individual tax returns (paper and electronic).
- II. Evaluated the effectiveness of the IRS' processing of individual income tax returns reporting a deduction for donated vehicles by reviewing samples of tax returns.
- A. Extracted a file with 2,101,128 tax returns from the Individual Master File Return Transaction File, which is stored at the TIGTA Data Center Warehouse. 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, 2007.⁴
 1. Selected a random statistically valid sample of paper-filed tax returns (see Step II.A.3.) from the population based on a 95 percent confidence level, a projected 50 percent error rate, and a precision of ± 3.1 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 the TIGTA to validate our statistical sampling methodology. We validated the tax return data against the data on the Individual Master File Return Transaction File.
 2. Reviewed a random statistically valid sample of 1,045⁵ paper-filed tax returns with a Noncash Charitable Contributions (Form 8283) to determine whether (1) the deductions were for vehicles donated to charitable organizations⁶ and (2) Contributions of Motor Vehicles, Boats, and Airplanes (Form 1098-C) (or acknowledgements from the donee) were attached to the returns.
 - B. Extracted a file with 75,474 tax returns from the Tax Return Database, which is stored at the TIGTA Data Center Warehouse. We used the criterion of electronically filed individual income tax returns with noncash contributions in excess of \$500 for the tax year ending December 31, 2007, and motor vehicles with model years from 1900 through 2007 noted in the Property Description field of Form 8283.
 1. Selected a random statistically valid sample of electronically filed tax returns (see Step II.B.2.) from the population based on a 95 percent confidence level, a projected 50 percent error rate, and a precision of ± 7 percent.⁷ A statistical sampling method was used to make a projection about the population from which

⁴ We selected this tax period so any deductions for noncash charitable contributions would be subject to AJCA Provision 884.

⁵ We selected a random sample of 1,200 paper-filed tax returns to ensure that we received the required 999 sampled cases. We reviewed all 1,045 tax returns we received.

⁶ From the 1,045 tax returns, we identified 32 paper-filed tax returns with a vehicle donation greater than \$500 listed on the Form 8283.

⁷ We adjusted the precision levels to arrive at workable sample sizes. We used a Statistical Sample Size Calculator to determine the precision and sample sizes.



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the sample was selected. We provided the numbers to the statistician contracted by the TIGTA to validate our statistical sampling methodology. We validated the tax return data against the data on the Tax Return Database.

2. Reviewed a random statistically valid sample of 250 electronically filed tax returns to determine whether (1) a motor vehicle was reported on Form 8283 and (2) U.S. Individual Income Tax Transmittal for an IRS *e-file* Return (Form 8453) (with Form 1098-C or an acknowledgement from the donee attached) was filed.
 - C. Determined whether the IRS took steps to obtain any missing documentation and what steps it took if no documentation was ever provided by the taxpayer.
- III. Determined whether the charitable organizations receiving the donated vehicles submitted the Form 1098-C to the IRS.
- A. Reviewed Information Return Processing Transcript Reports using both the taxpayers' primary and secondary Social Security Numbers for all Individual Master File paper and electronically filed tax returns identified in Steps II.A.1. and II.B.1. where taxpayers claimed motor vehicle deductions greater than \$500.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Assistant Deputy Commissioner for Services and Enforcement SE
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
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
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Deputy Commissioner for Services and Enforcement SE
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Commissioner, Wage and Investment Division SE:W



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$10,098,283 per year involving 30,160¹ taxpayers; \$50.5 million over 5 years involving 150,800 taxpayers.² This represents the additional revenue associated with tax assessments for 30,160 unsubstantiated deductions for motor vehicle donations claimed on Tax Year 2007 paper-filed tax returns.³ The value of the outcome measure does not include amounts (costs) that could partially offset this benefit due to reallocating some IRS resources (see page 4).

Methodology Used to Measure the Reported Benefit:

To estimate the potential additional revenue associated with resolving unsubstantiated deductions for motor vehicle donations claimed on Tax Year 2007 paper-filed tax returns, we:

1. Reviewed a random statistically valid sample of 1,045⁴ paper-filed tax returns with a Noncash Charitable Contributions (Form 8283) to determine whether (1) the deductions were for vehicles donated to charitable organizations⁵ and (2) Contributions of Motor Vehicles, Boats, and Airplanes (Form 1098-C) (or acknowledgements from the donee) were attached to the returns. Our sample was selected from a population of 2,101,128 tax returns for the tax year ending December 31, 2007.
2. Estimated 30,160 taxpayers claimed unsubstantiated deductions for charitable contributions of motor vehicles of \$100,982,826 on Tax Year 2007 returns.

¹ The figure 30,160 represents cases where taxpayers did not file the required documentation and the charities did not file the Form 1098-C with the IRS.

² The 1-year and 5-year projections were computed using the lowest effective tax rate for single, married, separate, and head of household.

³ We selected tax returns with motor vehicle donations in excess of \$500 for the year ending December 31, 2007.

⁴ We selected a random sample of 1,200 paper-filed tax returns to ensure that we received the required 999 sampled cases. We reviewed all 1,045 tax returns we received.

⁵ From the 1,045 tax returns, we identified 32 paper-filed tax returns with a vehicle donation greater than \$500 listed on the Form 8283.



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3. Used the lowest 'effective' tax rate of 10 percent for filing statuses single, married, separate, and head of household to project the unsubstantiated deductions for motor vehicle donations resulting in approximately \$10,098,283 in tax assessments.
4. Shared our methodology for projecting our attribute sample into the population of U.S. Individual Income Tax Returns (Form 1040) with the statistician contracted by the TIGTA, who confirmed the accuracy and validity of the projections.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$6,961,903 per year involving 33,812⁶ taxpayers; \$34.8 million over 5 years involving 169,060 taxpayers.⁷ This represents the additional revenue associated with tax assessments for 33,812 unsubstantiated deductions for motor vehicle donations claimed on Tax Year 2007 electronically filed tax returns.⁸ The value of the outcome measure does not include amounts (costs) that could partially offset this benefit due to reallocating some IRS resources (see page 4).

Methodology Used to Measure the Reported Benefit:

To estimate the potential additional revenue associated with resolving unsubstantiated deductions for motor vehicle donations claimed on Tax Year 2007 electronically filed tax returns, we:

1. Reviewed a random statistically valid sample of 250 electronically filed tax returns with Form 8283 to determine whether (1) the deductions were for vehicles donated to charitable organizations and (2) Form 1098-C (or acknowledgements from the donee) were attached to the returns. Our sample was selected from a population of 75,474 tax returns for the tax year ending December 31, 2007.
2. Estimated 33,812 taxpayers claimed unsubstantiated deductions for charitable contributions of motor vehicles of \$69,619,029 on Tax Year 2007 returns.
3. Used the lowest 'effective' tax rate of 10 percent for filing statuses single, married, separate, and head of household to project the unsubstantiated deductions for motor vehicle donations resulting in approximately \$6,961,903 in tax assessments.
4. Shared our methodology for projecting our attribute sample into the population of Forms 1040 with the statistician contracted by the TIGTA, who confirmed the accuracy and validity of the projections.

⁶ The figure 33,812 represents cases where taxpayers did not file the required documentation and the charities did not file the Form 1098-C with the IRS.

⁷ The 1-year and 5-year projections were computed using the lowest effective tax rate for single, married, separate, and head of household filing statuses.

⁸ We selected tax returns with motor vehicle donations in excess of \$500 for the year ending December 31, 2007.



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Appendix V

Statistical Methodology

In 21 (66 percent) of 32 paper-filed tax returns and 165 (74 percent) of 223 electronically filed tax returns claiming deductions for contributions of motor vehicles, taxpayers failed to provide the required substantiation for deductions of approximately \$55,436 and \$307,659,¹ respectively.

From our random statistically valid samples of 1,045 paper and 250 electronically filed tax returns, we estimate 92,037 taxpayers claimed unsubstantiated deductions for charitable contributions of motor vehicles of \$204 million on Tax Year 2007 returns.

These estimates were determined using the two samples described in Figure 1 on page 5. For the sample of paper returns with motor vehicle donations greater than \$500, we estimate 42,224 taxpayers could have claimed unsubstantiated motor vehicle contributions totaling \$111 million. The number of taxpayers range from 24,343 to 60,104 totaling \$9 million to approximately \$214 million. For the sample of electronic returns with motor vehicle donations greater than \$500, we estimate 49,813 taxpayers could have claimed unsubstantiated motor vehicle contributions totaling approximately \$93 million. The number of taxpayers range from 45,379 to 54,246 totaling approximately \$78 million to \$108 million.

¹ 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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Appendix VI

Detailed Requirements of the American Jobs Creation Act of 2004, Provision 884

Individual taxpayers are required to file Noncash Charitable Contributions (Form 8283) if their charitable deductions claimed for noncash contributions exceed \$500. The AJCA, Provision 884, added more 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 \$500.¹

Taxpayers filing electronic returns are required to file U.S. Individual Income Tax Transmittal for an IRS *e-file* Return (Form 8453) to submit Form 1098-C or any required paper forms. 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 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.

¹ Although the Provision was effective for donations made after December 31, 2004, the Form 1098-C was not completed until September 13, 2005.



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Appendix VII

Glossary of Terms

Automated Underreporter Program – Works underreporter cases in IRS campuses by matching information returns [e.g., various information returns (Form 1099 series), Wage and Tax Statements (Form W-2)] against data reported on U.S. Individual Income Tax Returns (Form 1040).

Campus – The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Fair Market Value – 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.

Federal Register – Official daily publication for rules, proposed rules, and notices of Federal agencies and organizations, as well as executive orders and other presidential documents.

Form 1099 – An information return used to report various types of income other than wages, salaries, and tips.

Individual Master File – The IRS database that maintains transactions or records of individual tax accounts.

Information Return Processing System – Receives data submitted by employers and other third parties reporting taxpayer income such as wages, pensions, interest, and dividends paid during the tax year.

Legislative Implementation Tracking System – Monitors implementation of legislation and lists the required actions, estimated due dates, and the functions responsible for taking the necessary actions.

Math Error Authority – Math errors include an omission of information required on the tax return to substantiate an entry. In math error cases, the IRS may assess and send a notice of assessment of additional tax without using deficiency procedures.

Return Transaction File – Contains line items transcribed during returns processing and other fields such as math calculations.

Tax Return Database – Contains all electronically filed original tax return information for individual and business filers for Tax Years 1998 and beyond.



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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.

U.S. Individual Income Tax Transmittal for an IRS *e-file* Return (Form 8453) – Used to authenticate the electronic portion of U.S. Individual Income Tax Return (Form 1040) and to send any required paper forms, such as Contributions of Motor Vehicles, Boats, and Airplanes (Form 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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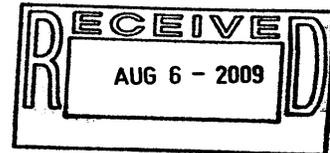
Appendix VIII

Management's Response to the Draft Report

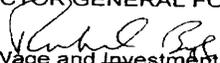


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

AUG 06 2009



MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Procedures to Address Noncompliance
With the Reporting Requirements for Contributions of Motor
Vehicles Continue to Be Inadequate (Audit #200830050)

I reviewed the subject draft report and appreciate your feedback regarding our effectiveness in processing returns reporting deductions for donations of motor vehicles to charitable organizations.

In addition, I want to thank you for acknowledging our efforts to inform taxpayers of the substantiation and reporting requirements for cash and noncash charitable contributions under Section 170 of the Internal Revenue Code (the Code), and our work with external stakeholders to promote awareness of the increased reporting requirements.

I agree with your assessment that return processing procedures should be updated to ensure returns without the required substantiation for charitable contributions of motor vehicles are not allowed until the required substantiation is submitted. In order to address the issue, we will process these returns using math error authority and disallow the full deduction for the charitable contributions of motor vehicles without required supporting documentation. This documentation includes Form 8283, *Noncash Charitable Contributions*, and Form 1098-C, *Contributions of Motor Vehicles, Boats and Airplanes*, or contemporaneous written acknowledgement of the contribution by the donee organization that meets the requirements of Section 170(f) of the Code. If the taxpayer provides the missing required substantiation later, the deduction will be reccredited to their account.

We do not agree with your proposal to develop procedures to match the information reported by charities on Forms 1098-C with the information reported on taxpayers' returns. Motor vehicle deductions are one of many noncash charitable contributions reported on Schedule A (Form 1040), *Itemized Deductions*, therefore, any matching



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program would not yield good results. This noncash contribution review is more suited for the Correspondence Examination Program, where it is currently worked.

Attached are our comments to your specific recommendations. We agree with the outcome measures reported in Appendix IV. If you have any questions regarding this response, please call me, at (404) 338-7060, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment



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Attachment

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should ensure returns without required substantiation for charitable contributions of motor vehicles (including those with missing or incomplete documentation) are processed pursuant to math error authority.

CORRECTIVE ACTION

We agree with this recommendation. The Wage and Investment Division, Submission Processing function, will process these returns using math error authority and deny claims for charitable contributions of motor vehicles when the supporting documentation is not submitted with the return. If the taxpayer provides the missing required substantiation later, the deduction will be recredited to their account.

IMPLEMENTATION DATE

January 15, 2010

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 2

The Commissioner, Wage and Investment Division, should coordinate with the other responsible operating divisions to ensure all Forms 1098-C are transcribed and to develop procedures to match the information reported by charities on Forms 1098-C with the information reported on taxpayers' returns.

CORRECTIVE ACTION

We do not agree with this recommendation. Motor vehicle deductions are one of many noncash charitable contributions reported on Schedule A (Form 1040), *Itemized Deductions*, with no separate line to report it; therefore, the quality of any match would be poor. This noncash contribution review is better suited for the Correspondence Examination Program, where it is currently worked based on a series of rules.

IMPLEMENTATION DATE

NA

RESPONSIBLE OFFICIAL

NA



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CORRECTIVE ACTION MONITORING PLAN

NA

RECOMMENDATION 3

The Commissioner, Tax Exempt and Government Entities Division, should use outreach, educational material, and other methods to ensure that charitable organizations comply with the requirement to file Form 1098-C with the IRS for each donated motor vehicle with a value in excess of \$500.

CORRECTIVE ACTION

We disagree with this recommendation. The Tax Exempt and Government Entities (TE/GE) Division already has a substantial outreach program for motor vehicle donations and has already completed what is being recommended.

Since the enactment of Provision 884, *Donations of Motor Vehicles, Boats, and Airplanes*, of the American Jobs Creation Act of 2004, TE/GE has worked diligently to educate charities about the requirement to file Form 1098-C with the IRS. We will continue our educational effort using the various methods described below.

The TE/GE Division created Publication 4302, *A Charity's Guide to Vehicle Donations*, as well as Publication 4303, *A Donor's Guide to Vehicle Donations*. These publications explain the vehicle donation rules and the requirement that the charity file Form 1098-C with the IRS. In addition, the donor is instructed to attach Form 8283 along with either a copy of Form 1098-C or a written acknowledgement from the charity that contains the same information to his or her Form 1040. Both publications are available from the home page of IRS.gov, on the Charities and Nonprofits page, or by calling the IRS at (800) 829-3676. These publications also are referenced in other Exempt Organizations (EO) publications.

In addition, we have a Vehicle Donation Guidance web page that discusses the Form 1098-C filing requirement with links to the form and instructions. This web page is easily located by entering "vehicle donations" into the search function on IRS.gov, or through the new EO site map.

The TE/GE Division has been working with other areas of the IRS to design the Charitable Contribution and Appraisal/Appraiser Requirements website. Soon to be released, this comprehensive website will include information about the requirement that charities file Form 1098-C for motor vehicle donations.

The TE/GE Division uses the following outreach methods to inform or remind charities of the Form 1098-C filing requirement:



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- Periodic reminders to charities and tax practitioners who represent them via EO Update (an electronic newsletter that links to material posted on the Charities and Non-Profits page).
- Provide information and the vehicle donation publications to attendees at our annual Small and Mid-Sized EO workshops (18 workshops per year).
- Provide copies of the vehicle donation publications and answer questions about the Form 1098-C filing requirement at the Nationwide Tax Forums each year.
- Promote our web-based mini course entitled "Can I Deduct My Charitable Contributions?" which has an in-depth discussion of the vehicle donation rules including Form 1098-C.

IMPLEMENTATION DATE

Completed

RESPONSIBLE OFFICIAL

Director, Exempt Organizations, Tax Exempt and Government Entities Division

CORRECTIVE ACTION MONITORING PLAN

N/A