



*Many Taxpayers Who Were Not Eligible
Received Additional Education Credits
Intended for Those Attending Schools
in Midwestern Disaster Areas*

September 23, 2010

Reference Number: 2010-40-123

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



HIGHLIGHTS

MANY TAXPAYERS WHO WERE NOT ELIGIBLE RECEIVED ADDITIONAL EDUCATION CREDITS INTENDED FOR THOSE ATTENDING SCHOOLS IN MIDWESTERN DISASTER AREAS

Highlights

Final Report issued on September 23, 2010

Highlights of Reference Number: 2010-40-123 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Tax credits are available to help taxpayers offset the costs of higher education. These credits are available to certain taxpayers who pay qualified education expenses for higher education for themselves, their spouses, or dependents. The Hope Credit is limited to eligible students enrolled in their first 2 years of post-secondary education. Congress passed the Heartland Disaster Tax Relief Act of 2008 with provisions benefitting taxpayers affected by a major disaster. One provision allowed taxpayers with eligible students attending eligible educational institutions in the designated Midwestern Disaster Areas to claim twice the qualifying amount of education credits. For Tax Year 2008, this increased the maximum amount of Hope Credit from \$1,800 to \$3,600 for each qualifying student.

Some taxpayers are claiming more than the standard maximum amount of Hope Credit even though the listed students do not qualify under the Heartland Disaster Tax Relief Act of 2008. In other instances, the students may not qualify for any portion of the Hope Credit.

WHY TIGTA DID THE AUDIT

This audit was initiated because, during a prior audit of education credits, TIGTA found indications that control weaknesses may exist that allow taxpayers to claim Hope Credits greater than the amounts allowed. The overall objective of this audit was to determine whether Internal Revenue Service (IRS) controls were in place to ensure only eligible taxpayers received

education credit tax relief available to affected taxpayers in the Midwestern Disaster Areas.

WHAT TIGTA FOUND

TIGTA's review of a statistically valid sample of 383 tax returns with claims for more than the standard maximum amount of Hope Credit determined that 197 of the claims were for students who did not qualify for the Hope Credit, did not attend school in the Midwestern Disaster Areas, or may not have attended school at all. TIGTA found that the taxpayers making these claims received \$224,504 more than they were entitled to. Based on this data, TIGTA estimates that taxpayers filing 48,940 tax returns with such claims erroneously received almost \$55.8 million in excessive Hope Credits for Tax Year 2008.

Overall, TIGTA found that the IRS has no controls in place to determine whether students qualify for more than the standard maximum amount. TIGTA also found that there is no maximum limit programmed for the amount of Hope Credit that can be claimed other than the adjusted gross income limitations. The only other limitation appears to be a taxpayer's tax liability.

WHAT TIGTA RECOMMENDED

The IRS should ensure that only qualifying taxpayers are allowed to receive more than the normal maximum amount of Hope Credit allowed. Taxpayers that have improperly received an excessive amount of credit should be examined, and any excessive amounts claimed should be recovered. Additional steps should also be taken to ensure that taxpayers qualify for the additional amount. The IRS should also ensure adherence to increased maximums on any future provisions.

IRS management agreed with three recommendations and partially agreed with one recommendation. Management agreed to conduct examinations of improper claims, evaluate the feasibility of an automated process to verify claims, update computer processing controls to limit the amount of Credit that can be claimed, and make modifications to forms to increase compliance in the future.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 23, 2010

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM:

Michael R. Phillips

Michael R. Phillips

Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Many Taxpayers Who Were Not Eligible
Received Additional Education Credits Intended for Those Attending
Schools in Midwestern Disaster Areas (Audit # 201040033)

This report presents the results of our review to determine whether Internal Revenue Service controls were in place to ensure only eligible taxpayers received education credit tax relief available to affected taxpayers in the Midwestern Disaster Areas. This audit is part of the Treasury Inspector General for Tax Administration's Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Implementing Tax Law Changes.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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Abbreviations

IRS	Internal Revenue Service
TY	Tax Year



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Background

Tax credits are available to help taxpayers offset the costs of higher education. These credits are available to taxpayers who pay qualified expenses for higher education for themselves, their spouses, or their dependents that are claimed as exemptions on their tax returns as long as they are eligible students.

- Hope Credit – For each eligible student in Tax Year (TY) 2008, this credit was equal to 100 percent of the first \$1,200 of qualified education expenses and 50 percent of the next \$1,200 of qualified expenses, for a maximum credit of \$1,800 per eligible student. The amount of the Hope Credit is phased out if the modified adjusted gross income is between \$48,000 and \$58,000 (\$96,000 and \$116,000 if a joint return is filed). This credit is limited to eligible students enrolled in their first 2 years of post-secondary education attending at least half-time. It does not apply to the third, fourth, or higher years of undergraduate or graduate programs.
- Lifetime Learning Credit – In TY 2008, this credit was equal to 20 percent of the first \$10,000 of qualified education expenses, for a maximum credit of \$2,000 per eligible taxpayer. This credit is available every year for an unlimited number of years.
- American Opportunity Credit – The American Recovery and Reinvestment Act of 2009² added this credit for TYs 2009 and 2010, making this education credit partially refundable and making it available to a broader range of taxpayers. For these years, this credit is equal to the sum of 100 percent of the first \$2,000 of qualified tuition and related expenses and 25 percent of the next \$2,000, for a total maximum credit of \$2,500 per eligible student. The credit is also expanded to apply to the first 4 years of post-secondary education.

The Heartland Disaster Tax Relief Act of 2008¹ allows students attending an eligible educational institution located within the “Midwestern Disaster Area” to claim twice the amount of Hope and Lifetime Learning Credits.

Institutions of higher education are required to provide each student with a Tuition Statement (Form 1098-T) that reports payments received or amounts billed for qualified tuition and related expenses, scholarships and grants given, adjustments made for a prior year, and the name and

¹ Pub. L. No. 110-343, 122 Stat. 3912.

² Pub. L. No. 111-5, 123 Stat. 115 (2009).



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location of the institution. The taxpayer in turn reports qualified education expenses on Education Credits (American Opportunity, Hope, and Lifetime Learning Credits) (Form 8863) and claims the credit on the appropriate line of the U.S. Individual Income Tax Return (Form 1040). In addition, educational institutions provide the Internal Revenue Service (IRS) with the same Form 1098-T information they provided to the students. This information is entered onto the IRS' Information Returns Master File.³ The data on this system can help to validate the information provided on taxpayers' tax returns.

Congress passed the Heartland Disaster Tax Relief Act of 2008, with provisions benefiting taxpayers affected by a major disaster. One provision allowed eligible students attending eligible educational institutions in specific counties located within the States of Arkansas, Illinois, Indiana, Iowa, Missouri, Nebraska, and Wisconsin to claim twice the normal amount of the Hope and Lifetime Learning Credits. For students attending school in the counties that encompass the "Midwestern Disaster Area," the maximum amount of Hope Credit was increased from \$1,800 to \$3,600 for each qualifying student, and the maximum amount of Lifetime Learning Credit was increased from 20 percent of the maximum qualified education expenses paid to 40 percent. The definition of qualified education expenses was also expanded to include books, supplies, and equipment required for enrollment or attendance, as well as reasonable costs for qualified room and board. The American Opportunity Credit was not affected.

This review was performed at the IRS Campus⁴ in Ogden, Utah, during the period October 2009 through April 2010. 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.

³ A database containing all information returns transcribed by the IRS. It contains data about both the payer (filer) as well as data about the payee (recipient of income) from various forms.

⁴ 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.



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Results of Review

Some Taxpayers Received More Hope Credit Than They Were Entitled to Receive

The Hope Credit can be claimed for eligible students enrolled in their first 2 years of post-secondary education. Students attending eligible educational institutions located within the Midwestern Disaster Area may claim up to twice the standard maximum amount of Hope Credit. For TY 2008, this equals \$3,600 (100 percent of the first \$2,400 in qualified education expenses and 50 percent of the next \$2,400 of qualified education expenses). The maximum amount is available for each qualifying student.

We found that 51 percent of Hope Credit claims for greater than the standard maximum amount were for students that did not qualify for the Hope Credit, did not attend school in a Midwestern Disaster Area, or may not have attended school at all.

From the IRS' Individual Return Transaction File⁵ on the Treasury Inspector General for Tax Administration Data Center Warehouse,⁶ we identified 95,149 TY 2008 Forms 1040 (cases) that included claims for more than the standard maximum amount of Hope Credit (we included claims by taxpayers with either 1 or 2 students). We analyzed a statistically valid sample of 383 cases to determine whether the "qualifying" students were eligible to receive the higher amount of Hope Credit. From our sample, we found that 197 claims (51 percent) were for students that did not qualify for the Hope Credit, did not attend school in a Midwest Disaster Area, or may not have attended school at all.⁷

- For 44 of 197 cases, IRS records (Form 1098-T data on the Information Returns Master File) showed that these students did not qualify for the Hope Credit because they were not at least half-time students or they were graduate students.
- For 101 of the 197 cases, IRS records indicated that the students for which the credits were claimed appeared to have qualified for the credits, but had not attended educational institutions in the Midwestern Disaster Area.

⁵ A database the IRS maintains that contains information on the individual tax returns it receives.

⁶ A collection of IRS databases containing various types of taxpayer account information that is maintained by the Treasury Inspector General for Tax Administration for the purpose of analyzing data for ongoing audits.

⁷ Some of the taxpayers inappropriately claiming the Hope Credit were IRS employees. We referred this information to the Treasury Inspector General for Tax Administration Office of Investigations for further action.



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- For the remaining 52 cases, no Form 1098-T information was present on IRS records to indicate the students for which the credits were claimed attended any school. The absence of such supporting data is a strong indicator that the students listed may not have actually been qualifying students.

Three control weaknesses allowed the inappropriate claims

Three control weaknesses allowed taxpayers to inappropriately receive additional Hope Credits intended only for students attending school in Midwest Disaster Areas.

1. The IRS requires no third-party documentation with the tax return to support a claim for an education credit. As mentioned earlier, taxpayers are provided with copies of Form 1098-T. This form not only contains amounts taxpayers paid or were billed for education expenses, but also contains the name and address of the educational institution and an indicator of whether the student was at least a half-time student.
2. Form 8863 contains no indicator that a student attended school in a Midwest Disaster Area or an indicator showing whether the student was at least a half-time student. Therefore, the IRS has no way to distinguish between a student attending school in a disaster area and a student for whom the taxpayer incorrectly claims more Hope Credit than he or she was entitled to claim. It also cannot determine whether the student was at least a half-time student.
3. The IRS has not programmed its computers to limit the amount of Hope Credit claimed. Our review of the IRS' Functional Specification Package⁸ for the processing of Form 8863 showed that there were no controls in place limiting the amount of Hope Credit that can be claimed other than adjusted gross income limits. Based on this and our case review, it appears the only other factor limiting the amount of Hope Credit is the amount of tax liability owed by the taxpayer. For instance, even though the maximum amount of Hope Credit is \$3,600 for 1 student attending school in a Midwest Disaster Area, taxpayers claiming a \$5,000 Hope Credit amount would receive the full amount if their tax liability was at least \$5,000. If the same taxpayer claiming a \$5,000 Hope Credit had a tax liability of \$4,800, the Hope Credit would be limited to \$4,800.

From our sample of 383 cases, we identified 4 cases for which the taxpayers claimed more than the Midwestern Disaster Area maximum amount (\$3,600) of Hope Credit for a single student. In three of these cases, the taxpayer received more than the maximum amount allowed. ***1*****

Overall, we found that the taxpayers who filed the 197 tax returns in our sample and claimed more than the standard maximum amount of Hope Credit but did not qualify for the increased

⁸ The IRS' detailed specifications for computerized tax return processing.



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amount received \$224,504 more than they were entitled to. Based on this data, we estimate that taxpayers filing 48,940 tax returns with such claims erroneously received almost \$55.8 million in excessive Hope Credits.

We also found a correlation between where the primary taxpayer lived and whether the student(s) actually qualified for the increased amount. We analyzed our sample cases by comparing the primary taxpayers' State addresses to the Midwestern Disaster Area States⁹ and found that of the 197 exception cases, 132 (67 percent) of the primary taxpayers did not live in States affected by the Midwestern disasters. From those in our sample with a student(s) that qualified for the increased maximum, only three of the primary taxpayers lived outside one of the States within the Midwestern Disaster Area.

Recommendations

Recommendation 1: The Director, Reporting Compliance, Wage and Investment Division, should conduct post-refund examinations of erroneous claims to ensure refunds for excessive claims are recovered. Form 1098-T information received from the educational institutions could be used to validate whether the students attended eligible educational institutions located in Midwestern Disaster Areas. It could also be used to determine whether the students were at least half-time students.

Management's Response: IRS management agreed with this recommendation. The IRS will conduct post-refund examinations of the 197 cases we identified as improperly claiming the credit and will use the results of those examinations to evaluate the value of additional examinations.

Recommendation 2: The Director, Reporting Compliance, Wage and Investment Division, should develop an automated process to utilize the data provided by education institutions on Forms 1098-T to identify taxpayers claiming questionable claims for education credits. Claims with no Forms 1098-T or claims for the Hope Credit with Forms 1098-T indicating students were not at least half-time students or were graduate students should be scrutinized by the Examination function. If an automated process cannot be developed, the Director should initiate a requirement for taxpayers claiming education credits to attach Forms 1098-T to their tax returns and the process described above should be performed manually during processing.

Management's Response: IRS management partially agreed with this recommendation. The IRS agreed to evaluate the feasibility of an automated process to use the Form 1098-T data and match it to the appropriate tax return. If feasible, the IRS will submit the necessary Unified Work Request. Because the requested action will be subject to funding and resource prioritization by the Modernization and Information

⁹ Although eligibility for the increased credit was based on county, we performed this analysis by State because that information was readily available on the Forms 1040 and the Forms 1098-T.



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Technology Services organization, submission of the Unified Work Request will complete this corrective action. The IRS will also test a filter in Fiscal Year 2011 to identify taxpayers with no Form 1098-T claiming education expenses. However, the IRS does not agree to ask the taxpayer to attach the Form 1098-T to the return. In the event an automated match cannot be accomplished, the IRS will select a sample of returns to review and manually match against available Form 1098-T data received from the educational institutions. The volume each year will depend on the labor intensive nature of the process and the relative success of the program compared to other correspondence examination programs.

Recommendation 3: If similar provisions are enacted in the law for future disasters, the Director, Forms and Publications, Wage and Investment Division, should require taxpayers to specifically indicate on Forms 8863 when they are claiming increased education credit because of a disaster provision. Consideration should be given to modifying the Form 8863 with a check box for this purpose. The Director should also consider a requirement to include the county and State of the educational institution attended.

Management's Response: IRS management agreed with this recommendation. The IRS will make the recommended changes to Form 8863 if similar legislation is enacted in the future.

Recommendation 4: The Director, Submission Processing, Wage and Investment Division, should ensure that computer processing controls are set to limit the amount of Hope Credit that can be claimed based on the number of students claimed and the maximum amounts allowable. The Director should also ensure adherence to increased maximums on any future provisions.

Management's Response: IRS management agreed with this recommendation, and will submit a Unified Work Request, by January 15, 2011, to update computer processing controls limiting the amount of American Opportunity Credit (previously the Hope Credit) that can be claimed based on the number of students claimed and the maximum amounts allowable. Because the requested action will be subject to funding and resource prioritization by the Modernization and Information Technology Services organization, submission of the Unified Work Request will complete the corrective action.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether IRS controls were in place to ensure only eligible taxpayers received education credit tax relief available to affected taxpayers in the Midwestern Disaster Areas. To accomplish our objective, we:

- I. Determined the purpose of the education credit provisions available to affected taxpayers in the Midwestern Disaster Areas. We determined which taxpayers are eligible to claim the credits, the dollar limits associated with the credits, and whether adequate instructions were available for taxpayers to properly claim the credits.
 - A. Reviewed the laws and regulations enacted by Congress to provide tax relief for affected taxpayers in the Midwestern Disaster Area.
 - B. Reviewed the applicable Internal Revenue Code sections associated with the Midwestern Disaster Area (the Heartland Disaster Tax Relief Act of 2008).¹ We determined whether information in *Information for Affected Taxpayers in the Midwestern Disaster Areas* (Publication 4492-B) thoroughly explains the tax provisions of the Heartland Disaster Tax Relief Act of 2008 and the related education credits.
 - C. Reviewed the instructions provided to taxpayers in *Tax Benefits for Education* (Publication 970) or other applicable instructions dealing with education credits. We determined whether the explanation of the tax relief for Midwestern Disaster Area taxpayers is accurately and sufficiently explained in regards to the education credits.
 - D. Determined whether it appears that the IRS interpreted and implemented the law in accordance with Congressional intent.
- II. Determined what IRS controls exist to ensure taxpayers are properly claiming the education credits for affected taxpayers in the Midwestern Disaster Areas.
 - A. Interviewed IRS processing personnel and programmers to determine what controls are in place for the education credit dollar tolerances.
 - B. Analyzed applicable IRS programming to determine what processing controls have been developed and implemented for the education credits to ensure that taxpayers are eligible for the higher amount of credit as defined by the Midwestern Disaster Area criteria.

¹ Pub. L. No. 110-343, 122 Stat. 3912.



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- C. Determined whether any post-processing controls exist which specifically review the education credits claimed by Midwestern Disaster Area taxpayers.
 - D. Determined whether controls appear to be programmed and worked properly.
- III. Determined whether IRS controls ensure only eligible taxpayers are receiving Midwestern Disaster Area tax relief for the Hope Credit.
- A. Downloaded all cases from the Information Returns Transaction File² located on Treasury Inspector General for Tax Administration's Data Center Warehouse³ for all TY 2008 returns which have claimed more than the standard Hope Credit for taxpayers claiming one or two students. We analyzed the volumes of cases to quantify the extent of the possible problem.
 - B. Performed validity checks of the data received in Step III.A. to ensure cases reviewed met our criteria.
 - C. Selected and reviewed a statistically valid random sample⁴ of 383 TY 2008 Education Credits (American Opportunity, Hope, and Lifetime Learning Credits) (Form 8863) on which the taxpayer claimed more than the standard Hope Credit amount for 1 or 2 students from a population of 95,149 returns meeting this criteria. We checked the Integrated Data Retrieval System⁵ to determine 1) where the taxpayer lived, 2) where the student attended school, 3) whether the student was at least half-time, 4) whether the taxpayer was entitled to the tax relief, and 5) whether there was any compliance activity on the account. We notated the types of processing errors.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: Wage and Investment Division policies, procedures, and practices for processing Hope Credit claims. We evaluated these controls by reviewing policies and procedures for processing education credits and reviewing processed Hope Credit claims claiming more than the standard maximum credit allowed.

² A database the IRS maintains that contains information on the individual tax returns it receives.

³ A collection of IRS databases containing various types of taxpayer account information that is maintained by the Treasury Inspector General for Tax Administration for the purpose of analyzing data for ongoing audits.

⁴ The sample was based on a confidence level of 95 percent, a precision of ± 5 percent, and an expected error rate of 50 percent, resulting in a sample size of 383. We selected statistical samples because we wanted to project our results over the entire population.

⁵ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

Kyle R. Andersen, Director

Bill R. Russell, Audit Manager

Douglas C. Barneck, Lead Auditor

Glory Jampetero, Senior Auditor

John Mansfield, Senior Auditor



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
SE:W:CAR
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
Director, Media and Publications, Wage and Investment Division SE:W:CAR:MP
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Chief Counsel CC
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Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division
SE:W:S:PRA:PEI



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Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Revenue Protection – Potential; \$55,773,489 in ineligible claims for the Hope Credit on an estimated 48,940 tax returns (see page 3).

Methodology Used to Measure the Reported Benefit:

We obtained all returns on the Individual Returns Transaction File¹ which claimed more than the standard maximum Hope Credit for one or two students during TY 2008. We identified 95,149 taxpayer returns that met these criteria. We reviewed a statistically valid sample of 383 cases to determine if the students attended eligible institutions located in the Midwestern Disaster Areas. We further analyzed these cases to determine the amounts of Hope Credit that taxpayers received that they were not entitled to.

Our review of the 383 cases showed that 197 cases (51 percent) did not qualify for the higher amount of Hope Credit claimed. These 197 cases consisted of 101 cases (26 percent) that did not include students that attended qualified institutions in Midwestern Disaster Areas, 44 cases (11 percent) that did not qualify for the Hope Credit because they were not at least half-time students or they were graduate students,² and 52 cases (14 percent) that did not have Tuition Statements (Form 1098-T) on file with the IRS showing that they were, in fact, students. The total amount of Hope Credit these taxpayers received that they were not entitled to was \$224,504. From our population of 95,149 taxpayers, we estimate that taxpayers filing 48,940 tax returns with such claims received \$55,773,489 in Hope Credits to which they were not entitled. Our estimate is based on a 95 percent confidence level and a precision (range) of +/- \$9,229,563.

¹ A database the IRS maintains that contains information on the individual tax returns it receives.

² Even though these taxpayers did not qualify for the Hope Credit, their education expenses likely qualified them for the Lifetime Learning Credit. Our computations took into account the amount of Lifetime Learning Credit that the taxpayers would be eligible for.



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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

RECEIVED
SEP 10 2010
BY: *DAB*

September 2, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Richard Byrd, Jr. *Larry Dandi*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Many Taxpayers Who Were Not Eligible
Received Additional Education Credits Intended for Those
Attending Schools in Midwestern Disaster Areas
(Audit # 201040033)

We have reviewed the subject draft report and appreciate your perspective on our administration of education credits to affected taxpayers in the Midwestern Disaster Areas. We believe improvements are needed to ensure eligible students receive the benefits they deserve, and taxpayers claiming inappropriate credits are denied those benefits.

We will request computer processing controls to limit the amount that can be claimed for the American Opportunity Credit,¹ and consideration has already been given to form changes on the Form 8863, *Education Credits (Hope and Lifetime Learning Credits)*. In Fiscal Year 2011, we will begin examining taxpayers who do not have a Form 1098-T, *Tuition Statement*, but are claiming education expenses. We will also evaluate the feasibility of an automated process to use the Form 1098-T data and match it to the appropriate tax return.

We do not agree that requiring taxpayers to attach Form 1098-T to their returns is appropriate, even if we are unable to develop an automated matching process. The Paperwork Reduction Act requires all Federal agencies to evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility. Because the IRS already obtains this information from third-parties, it would be inappropriate to request the same information from taxpayers. If we are unable to develop an automated matching process, we will select a sample of returns each year and manually match against Form 1098-T data for possible examination.

¹ The American Opportunity Credit was previously known as the Hope Credit. The American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, 123 Stat. 115) added this credit for Tax Years 2009 and 2010.



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We have reviewed the methodology you used to formulate the outcome measures described in Appendix IV and agree with the reported benefits.

Attached are our responses to your specific recommendations. If you have any questions regarding this response, please contact me, or a member of your staff may contact Ray Johnson, Acting Director, Reporting Compliance, Wage and Investment Division, at (404) 336-8983.

Attachment



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Attachment

RECOMMENDATION 1: The Director, Reporting Compliance, Wage and Investment Division, should conduct post-refund examinations of erroneous claims to ensure refunds for excessive claims are recovered. Form 1098-T information received from the educational institutions could be used to validate whether the students attended eligible educational institutions located in Midwestern Disaster Areas. It could also be used to determine whether the students were at least half-time students.

CORRECTIVE ACTION

We agree with this recommendation. We will conduct post refund examinations of the 197 cases identified by Treasury Inspector General for Tax Administration as improperly claiming the credit, and will use the results of those examinations to evaluate the value of additional examinations.

IMPLEMENTATION DATE

July 15, 2011

RESPONSIBLE OFFICIAL

Director, Reporting Compliance, Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 2: The Director, Reporting Compliance, Wage and Investment Division, should develop an automated process to utilize the data provided by education institutions on Forms 1098-T to identify taxpayers claiming questionable claims for education credits. Claims with no Forms 1098-T or claims for the Hope Credit with Forms 1098-T indicating students were not at least half-time students or were graduate students should be scrutinized by the Examination function. If an automated process cannot be developed, the Director should initiate a requirement for taxpayers claiming education credits to attach Forms 1098-T to their tax returns and the process described above should be performed manually during processing.

CORRECTIVE ACTION

We partially agree with this recommendation. We agree to evaluate the feasibility of an automated process to use the Form 1098-T, *Tuition Statement*, data and match it to the appropriate tax return. If feasible, we will submit the necessary Unified Work Request (UWR). Because the requested action will be subject to funding and resource prioritization by Modernization and Information Technology Services (MITS), submission of the UWR will complete this corrective action. We will also test a filter in Fiscal Year



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2011 to identify taxpayers with no Form 1098-T claiming education expenses. However, we do not agree to ask the taxpayer to attach the Form 1098-T to the return. In the event an automated match cannot be accomplished, we will select a sample of returns to review and manually match against available Form 1098-T data received from the Educational Institutions. The volume each year will depend on the labor intensive nature of the process and the relative success of the program compared to other correspondence examination programs.

IMPLEMENTATION DATE

September 15, 2011

RESPONSIBLE OFFICIAL

Director, Reporting Compliance, Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 3: If similar provisions are enacted in the law for future disasters, the Director, Forms and Publications, Wage and Investment Division, should require taxpayers to specifically indicate on Forms 8863 when they are claiming increased education credit because of a disaster provision. Consideration should be given to modifying the Form 8863 with a check box for this purpose. The Director should also consider a requirement to include the county and state of the educational institution attended.

CORRECTIVE ACTION

We agree with this recommendation. We will make the recommended changes to Form 8863, Education Credits (*American Opportunity, Hope, and Lifetime Learning Credits*), if similar legislation is enacted in the future.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

Director, Media and Publications, Customer Assistance, Relationships and Education, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

N/A



*Many Taxpayers Who Were Not Eligible
Received Additional Education Credits
Intended for Those Attending Schools
in Midwestern Disaster Areas*

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RECOMMENDATION 4: The Director, Submission Processing, Wage and Investment Division, should ensure that computer processing controls are set to limit the amount of Hope Credit that can be claimed based on the number of students claimed and the maximum amounts allowable. The Director should also ensure adherence to increased maximums on any future provisions.

CORRECTIVE ACTION

We agree with this recommendation, and will submit a UWR, by January 15, 2011, to update computer processing controls limiting the amount of American Opportunity Credit (previously the Hope Credit) that can be claimed based on the number of students claimed and the maximum amounts allowable. Since the requested action will be subject to funding and resource prioritization by MITS, submission of the UWR will complete the corrective action.

IMPLEMENTATION DATE

January 15, 2011

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

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