



*Improvements Are Needed in the
Administration of Education Credits and
Reporting Requirements for
Educational Institutions*

September 30, 2009

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Redaction Legend:

2(a) = Law Enforcement Criteria



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 30, 2009

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM:

Michael R. Phillips
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Improvements Are Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions (Audit #200830015)

This report presents the results of our review to determine whether taxpayers are properly claiming education credits and whether Internal Revenue Service (IRS) controls are properly identifying those taxpayers who are not. This audit was included in our Fiscal Year 2008 Annual Audit Plan under the major management challenge of Processing Returns and Implementing Tax Law Changes.

Impact on the Taxpayer

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 and can only be claimed for 2 tax years.¹ The Lifetime Learning Credit is also available for the first 2 years of post-secondary education as well as an unlimited number of years in the future. Some taxpayers are claiming the Hope Credit for more years than are allowed by law. In addition, educational institutions are spending millions of dollars and staff hours each year to provide taxpayers and the IRS with copies of Tuition Statements (Form 1098-T). However, the IRS does not use this Form in its compliance programs, or accept the Form as documentation to support claims for education credits.

¹ The American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, 123 Stat. 115) modifies the existing Hope Credit for Tax Years (TY) 2009 and 2010, making the credit partially refundable and making it available to a broader range of taxpayers for up to 4 years.



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Synopsis

We identified approximately 203,000 taxpayers who claimed the Hope Credit for the same student for the 3 consecutive years ending in Tax Year (TY) 2006 (TYs 2004, 2005, and 2006). The amounts of the credits inappropriately claimed in TY 2006 averaged close to \$1,500 and totaled just over \$300 million. Over 58,000 of these taxpayers claimed the credit for the same student for 4 consecutive tax years (TYs 2004 through 2007). The amounts of the credits inappropriately claimed for a fourth year totaled almost \$80 million.

In a separate computer run, we identified over 169,000 taxpayers who claimed the Hope Credit for the same student for the 3 consecutive tax years ending in TY 2007 (TYs 2005, 2006, and 2007).² The amounts of the credits inappropriately claimed averaged close to \$1,400 and totaled just over \$232 million.

We determined that taxpayers were allowed to take these erroneous credits for two reasons. First, the IRS does not have math error authority to immediately disallow claims for the Hope Credit for the same student for more than 2 years. Second, the IRS Examination function scrutinizes these cases after refunds are issued, and the criteria the function applies only identifies a small fraction of the erroneous cases.

Internal Revenue Code Section 6050S requires educational institutions to issue Forms 1098-T to taxpayers and to the IRS to assist both in determining the amount of qualified tuition and related expenses for which an education tax credit is allowable. This law allows educational institutions to report either an amount for Box 1, Payments Received for Qualified Tuition and Related Expenses, or for Box 2, Amounts Billed for Qualified Tuition and Related Expenses on the Form.

We performed a computer analysis of all Forms 1098-T filed for TYs 2005, 2006, and 2007 and found that Box 1, the actual amount paid, was blank on close to 80 percent of the Forms. The only amount relevant for cash basis taxpayers, and the only amount beneficial to both the taxpayer and the IRS for computing the amount of credit allowed, is the amount paid by the taxpayer for qualified tuition and related expenses.

We were informed that the IRS does not use Form 1098-T in its Automated Underreporter (AUR) matching program³ and does not accept Form 1098-T as proof of educational expenses

² Some of the taxpayers inappropriately claiming the credit for a third year were IRS employees. We referred this information to the Treasury Inspector General for Tax Administration Office of Investigations for further action.

³ The AUR Program matches information reported on individual tax returns against information reported by banks, employers, and other payers. When the AUR matching process identifies a discrepancy, an AUR case is established and an Underreporter Notice (CP 2000) is issued to the taxpayer. The CP 2000 notice may contain proposed changes to income, payments, credits, and/or deductions. Depending on the taxpayer's response to the notice, the AUR caseworker will make necessary tax adjustments to the taxpayer's account.



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when a taxpayer's return is audited. As a result, educational institutions are needlessly expending approximately 5.1 million hours each year to complete Forms 1098-T and an estimated \$3.8 million to mail the Forms to students.

Legislative Recommendations

- Provide the IRS with math error authority to disallow claims for the Hope Credit that are taken for more years than allowed by law.
- Enact legislation to either make Form 1098-T useable to the IRS and taxpayers by requiring educational institutions to report amounts paid rather than allowing them to choose between amounts paid and amounts billed, or relieve educational institutions of the burden of producing this Form.

Recommendation

If legislation is enacted to require educational institutions to report amounts paid rather than amounts billed on Form 1098-T, the Commissioner, Wage and Investment Division, should ensure that Education Credits (Hope and Lifetime Learning Credits) (Form 8863) contains specific line items to make it matchable to the information reported on Form 1098-T.

Response

IRS management agreed with all three of our recommendations. The IRS was pleased that we are requesting Congressional consideration for two legislative recommendations that they believe will make their administration of these credits more productive. Pending the enactment of the legislation, the IRS agreed to make the necessary changes to the Form 1098-T and Form 8863 to comply with the legislation and will take the action necessary to ensure the changes made are useful to taxpayers and for tax administration purposes. Management's complete response to the draft report is included in Appendix V.

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 Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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Abbreviations

AUR	Automated Underreporter
FY	Fiscal Year
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 education expenses for higher education for themselves, their spouse, or a dependent that is claimed as an exemption on their tax return so long as they are eligible students.

- Hope Credit – For each eligible student in Tax Year (TY) 2007, this credit was equal to 100 percent of the first \$1,100 of qualified education expenses and 50 percent of the next \$1,100 of qualified expenses, for a maximum credit of \$1,650 per eligible student. This credit is limited to eligible students enrolled in their first 2 years of post-secondary education attending at least half time.

The American Recovery and Reinvestment Act of 2009¹ modifies the existing Hope Credit for TYs 2009 and 2010, making the credit partially refundable and making it available to a broader range of taxpayers. The modifications are entitled the American Opportunity Tax Credit. For these years, the credit is increased 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.

- Lifetime Learning Credit – In TY 2007, 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.

The credits for TYs 2007 and 2008 are nonrefundable, meaning the credits can reduce the amount of income tax individuals pay but cannot exceed the amount of tax owed.² The amount of either education credit is phased out if the taxpayer's modified Adjusted Gross Income is between \$47,000 and \$57,000 (\$94,000 and \$114,000 if the taxpayer files a joint tax return).

A Tuition Statement (Form 1098-T) is provided to students by institutions of higher education which reports payments received for qualified tuition and related expenses, amounts billed for qualified tuition and related expenses, scholarships and grants given, and adjustments made for a prior year. The taxpayer in turn reports qualified education expenses on Education Credits (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).

¹ Pub. L. No. 111-5, 123 Stat. 115.

² The modifications made for TYs 2009 and 2010 provided for 40 percent of the American Opportunity Tax Credit to be refundable.



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This review was performed at the Internal Revenue Service (IRS) Campus³ in Ogden, Utah, during the period February 2008 through March 2009 and included a review of tax information from returns filed and processed nationwide, as well as an evaluation of information provided by the IRS Discretionary Examination and Automated Underreporter Programs. 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 Campuses are the data processing arm of the IRS. They 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 the Hope Credit for the Same Student for More Than 2 Years

The Hope Credit can be claimed for eligible students enrolled in their first 2 years of post-secondary education and cannot be claimed for the same student for more than 2 tax years. This credit does not apply to the third, fourth, or higher years of undergraduate or graduate programs.

We identified approximately 203,000 taxpayers who claimed the Hope Credit for the same student for the 3 consecutive tax years ending in TY 2006 (TYs 2004, 2005, and 2006).⁴ The amounts of the credits inappropriately claimed in TY 2006 averaged close to \$1,500 and totaled just over \$300 million. Over 58,000 of these taxpayers claimed the credit for the same student for 4 consecutive tax years (TYs 2004 through 2007). The amounts of the credits inappropriately claimed for a fourth year totaled almost \$80 million.

In a separate computer run, we identified over 169,346 taxpayers who claimed the Hope Credit for the same student for the 3 consecutive tax years ending in TY 2007 (TYs 2005, 2006, and 2007).⁵ The amounts of the credits inappropriately claimed for a third year in TY 2007 averaged close to \$1,400 and totaled over \$232 million.

Since the Hope Credit is not a refundable credit, the amount of the credit realized is limited to the amount of tax owed (after applying most other credits). We conducted further analysis of the accounts of the taxpayers that claimed the credit in TY 2007 for a third year and determined that 168,347 taxpayers inappropriately received credits totaling over \$206 million.

We determined that taxpayers were allowed to take these erroneous credits for two reasons. First, the IRS does not have math error authority to immediately disallow claims for the Hope Credit for the same student for more than 2 years. Second, the IRS Examination function scrutinizes these cases after refunds are issued, and the criteria the function applies only identifies a small fraction of the erroneous cases.

⁴ The totals and amounts reported in this section of the report are based on taxpayers claiming only one student. Taxpayers claiming multiple students were excluded in order to simplify the computer programming necessary to make the calculation. Therefore, additional erroneous claims likely exist.

⁵ Some of the taxpayers inappropriately claiming the credit for a third year 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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Math Error Authority

Currently, the IRS has legal authority to correct certain errors during processing, including calculation errors and entries that are inconsistent or exceed statutory limits, without having to issue the taxpayer a statutory notice of deficiency. Claims for the Hope Credit beyond the 2 years allowed in the law do not fall under this limited math error authority.

Examination Criteria

The IRS Examination function has a program to identify and audit taxpayers who claim the Hope Credit for more than 2 years. However, there are few returns actually audited (68 returns in Fiscal Year (FY) 2005, 527 in FY 2006, 848 in FY 2007 and 2,175 in FY 2008). To determine why these numbers were so low, we analyzed the IRS' computer program designed to identify cases for audit and found that the programming contained a filter that the Examination function did not intend to be included. The programming identified taxpayers claiming the Hope Credit (for a specific amount) for the same student in a third consecutive year, but the return was not selected for inclusion in the Examination Program unless the taxpayer^{2(a)}

^{2(a)} This additional filter excludes almost all of the taxpayers improperly claiming the Hope Credit for a third year. We ran a query on our data, using the IRS' flawed programming criteria, and determined that the IRS would have only identified 2,612 (less than 2 percent) of the 169,346 taxpayers that claimed the credit for more than 2 years. We notified the Examination function of this programming error in an email alert dated February 2, 2009, and it agreed to correct the error.

However, the IRS informed us that even if the programming was corrected to identify all erroneous claims for more than 2 years, only a very small number, between 2,000 and 2,500, of the additional cases we identified would meet the criteria for audit due to the examination tolerances. Despite knowing that these claims for the Hope Credit are invalid, the IRS is unable to work the erroneous claims. This situation magnifies the need for the IRS to receive math error authority in order to disallow these claims before the returns and related refunds are processed.

Based on our analysis of taxpayers inappropriately claiming the Hope Credit for the same student for a third year and taking into consideration that these taxpayers would be eligible to claim a smaller Lifetime Learning Credit, as well as taking into consideration the cases that would be identified by the Examination function, we estimate that taxpayers will receive erroneous credits totaling over \$398 million over a 3-year period.

Further, the IRS Examination function used 4,246 staff hours examining the cases meeting its criteria in FY 2008. The IRS estimates the average direct costs to work these cases was about \$19.99 per hour. If the IRS received math error authority to disallow claims for the Hope Credit, close to \$85,000 per year could be used for other Examination function programs.



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Legislative Recommendation

Recommendation 1: Provide the IRS with math error authority to disallow claims for the Hope Credit that are taken for more years than allowed by law.

Management's Response: The IRS agreed with this recommendation. The IRS stated that if this legislation is enacted, the Commissioner, Wage and Investment Division, will review the legislation and then determine whether it is both feasible and cost effective to use math error authority during processing.

As Currently Administered, the Tuition Statement (Form 1098-T) Is Not Meeting Its Intended Purpose and Is an Unnecessary Burden to Educational Institutions

Internal Revenue Code Section 6050S requires educational institutions to issue Forms 1098-T to taxpayers and the IRS to assist both in determining the amount of qualified tuition and related expenses for which an education tax credit is allowable. Instructions for the Form 1098-T allow educational institutions to report either an amount for Box 1, Payments Received for Qualified Tuition and Related Expenses, or for Box 2, Amounts Billed for Qualified Tuition and Related Expenses.

We performed a computer analysis of all Forms 1098-T filed for TYs 2005, 2006, and 2007 and found that Box 1, the actual amount paid, was blank on close to 80 percent of the Forms. This makes the Form useless for the purpose of tax administration because the only amount relevant for cash basis taxpayers, and the only amount beneficial to both the taxpayer and the IRS for computing the amount of credit allowed, is the amount actually paid by the taxpayer for qualified tuition and related expenses.

The amount of education credits claimed often does not correlate to the amount of Qualified Tuition and Related Expenses reported on Form 1098-T

We reviewed a judgmental sample of 36 taxpayer accounts which had claimed either the Hope Credit or the Lifetime Learning Credit to determine if there appeared to be any correlation between the Qualified Tuition and Related Expense amounts reported on Forms 1098-T and the amounts claimed by the taxpayers as qualified expenses on Forms 8863. We were able to match figures with 14 (74 percent) of the 19 cases in which taxpayers claimed the Lifetime Learning Credit and only 11 (65 percent) of the 17 cases in which taxpayers claimed the Hope Credit.

For the period of our review, the law defined qualified education expenses as tuition and certain related expenses required for enrollment or attendance at an eligible educational institution. Student activity fees and expenses for course-related books, supplies, and equipment are included in qualified education expenses only if the fees and expenses must be paid to the



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educational institution as a condition of enrollment or attendance.⁶ These related expenses may not have been included on the Forms 1098-T provided to the IRS and the taxpayer.

With the passage of the American Recovery and Reinvestment Act in 2009, all 'course materials' will be allowed as a qualified related expense regardless of whether or not they were paid to the educational institution. This change will significantly increase the probability that amounts on Form 1098-T will not correspond to amounts claimed on Form 8863 because course materials are not accounted for by educational institutions.

The IRS requires educational institutions to complete and mail Form 1098-T but it does not use the Form or accept it as supporting documentation

We were informed that the IRS does not use Form 1098-T in its Automated Underreporter (AUR) matching program and does not accept Form 1098-T as proof of education expenses paid when a taxpayer's return is audited.

The IRS' AUR Program matches information reported on individual tax returns against information reported by banks, employers, and other payers. When the AUR matching process identifies a discrepancy, an AUR case is established and an Underreporter Notice (CP 2000) is issued to the taxpayer. The CP 2000 notice may contain proposed changes to income, payments, credits, and/or deductions. Depending on the taxpayer's response to the CP 2000 notice, the AUR caseworker will make necessary tax adjustments to the taxpayer's account.

The form used by taxpayers to claim the Hope and Lifetime Learning Credits (Form 8863) requests only one entry for qualified expenses rather than distinguishing between tuition and related expenses. Because related expenses might not be reflected on Form 1098-T, and because the educational institutions can report either the amounts billed or the amounts paid to the institution, the information on Form 1098-T and Form 8863 is not matchable. We were also informed by the IRS Examination function that Form 1098-T was not acceptable documentation to support education expenses paid.

The IRS estimates that it takes 13 minutes to complete Form 1098-T and costs approximately 16 cents per Form to mail at the bulk rate. Educational institutions are filing approximately 24 million Forms 1098-T per year. Based on these estimates, educational institutions expend approximately 5.1 million hours each year to complete Forms 1098-T and \$3.8 million to mail the Forms to students.

⁶ The American Recovery and Reinvestment Act of 2009 significantly expands the additional expenses that can be added to tuition to determine the amount of the credit.



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Legislative Recommendation

Recommendation 2: Enact legislation to either make Form 1098-T useable to the IRS and taxpayers by requiring educational institutions to report amounts paid rather than allowing them to choose between amounts paid and amounts billed, or relieve educational institutions of the burden of producing this Form.

Management's Response: The IRS agreed with this recommendation. The IRS stated that if legislation is enacted that either requires changes to the Form 1098-T, or relieves educational institutions from the burden of producing the Form 1098-T, the Commissioner, Wage and Investment Division, will make the necessary changes.

Recommendation

Recommendation 3: If legislation is enacted to require educational institutions to report amounts paid rather than amounts billed on Form 1098-T, the Commissioner, Wage and Investment Division, should ensure that Form 8863 contains specific line items to make it matchable to the information reported on Form 1098-T.

Management's Response: The IRS agreed with this recommendation. The Commissioner, Wage and Investment Division, will make the required changes to Form 1098-T and Form 8863 if new legislation is enacted and also agreed to take the action necessary to ensure the changes made are useful to taxpayers and for tax administration purposes.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether taxpayers are properly claiming education credits and whether IRS controls are properly identifying those taxpayers who are not. To accomplish our objective, we:

- I. Determined the purpose of the education credits, which taxpayers are eligible to claim the credits, the dollar limits associated with the credits, and whether adequate instructions are available to taxpayers to properly claim the credits.
 - A. Reviewed the instructions provided to taxpayers in *Tax Benefits for Education* (Publication 970) and *Your Federal Income Tax For Individuals* (Publication 17) or other applicable instructions dealing with education credits.
 - B. Reviewed the applicable Internal Revenue Code sections associated with the education credits.
 - C. Determined whether IRS instructions seem to be relatively clear, understandable, and available to taxpayers.
- II. Determined what controls exist to ensure taxpayers are properly claiming the education credits.
 - A. Determined whether compliance programs existed to review returns claiming the education credits to ensure:
 1. The student is enrolled at least half time.
 2. The Hope Credit has not already been claimed in the 2 previous years.
 3. The person claiming the credits meets the Adjusted Gross Income criteria.
 4. The credits are claimed by the entitled person.
 - B. Analyzed the programs discussed in Step II.A. to determine if they were effective in identifying questionable claims for the Hope Credit.
 - C. Determined the criteria used to select the returns for audit, the criteria used to audit the returns, the number of returns audited, the change/no change rates, and the dollar assessments made per year.
 - D. Evaluated the Tuition Statement (Form 1098-T) to determine its purpose, how it is used, and its effectiveness. We determined how much time and money it costs educational institutions to prepare and mail Forms 1098-T.



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- III. Determined whether taxpayers properly claimed the education credits.
- A. Selected a statistically valid sample¹ of 100 taxpayer accounts (TY 2007) claiming an education credit on Form 8863 and reviewed each account to determine whether:
1. Form 1098-T was filed with the return.
 2. Box 8 was checked indicating that the taxpayer is at least a half-time student.
 3. The Hope Credit was claimed for more than 2 years.
 4. The taxpayer was also claiming the tuition and fees deduction.
 5. The Adjusted Gross Income criteria was met.
 6. The education credit was claimed on the tax return of the person claiming the exemption for the student.
 7. The credit amount claimed was within the credit limit allowed.
- B. Reviewed a judgmental sample of 36² taxpayer accounts (TY 2007) claiming an education credit on Form 8863 to determine if there was a correlation between the amount of the education credit claimed on the Form 8863 and the amounts reported on the related Form 1098-T.
- C. Requested from the Treasury Inspector General for Tax Administration Electronic Data Processing group an Individual Master File³ extract of the number of Forms 1098-T filed with the IRS for TYs 2005, 2006, and 2007 and whether there was an amount in Box 1 (Payments Received for Qualified Tuition and Related Expenses).
- D. Matched files of taxpayers claiming the Hope Credit for a third year in TY 2006 or TY 2007 to current IRS employee files to determine if any IRS employees had claimed the Hope Credit for a student for more than 2 years.
- E. Performed queries using the Data Center Warehouse⁴ to identify all taxpayers claiming the Hope Credit for the same student for more than 2 years with the additional years being either TY 2006 or TY 2007.

¹ The sample was based on a confidence level of 95 percent, a precision rate of ± 8 percent, and an expected error rate of 20 percent, resulting in a sample size of 97. We selected statistical samples because we wanted to project our results over the entire population.

² A judgmental sample was selected because we did not intend to project the results over the population. Our intent was only to determine to what degree the amounts correlated.

³ The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.

⁴ The Data Center Warehouse is 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.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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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:

- Revenue Protection – Potential; \$398,208,090 in ineligible claims for the Hope Credit by an estimated 505,041 taxpayers over a 3-year period (see page 3).

Methodology Used to Measure the Reported Benefit:

We obtained all Individual Master File¹ accounts which claimed the Hope Credit during TYs 2005, 2006, and 2007. We identified 169,346 taxpayer accounts that claimed the credit for the same student in all 3 years. These taxpayers erroneously claimed \$232,771,098 of the credit in the third year. We further analyzed these accounts to determine the actual number of taxpayers that received the credit and the actual amounts received (some taxpayers that claimed the credit were not allowed the credit). We identified 168,347 taxpayers that had actually received \$206,808,710 in erroneous Hope Credits for the third year in TY 2007.

Providing that these taxpayers would each be eligible for \$440 in Lifetime Learning Credits, we reduced this figure by \$74,072,680 (168,347 x \$440). The projected revenue protected would be \$132,736,030 per year. We are projecting this figure over 3 years (TYs 2011, 2012, and 2013) rather than 5 years to account for the 2-year period during which the American Opportunity Tax Credit replaces the Hope Credit. Therefore, the total revenue protected is \$398,208,090 (\$132,736,030 x 3 years).

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; \$254,631 over 3 years which could be applied to other Examination function programs (see page 3).

Methodology Used to Measure the Reported Benefit:

During FY 2008, the IRS Examination function reviewed and closed 2,175 cases where taxpayers were inappropriately claiming the Hope Credit for the same student for more than 2 years. The IRS Examination function used 4,246 staff hours examining those cases. The IRS

¹ The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.



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estimates the average direct costs to work these cases was about \$19.99 per hour. If the IRS received math error authority to disallow claims for the Hope Credit, \$84,877 could be used for other Examination function programs (4,246 x \$19.99). We are projecting this figure over 3 years (TYs 2011, 2012, and 2013) rather than 5 years to account for the 2-year period during which the American Opportunity Tax Credit replaces the Hope Credit. Therefore, the value of the resources made available is \$254,631 (\$84,877 x 3 years).

Type and Value of Outcome Measure:

- Reduction of Burden on Taxpayers – Potential; \$19 million over 5 years in postage costs (see page 5).

Methodology Used to Measure the Reported Benefit:

The IRS requires educational institutions to provide students with a Tuition Statement (Form 1098-T) at the end of each tax year. We requested and obtained an Individual Master File extract for TYs 2005 through 2007 and determined that educational institutions mail approximately 23.8 million Forms 1098-T every year. According to the United States Postal Service, the bulk rate for mailing such forms is approximately \$0.16 per form. We therefore conclude that educational institutions spend approximately \$3.8 million (23.8 million x \$0.16) each year to mail these forms, or \$19 million over 5 years (5 years x \$3.8 million).

Type and Value of Outcome Measure:

- Reduction of Burden on Taxpayers – Potential; 25.5 million hours over 5 years are spent by educational institutions preparing Forms 1098-T (see page 5).

Methodology Used to Measure the Reported Benefit:

Approximately 23.8 million Forms 1098-T were filed each year by educational institutions during TYs 2005 through 2007. The IRS determined that it takes 13 minutes to complete Form 1098-T. We therefore estimate that educational institutions are expending over 5.1 million hours each year to complete Forms 1098-T [(23.8 million x 13 minutes)/60 minutes]. This projects to 25.5 million hours over a 5-year period (5 years x 5.1 million hours).



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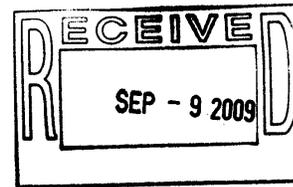
Appendix V

Management's Response to Draft Report

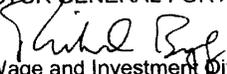


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

SEP 9 2009



MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR-GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Improvements Are Needed in the
Administration of Education Credits and Reporting
Requirements for Educational Institutions (Audit #200830015)

I reviewed the subject draft report and appreciate your perspective on our administration of education credits. We agree with your findings and believe improvements are needed to ensure eligible students receive the benefits they deserve and taxpayers claiming inappropriate credits are denied those benefits. We are pleased that you are requesting Congressional consideration for two recommendations designed to make our administration of these credits more productive.

We have reviewed the methodology you used to formulate the outcome measures described in Appendix IV. Your methodology appears sound and, as such, we have no reason to disagree with your outcome measures. However, recent legislative changes allowing these credits over four years, rather than two, could reduce the revenue potential you cited. Please note these outcome measures will only be achieved if the additional math error authority you recommended is granted via legislation.

Attached are our comments to your specific recommendations. If you have any questions regarding this response, please call me at (404) 338-7060, or a member of your staff may contact Don Mainwaring, Director, Reporting Compliance, Wage and Investment Division, at (404) 338-8983.

Attachment



*Improvements Are Needed in the Administration of Education
Credits and Reporting Requirements for
Educational Institutions*

Attachment

LEGISLATIVE RECOMMENDATION

RECOMMENDATION 1

Provide the IRS with math error authority to disallow claims for the Hope Credit that are taken for more years than allowed by law.

CORRECTIVE ACTION

If legislation is enacted that provides IRS with math error authority to disallow the Hope Credit when it is claimed more than the allowable number of years, the Wage and Investment Division will review the legislation and then determine whether it is both feasible and cost effective to use such authority during processing.

LEGISLATIVE RECOMMENDATION

RECOMMENDATION 2

Enact legislation to either make Form 1098-T useable to the IRS and taxpayers by requiring educational institutions to report amounts paid rather than allowing them to choose between amounts paid and amounts billed or relieve educational institutions of the burden of producing this form.

CORRECTIVE ACTION

If legislation is enacted that requires changes to the Form 1098-T, *Tuition Statement*, we will ensure changes to the form are made, as described by the provisions of the law. If the Office of Tax Policy relieves educational institutions of the burden of producing Form 1098-T, we will make whatever changes are necessary as a result of that decision.

RECOMMENDATION 3

If legislation is enacted to require educational institutions to report amounts paid rather than amounts billed on Form 1098-T, the Commissioner, Wage and Investment Division, should ensure that Education Credits (Hope and Lifetime Learning Credits) (Form 8863) contains specific line items to make it matchable to the information reported on Form 1098-T.

CORRECTIVE ACTION

We agree to make any changes to Form 1098-T and Form 8863, *Education Credits (Hope and Lifetime Learning Credits)*, that are warranted by the provisions of enacted law. At this time we do not know what the final legislation will be. We will take additional actions, as necessary, to ensure changes made, are useful to taxpayers and for tax administration purposes.



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IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A