



**RECOVERY ACT**

*Billions of Dollars in Education Credits  
Appear to Be Erroneous*

**September 16, 2011**

**Reference Number: 2011-41-083**

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:**

2(f) = Risk Circumvention of Agency Regulation or Statute

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Phone Number | 202-622-6500

Email Address | [TIGTACommunications@tigta.treas.gov](mailto:TIGTACommunications@tigta.treas.gov)

Web Site | <http://www.tigta.gov>



## HIGHLIGHTS



### BILLIONS OF DOLLARS IN EDUCATION CREDITS APPEAR TO BE ERRONEOUS

## Highlights

Final Report issued on September 16, 2011

Highlights of Reference Number: 2011-41-083 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

### IMPACT ON TAXPAYERS

The American Recovery and Reinvestment Act of 2009 (Recovery Act) amended the Hope Scholarship Credit to provide for a refundable tax credit called the American Opportunity Tax Credit. This credit is to help taxpayers offset the costs of higher education.

### WHY TIGTA DID THE AUDIT

Recovery Act activities require agencies to ensure appropriate measures are taken to prevent fraud, waste, and abuse. This audit was initiated because TIGTA is required to monitor the Internal Revenue Service (IRS) implementation of Recovery Act provisions. Our overall objective was to assess the effectiveness of IRS processes to identify erroneous American Opportunity Tax Credit claims from January 1 through May 28, 2010.

### WHAT TIGTA FOUND

As of May 28, 2010, TIGTA identified 2.1 million taxpayers receiving \$3.2 billion in education credits that appear to be erroneous, and at least 1.1 million (52 percent) had tax returns prepared by a paid tax return preparer. Specifically:

- 1.7 million taxpayers received \$2.6 billion in education credits for students for whom there was no supporting documentation in IRS files that they attended an educational institution.
- 370,924 individuals claimed as students who were not eligible because they did not attend the required amount of time and/or were postgraduate students, resulting in an estimated \$550 million in erroneous education credits.

- 63,713 taxpayers erroneously received \$88.4 million in education credits for students claimed as a dependent or spouse on another taxpayer's tax return.
- 250 prisoners erroneously received \$255,879 in education credits.

In addition, TIGTA identified that a valid Social Security Number is required for Federal student aid but not for education credits. Our review identified 84,754 students who did not have a valid Social Security Number but were claimed by taxpayers who received \$103 million in education credits.

### WHAT TIGTA RECOMMENDED

TIGTA made a number of recommendations including revising the current tax form to claim education credits, coordinating with the Department of Education to assess using its data files in tax return processing, revising compliance programs to identify taxpayers who erroneously claim the credit, and coordinating with the Department of the Treasury to determine whether legislation is needed to clarify whether or not the credit may be claimed for students without a valid Social Security Number.

The IRS agreed with 10 of our 11 recommendations and partially agreed to the remaining recommendation. The IRS disagreed with our recommendation to initiate a Tax Return Preparer Project to address those preparers associated with large volumes of erroneous education credit claims.

In its response to the report, the IRS did not agree with the amount of erroneous claims identified by TIGTA. However, in subsequent communications, IRS management has informed us that they have found a high percentage of the claims TIGTA identified to be erroneous. As of July 2011, IRS audit results showed that 72 percent of the claims reviewed were erroneous, and it has proposed assessments totaling over \$2.2 million for 1,477 tax returns it has audited so far. IRS management noted that they expect the percentage found to be erroneous to further increase and, as a result, have increased the number of tax returns that they plan to review with this condition in Fiscal Year 2012.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 16, 2011

**MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION**

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Billions of Dollars in Education Credits Appear to Be Erroneous (Audit # 201040147)

This report presents the results of our review to assess the effectiveness of Internal Revenue Service (IRS) processes to identify erroneous American Opportunity Tax Credit (AOTC) claims from January 1 through May 28, 2010. This review is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Erroneous and Improper Credits and Payments.

The American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup> provides separate funding to the Treasury Inspector General for Tax Administration (TIGTA) through September 30, 2013, to be used in oversight activities of IRS programs. This audit was conducted using Recovery Act funds.

In its response to our report, the IRS did not agree with the amount of erroneous claims identified by the TIGTA. Nonetheless, it did agree to our recommendation to develop a recovery program to address the 1.7 million taxpayers who appear to have erroneously received more than \$2.6 billion in education credits for students with no supporting documentation that they attended an educational institution.

In subsequent communications, IRS management has informed us that they have found a high percentage of the claims we identified to be erroneous. The IRS's Examination function is currently performing a review of tax returns of individuals claiming students for whom the IRS has no supporting documentation. As of July 2011, its audit results show that 72 percent of the claims reviewed are erroneous and it has proposed assessments totaling over \$2.2 million for 1,477 tax returns it has audited so far. IRS management noted that they expect the percentage

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<sup>1</sup> Pub. L. No. 111-5 123 Stat. 115 (2009).



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found to be erroneous to further increase and, as a result, have increased the number of tax returns they plan to review with this condition in Fiscal Year 2012.

We also have another concern related to the general comments in the IRS's response. We do not believe that IRS management is making a valid comparison in its response that "The conclusion reached by TIGTA that education credit claims are necessarily erroneous when they cannot be matched to Form 1098-T [Tuition Statement] is not consistent with the findings in a previous audit." The report IRS management is referencing is a report on Government Entities and the conclusion is that the information documents submitted by these entities are sometimes inaccurate; the report does not conclude that these entities are failing to submit the information documents. By far, the largest proportion of American Opportunity Tax Credit claims that appear to be erroneous did not have an associated Form 1098-T at all. We did identify inaccurate Forms 1098-T related to half-time and graduate students; however, we used a statistically valid sample to adjust our projection related to these students.

Management's complete response to the draft report is included in Appendix VI.

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*

AOTC	American Opportunity Tax Credit
EIN	Employer Identification Number
IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
TY	Tax Year



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## *Background*

Education credits are available to help offset the costs of higher education for taxpayers, their spouses, and dependents who qualify as eligible students. The American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup> amended the Hope Scholarship Tax Credit (Hope Credit) to provide for a refundable tax credit<sup>2</sup> known as the American Opportunity Tax Credit (AOTC).<sup>3</sup> The AOTC allows taxpayers to receive a credit for higher education expenses up to \$4,000 for Tax Years (TY)<sup>4</sup> 2009 and 2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010<sup>5</sup> further extended the AOTC to apply to TYs 2011 and 2012. Figure 1 compares the benefits and requirements of the AOTC with the Hope Credit for TYs 2009 and 2010.

**Figure 1: Comparison of the AOTC and Hope Credit Benefits and Requirements**

	AOTC	Hope Credit
<b>Maximum Credit</b>	Up to \$2,500 per eligible student – 100% of the first \$2,000 of qualified expenses plus 25% of the next \$2,000 in qualified expenses.	Up to \$1,800 (\$3,600 if a student is in the Midwest disaster area) credit per eligible student.
<b>Refundability</b>	The first 40% of the qualified expenses is refundable up to \$1,000.	Nonrefundable – the credit is limited to the amount of tax paid/owed.
<b>Availability</b>	Available ONLY for the first 4 years of postsecondary education (including any year(s) the Hope Credit was claimed).	Available ONLY for the first 2 years per eligible student.
<b>Degree Program Required</b>	Student must be pursuing an undergraduate degree or other recognized education credential and enrolled at least half-time for at least one academic period during the year.	
<b>Qualifying Expenses</b>	Tuition and enrollment fees, course-related books, supplies, and equipment.	Tuition and enrollment fees including amounts required to be paid to the institution for course-related books, supplies, and equipment. Additional expenses allowed for students in Midwest disaster areas.
<b>Adjusted Gross Income Limits</b>	\$80,000–\$90,000 for Single or Head of Household. \$160,000–\$180,000 for Married Filing Jointly.	\$50,000–\$60,000 for Single or Head of Household. \$100,000–\$120,000 for Married Filing Jointly.

Source: Internal Revenue Service (IRS) *Tax Benefits for Education (Publication 970)*.

<sup>1</sup> Pub. L. No. 111-5 123 Stat. 115 (2009).

<sup>2</sup> Refundable credits can result in refunds even if no income tax is withheld or paid when the credits exceed the tax liability.

<sup>3</sup> For purposes of this report, the use of the term “education credit(s)” refers to the AOTC, which accounted for nearly 85 percent of all education credits received in Tax Year 2009.

<sup>4</sup> A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

<sup>5</sup> Pub. L. No. 111-312 124 Stat. 3296 (2010).





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Taxpayers claim the AOTC using the Education Credits (American Opportunity and Lifetime Learning Credits) (Form 8863) and attaching it to their U.S. Individual Income Tax Return (Form 1040). Figure 2 provides the number of taxpayers receiving education credits and the amount of the credits received as of December 31, 2010. Eighty-nine percent of the taxpayers claiming the AOTC claimed only one student.

**Figure 2: AOTC and Total Education Credits Received as of December 31, 2010**

	<b>Total AOTC Received</b>	<b>Total Education Credits Received<sup>6</sup></b>
Taxpayers	8,871,019 <sup>7</sup>	12,273,023
Dollars	\$15,493,013,631	\$18,332,919,961 <sup>8</sup>

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of education credits through December 31, 2010.

Recovery Act activities require a high level of scrutiny, and taxpayer dollars spent on economic recovery must be subject to unprecedented levels of transparency and accountability. Federal agencies are required to ensure Recovery Act funds are used for authorized purposes and appropriate measures are taken to prevent fraud, waste, and abuse. As such, the TIGTA is required to monitor IRS implementation of Recovery Act provisions, and this audit was conducted to meet those requirements.

This review was performed at the Wage and Investment Division Headquarters in Atlanta, Georgia, and the Submission Processing function offices in Lanham, Maryland, and Cincinnati, Ohio, during the period July 2010 through April 2011. 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.

<sup>6</sup> The difference between Total AOTC Received and Total Education Credits Received is the amount received for Hope Credits related to the Midwest disaster and Lifetime Learning Credits.

<sup>7</sup> The total number of taxpayers who received the AOTC was 8,871,019, of whom all received the refundable portion of the AOTC and 7,119,870 received the nonrefundable portions.

<sup>8</sup> The amount received is the amount the IRS computes that the taxpayer should receive for the education credit. This amount may not actually be refunded to the taxpayer if there are errors on the tax return.



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## *Results of Review*

Based on the results of our review, the IRS does not have effective processes to identify taxpayers who claim erroneous education credits. These ineffective processes have resulted in 2.1 million taxpayers receiving a total of \$3.2 billion in education credits (\$1.6 billion in refundable credits and \$1.6 billion in nonrefundable credits) that appear to be erroneous. Over 4 years, erroneous education credits could potentially reach \$12.8 billion.<sup>9</sup> As such, the IRS is not meeting the intent of the Office of Management and Budget requirement that Recovery Act funds be used for authorized purposes and that every step is taken to prevent instances of fraud, waste, and abuse. Not only is the loss of revenue due to erroneous education credits higher because of the increase in the amount of the credit, but also many of these claims result in additional costs to the Government now that up to \$1,000 of the credit is refundable. The refundable amount of the credit can result in taxpayers receiving a tax refund even if no income tax is withheld or paid. Figure 3 provides the number of taxpayers receiving erroneous education credits and amount of erroneous education credits received as of May 28, 2010.

**Over 4 years, erroneous claims for education credits could potentially reach \$12.8 billion.**

**Figure 3: Potentially Erroneous Education Credits Received Through May 28, 2010**

Erroneous Education Credit Ineligibility Classification	Number of Taxpayers Receiving Erroneous Credits	Claims Prepared by a Paid Tax Return Preparer		Amount of Erroneous Credits
		Number	Percentage	
Students Who Did Not Attend an Educational Institution	1,700,653	1,079,714	63%	<b>\$2.57 billion (Potential)</b>
Students Who Attended Less Than Half-Time or Were Graduate Students	361,467	N/A	N/A	<b>\$550 million (Projected)</b>
Students Allowed as Dependents on Another Taxpayer's Tax Return	63,713	32,478	51%	<b>\$88.4 million (Actual)</b>
Prisoners (Incarcerated All Year) Claiming Dependent Students	250	60	24%	<b>\$255,879 (Actual)</b>
<b>TOTAL</b>	<b>2,126,083</b>			<b>\$3.2 billion</b>

Source: TIGTA analysis of education credits through May 28, 2010.

<sup>9</sup> The AOTC is currently available for 4 years from TY 2009 to TY 2012.



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**Many Erroneous Education Credits Were Claimed on Tax Returns  
That Were Completed by a Paid Tax Return Preparer**

Our review identified that 1.1 million (52 percent)<sup>10</sup> of the 2.1 million taxpayers who received more than \$3.2 billion in education credits that appear erroneous had tax returns prepared by a paid tax return preparer. The erroneous claims associated with tax returns completed by a tax return preparer exceeded \$1.6 billion. Figure 4 shows that further analysis of these tax returns identified tax return preparers who prepared large volumes of returns with erroneous education credit claims.

**Figure 4: Tax Return Preparers Associated With Erroneous Education Credits**

Range of Tax Returns Prepared With Erroneous Education Credits	Number of Tax Return Preparers	Number of Tax Returns Prepared
More Than 999	41	93,618
499 to 998 Tax Returns	148	98,111
99 to 498 Tax Returns	1,552	298,228
Less Than 99 Tax Returns	138,691	621,061
<b>Total Identifiable Prepared Tax Returns</b>	<b>140,432</b>	<b>1,111,018</b>

Source: TIGTA analysis of education credits through May 28, 2010.

The IRS developed a comprehensive enforcement strategy by applying significant examination and collection resources to tax return preparer compliance. The IRS believes its new efforts to regulate tax return preparers will result in decreased fraud and a decreased improper payment rate. As part of this strategy, the IRS will increase the coordination among its operating divisions and increase the staffing of the Office of Professional Responsibility to allow for increased investigations of practitioners and preparers.

For preparers who are not complying with the rules, the IRS initially plans to send notices to advise them of its concerns and encourage future compliance. Later actions will include imposing penalties and suspension/removal from the Return Preparer Program.

**Recommendation**

**Recommendation 1:** The Commissioner, Wage and Investment Division, should initiate a Tax Return Preparer Project to address those preparers associated with large volumes of erroneous education credit claims.

<sup>10</sup> This is a conservative estimate since the students who are less than half-time or graduate students was based on a projection and the paid return preparers associated with these tax returns cannot be determined.



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**Management’s Response:** IRS management agreed that sanctions are appropriate when tax return preparers are found to have knowingly prepared false returns or failed to follow due diligence in the preparation of tax returns. IRS management does not agree with the TIGTA’s reasoning that education credits that cannot be matched to Tuition Statement (Form 1098-T) information filed with the IRS are conclusively erroneous. The IRS is taking steps to work with educational institutions and other outside stakeholders to ensure that Form 1098-T reporting is accurate, but it does not consider a formal Tax Return Preparer project appropriate for this issue at this time. As part of the IRS’s ongoing compliance and outreach activities for the education credit, it will ascertain the extent of erroneous claims and evaluate if a heightened level of action is necessary beyond the traditional return preparer penalties considerations required by auditing standards.

***Education Credits Are Being Received by Taxpayers Claiming Students Who Did Not Attend an Educational Institution***

Our review identified 1.7 million taxpayers as of May 28, 2010, who received \$2.57 billion in education credits (\$10.3 billion over 4 years) that appear to be erroneous based on IRS records. Each of these taxpayers claimed students for whom there was no associated Form 1098-T in IRS files supporting the student’s attendance at an educational institution. \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.

***Based on IRS records, taxpayers claiming students who did not attend an educational institution appear to have received \$2.57 billion in erroneous education credits.***

Educational institutions are required to provide a Form 1098-T to students who attend their institution and a duplicate copy to the IRS. Forms 1098-T are required to be provided to students by the beginning of February each year and to the IRS by the beginning of March for paper Forms 1098-T and by the end of March for electronic Forms 1098-T. We identified all TY 2009 Forms 1098-T (more than 26 million) provided to the IRS by December 31, 2010, to ensure the IRS had sufficient time to receive the forms from the educational institutions. Figure 5 provides an example of a Form 1098-T.



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Figure 5: Example of Form 1098-T

Form 1098-T Tuition Statement for 2010. Includes fields for filer name, student name, social security number, and amounts for tuition, scholarships, and grants.

Source: Form 1098-T from the IRS.gov web site.

We alerted IRS management of the above results on November 4, 2010, and recommended the IRS initiate a recovery program. IRS officials responded that, given the large numbers of potentially noncompliant cases we identified, they recognize the need to develop a more strategic approach to address noncompliance with respect to claims for education credits while balancing the need to avoid placing additional burden on taxpayers who may be compliant. In addition, the IRS noted that it took the initiative in August 2010 to identify TY 2009 cases in which the education credit was claimed and no Form 1098-T could be associated with the student. \*\*2(f)\*\*

Although the IRS is currently undertaking a compliance initiative, it had not previously developed adequate processes to identify taxpayers claiming erroneous education credits despite the fact that education credits have been available to taxpayers since 1997<sup>11</sup> and the fact that the IRS has third-party Form 1098-T information to assist in verifying claims.

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11 Taxpayer Relief Act of 1997, Pub. L. 105-34 111 Stat. 788 (1997).



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Figure 6: Form 8863 Part I

Table with 6 columns: (a) Student's name, (b) Student's social security number, (c) Qualified expenses, (d) Subtract \$2,000, (e) Multiply the amount by 25%, (f) Final amount calculation. Includes a caution about the 4-year limit.

Source: Form 8863 from the IRS.gov web site.

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The Department of Education has information that the IRS could use to verify the eligibility of students

Our discussions with Department of Education representatives identified two database files that the IRS could use to verify the eligibility of students for education credits at the time a tax return is processed:

- **Integrated Postsecondary Education Data System** – A database file that includes all educational institutions that participate in the Federal Student Financial Aid Program (Title IV certified institutions).<sup>12</sup> One requirement for claiming an education credit is that the student attends an eligible institution (i.e., a Title IV institution).<sup>13</sup> The database is updated annually and contains the IRS-issued Employer Identification Number (EIN) for each educational institution.

Our limited review of the system found some inaccuracies with the EINs. However, the Department of Education expressed its willingness to work with educational institutions to perfect the EIN data. \*\*\*\*\*2(f)\*\*\*\*\*

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\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*

- **National Student Loan Data System** – A database file that contains information on all students who receive a student loan and/or grant. Representatives from the Department of Education estimated approximately two-thirds of all postsecondary students, an estimated 7 to 8 million students a year, receive some type of financial aid. What makes this information valuable to the IRS is that any student listed in this database must have attended an educational institution at least half-time (which is a requirement to qualify for an education credit).<sup>14</sup> This database could be used during the processing of a tax return to confirm whether students claimed for education credits meet the requirement of attending at least half-time. In addition, if a student is a graduate student, this information will also be available on the database in most cases.<sup>15</sup>

Executive Order 13520, *Reducing Improper Payments and Eliminating Waste in Federal Programs*, outlines the Presidential directive to improve information sharing among agencies with the goal of reducing improper payments. Information sharing between the IRS and the Department of Education would be in line with this directive. The use of these database files during tax return processing would allow the IRS to isolate tax returns with a high probability of erroneous education credit claims. For example:

<sup>12</sup> Title IV institutions have a written agreement with the Secretary of Education to participate in any of the Title IV Federal student financial assistance programs.

<sup>13</sup> Internal Revenue Code §25A(f)(2)(B).

<sup>14</sup> Internal Revenue Code §25A(f)(2)(B).

<sup>15</sup> Graduate student information is not available on the database if the student loans have been consolidated.





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*Taxpayer A files his or her TY 2010 Form 1040 and claims Student X for the AOTC on Form 8863. During tax return processing, the IRS could match Student X's Social Security Number (SSN) from Form 8863 to information contained in the National Student Loan Data System database. If there is a match, it confirms that Student X attended an eligible institution at least half-time, meeting two key requirements to qualify for the AOTC. If Student X does not match to information in the National Student Loan Data System database (perhaps because he or she did not obtain financial aid), the IRS could then match the EIN of the educational institution Student X attended to the EINs in the Integrated Postsecondary Education Data System database. If there is a match, the IRS has verified Student X attended an eligible educational institution. If there is not a match, the IRS could develop processes to further ensure the validity of only these claims.*

### **Recommendations**

The Commissioner, Wage and Investment Division, should:

**Recommendation 2:** Revise the Form 8863 to require taxpayers to provide identifying information for the educational institution that the student(s) being claimed for the education credits attended. This identifying information should include the name, address, and Federal EIN of the educational institution. In addition, the form should be revised to include specific information supporting key eligibility requirements that could be used to verify requirements were met which may serve as a deterrent for those taxpayers who intend to erroneously claim these credits.

**Management's Response:** IRS management agreed with this recommendation. Form 8863 for TY 2012 is being revised to capture the educational institution identifying information that will guide taxpayers through the credit eligibility determination.

**Recommendation 3:** Coordinate with the Department of Education to discuss the feasibility of obtaining extracts of the Integrated Postsecondary Education Data System and the National Student Loan Data System database files. In addition, work with the Department of Education to develop a process to verify the accuracy of the educational institutions reporting of their EINs to enable the IRS to use these data during tax return processing.

**Management's Response:** IRS management agreed with this recommendation. The IRS has contacted the Department of Education to discuss the feasibility of obtaining information from the Integrated Postsecondary Education Data System and the National Student Loan Data System databases. The IRS is analyzing disclosure implications and considering the feasibility of using the data. If feasible, the IRS will work with the Department of Education to develop a process to verify the accuracy of the educational institution's Employee Identification Numbers.



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**Recommendation 4:** If the Department of Education information is feasible for use in tax return processing, develop processes to use the information at the time tax returns are processed to identify taxpayers who do not qualify for education credits being claimed.

**Management's Response:** IRS management agreed with this recommendation as long as data acquired from the Department of Education is feasible for use during tax return processing. In that case, the IRS will determine the appropriate point in the process where the use of the data will be most beneficial in verifying eligibility for education credits.

**Recommendation 5:** Develop a recovery program to address the 1.7 million taxpayers who appear to have erroneously received more than \$2.6 billion in erroneous education credits for students with no supporting documentation that they attended an educational institution.

**Management's Response:** While the IRS believes the number of claims appearing to be erroneous is overstated, IRS management agreed with this recommendation and has taken action to address the potential noncompliance in this taxpayer segment. In Fiscal Year 2010, the IRS identified TY 2009 cases for which the AOTC was claimed and could not be matched to a corresponding Form 1098-T. Resources have been allocated in the work plans of both programs to continue addressing the issue throughout Fiscal Years 2011 and 2012.

**Office of Audit Comment:** While IRS management did not agree with the amount of erroneous claims identified by the TIGTA, it did agree to our recommendation to develop a recovery program to address the 1.7 million taxpayers who appear to have erroneously received more than \$2.6 billion in education credits for students with no supporting documentation that they attended an educational institution. In subsequent communications, IRS management has informed us that they have found a high percentage of the claims we identified to in fact be erroneous. The IRS's Examination function is currently performing a review of tax returns of individuals claiming students for which the IRS has no supporting documentation. As of July 2011, its audit results show that 72 percent of the claims reviewed are erroneous and it has proposed assessments totaling over \$2.2 million for 1,477 tax returns it has audited so far. IRS management noted that they expect the percentage found to be erroneous to further increase and, as a result, have increased the number of tax returns they plan to review with this condition in Fiscal Year 2012.

**Recommendation 6:** Revise the compliance program to identify taxpayers who have claimed students on their tax return but no associated Form 1098-T was submitted to the IRS and there is no supporting data on the Department of Education databases.

**Management's Response:** IRS management agreed with this recommendation. The IRS currently has a process in place to identify those individuals who have claimed students on their tax return but have no associated Form 1098-T. The IRS has examined



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a number of these claims in Fiscal Year 2011 and plans to examine additional cases meeting these same criteria in Fiscal Year 2012. If it is determined that the Department of Education database information is feasible to use, the IRS will consider adding that information to its process.

Erroneous Education Credits Are Being Received for Students Who Did Not Attend the Required Length of Time and/or Were Enrolled in Postgraduate Studies

Based on our review of a statistically valid sample of 100 Forms 1098-T, we estimate that 370,924 students were not eligible for education credits, which resulted in \$550 million in erroneous education credits. Over 4 years, \$2.2 billion in credits could be erroneously claimed for ineligible students.

Our review identified nearly 1.3 million taxpayers as of May 28, 2010, who claimed students who did not attend an educational institution at least half-time or who were graduate students, or both, disqualifying the students for the AOTC. \*\*\*\*\*2(f)\*\*\*\*\*

The law<sup>17</sup> requires:

- Student(s) be enrolled at least half-time at an accredited postsecondary institution of higher learning.
• Student(s) are in their first 4 years of post-secondary education.

The nearly 1.3 million taxpayers claimed students who did not meet these criteria. The Form 1098-T includes two checkboxes to be filled in by the educational institution confirming that the student was at least a half-time student and/or a graduate student.<sup>18</sup> Figure 8 provides an example of the specific checkboxes provided on the Form 1098-T.

Figure 8: Example of Boxes 8 and 9

Form 1098-T boxes 8 and 9: 8 Check if at least half-time student [ ] 9 Check if a graduate student [ ]

Source: Form 1098-T.

16 These 1.3 million students received only 1 TY 2009 Form 1098-T indicating they were not at least half-time or were graduate students or both.

17 Internal Revenue Code §25A(b)(2)(B) and §25A(i)(2).

18 The IRS's Education Benefits (Publication 970) states that students must be pursuing an undergraduate degree to qualify for the AOTC.



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We alerted IRS management of our results on October 12, 2010, and recommended the IRS initiate a recovery program. \*\*\*\*\*2(f)\*\*\*\*\*  
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\*\*\*\*\*2(f)\*\*\*\*\*. The IRS also responded that the vast majority of the cases that the TIGTA identified were because the educational institution did not check the box indicating the student was at least a half-time student. IRS management noted that they are currently conducting research to determine if leaving Box 8 blank on Forms 1098-T is intentional or is an oversight on the part of the educational institutions that could be corrected through outreach and guidance. Although the IRS raised concerns regarding the accuracy of Form 1098-T filings by educational institutions, it did not have information to verify that this is a problem. \*\*\*2(f)\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.

To confirm the accuracy of the information in Boxes 8 and 9 on Forms 1098-T, we selected a statistically valid sample of 100 Forms 1098-T (80 less than half-time students and 20 graduate students) from the 1.2 million Forms 1098-T that indicated the student did not qualify for the AOTC.<sup>19</sup> In an attempt to verify the accuracy of Boxes 8 and 9, we contacted the educational institutions and third parties that maintain enrollment data.

Our review of the 100 Forms 1098-T identified:

- 28 (28 percent) for which the information in Box 8 or Box 9 was accurate.
- 46 (46 percent) for which the information in Box 8 or Box 9 was inaccurate.
- 26 (26 percent) for which we were unable to confirm the accuracy of the information in Box 8 and/or Box 9.

It should be noted that for 70 percent of the 20 Forms 1098-T that contained graduate student information in our sample, the information was accurate.<sup>20</sup> Within the population of almost 1.3 million taxpayers, 233,883 taxpayers received \$427 million in education credits for graduate students.

***Recommendations***

The Commissioner, Wage and Investment Division, should:

***Recommendation 7:*** Develop a process to identify and notify educational institutions that are preparing inaccurate Forms 1098-T.

<sup>19</sup> See Appendix I for our sampling methodology.

<sup>20</sup> In these cases, an accurate Form 1098-T indicating the student is a graduate student means the student is not eligible for the AOTC per Publication 970 and the instructions for Box 9 on Form 1098-T.



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**Management's Response:** IRS management agreed with this recommendation. The IRS has initiated steps to systemically identify and reject documents using incorrect coding on Form 1098-T for TY 2011. It will also conduct additional research to determine if it can accurately identify educational institutions that are preparing inaccurate Forms 1098-T and then determine the appropriate treatment.

**Recommendation 8:** \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*.

**Management's Response:** \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*.

**Erroneous Education Credits Are Being Received for Students Claimed on Another Tax Return and by Prisoners**

Our review identified 63,963 taxpayers who received \$88.6 million in education credits that appear to be erroneous based on TY 2009 tax return information that the IRS maintains. Over 4 years, erroneous education credits could reach \$355 million. \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*  
 \*\*\*\*\*2(f)\*\*\*\*\*.

Figure 9 provides a breakdown of these claims.

**Figure 9: Erroneous Education Credits for Students Claimed on Another Tax Return and by Prisoners**

Type of Ineligible Claim	Number of Taxpayers	Erroneous Amount Allowed
Claiming Students Allowed as a Dependent or Spouse on Another Taxpayer's Tax Return	63,713	\$88,389,833
Prisoners Incarcerated for the Entire Year in 2009 Claiming Education Credits for a Dependent	250	\$255,879
<b>Total</b>	<b>63,963</b>	<b>\$88,645,712</b>

Source: TIGTA analysis of education credits through May 28, 2010.



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**Taxpayers erroneously received education credits for students allowed as a dependent on another taxpayer's tax return**

Our review identified 63,713 taxpayers who received education credits for 64,223 students who were claimed as a dependent or spouse on another taxpayer's tax return. These 63,713 taxpayers erroneously received \$88.4 million in education credits. Internal Revenue Code §25A(g)(3) disallows the education credit for students who have been allowed as a personal exemption (under Internal Revenue Code §151) on another taxpayer's tax return. Internal Revenue Code §151 addresses personal exemptions for taxpayers, spouses, and dependents.

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**Prisoners who were incarcerated for the entire year claimed dependent students and erroneously received education credits**

Our review identified 250 prisoners who filed as single or head of household, were incarcerated during all of 2009, erroneously claimed dependent students, had no wages reported to the IRS, and received \$255,879 in erroneous education credits. We believe these claims are erroneous because TY 2009 IRS guidelines for claiming a dependent child require the taxpayer to have provided more than one-half of the dependent's total support for the year. It is unlikely that a taxpayer incarcerated for the entire tax year met the support test for a qualifying child. In addition, the IRS had received no information documents (i.e., Wage and Tax Statements (Form W-2)) to substantiate the income these prisoners reported on their 2009 tax returns. The IRS has data that can be used when a tax return is processed to identify prisoners erroneously claiming this credit.

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## **Recommendations**

The Commissioner, Wage and Investment Division should:

**Recommendation 9:** Develop processes to identify ineligible taxpayers erroneously claiming education credits including identifying taxpayers claiming a student allowed as a dependent on another's tax return and prisoners erroneously receiving education credits.

**Management's Response:** IRS management agreed with this recommendation. The IRS has a process in place to identify taxpayers erroneously claiming education credits and will consider them for either soft notice or audit treatment. It will also reevaluate the process to ensure it is identifying all potential noncompliant taxpayers.

**Recommendation 10:** Develop a recovery program to review the tax returns of the 63,963 taxpayers claiming a student who was claimed as a dependent on another tax return and prisoners erroneously receiving education credits.

**Management's Response:** IRS management agreed with this recommendation. The 250 prisoners identified by the TIGTA as having received refunds due to inappropriate claims by the AOTC will be subject to post-refund examination during Fiscal Year 2012. The remaining 63,713 individuals identified will be considered for compliance treatment with either a soft notice or examination.

## ***A Valid Social Security Number Is Required for Federal Student Aid but Not for Education Credits***

Our review identified 84,754 students who did not have a valid SSN claimed by taxpayers who received \$103 million in education credits. Each of these students had an Individual Taxpayer Identification Number (ITIN). An ITIN is available to individuals who are required to have a TIN for tax purposes, but do not have and are not eligible to obtain an SSN. Taxpayers who are unable to obtain an SSN but have a tax return filing requirement can be either resident or nonresident aliens.

We alerted the IRS that taxpayers were receiving education credits for students with ITINs and that it should consider using existing math error authority<sup>23</sup> to disallow education credits to taxpayers when students claimed do not have a valid SSN. The IRS responded that, based on its interpretation of the law, there is no requirement for the student to have an SSN as defined in Title 20 United States Code §1901 (a)(1) of the Higher Education Act of 1965<sup>24</sup> to claim the

<sup>23</sup> Math error authority is granted by Congress and allows the IRS to identify calculation errors and obvious noncompliance. This provides an administrative benefit to the IRS because it can correct certain errors during tax return processing without having to wait to audit a taxpayer's return.

<sup>24</sup> Higher Education Act of 1965, Pub. L. No. 89-329 79 Stat. 1219 (1965).



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AOTC. The IRS states that a valid TIN, which includes an ITIN, is all that is needed to claim an education credit.

We agree that the law related to these education credits does not include any specific language regarding the need for a valid SSN. However, Federal law prohibits individuals residing without authorization in the United States from receiving most Federal public benefits and defines a Federal public benefit as:<sup>25</sup>

*Any grant, contract, loan, professional license, or commercial license provided by an agency of the United States or by appropriated funds of the United States; and any retirement, welfare, health, disability, public or assisted housing, postsecondary education, food assistance, unemployment benefit, or any other similar benefit for which payments or assistance are provided to an individual, household, or family eligibility unit by an agency of the United States or by appropriated funds of the United States.*

Education credits are for postsecondary education and can be paid from appropriated funds to individuals who owe no tax. Notwithstanding, there has been no additional guidance from the Department of the Treasury as to whether the above prohibition on providing Federal public benefits applies to refundable tax credits.

The requirements for claiming education credits are in direct contrast with requirements for receiving Federal student aid. For example, a student needs a valid SSN to receive Federal grants and loans but does not need a valid SSN to claim education credits.

- At the time of Higher Education Act enactment in 1965, and when most of the amendments to this law were enacted, the ITIN did not exist. The ITIN program was created in 1996 by Department of the Treasury regulations that require a valid TIN for resident and nonresident aliens not eligible for an SSN to report and pay taxes on United States income. As it now stands, student financial assistance in the form of this refundable tax credit does not conform in all respects to the full Higher Education Act definition of student eligibility for Federal financial assistance.
- Internal Revenue Code §25A(b)(3) uses only a portion of the Higher Education Act for its definition of an eligible student. The definition used in the Internal Revenue Code is taken from Title IV of the Act, which is the section that establishes guidelines for Federal financial assistance to students. The Higher Education Act established the two primary sources of Federal aid to students: grants and loans. Student eligibility for Federal aid requires a student to provide the Department of Education with an SSN. The Department of Education verifies the student's SSN with the Social Security Administration immediately after the student applies for aid. Only applicants with valid SSNs are offered aid.

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<sup>25</sup> *Personal Responsibility and Work Opportunity Reconciliation Act of 1996*, Pub. L. No. 104-193, 110 Stat. 2105 (codified in scattered sections of 42 U.S.C., 21 U.S.C., 8 U.S.C., and 7 U.S.C.).





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***Legislative Recommendation***

**Recommendation 11:** Coordinate with the Office of Tax Policy<sup>26</sup> to determine whether legislation is needed to clarify whether refundable tax credits, such as the AOTC, are Federal benefits as defined in the Personal Responsibility and Work Opportunity Reconciliation Act of 1996<sup>27</sup> and thus may be claimed only for students with a valid SSN and, if these credits may not be paid, to provide the IRS with math error authority to disallow claims for these credits.

**Management’s Response:** IRS management agreed to coordinate with the Department of the Treasury’s Office of Tax Policy to discuss their views of the current state of law regarding the eligibility for the AOTC.

<sup>26</sup> The Office of Tax Policy assists the Secretary of the Treasury in developing and implementing tax policies and programs.

<sup>27</sup> Pub.L. 104-193, 110 Stat. 2105.



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**Appendix I**

*Detailed Objective, Scope, and Methodology*

Our overall objective was to assess the effectiveness of IRS processes to identify erroneous AOTC claims from January 1 through May 28, 2010. To accomplish our objective, we:

- I. Identified a population of 8,286,770 taxpayers who received the AOTC on electronically filed and paper tax returns processed during the 2010 Filing Season<sup>1</sup> through May 28, 2010. From these data, we created a file of the 8,286,770 taxpayer SSNs, including the 9,055,993 SSNs of students who were claimed for the AOTC.
- II. Determined if taxpayers who received the AOTC claimed students who did not attend an eligible institution, were not at least half-time students, or were graduate students.
  - A. Assessed IRS processes/procedures to determine if processes had been established to identify if any students for the AOTC did not attend an eligible institution, were not at least half-time students, or were graduate students.
  - B. Identified 1,991,020 AOTC students who did not attend an eligible institution by matching students identified in Step I to TY<sup>2</sup> 2009 Tuition Statements (Form 1098-T) to identify students for whom the IRS had no record (as of December 31, 2010) of receiving a Form 1098-T.
  - C. Identified 1,324,730 AOTC students who were not at least half-time or were graduate students or both by matching students identified in Step I to TY 2009 Forms 1098-T to identify 1,087,118 students who received a Form 1098-T with Box 8 unchecked (were not at least half-time students) and 237,612 with Box 9 checked (were graduate students), including 45,915 who were both.
    1. Reviewed a statistical sample of 100 Forms 1098-T that were randomly selected from 1,324,730 students who received only 1 Form 1098-T indicating they were not at least half-time or were graduate students. We originally selected a sample of 73 and oversampled to 100. Our sampling criteria included:

Population = 1,324,730

Confidence Level = 95 percent

<sup>1</sup> The period from January through mid-April when most individual income tax returns are filed.

<sup>2</sup> A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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Desired Precision =  $\pm 5.0$  percent<sup>3</sup>

Estimated Error Rate = 5.0 percent

2. Projected the results of the statistical sample to the population.
- D. Met with Department of Education executives and discussed the various databases they had with student and educational institution information to determine which one(s) might best assist the IRS in validating eligible students and eligible education institutions for the AOTC during tax return processing.
- III. Determined if prisoners erroneously received the AOTC by matching the results of Step I to the 2009 Prisoner File.<sup>4</sup> We validated the results (of computer processed prisoner data) against the Integrated Data Retrieval System<sup>5</sup> and found no discrepancies. We identified 250 prisoners who were incarcerated the entire tax year, filed single or head of household, did not have a supporting Wage and Tax Statement (Form W-2), and received the AOTC for dependents they claimed as students.
- IV. Determined how many of our identified exception cases were prepared by paid return preparers. We matched identified exception cases against TIGTA's Return Transaction File (RTF) Preparer File<sup>6</sup> located in the Data Center Warehouse to identify all exception returns with preparer information.
- V. Evaluated the reliability of IRS computer-processed data by ensuring TIGTA Information Systems programmers performed run-to-run balancing and counts on the data to ensure all records were accounted for from the IRS Information Returns Master File<sup>7</sup> through December 31, 2010. We also verified the Form 1098-T data and Prisoner File data to the IRS Integrated Data Retrieval System. Although the Form 8863 data used during this audit had been obtained and validated during the 2010 Filing Season review,<sup>8</sup> we also validated it during this audit. We concluded that the computer-processed data were sufficiently reliable to support the audit findings, conclusions, and recommendations.

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<sup>3</sup> We considered various precisions and sample sizes; however, our final selection was based on available audit resources.

<sup>4</sup> The data contained in the Prisoner Files has been provided to the IRS by the Federal Bureau of Prisons and the individual States and is used by the IRS to identify prisoner-taxpayers during tax return processing.

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

<sup>6</sup> The Return Transaction File contains line items transcribed during return processing and other fields such as math calculations. Subsequent or amended return data are not contained in the file.

<sup>7</sup> An IRS computer system of current tax year information return data submitted to the IRS (1) by the payer on various forms and schedules (F1096, F1042, F1098, F1099, Sch K-1, F5498, F8300 and F8362) and (2) by the Social Security Administration for data reported on W-2s, W-3s, and W-4s.

<sup>8</sup> *Verifying Eligibility for Certain New Tax Benefits Was a Challenge for the 2010 Filing Season* (Reference Number 2010-41-128, dated September 30, 2010).



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**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: the processes for planning, organizing, directing, and controlling program operations for new tax legislation such as the AOTC. We also evaluated the controls that are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during application processing of tax returns with these credits.



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**Appendix II**

*Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)  
Russell Martin, Director  
Tina Parmer, Audit Manager  
Sharla Robinson, Senior Auditor  
Bonnie Shanks, Lead Auditor  
J. Ed Carr, Auditor  
Kim McMenamin, Auditor  
Brian Hatterly, Senior Information Technology Specialist  
Martha Stewart, Senior Information Technology Specialist



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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 of Operations, Wage and Investment Division SE:W  
Deputy Commissioner of Services, Wage and Investment Division SE:W  
Director, Business Modernization Office, Wage and Investment Division SE:W:BMO  
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division  
SE:W:CAR  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division  
SE:W:ETARC  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM  
Director, Field Assistance, Wage and Investment Division SE:W:CAR:FA  
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Director, Stakeholder Partnership, Education, and Communications, Wage and Investment  
Division SE:W:CAR:SPEC  
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PEI  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division  
SE:W:S:PEI



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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.

For all of the outcomes listed in this Appendix, we conducted computer analyses of TY 2009 individual income tax returns. The returns were received by the IRS Submission Processing sites between January 1 and May 28, 2010.

We identified 1.7 million taxpayers as of May 28, 2010, who appear to have erroneously received \$2.57 billion (\$1.32 billion refundable and \$1.25 billion nonrefundable) in the AOTC.<sup>1</sup> This could reach \$10.3 billion (\$5.3 billion refundable and \$5 billion in nonrefundable) in the AOTC over 4 years. Each of these taxpayers claimed students who had no associated Tuition Statement (Form 1098-T) in IRS files supporting the student's attendance at an educational institution.

#### **Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$5.3 billion from 1.7 million taxpayers who appear to have erroneously received the refundable portion of the AOTC over 4 years for students claimed who did not attend an educational institution (see page 5).

#### **Methodology Used to Measure the Reported Benefit:**

We used computer analysis to identify 1.9 million taxpayers who claimed the AOTC for nearly 2 million students. These students had no associated Form 1098-T in IRS files supporting that they attended an educational institution.

We then reduced the 1.9 million (1,887,637) taxpayers by 186,984 duplicates from other exceptions to arrive at 1.7 million (1,700,653) taxpayers who appear to have erroneously received \$1.32 billion in refundable AOTC for 1.8 million students.<sup>2</sup> The amount of erroneous refundable AOTC over 4 years could reach \$5.3 billion. To calculate the \$1.32 billion in refundable AOTC, we analyzed the 1.8 million exception students to determine:

<sup>1</sup> All amounts were rounded.

<sup>2</sup> 1,991,020 (2 million) exception students less 200,340 duplicate exception students = 1,790,680 (1.8 million) exception students.



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- **Group 1** – Those who were the only AOTC student the taxpayer claimed (i.e., all the refundable AOTC would be attributable to that student). We identified 1,504,308 students claimed by taxpayers to arrive at *\$1,090,481,756 in actual refundable AOTC*.
- **Group 2** – Those who were 1 of 2 (only AOTC) students claimed (i.e., the refundable AOTC attributable to each exception student in this category was an average of \$800.72).<sup>3</sup> We identified 239,478 students ( $239,478 \times \$800.7178954 = \$191,754,320$  refundable AOTC attributable to these exception students).
- **Group 3** – Those who were 1 of 3 (only AOTC) students claimed (i.e., the refundable AOTC attributable to each exception student in this category was an average of \$803.85).<sup>4</sup> We identified 29,999 students ( $29,999 \times \$803.8529118 = \$24,114,784$  refundable AOTC attributable to these exception students).
- **Group 4** – Those who were 1 of a combination of AOTC and Lifetime Learning Credit students claimed (i.e., the refundable AOTC attributable to each exception student in this category was an average of \$807.59).<sup>5</sup> We identified 16,895 students ( $16,895 \times \$807.5937180 = \$13,644,296$  refundable AOTC attributable to these exception students).

**Table 1: Calculation of Refundable AOTC**

	Exception Students	Actual or Average	Attributable Refundable AOTC
Group 1	1,504,308	Actual	\$ 1,090,481,756
Group 2	239,478	x \$800.7178954 =	\$ 191,754,320
Group 3	29,999	x \$803.8529118 =	\$ 24,114,784
Group 4	16,895	x \$807.5937180 =	\$ 13,644,296
<b>TOTAL</b>	<b>1,790,680</b>		<b>\$ 1,319,995,156</b>

*Source: TIGTA analysis of education credits through May 28, 2010.*

- The \$5.3 billion was computed by multiplying \$1,319,995,156 x 4 years.

<sup>3</sup> Through May 28, 2010, we identified 1,335,784 students who were 1 of 2 AOTC students claimed by 667,892 taxpayers who received \$1,069,586,153 in refundable AOTC.  $\$1,069,586,153 / 1,335,784 = \$800.7178954$  average refundable AOTC attributable to students in this group (Group 2).

<sup>4</sup> Through May 28, 2010, we identified 129,948 students who were 1 of 3 AOTC students claimed by 43,316 taxpayers who received \$104,459,078 in refundable AOTC.  $\$104,459,078 / 129,948 = \$803.8529118$  average refundable AOTC attributable to students in this group (Group 3).

<sup>5</sup> Through May 28, 2010, we identified 179,172 students who were a combination of AOTC and Lifetime Learning Credit students claimed by 164,473 taxpayers who received \$144,698,182 in refundable AOTC.  $\$144,698,182 / 179,172 = \$807.5937180$  average refundable AOTC attributable to students in this group (Group 4).





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**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$5 billion from 1.7 million taxpayers who appear to have erroneously received the nonrefundable portion of the AOTC over 4 years for students claimed who did not attend a qualifying educational institution (see page 5).

**Methodology Used to Measure the Reported Benefit:**

We used computer analysis to identify 1.9 million taxpayers who claimed the AOTC for nearly 2 million students. These students had no associated Form 1098-T in IRS files supporting that they attended an educational institution.

We then reduced the 1.9 million (1,887,637) taxpayers by 186,984 duplicates from other exceptions to arrive at 1.7 million (1,700,653) taxpayers who appear to have erroneously received \$1.25 billion in nonrefundable AOTC for 1.8 million students. The amount of erroneous nonrefundable AOTC over 4 years could reach \$5 billion. To calculate the \$1.25 billion in nonrefundable AOTC, we analyzed the 1.8 million exception students to determine:

- **Group 1** – Those who were the only AOTC student the taxpayer claimed (i.e., all the nonrefundable AOTC would be attributable to that student). We identified 1,504,308 students claimed by taxpayers to arrive at \$988,665,717 in actual nonrefundable AOTCs.
- **Group 2** – Those who were 1 of 2 (only AOTC) students claimed (i.e., the nonrefundable AOTC attributable to each exception student in this category was an average of \$917.14).<sup>6</sup> We identified 239,478 students ( $239,478 \times \$917.1399696 = \$219,634,846$  nonrefundable AOTC attributable to these exception students).
- **Group 3** – Those who were 1 of 3 (only AOTC) students claimed (i.e., the nonrefundable AOTC attributable to each exception student in this category was an average of \$850.63).<sup>7</sup> We identified 29,999 students ( $29,999 \times \$850.6324446 = \$25,518,123$  nonrefundable AOTC attributable to these exception students).
- **Group 4** – Those who were one of a combination of AOTC and Lifetime Learning Credit students claimed (i.e., the nonrefundable AOTC attributable to each exception student in

<sup>6</sup> Through May 28, 2010, we identified 1,335,784 students who were 1 of 2 AOTC students claimed by 667,892 taxpayers who received \$1,225,100,897 in nonrefundable AOTC.  $\$1,225,100,897 / 1,335,784 = \$917.1399696$  average nonrefundable AOTC attributable to students in this group (Group 2).

<sup>7</sup> Through May 28, 2010, we identified 129,948 students who were 1 of 3 AOTC students claimed by 43,316 taxpayers who received \$110,537,985 in nonrefundable AOTC.  $\$110,537,985 / 129,948 = \$850.6324446$  average nonrefundable AOTC attributable to students in this group (Group 3).



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this category was an average of \$884.89).<sup>8</sup> We identified 16,895 students (16,895 x \$884.89 = \$14,950,217 nonrefundable AOTC attributable to these exception students).

**Table 2: Calculation of Refundable AOTC**

	<b>Exception Students</b>	<b>Actual or Average (rounded)</b>	<b>Attributable Nonrefundable AOTC</b>
<b>Group 1</b>	1,504,308	Actual	\$ 988,665,717
<b>Group 2</b>	239,478	x \$917.1399696 =	\$ 219,634,846
<b>Group 3</b>	29,999	x \$850.6324446 =	\$ 25,518,123
<b>Group 4</b>	16,895	x \$884.8900000 =	\$ 14,950,217
<b>TOTAL</b>	<b>1,790,680</b>		<b>\$ 1,248,768,902</b>

- The \$5 billion was computed by multiplying \$1,248,768,902 x 4 years.

**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$1.1 billion in refundable AOTC erroneously received over 4 years by an estimated 361,467<sup>9</sup> taxpayers for a projected 370,924 students who did not attend an educational institution the required length of time and/or were enrolled in postgraduate studies (see page 12).

**Methodology Used to Measure the Reported Benefit:**

We identified nearly 1.3 million taxpayers as of May 28, 2010, who claimed the AOTC for 1.3 million students who appeared to not have attended an educational institution at least half-time or who were a graduate student, or both, disqualifying the taxpayers for the AOTC. These taxpayers, based on TY 2009 tax return data, potentially received erroneous education credits of more than \$2 billion.

We selected and reviewed a statistically valid sample of 100 Forms 1098-T.<sup>10</sup> Based on our review of the statistically valid sample of 100 Forms 1098-T, validated by third parties, we found that 28 percent were accurate. Based on this accuracy rate, we were able to project that

<sup>8</sup> Through May 28, 2010, we identified 179,172 students who were a combination of AOTC and Lifetime Learning Credit students claimed by 164,473 taxpayers who received \$158,547,511 in nonrefundable AOTC.

\$158,547,511 / 179,172 = \$884.89 average nonrefundable AOTC attributable to students in this group (Group 4).

<sup>9</sup> We arrived at an estimated 361,467 taxpayers by applying the 28 percent accuracy rate to the 1,290,955 taxpayers in the population of 1,324,730 Forms 1098-T. Since the statistically valid sample was taken from the 1,324,730 students who received only 1 Form 1098-T (rather than from the 1,290,955 taxpayers who claimed the students and received the AOTC), we cannot *statistically* project to the number of taxpayers. The statistician provided us with projections to 1) the number of accurate Forms 1098-T and 2) the amount of AOTC associated with the student who received the accurate Form 1098-T.

<sup>10</sup> The sample was based on a confidence level of 95 percent, a precision of ± 5 percent, and an expected error rate of 5 percent.



*Billions of Dollars in Education Credits  
Appear to Be Erroneous*



370,924 students within the population of 1,324,730 received an accurate Form 1098-T indicating they did not attend an educational institution at least half-time or were a graduate student, or both, and were not eligible for the AOTC. This resulted in a projected \$263 million in refundable AOTC erroneously received by an estimated 361,467 taxpayers. We are 95 percent confident that the number of accurate Forms 1098-T in the population is between 253,762 and 488,086 (the margin of error is  $\pm 117,162$ ). In addition, we are 95 percent confident that the amount of the erroneous refundable AOTC received related to these forms is between \$166,719,886 and \$358,283,596 (the margin of error is  $\pm \$95,781,855$ ). Over 4 years, erroneous refundable education credits could reach \$1.1 billion (\$263 million x 4).

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$1.1 billion in nonrefundable AOTC erroneously received over 4 years by an estimated 361,467 taxpayers for a projected 370,924 students who did not attend an educational institution the required length of time and/or were enrolled in postgraduate studies (see page 12).

**Methodology Used to Measure the Reported Benefit:**

We identified nearly 1.3 million taxpayers as of May 28, 2010, who claimed the AOTC for 1.3 million students who appeared to not have attended an educational institution at least half-time or who were a graduate student or both, disqualifying the taxpayers for the AOTC. These taxpayers, based on TY 2009 tax return data, potentially received erroneous education credits for more than \$2 billion.

We selected and reviewed a statistically valid sample of 100 Forms 1098-T. Based on our review of the statistically valid sample of 100 Forms 1098-T, validated by third parties, we found that 28 percent were accurate. Based on this accuracy rate, we were able to project that 370,924 students within the population of 1,324,730 received an accurate Form 1098-T indicating they did not attend an educational institution at least half-time or were a graduate student, or both, and were not eligible for the AOTC. This resulted in a projected \$287 million in nonrefundable AOTC erroneously received by an estimated 361,467 taxpayers. We are 95 percent confident that the number of accurate Forms 1098-T in the population is between 253,762 and 488,086 (the margin of error is  $\pm 117,162$ ). In addition, we are 95 percent confident that the amount of the erroneous nonrefundable AOTC received related to these forms is between \$161,582,023 and \$412,640,212 (the margin of error is  $\pm \$125,529,094$ ). Over 4 years, erroneous nonrefundable education credits could reach \$1.1 billion (\$287 million x 4).



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**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$203 million from 63,963 taxpayers over 4 years who are ineligible to receive the AOTC (see page 14).

**Methodology Used to Measure the Reported Benefit:**

We used computer analysis to identify 63,963 taxpayers where the TY 2009 tax return information the IRS maintains identifies these taxpayers as being ineligible to receive \$50.7 million in refundable AOTC. The refundable portion of the AOTC was calculated by taking the actual refundable AOTC of \$43,773,396 attributable to taxpayers who claimed only 1 student and combining it with the estimated refundable AOTC of \$6,970,947 (calculated using the same averages in Table 1) for taxpayers who claimed 2 or more students. Over 4 years, refundable erroneous education credits could reach \$203 million (\$50.7 million x 4).

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$152 million from 63,963 taxpayers over 4 years who are ineligible to receive the AOTC (see page 14).

**Methodology Used to Measure the Reported Benefit:**

We used computer analysis to identify 63,963 taxpayers where the TY 2009 tax return information the IRS maintains identifies these taxpayers as being ineligible to receive \$37.9 million in nonrefundable AOTC. The nonrefundable portion of the AOTC was calculated by taking the actual nonrefundable AOTC of \$30,013,501 attributable to taxpayers who claimed only 1 student and combining it with the estimated nonrefundable AOTC of \$7,887,868 (calculated using the same averages in Table 2) for taxpayers who claimed 2 or more students. Over 4 years, nonrefundable erroneous education credits could reach \$151.6 million (\$37.9 million x 4).

The process of calculating the \$50.7 million refundable AOTC and the \$37.9 million nonrefundable AOTC was the same as the process detailed in the first exception, using the same averages per student shown in Tables 1 and 2. The only difference is fewer students in each category/group of students.

We identified 78,891 individuals as of May 28, 2010, who erroneously received \$103 million (\$56.63 million refundable and \$46.4 million nonrefundable) in AOTC.<sup>11</sup> This could reach \$412 million (\$226.5 million refundable and \$185.6 million nonrefundable) in AOTC over 4 years. Each of these individuals claimed students who did not have a valid SSN. The IRS has existing math error authority to disallow education credits to individuals when students claimed do not have a valid SSN.

<sup>11</sup> All amounts were rounded.



*Billions of Dollars in Education Credits  
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**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$226.5 million in refundable AOTC erroneously received over 4 years by 78,891 taxpayers for students who had an ITIN. It should be noted that realization of this outcome measure is contingent upon interpretation or enactment of legislation (see page 16).

**Methodology Used to Measure the Reported Benefit:**

We used computer analysis to identify 78,891 taxpayers as of May 28, 2010, who claimed 84,754 students who had ITINs, for a total of \$56.63 million in refundable AOTC. The refundable portion of the AOTC was calculated by taking the actual refundable AOTC of \$44,189,392 attributable to taxpayers who claimed only 1 student and combining it with the estimated refundable AOTC of \$12,441,921 (calculated using the same averages in Table 1) for taxpayers who claimed 2 or more students, for a total of \$56,631,313. Over 4 years, refundable erroneous education credits could reach \$226.5 million (\$56.63 million x 4).

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$185.6 million in nonrefundable AOTC erroneously received over 4 years by 78,891 taxpayers for students who had an ITIN. It should be noted that realization of this outcome measure is contingent upon interpretation or enactment of legislation (see page 16).

**Methodology Used to Measure the Reported Benefit:**

We used computer analysis to identify 78,891 taxpayers as of May 28, 2010, who claimed 84,754 students who had ITINs, for a total of \$46.4 million in nonrefundable AOTC. The nonrefundable portion of the AOTC was calculated by taking the actual nonrefundable AOTC of \$32,291,988 attributable to taxpayers who claimed only 1 student and combining it with the estimated nonrefundable AOTC of \$14,100,094 (calculated using the same averages in Table 2) for taxpayers who claimed 2 or more students, for a total of \$46,392,082. Over 4 years, nonrefundable erroneous education credits could reach \$185.6 million (\$46.4 million x 4).

The process of calculating the \$56.63 million refundable AOTC and the \$46.4 million nonrefundable AOTC was the same as the process detailed in the 2 exceptions, using the same averages per student shown in Tables 1 and 2. The only difference is fewer students in each category/group of students.



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**Appendix V**

*Tax Year 2010 Education Credits  
(American Opportunity and  
Lifetime Learning Credits) (Form 8863)*

Form <b>8863</b> Department of the Treasury Internal Revenue Service (99)	<b>Education Credits (American Opportunity and Lifetime Learning Credits)</b> ▶ See separate instructions to find out if you are eligible to take the credits. ▶ Attach to Form 1040 or Form 1040A.	OMB No. 1545-0074 <b>2010</b> Attachment Sequence No. 50
Name(s) shown on return		Your social security number



*You cannot take both an education credit and the tuition and fees deduction (see Form 8917) for the same student for the same year.*

**Part I American Opportunity Credit**  
**Caution:** You cannot take the American opportunity credit for more than 4 tax years for the same student.

1	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (see instructions). Do not enter more than \$4,000 for each student.	(d) Subtract \$2,000 from the amount in column (c). If zero or less, enter -0-.	(e) Multiply the amount in column (d) by 25% (.25)	(f) If column (d) is zero, enter the amount from column (c). Otherwise, add \$2,000 to the amount in column (e).
2	<b>Tentative American opportunity credit.</b> Add the amounts on line 1, column (f). If you are taking the lifetime learning credit for a different student, go to Part II; otherwise, go to Part III . . . . . ▶					2

**Part II Lifetime Learning Credit**  
**Caution:** You cannot take the American opportunity credit and the lifetime learning credit for the same student in the same year.

3	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (see instructions)
4	Add the amounts on line 3, column (c), and enter the total . . . . .		4
5	Enter the smaller of line 4 or \$10,000 . . . . .		5
6	<b>Tentative lifetime learning credit.</b> Multiply line 5 by 20% (.20). If you have an entry on line 2, go to Part III; otherwise go to Part IV . . . . .		6



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Form 8863 (2010)

Page **2**

**Part III Refundable American Opportunity Credit**

<b>7</b>	Enter the amount from line 2 . . . . .			<b>7</b>	
<b>8</b>	Enter: \$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er) . . . . .	<b>8</b>			
<b>9</b>	Enter the amount from Form 1040, line 38,* or Form 1040A, line 22 . . . . .	<b>9</b>			
<b>10</b>	Subtract line 9 from line 8. If zero or less, <b>stop</b> ; you cannot take any education credit . . . . .	<b>10</b>			
<b>11</b>	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er) . . . . .	<b>11</b>			
<b>12</b>	If line 10 is: • Equal to or more than line 11, enter 1.000 on line 12 . . . . . • Less than line 11, divide line 10 by line 11. Enter the result as a decimal (rounded to at least three places) . . . . .			<b>12</b>	
<b>13</b>	Multiply line 7 by line 12. <b>Caution:</b> If you were under age 24 at the end of the year <b>and</b> meet the conditions on page 4 of the instructions, you <b>cannot</b> take the refundable American opportunity credit. Skip line 14, enter the amount from line 13 on line 15, and check this box . . . . . <input type="checkbox"/>			<b>13</b>	
<b>14</b>	<b>Refundable American opportunity credit.</b> Multiply line 13 by 40% (.40). Enter the amount here and on Form 1040, line 66, or Form 1040A, line 43. Then go to line 15 below . . . . .			<b>14</b>	

**Part IV Nonrefundable Education Credits**

<b>15</b>	Subtract line 14 from line 13 . . . . .			<b>15</b>	
<b>16</b>	Enter the amount from line 6, if any. If you have no entry on line 6, skip lines 17 through 22, and enter the amount from line 15 on line 6 of the Credit Limit Worksheet (see instructions) . . . . .			<b>16</b>	
<b>17</b>	Enter: \$120,000 if married filing jointly; \$60,000 if single, head of household, or qualifying widow(er) . . . . .	<b>17</b>			
<b>18</b>	Enter the amount from Form 1040, line 38,* or Form 1040A, line 22 . . . . .	<b>18</b>			
<b>19</b>	Subtract line 18 from line 17. If zero or less, skip lines 20 and 21, and enter zero on line 22 . . . . .	<b>19</b>			
<b>20</b>	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er) . . . . .	<b>20</b>			
<b>21</b>	If line 19 is: • Equal to or more than line 20, enter 1.000 on line 21 and go to line 22 • Less than line 20, divide line 19 by line 20. Enter the result as a decimal (rounded to at least three places) . . . . .			<b>21</b>	
<b>22</b>	Multiply line 16 by line 21. Enter here and on line 1 of the Credit Limit Worksheet (see instructions) ►			<b>22</b>	
<b>23</b>	<b>Nonrefundable education credits.</b> Enter the amount from line 11 of the Credit Limit Worksheet (see instructions) here and on Form 1040, line 49, or Form 1040A, line 31 . . . . .			<b>23</b>	

\*If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter.

Form **8863** (2010)

Source: TY2010 Form 8863 from IRS.gov web site.



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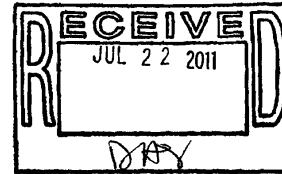
**Appendix VI**

*Management's Response to the Draft Report*



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308



July 22, 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report - Billions of Dollars in Education Credits  
Appear to Be Erroneous (Audit # 201040147)

We have reviewed the subject draft report. During this audit, the Treasury Inspector General for Tax Administration (TIGTA) identified issues representative of the challenges presented by administering certain refundable credits permitted by the Internal Revenue Code (the Code). The American Opportunity Tax Credit (AOTC) provides assistance to students pursuing higher education goals. For Tax Year (TY) 2009, approximately 8.9 million taxpayers received almost \$15.5 billion in AOTC benefits. The IRS strives to provide balanced administration of the AOTC, and other refundable credits, by applying safeguards and controls that deter the payment of improper claims without adversely impacting the timely processing and payment of refunds to entitled taxpayers.

The IRS agrees that processes should ensure that the AOTC is afforded only to taxpayers who are eligible. We have taken a number steps in this regard over the last year and continue to make additional program improvements. As discussed in more detail below, we have agreed with most of the report recommendations.

The IRS believes, however, that the amount of erroneous claims speculated in the report is likely to be substantially overstated. Furthermore, we have found significant issues in Form 1098-T reporting that indicate that, while these information returns are helpful, additional analysis is required before determining whether missing forms or discrepancies on those forms reflect inaccurate claims, or inaccurate information reporting associated with otherwise accurate claims. We are taking aggressive steps and working with educational institutions and outside stakeholders to address these issues and ensure that Form 1098-T reporting is accurate.





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We disagree with the premise on which TIGTA has made the assumption that up to 2.1 million taxpayers appear to have claimed and received erroneous education credits. This observation is based on the inability to match certain tax returns claiming education credits with the corresponding information returns, Form 1098-T, *Tuition Statement*, filed by the respective educational institutions with the IRS. As discussed in the report, education credits are allowable based on the payment of qualified tuition and related expenses by, or on the behalf of, eligible students. Student eligibility is determined by maintaining a status of at least half-time enrollment during the year at a qualified educational institution. While the Form 1098-T is a key source of information to determine credit eligibility, the absence of the form or absence of particular information from the form does not necessarily mean that the taxpayer is not eligible for the credit. The law does not disqualify taxpayers from claiming educational credits when the educational institution has not complied with its requirement to file the information report correctly.

In addition, there are legitimate reasons why the information on the Form 1098-T could be different from the amount of credit allowed to the taxpayer. For example, timing differences can occur that will cause the reporting of all expenses on Form 1098-T in one year, when the student is required to claim the credit over two tax years. In addition, students whose tuition was fully paid through scholarships would not receive Form 1098-T, although they may have related expenses, such as course materials not purchased through the educational institution, which would qualify for the credit.

The conclusion reached by TIGTA that education credit claims are necessarily erroneous when they cannot be matched to Form 1098-T is not consistent with the findings in a previous audit.<sup>1</sup> We believe the results of TIGTA's analysis highlight reporting compliance issues affecting the information returns. In the current report, a review of a statistically valid sample of Forms 1098-T revealed that information was confirmed as accurate in only 28 percent of cases. We have also become aware of Forms 1098-T that were filed with taxpayers and the IRS with unallowable characters in the boxes denoting at least half-time enrollment or graduate student status. The result of the submission of the forms in this manner is the potential appearance that taxpayers are not eligible for the credit when that may not be the case.

We have taken steps to identify and address non-compliance with Form 1098-T filing requirements as well as with the AOTC. We believe that a multi-pronged approach will be necessary to define the scope of the issue and collect the data necessary to develop an effective strategy to improve information reporting compliance by the educational institutions and deter erroneous claims by those individuals who are neither eligible nor entitled to claim them. When this issue was recognized in 2010, we took action to identify income tax returns where the claimed credit could not be matched to Form

<sup>1</sup> Report 2011-30-019, *Targeted Compliance Efforts May Reduce the Number of Inaccurate Information Returns Submitted by Government Entities*, February 15, 2011.



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1098-T. Examinations of those returns have been initiated and resources have been allocated in both the FY 2011 and FY 2012 examination plans to continue to identify and address the issue in the compliance environment. We will use the data collected from these audits to further refine our compliance strategies.

We are expanding our outreach and education efforts around the AOTC to educate all parties associated with the credit. This includes taxpayers, students, return preparers, educational institutions, and those entities providing support services, such as software developers and information return preparation services.

We have reviewed the Outcome Measures in Appendix IV and agree with your findings and methodologies associated with dependents and prisoners. As previously discussed, we do not agree with the reported Outcome Measures based on the assumption that claimed credits that could not be matched to corresponding Forms 1098-T are erroneous claims. We disagree with the Outcome Measure based on less than half-time enrollment. As discussed, missing information on the Form 1098-T is not conclusive that the student failed to meet enrollment requirements, especially in light of the findings that the accuracy of the forms completed by the educational institutions is at issue. Finally, we disagree with the Outcome Measures based on education credits claimed by students using an Individual Taxpayer Identification Number (ITIN). Under the Code, educational credits are available to ITIN holders. As you are aware, the IRS is obligated to administer the law as written.

Attached are our comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Robin L. Canady, Director, Strategy and Finance, at (404) 338-8801.

Attachment



*Billions of Dollars in Education Credits  
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Attachment

**RECOMMENDATION 1**

The Commissioner, Wage and Investment Division, should initiate a Tax Return Preparer Project to address those preparers associated with large volumes of erroneous education credit claims.

**CORRECTIVE ACTION**

We agree that sanctions are appropriate when tax return preparers are found to have knowingly prepared false returns, or failed to follow due diligence in the preparation of tax returns. We do not agree with the Treasury Inspector General for Tax Administration's (TIGTA) reasoning that education credit claims that cannot be matched to Form 1098-T, *Tuition Statement*, information filed with the IRS are conclusively erroneous. We are taking steps to work with educational institutions and other outside stakeholders to ensure that Form 1098-T reporting is accurate, but do not consider a formal Tax Return Preparer project appropriate for this issue at this time.

As part of our ongoing compliance and outreach activities for education credit, we will ascertain the extent of erroneous claims and evaluate if a heightened level of action is necessary beyond the traditional return preparer penalties considerations required by auditing standards.

**IMPLEMENTATION DATE**

December 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Earned Income Tax Credit, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

The Commissioner, Wage and Investment Division should:

**RECOMMENDATION 2**

Revise the Form 8863 to require taxpayers to provide identifying information for the educational institution that the student(s) being claimed for the education credits attended. This identifying information should include the name, address, and Federal EIN of the educational institution. In addition, the form should be revised to include specific information supporting key eligibility requirements that could be used to verify requirements were met which may serve as a deterrent for those taxpayers who intend to erroneously claim these credits.



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**CORRECTIVE ACTION**

We agree with this recommendation. Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*, for Tax Year (TY) 2012 is being revised to capture the educational institution identifying information and eligibility information that will guide taxpayers through the credit eligibility determination.

**IMPLEMENTATION DATE**

January 15, 2013

**RESPONSIBLE OFFICIAL**

Director, Media and Publications, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 3**

Coordinate with the Department of Education to discuss the feasibility of obtaining extracts of the IPEDS and the NSLDS database files. In addition, work with the Department of Education to develop a process to verify the accuracy of the educational institutions reporting of their EINs to enable the IRS to use these data during tax return processing.

**CORRECTIVE ACTION**

We agree with this recommendation. The IRS has contacted the Department of Education (DOE) to discuss the feasibility of obtaining information from the Integrated Postsecondary Education Data System and the National Student Loan Data System databases. We are analyzing disclosure implications and considering the feasibility of using the data. If feasible, we will work with the DOE to develop a process to verify the accuracy of the educational institutions' Employer Identification Numbers.

**IMPLEMENTATION DATE**

December 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Earned Income Tax Credit, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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



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**RECOMMENDATION 4**

If the Department of Education information is feasible for use in tax return processing, develop processes to use the Department of Education information at the time tax returns are processed to identify taxpayers who do not qualify for education credits being claimed.

**CORRECTIVE ACTION**

If data acquired from the DOE is feasible for use during tax return processing, we will determine the appropriate point in the process where the use of the data will be most beneficial in verifying eligibility for education credits.

**IMPLEMENTATION DATE**

February 15, 2013

**RESPONSIBLE OFFICIAL**

Director, Earned Income Tax Credit, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 5**

Develop a recovery program to address the 1.7 million taxpayers who appear to have erroneously received more than \$2.6 billion in erroneous education credits for students with no supporting documentation that they attended an educational institution.

**CORRECTIVE ACTION**

While we believe the number of claims appearing to be erroneous is overstated, we agree with this recommendation and have taken action to address the potential non-compliance in this taxpayer segment. In Fiscal Year (FY) 2010, we identified TY 2009 cases in the Automated Underreporter and Correspondence Exam programs where the American Opportunity Tax Credit (AOTC) was claimed and could not be matched to a corresponding Form 1098-T. Resources have been allocated in the work plans of both programs to continue addressing the issue throughout FY 2011 and FY 2012.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division



*Billions of Dollars in Education Credits  
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**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 6**

Revise the compliance program to identify taxpayers who have claimed students on their tax return but no associated Form 1098-T was submitted to the IRS and there is no supporting data on the Department of Education databases.

**CORRECTIVE ACTION**

We agree with this recommendation. We currently have a process in place to identify those individuals who have claimed students on their tax return but have no associated Form 1098-T. We have examined a number of these claims in FY 2011, and plan to examine additional cases meeting these same criteria in FY 2012. If it is determined that the DOE database information is feasible to use, we will consider adding it to our process.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

The Commissioner, Wage and Investment Division, should:

**RECOMMENDATION 7**

Develop a process to identify and notify educational institutions that are preparing inaccurate Forms 1098-T.

**CORRECTIVE ACTION**

We agree with this recommendation. We have initiated steps to systemically identify and reject documents using incorrect coding on Forms 1098-T for TY 2011. We will also conduct additional research to determine if we can accurately identify educational institutions that are preparing inaccurate Forms 1098-T and then determine the appropriate treatment.

**IMPLEMENTATION DATE**

December 15, 2012



Billions of Dollars in Education Credits Appear to Be Erroneous



**RESPONSIBLE OFFICIAL**

Director, Electronic Products and Services Support, Wage and Investment Division  
Director, Earned Income Tax Credit, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 8**

\*\*\*\*\*2(f)\*\*\*\*\*  
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**CORRECTIVE ACTION:**

\*\*\*\*\*2(f)\*\*\*\*\*  
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**IMPLEMENTATION DATE**

October 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

The Commissioner, Wage and Investment Division, should:

**RECOMMENDATION 9**

Develop processes to identify ineligible taxpayers erroneously claiming education credits including identifying taxpayers claiming a student allowed as a dependent on another's tax return and prisoners erroneously receiving education credits.

**CORRECTIVE ACTION:**

We agree with this recommendation. We have a process in place to identify taxpayers erroneously claiming education credits, and will consider them for either soft notice or audit treatment. We will re-evaluate the process to ensure it is identifying all potential non-compliant taxpayers.



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**IMPLEMENTATION DATE**

October 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 10**

Develop a recovery program to review the tax returns of the 63,963 taxpayers claiming a student who was claimed as a dependent on another tax return and prisoners erroneously receiving education credits.

**CORRECTIVE ACTION**

We agree with this recommendation. The 250 prisoners identified by TIGTA as having received refunds due to inappropriate claims for the AOTC will be subject to post-refund examination during FY 2012. The remaining 63,713 individuals identified will be considered for treatment in Compliance with either a soft notice or examination.

**IMPLEMENTATION DATE**

October 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division  
Director, Earned Income Tax Credit, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**LEGISLATIVE RECOMMENDATION**

**RECOMMENDATION 11**

Coordinate with the Office of Tax Policy to determine whether legislation is needed to clarify whether refundable tax credits, such as the AOTC, are Federal benefits as defined in the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 and thus may be claimed only for students with a valid SSN and, if these credits may not be paid, to provide the IRS with math error authority to disallow claims for these credits.





*Billions of Dollars in Education Credits  
Appear to Be Erroneous*



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**CORRECTIVE ACTION**

We will discuss with the Department of Treasury's Office of Tax Policy their views of the current state of the law regarding the eligibility for the AOTC.

**IMPLEMENTATION DATE**

October 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Earned Income Tax Credit, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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