



*Billions of Dollars in Potentially Erroneous  
Education Credits Continue to Be Claimed for  
Ineligible Students and Institutions*

**March 27, 2015**

**Reference Number: 2015-40-027**

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

**Redaction Legend:**

1 = Tax Return/Return Information

2 = Risk Circumvention of Agency Regulation or Statute

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## HIGHLIGHTS

### **BILLIONS OF DOLLARS IN POTENTIALLY ERRONEOUS EDUCATION CREDITS CONTINUE TO BE CLAIMED FOR INELIGIBLE STUDENTS AND INSTITUTIONS**

## Highlights

### **Final Report issued on March 27, 2015**

Highlights of Reference Number: 2015-40-027 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

### **IMPACT ON TAXPAYERS**

The Taxpayer Relief Act of 1997 created two permanent education tax credits, the Hope Credit and Lifetime Learning Credit. The American Recovery and Reinvestment Act of 2009 temporarily replaced the Hope Credit with a refundable tax credit known as the American Opportunity Tax Credit (AOTC). The AOTC was initially set to expire at the end of Calendar Year 2010 but has since been extended through Calendar Year 2017. These credits help taxpayers offset the costs of higher education.

### **WHY TIGTA DID THE AUDIT**

Prior TIGTA audits have reported that taxpayers have claimed billions of dollars of erroneous education credits. TIGTA has made a number of recommendations to the IRS to help reduce the number of these erroneous claims. This audit was initiated to assess the IRS's efforts to improve the detection and prevention of questionable education credit claims.

### **WHAT TIGTA FOUND**

The IRS still does not have effective processes to identify erroneous claims for education credits. Although the IRS has taken steps to address some of our recommendations, many of the deficiencies TIGTA previously identified still exist. As a result, taxpayers continue to receive billions of dollars in potentially erroneous education credits. Based on our analysis of education credits claimed and received on Tax Year 2012 tax returns, TIGTA estimates that more than 3.6 million taxpayers (claiming more

than 3.8 million students) received more than \$5.6 billion in potentially erroneous education credits (\$2.5 billion in refundable credits and \$3.1 billion in nonrefundable credits). Specifically, TIGTA estimates:

- More than 2 million taxpayers received more than \$3.2 billion in education credits for students with no Form 1098-T, *Tuition Statement*.
- More than 1.6 million taxpayers received approximately \$2.5 billion in education credits for students attending ineligible institutions.
- 419,827 taxpayers received more than \$650 million for students who were used to claim the AOTC for more than four tax years.
- 427,345 taxpayers received approximately \$662 million in AOTCs for students who attended school less than half-time.

Further analysis of the more than 3.6 million taxpayers TIGTA identified as claiming education credits for ineligible students or ineligible institutions showed that 765,943 (21 percent) claimed both a student for which the IRS has no Form 1098-T and listed an ineligible institution on their Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*.

### **WHAT TIGTA RECOMMENDED**

TIGTA made five recommendations to the IRS to improve the detection and prevention of erroneous education credit claims, including that the IRS work with the Department of the Treasury to consider a legislative proposal to move the required filing date for Forms 1098-T to January 31 so that this information can be used at the time tax returns are processed to help identify improper education credit claims.

The IRS agreed to implement two of the recommendations but did not agree to implement the other three. TIGTA notes its concern with the IRS's response to the recommendations in the report.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 27, 2015

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

**FROM:**

Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions (Audit # 201440015)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) efforts to improve the detection and prevention of questionable education credit claims. This audit was included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper Payments.

In response to our report, management did not agree that the IRS does not have effective processes to identify erroneous education credit claims. While the IRS has developed processes to identify erroneous education credit claims, as shown in Figure 9 of our report, those processes only identified 50 percent of the more than 3.6 million questionable education credit claims we identified during our review. As such, we believe the conclusion is accurate that the IRS's processes are not effective in identifying erroneous education credit claims.

As it relates to the use of IRS examination results to refine our estimates, the IRS noted that the population of returns it selects for audit is biased toward those with a higher probability for errors than would be found in the general population. While that is true, it is important to note that the returns we identified also have a higher probability for errors than those in the general population. Our estimates and outcome measures are based on education credit claims that have the same characteristics as claims the IRS has confirmed are erroneous. We make clear in the report that the actual amount is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS. 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 or Russell P. Martin, Acting Assistant



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Inspector General for Audit (Returns Processing and Account Services) at (978) 809-0296 if you have questions.



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*Abbreviations*

AOTC	American Opportunity Tax Credit
EIN	Employer Identification Number
IRS	Internal Revenue Service
PEPS	Postsecondary Education Participants System
TIGTA	Treasury Inspector General for Tax Administration

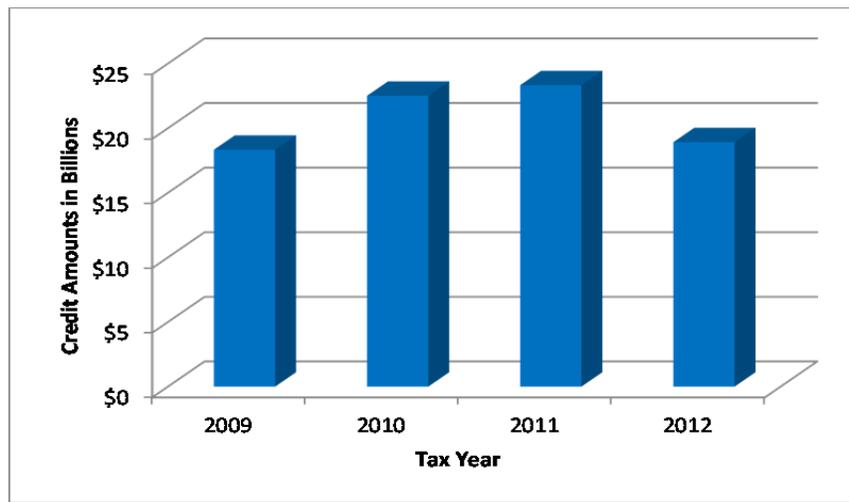


## *Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

### *Background*

Education tax credits help taxpayers offset the costs of higher education and have become an increasingly important component of Federal higher education policy. The amount of education credits individuals claim each year has increased from more than \$3 billion for Tax Year 1998 to almost \$19 billion for Tax Year 2012.<sup>1</sup> Figure 1 shows the amount of education credits taxpayers<sup>2</sup> claimed for Tax Years 2009 through 2012.

**Figure 1: Education Credits Claimed for Tax Years 2009 Through 2012**



*Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the Internal Revenue Service (IRS) Return Transaction File for Tax Years 2009 through 2012 as of April 9, 2014.*

The Taxpayer Relief Act of 1997<sup>3</sup> created two permanent education tax credits, the Hope Credit and the Lifetime Learning Credit. The American Recovery and Reinvestment Act of 2009<sup>4</sup> temporarily replaced the Hope Credit with a refundable tax credit<sup>5</sup> known as the American Opportunity Tax Credit (AOTC). The AOTC was initially set to expire at the end of Calendar Year 2010 but has since been extended through Calendar Year 2017.

<sup>1</sup> The IRS attributes the fluctuation of claims for education credits to the increases/declines in college enrollment.

<sup>2</sup> This report uses the term "taxpayers" in lieu of "taxpayer accounts." Therefore, married taxpayers who file one return together are counted as one taxpayer for the purposes of this report.

<sup>3</sup> Pub. L. No. 105-34, 111 Stat. 788.

<sup>4</sup> Pub. L. No. 111-5, 123 Stat. 115.

<sup>5</sup> A refundable credit is not limited to the amount of an individual's tax liability and can result in a Federal tax refund that is larger than the amount of a person's Federal income tax withholding for that year. In contrast, a nonrefundable credit can only reduce the tax liability to zero.



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**Education credit eligibility requirements**

Taxpayers claim education credits using Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*, and attach it to their Form 1040, *U.S. Individual Income Tax Return*. To be eligible to receive an education credit, an individual must be a U.S. citizen, U.S. resident, or resident alien and must attend a postsecondary educational institution or vocational training program (herein referred to collectively as educational institutions). Individuals can claim an education credit for qualified education expenses paid to any domestic or foreign postsecondary educational institution or training program that is certified to receive Federal student aid funding from the U.S. Department of Education (referred to as an eligible institution). In addition, individuals cannot claim both the AOTC and the Lifetime Learning Credit for the same student in the same tax year. If a student is eligible for both the AOTC and the Lifetime Learning Credit, individuals can choose which credit to claim. Figure 2 compares the benefits and requirements of the two education tax credits.

**Figure 2: Comparison of AOTC and Lifetime Learning Credit Benefits and Requirements for Tax Year 2012**

	<b>AOTC</b>	<b>Lifetime Learning Credit</b>
<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 of qualified expenses.	Up to \$2,000 per return – 20% of the first \$10,000 of qualified expenses paid for all eligible students.
<b>Refundability</b>	The first 40% of the qualified expenses is refundable, up to \$1,000. The remaining is nonrefundable.	Nonrefundable – the credit is limited to the amount of tax paid/owed.
<b>Availability</b>	Available ONLY for the first four tax years of postsecondary education (including any year(s) the Hope Credit was received).	Available for an unlimited number of years.
<b>Degree Program Required</b>	Student must be pursuing a program leading to a degree or other recognized education credential and enrolled at least half-time for at least one academic period during the year.	Student does not need to be pursuing a program leading to a degree or other recognized education credential. Student may be enrolled in one or more courses.
<b>Qualifying Expenses</b>	Tuition, required enrollment fees, and course-related materials, whether or not the materials are bought at the educational institution.	Tuition and enrollment fees including amounts required to be paid to the institution for course-related books, supplies, and equipment.
<b>Adjusted Gross Income Limits</b>	\$80,000 – \$90,000 for single or head of household and \$160,000 – \$180,000 for married filing jointly.	\$52,000 – \$62,000 for single or head of household and \$104,000 – \$124,000 for married filing jointly.
<b>Qualifying Educational Institution</b>	Any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.	Any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Source: Publication 970, *IRS Tax Benefits for Education*.



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**Prior TIGTA report raised concerns with IRS efforts to identify and prevent erroneous education credit claims**

In September 2011,<sup>6</sup> we reported that the IRS does not have effective processes to identify taxpayers who claim erroneous education credits; 2.1 million taxpayers received a total of \$3.2 billion in education credits (\$1.6 billion in refundable credits and \$1.6 billion in nonrefundable credits) that appeared to be erroneous. Figure 3 provides the number of taxpayers who received potentially erroneous education credits and the amount of credits received as of May 28, 2010.

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

Erroneous Education Credit Ineligibility Classification	Taxpayers Receiving Erroneous Credits	Claims Prepared by a Tax Return Preparer		Amount of Erroneous Credits
		Number	Percentage	
<b>Students Who Did Not Attend an Educational Institution</b>	1,700,653	1,079,714	63%	<b>\$2.57 billion (Potential)</b>
<b>Students Who Attended Less Than Half-Time or Were Graduate Students<sup>7</sup></b>	361,467	N/A	N/A	<b>\$550 million (Projected)</b>
<b>Students Allowed As Dependents on Another Taxpayer's Tax Return</b>	63,713	32,478	51%	<b>\$88.4 million (Actual)</b>
<b>Prisoners (Incarcerated All Year) Claiming Dependent Students</b>	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.

Appendix V provides a summary of the TIGTA audit recommendations included in our September 2011 report and actions taken by the IRS in response.

This review was performed with information obtained from the Wage and Investment Division office in Atlanta, Georgia, and the Small Business/Self-Employed Division office in Lanham, Maryland, during the period November 2013 through November 2014. We conducted this performance audit in accordance with generally accepted government auditing standards.

<sup>6</sup> TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 2011).

<sup>7</sup> Generally, graduate students do not qualify for the AOTC unless they have not completed the first four years of postsecondary education and they have not previously claimed the AOTC or Hope Credit for four tax years.



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Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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## *Results of Review*

The IRS does not have effective processes to identify erroneous claims for education credits. Although the IRS has taken steps to address some of our recommendations to improve the identification and prevention of erroneous education credit claims, many of the deficiencies we previously identified still exist. Based on our analysis of education credits claimed and received on Tax Year 2012 tax returns, we estimate more than 3.6 million taxpayers (claiming more than 3.8 million students) received more than \$5.6 billion (\$2.5 billion in refundable credits and \$3.1 billion in nonrefundable credits) in potentially erroneous education credits.<sup>8</sup> Figure 4 provides the number of taxpayers we estimate received potentially erroneous education credits for Tax Year 2012. Previously reported deficiencies are marked with an asterisk (\*).

**Figure 4: Estimated Potentially Erroneous Education Credits Received for Tax Year 2012<sup>9</sup>**

<b>Erroneous Education Credit Ineligibility Student Classification</b>	<b>Number of Students</b>	<b>Number of Tax Returns</b>	<b>Amount of Erroneous Credit<sup>10</sup></b>
<b>No Form 1098-T<sup>*11</sup></b>	2,219,763	2,094,162	<b>\$3.2 billion (Potential)</b>
<i>Unlikely Age*</i>	43,800	39,763	61.6 million (Potential)
<i>Full-Time Prisoner*</i>	3,576	3,500	5.4 million (Potential)
<b>Did Not Attend an Eligible Educational Institution</b>	893,767	844,718	<b>\$1.3 billion (Potential)</b>
<b>Received the AOTC for More Than Four Tax Years*</b>	319,069	319,069	<b>\$494.2 million (Projected)</b>
<b>Received the AOTC But Attended Less Than Half-Time*</b>	379,396	363,634	<b>\$563.2 million (Potential)</b>
<b>TOTAL</b>	<b>3,811,995</b>	<b>3,621,583</b>	<b>\$5.6 billion</b>

Source: TIGTA analysis of Tax Year 2012 education credits received as of December 31, 2013.

<sup>8</sup> The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

<sup>9</sup> Taxpayers meeting conditions in multiple categories are only counted once and are included in the order of the categories presented in Figure 4.

<sup>10</sup> Dollar amounts are computed using an average education credit amount received per tax return.

<sup>11</sup> Of the more than 2.2 million students we identified with no Form 1098-T, *Tuition Statement*, 43,800 are students of an unlikely age and 3,576 are incarcerated students.



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**Many of the Tax Returns With Questionable Education Credit Claims Are Prepared by Paid Tax Return Preparers**

Paid tax return preparers continue to prepare a significant number of returns with questionable education credit claims. More than 1.7 million (49 percent)<sup>12</sup> of the 3.6 million taxpayers with questionable education credit claims we identified were prepared by a tax return preparer. The potentially erroneous claims associated with these 1.7 million taxpayers totaled more than \$2.7 billion. This is similar to the percentage we have reported previously. In September 2011,<sup>13</sup> we reported that 1.1 million (52 percent) of the 2.1 million taxpayers who received questionable education credits as of May 28, 2010, had their tax return prepared by a tax return preparer.<sup>14</sup> The potentially erroneous education credits received by these 1.1 million taxpayers exceeded \$1.6 billion. Figure 5 shows that further analysis of the Tax Year 2012 tax returns identified tax return preparers who prepared large volumes of returns with erroneous education credit claims.

**Figure 5: Tax Return Preparers Associated With Potentially Erroneous Education Credits – Tax Year 2012**

Range of Tax Returns Prepared With Erroneous Education Credits	Number of Tax Return Preparers	Number of Tax Returns Prepared	Amount of Erroneous Education Credits
999 or More Tax Returns	25	38,097	\$59.0 million
499 to 998 Tax Returns	66	43,030	\$66.6 million
99 to 498 Tax Returns	1,545	282,840	\$438.1 million
Less Than 99 Tax Returns	288,299	1,396,677	\$2.2 billion
<b>Total Identifiable Prepared Tax Returns</b>	<b>289,935</b>	<b>1,760,644</b>	<b>\$2.7 billion</b>

Source: TIGTA analysis of Tax Year 2012 education credits received as of December 31, 2013.

In September 2011, we reported that the IRS had developed a comprehensive enforcement strategy to increase tax return preparer compliance. As part of this strategy, the IRS planned to increase the coordination among its operating divisions and increase staffing in the Office of Professional Responsibility to allow for increased investigation of practitioners and preparers. The IRS believed its efforts would result in decreased fraud and a decreased improper payment rate.

<sup>12</sup> This figure does not include the tax returns on which students were claimed for the AOTC for more than four years. We did not include these estimated tax returns because tax return preparers may not have known the student was used to previously claim the AOTC.

<sup>13</sup> TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 2011).

<sup>14</sup> Direct comparisons of the two years are invalid because our analysis included different segments of questionable claims.



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In addition, the IRS indicated that in March 2013, the IRS started identifying questionable AOTC claims prepared by tax return preparers for its Automated Questionable Credit Program.<sup>15</sup> For those tax returns identified, the IRS freezes the portion of the refund related to the AOTC and initiates correspondence with the taxpayer to obtain documentation supporting the claim. If documentation is not provided, the AOTC is not released and an examination is opened. The IRS stated that it opened 310 examinations and as of December 2014 had closed 181 cases generating more than \$170,000 in additional tax assessments.

Finally, the IRS stated that prior to the start of the 2014 Filing Season, it sent educational letters to approximately 1,000 tax return preparers to alert them that they had filed AOTC claims that appeared to be erroneous, remind them of their responsibilities as tax return preparers, and direct them to additional information. The IRS indicated that these tax return preparers' filing patterns and compliance with future AOTC claims will be tracked to determine if compliance has improved.

### ***Taxpayers Continue to Claim Education Credits for Ineligible Students and Ineligible Educational Institutions***

The IRS has yet to establish effective processes to identify taxpayers who claim erroneous education credits for students who did not attend an eligible institution or who did not attend for the required period of time. Our analysis of Tax Year 2012 tax returns identified the following education credit claims that appear to be erroneous based on IRS records:

- More than 2 million taxpayers (claiming more than 2.2 million students) who received education credits totaling more than \$3.2 billion with no Form 1098-T filed with the IRS by a postsecondary educational institution for the student claimed.<sup>16</sup>
- More than 1.6 million taxpayers (claiming nearly 1.7 million students) who received education credits totaling approximately \$2.5 billion for which Department of Education data show the educational institution listed on the Form 8863 was not certified to receive Federal student aid funding, *i.e.* not an eligible educational institution. To qualify for an education credit, students must attend a postsecondary educational institution that is certified by the Department of Education to receive Federal student aid funding.
- 427,345 taxpayers (claiming 431,622 students) who received AOTCs totaling approximately \$662 million for students who, based on Forms 1098-T, did not attend

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<sup>15</sup> The Automated Questionable Credit Program is a prerefund treatment process to cover more credits and under-tolerance refunds.

<sup>16</sup> Our analysis included all Tax Year 2012 Forms 1098-T (28.2 million) provided to the IRS by February 14, 2014, to ensure that the IRS had sufficient time to receive the forms from the education institutions. Tax Year 2012 Forms 1098-T were generally required to be submitted to the IRS from the educational institution by April 1, 2013.

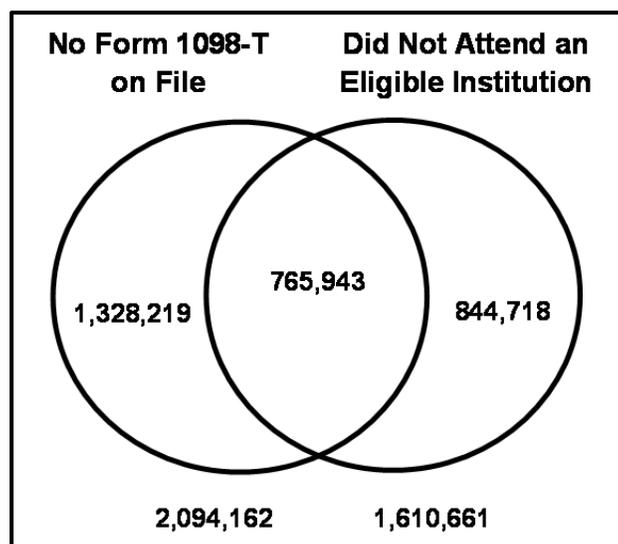


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school at least half-time as required.<sup>17</sup> Students must attend an eligible institution at least half-time to qualify for the AOTC.

Further analysis of the more than 3.6 million taxpayers we identified showed that 765,943 (21 percent) claimed both a student for which the IRS received no Form 1098-T and listed an ineligible institution on their Form 8863. Figure 6 shows the results of our analysis of taxpayers who received education credits for students with no Form 1098-T or who attended an ineligible institution.

**Figure 6: Analysis of Taxpayers Receiving Education Credits for Students With No Form 1098-T or Who Did Not Attend an Eligible Institution – Tax Year 2012**



Source: TIGTA analysis of Tax Year 2012 education credits received as of December 31, 2013.

**Form 1098-T is not available at the time tax returns are filed and processed**

Educational institutions are required to provide a Form 1098-T to students who attend their institution and file a copy of Form 1098-T with the IRS. The Form 1098-T provides the name and Employer Identification Number (EIN) of the institution, the name and Taxpayer Identification Number of the student who attended, and information on whether the student attended half-time or was a graduate student. Figure 7 provides an example of the Form 1098-T.

<sup>17</sup> It is possible for students to have multiple Forms 1098-T with the total equaling “at least half-time.”



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**Figure 7: Example of Form 1098-T**

<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED				<b>Tuition Statement</b>	
FILER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number		1 Payments received for qualified tuition and related expenses	OMB No. 1545-1574  <span style="font-size: 2em;"><b>2013</b></span>  Form <b>1098-T</b>		
		2 Amounts billed for qualified tuition and related expenses			
FILER'S federal identification no.	STUDENT'S social security number	3 Check if you have changed your reporting method for 2013 <input type="checkbox"/>		<b>Copy C For Filer</b>  For Privacy Act and Paperwork Reduction Act Notice, see the <b>2013 General Instructions for Certain Information Returns.</b>	
STUDENT'S name		4 Adjustments made for a prior year	5 Scholarships or grants		
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year	7 Check this box if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2014 <input type="checkbox"/>		
City or town, province or state, country, and ZIP or foreign postal code		9 Check if a graduate student <input type="checkbox"/>	10 Ins. contract reimb./refund		
Service Provider/Acct. No. (see instr.)	8 Check if at least half-time student <input type="checkbox"/>				
Form <b>1098-T</b>		www.irs.gov/form1098t		Department of the Treasury - Internal Revenue Service	

Source: IRS.gov website.

The IRS can use the Form 1098-T to verify that a student claiming an education credit attended an eligible educational institution or attended for the required period of time. However, these forms are not available at the time tax returns are filed. As such, the IRS is unable to use this information to identify potentially erroneous claims when tax returns are processed. Institutions are generally required to provide Forms 1098-T to the IRS by March 31 each year,<sup>18</sup> which is after many individuals have already filed their individual income tax return.<sup>19</sup>

**Based on IRS examinations, no Form 1098-T and no evidence of attendance at an educational institution at least half-time are strong indicators of erroneous claims**

We previously recommended that the IRS establish processes to identify taxpayers who claimed education credits for students for whom the IRS has not received a Form 1098-T.<sup>20</sup> The IRS has implemented post-processing initiatives in an effort to identify and examine tax returns with education credit claims that are not supported by a Form 1098-T. For example:

- We identified nearly 2.1 million taxpayers who received education credits for Tax Year 2012 for students without a Form 1098-T. The IRS selected 605 of these tax returns for examination. As of September 11, 2014, the IRS had closed 559 examinations with a

<sup>18</sup> Electronically filed Forms 1098-T are required to be filed by March 31 of each year. Paper Forms 1098-T are required to be filed with the IRS generally no later than February 28 of each year.

<sup>19</sup> Most individuals are required to file their individual income tax return no later than April 15 each year.

<sup>20</sup> TIGTA, Ref. No. 2010-40-123, *Many Taxpayers Who Were Not Eligible Received Additional Education Credits Intended for Those Attending Schools in Midwestern Disaster Areas* (Sept. 2010) and TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 2011).



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change rate of 59 percent. These examinations resulted in additional assessments of more than \$1.3 million.

- We identified 427,345 taxpayers who received the AOTC for Tax Year 2012 for students who attended an educational institution less than half-time. Between October 1, 2013, and September 11, 2014, the IRS selected 1,191 of these tax returns for examination. The IRS closed 112 examinations and made adjustments to 84 cases (75 percent change rate) totaling \$409,604.

**Third-party information is available that could be used to verify student and educational institution eligibility at the time tax returns are filed**

Receipt of the Forms 1098-T before tax returns are processed so that information can be used during processing would be the most effective means by which the IRS could identify potentially erroneous education credit claims. Nonetheless, discussions with the Department of Education identified that they maintain database files that could be used by the IRS at the time tax returns are filed to verify education credit claims. For example, the Department of Education maintains the Postsecondary Education Participants System (PEPS) database. This database could be used by the IRS to identify taxpayers who claim an ineligible educational institution. The database includes all eligible educational institutions that receive Federal student aid funding (Title IV certified institutions). The database is updated weekly and contains the IRS-issued EIN for each educational institution. This database is currently available to the public, and the Department of Education indicated to us its willingness to work with the IRS to provide the database in a useable format.

In response to recommendations we made in our September 2011 report, the IRS worked with the Department of Education to discuss the feasibility of using the Integrated Postsecondary Education Data System<sup>21</sup> and the National Student Loan Data System<sup>22</sup> to verify that students attended a postsecondary educational institution. The IRS determined that these databases would not result in a reliable verification of students' attendance in part because the databases did not include the educational institution's EIN. Without the EIN, it would be difficult for the IRS to perform computerized matches to information listed on tax returns at the time they are processed.

However, in its discussions with the Department of Education, the IRS did not explore the feasibility of using other database files they maintain, *i.e.*, the PEPS, to identify ineligible institutions used to claim education credits. The Integrated Postsecondary Education Data System that the IRS researched is a subset of the PEPS database and does not contain all of the data included in the PEPS. We found that the PEPS database includes the educational institution's EIN and could be used by the IRS to substantiate that the institutions listed on Forms 8863 are eligible to receive Federal student aid funding from the Department of

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<sup>21</sup> A database file that includes all educational institutions that participate in the Federal Student Financial Aid Program (Title IV certified institutions).

<sup>22</sup> A database file that contains information on all students who receive a student loan and/or grant.



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Education. In fact, we used the PEPS database to identify ineligible institutions reported on Forms 8863 for taxpayers claiming education credits on their Tax Year 2012 tax returns.

## **Recommendations**

The Commissioner, Wage and Investment Division, should:

**Recommendation 1:** Coordinate with the Department of Education to determine the feasibility of using Department of Education data, including but not limited to the PEPS database, to verify the eligibility of educational institutions shown on tax returns for the purposes of claiming education credits. Coordination efforts should include an assessment of the reliability and sufficiency of the data available.

**Management's Response:** The IRS disagreed with this recommendation. The IRS stated that it cannot use third-party information to correct a tax return during processing under existing statutory authority. Without the authority to address the use of ineligible institutions when claiming education credits during return processing, appreciable gains over current treatment options that require they follow deficiency procedures could not be achieved. The IRS agrees that the PEPS database has the potential to be a useful tool in addressing erroneous claims for education credits and, in the event expanded authority is granted to permit the use of third-party data during return processing, the IRS would be interested in discussing its use with the Department of Education. At this time, however, the IRS does not intend to act on the recommendation.

**Office of Audit Comment:** While the IRS does not have statutory authority to use third-party information to correct tax returns during processing, it may use this data during tax return processing to improve the identification of questionable claims for examination, including prerefund examination. Improving the IRS's ability to identify education credit claims that are most likely to be erroneous will help ensure that the IRS is effectively using its limited resources. For example, our use of Department of Education data identified 765,943 of the more than 2 million education credit claims for which the IRS had not received a Form 1098-T and the institution provided on the Form 8863 was an ineligible institution, thus increasing the likelihood that these claims are erroneous. The IRS also stated that use of Department of Education data to identify ineligible institutions would not result in "appreciable gains" over current treatment options. However, the IRS has advised us that it has not performed any analysis to support this claim.

**Recommendation 2:** If the IRS determines external data are sufficiently reliable, develop processes to verify education credit claims at the time tax returns are processed.

**Management's Response:** The IRS disagreed with this recommendation. The IRS stated that processes are already in place to use some external data in addressing questionable items on tax returns at the time of processing. The applicable treatment



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stream is determined by the statutory authority available to the IRS, the availability of resources, and the allocation of those limited resources to address compliance issues as effectively as possible. The IRS does not have the authority to use third-party data for verification of education credit claims at the time tax returns are processed. Instead, questionable claims are addressed through deficiency procedures, which may be used in a prerefund environment; however, that treatment is subject to the availability of limited resources.

**Office of Audit Comment:** As previously discussed, the IRS may use third-party data to improve its identification of questionable education credit claims for examination, including pre-refund examination, thus ensuring its limited resources are used effectively.

### ***Legislative Recommendation***

**Legislative Recommendation 3:** Coordinate with the Department of Treasury Office of Tax Policy to consider a legislative proposal to move the required filing date for Forms 1098-T to January 31 so that this information can be used at the time tax returns are processed to help identify improper education credit claims.

**Management's Response:** The IRS agreed with this recommendation. The IRS indicated a legislative proposal was submitted with the administration's Fiscal Years 2015 and 2016 budget requests, proposing that the filing date for information returns, with limited exceptions, would be established as January 31. The most recent proposed change would be effective upon enactment and include Form 1098-T.

### ***Erroneous American Opportunity Tax Credits Are Being Allowed for Students Claimed for More Than Four Years***

Analysis of tax return filings between Tax Years 2007 and 2013 identified 1.1 million students for which the AOTC was claimed for more than four years. Our review of a statistically valid sample of 139 of the 1.1 million students identified that 130 (94 percent) students were erroneously claimed for the AOTC.<sup>23</sup> Based on the results of our sample, we estimate that more than 1 million (94 percent) of the more than 1.1 million students we identified were used to receive potentially erroneous AOTCs totaling nearly \$1.7 billion.<sup>24</sup> Specifically, each of these students were claimed in excess of the four-year limit between Tax Years 2007 and 2013. For Tax Year 2012 alone, we estimate that 419,827 students who had already been claimed in four

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<sup>23</sup> We selected the sample using a 95 percent confidence level, a  $\pm 5$  percent precision, and a 10 percent estimated error rate.

<sup>24</sup> The projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that between 1,043,635 and 1,139,466 taxpayers received potentially erroneous AOTC totaling between \$1,616,486,252 and \$1,764,918,887 for Tax Year 2007 through Tax Year 2013.



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previous tax years were used to receive potentially erroneous AOTCs totaling more than \$650 million.<sup>25</sup>

Requirements state that the allowable four-year period for which taxpayers can claim the AOTC for any one student includes any previous claims for the Hope Credit and applies to any four tax years; the tax years do not need to be consecutive. Therefore, if a student was claimed for the AOTC or Hope Credit in any four prior tax years, the student cannot be used by any taxpayer to claim the credit a fifth time.

Previously, individuals could claim the Hope Credit for only two tax years per student. In September 2009,<sup>26</sup> we reported that 168,347 students had received the Hope Credit for more than the allowable two years and recommended that the IRS pursue math error authority to systemically deny claims that exceed the statutory limit. As of the date of this report, expanded authority has not been granted.

**In response to TIGTA concerns, the IRS established processes to identify taxpayers who claim the AOTC for the same student for more than four nonconsecutive tax years**

IRS examination filters in place at the time of our analysis identified taxpayers who claimed the AOTC for more than four *consecutive* tax years. However, the processes did not identify students<sup>27</sup> who are claimed for the AOTC or identify AOTC claimed for more than four *nonconsecutive* tax years. Of the 130 AOTC claims we identified as being erroneous, 37 (28 percent) tax returns with claims totaling \$73,436 involved claims for the same student filed in more than four *nonconsecutive* years.

In June 2014, the IRS confirmed that its examination selection filters identified taxpayers who claimed the AOTC for more than four tax years rather than identifying the students who were claimed. In addition, the IRS confirmed its filters did not identify students who were previously claimed in four *nonconsecutive* tax years. Subsequent to our discussion with the IRS, the IRS revised the examination selection filters to identify tax returns on which a student was used to claim the AOTC for more than four tax years, including those claimed in four *nonconsecutive* years.

According to the IRS, as of December 2014, the revised examination filters identified more than 426,000 Tax Year 2012 returns which contain AOTC claims in excess of four years both *consecutive* and *nonconsecutive* per student. We estimate that of the 426,000 tax returns that the

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<sup>25</sup> The projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that between 326,380 and 513,273 taxpayers received potentially erroneous AOTCs totaling \$505,529,982 and \$795,008,550 for Tax Year 2012. Our projection includes those students for whom the IRS has not received a Form 1098-T for Tax Year 2012.

<sup>26</sup> TIGTA, Ref. No. 2009-30-141, *Improvements Are Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions* (Sept. 2009).

<sup>27</sup> The qualifying student may or may not be the individual filing the tax return.



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revised filters identified, more than 300,000 tax returns claiming more than \$481 million in potentially erroneous AOTC would not have been identified for examination consideration if the IRS had not revised its examination selection filters.<sup>28</sup>

In addition, we found that the limitations in the IRS’s original examination filters resulted in unreliable examination results. For example, the IRS indicated that it selected 3,530 Tax Year 2012 returns with AOTC claims in excess of four tax years for examination and had closed 1,712 examinations as of November 6, 2014, \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*<sup>29</sup>\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*. Because the IRS’s original examination filters identified taxpayers who claimed the AOTC for more than four consecutive tax years (rather than the students who were claimed), the filters incorrectly identified AOTC claims that had not exceeded the four-year limit per student, thus lowering the examination change rate.

As previously mentioned, the IRS continues to request the authority to systemically deny AOTC claims that exceed the four-year limit; however, this authority still has not been granted. As such, the IRS must examine the tax returns it identifies. In addition, the number of tax returns the IRS can examine is limited to available resources. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* Although the availability of resources affects the number of tax returns the IRS can examine, the IRS can do more to prevent the allowance of AOTC claims in excess of four tax years per student. Currently, the IRS examines AOTC claims that appear to exceed the four-year limit after tax returns are processed and refunds are paid. However, the IRS could use its Automated Questionable Credit Program to identify and prevent the issuance of AOTC claims when the student has exceeded the four-year limit. The Automated Questionable Credit Program uses tax return filters to identify questionable tax credit claims for potential examination before the tax refund is paid.

**Recommendation**

**Recommendation 4:** The Commissioner, Wage and Investment Division, should establish Automated Questionable Credit Program filters to identify tax returns on which the student claimed has already exceeded the four-year AOTC limit for prerefund treatment.

<sup>28</sup> The projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that between 224,615 and 396,729 taxpayers received potentially erroneous AOTCs totaling between \$347,906,174 and \$614,493,548 for Tax Year 2007 through Tax Year 2013.

<sup>29</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. We used a judgmental sample to verify the accuracy of the IRS’s reported examination change rate. We did not intend to project the results of our analysis to the population of examinations the IRS performed.



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**Management's Response:** The IRS disagreed with this recommendation. The IRS stated that in cases in which students are not eligible for the AOTC because they have already claimed it for the maximum number of four years, they could be eligible for the Lifetime Learning Credit. According to the IRS, the variable outcomes that could result from denying the AOTC and considering the effect of the Lifetime Learning Credit, on a case-by-case basis, puts this issue beyond the scope of the Automated Questionable Credit Program. Processes are in place to evaluate the number of years for which students claimed the AOTC and direct those returns for further review.

**Office of Audit Comment:** Some taxpayers who exceed the AOTC lifetime limit may be eligible to receive the Lifetime Learning Credit. Nonetheless, the IRS should establish processes to address known abuse of the AOTC lifetime limit before tax refunds are paid regardless of whether these claims can be addressed in the IRS Automated Questionable Credit Program.

### ***Potentially Erroneous Education Credits Are Being Received for Students Who Are Incarcerated or of Unlikely Ages to Be Eligible***

The IRS has yet to establish effective processes to identify taxpayers who claim potentially erroneous education credits for students who are of an unlikely age to pursue postsecondary education or who are incarcerated. Our review identified:

- 39,763 taxpayers who received more than \$61.5 million in potentially erroneous education credits as of December 31, 2013, for 43,800 students who were under age 14 or over age 65. For each of these students, the IRS did not receive a Form 1098-T for the student being claimed.
- 2,148 taxpayers who received potentially erroneous education credits totaling approximately \$3.9 million for students who were incarcerated for all of Calendar Year 2012. For each of these students, the IRS did not receive a Form 1098-T for the student being claimed.

Education credit requirements do not require a student to be a specific age to qualify for an education credit, nor do they specify that a student must not be incarcerated. However, both conditions call into question the validity of a taxpayer's education credit claim. For example, students under the age of 14 or over the age of 65 are not likely to be attending a postsecondary educational institution. In addition, individuals who are incarcerated for a full calendar year are unlikely to meet the requirement that they be a taxpayer's dependent or incur qualifying educational expenses at an eligible educational institution.



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We previously raised concerns about the ages of the students claimed in TIGTA's 2013 Filing Season report issued in September 2013.<sup>30</sup> We reported that as of May 2, 2013, 42,961 taxpayers filing Tax Year 2012 returns received questionable education credits totaling approximately \$58.5 million for students under the age of 14 or over the age of 65. We last reported our concerns with incarcerated students in September 2011.<sup>31</sup> In the report, we identified 250 prisoners who received \$255,879 in questionable education credits.

***Incarcerated students who are listed as dependents are unlikely to meet education credit eligibility requirements***

In September 2011, we reported that the IRS had paid \$255,879 in education credits for 250 students who were incarcerated. As stated previously, the education eligibility criteria do not state that a student must not be incarcerated. However, we believe students who are incarcerated for a full calendar year for which education credits are claimed are highly questionable.

The IRS agrees that it is highly questionable that a full-time prisoner could have incurred qualified education expenses. The IRS has processes in place to identify potentially fraudulent tax returns filed by prisoners, including tax returns that claim education credits. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*. Our analysis of Tax Year 2012 tax returns identified 3,500 tax returns with an education credit claim \*\*\*\*\*2\*\*\*\*\*  
\*\*\*2\*\*\*\*\*. The IRS identified and examined 1,352 of the returns we identified as a result of its processing criteria. However, IRS processes did not identify the remaining 2,148 tax returns \*\*\*\*\*2\*\*\*\*\*. These 2,148 taxpayers received more than \$3.3 million in potentially erroneous education credits.

***Students who are of an age unlikely to be eligible for education credits also did not attend an eligible educational institution***

Additional analysis, which included contacting the Registrar Office at the educational institution listed on the tax return, of a statistically valid sample of 300 tax returns associated with the 43,800<sup>32</sup> students of an age unlikely to be eligible for an education credit identified:

- 123 (41 percent) tax returns for which our contact with the institution confirmed that the individual did not attend their institution.

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<sup>30</sup> TIGTA, Ref. No. 2013-40-124, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Sept. 2013).

<sup>31</sup> TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 2011).

<sup>32</sup> Our population included 22,603 students under age 14 and 21,197 students over age 65.



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- 112 (37 percent) tax returns listed an ineligible institution on Form 8863. For example, schools listed included preschools, elementary schools, junior high schools, and high schools.
- 65 (22 percent) tax returns for which the institution confirmed that the individual attended the institution (19 tax returns), declined to provide the requested information (28 tax returns), or was unable to timely respond to our requests (18 tax returns).

Figure 8 shows the results of our review of the statistical sample of 300 tax returns with education credit claims for students under age 14 or over age 65.

**Figure 8: Review of a Statistical Sample of Tax Year 2012 Education Credit Claims for Students Under Age 14 or Over Age 65**

<b>Students of Unlikely Ages</b>	<b>Under Age 14</b>	<b>Over Age 65</b>	<b>Total</b>
Number of Students Sampled	150	150	300
<b>Students Listing an Ineligible Institution</b>	<b>89</b>	<b>23</b>	<b>112</b>
<b>Students Listing an Eligible Institution</b>	<b>61</b>	<b>127</b>	<b>188</b>
<b>Confirmed Attendance</b>	<b>7</b>	<b>12</b>	<b>19</b>
Claimed Appropriate Credit	6	10	16
Did Not Claim Appropriate Credit <sup>33</sup>	***1***	***1***	3
<b>Confirmed Student Did Not Attend</b>	<b>41</b>	<b>82</b>	<b>123</b>
<b>Unable to Confirm Attendance<sup>34</sup></b>	<b>13</b>	<b>33</b>	<b>46</b>

Source: TIGTA analysis of Tax Year 2012 education credits received as of December 31, 2013.

The IRS agrees that the age of a student can be indicative of a potentially erroneous education credit claim. The IRS has developed filters to identify claims for students who are under the age of 15 and over the age of 75. Our analysis of the IRS's filters found that the filters would identify most of the tax returns we identified with the exception of those claiming students between the ages of 65 and 75.

<sup>33</sup> Three of the 19 students for which we were able to confirm attendance at the listed institution were incorrectly used to claim the AOTC and instead should have been used to claim the Lifetime Learning Credit.

<sup>34</sup> This includes 28 educational institutions that declined due to privacy concerns and 18 that did not timely respond to our requests.



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## **Recommendation**

**Recommendation 5:** The Commissioner, Wage and Investment Division, should modify existing filters used to identify erroneous education credit claims made by taxpayers to include all returns on which the students are prisoners and establish processes to identify and address such claims before the tax refunds are issued.

**Management's Response:** The IRS agreed with this recommendation. The IRS stated that a new prisoner filter was implemented for the 2015 Filing Season to identify dependent students used to claim the AOTC and are imprisoned. Returns identified by this filter are directed to the Automated Questionable Credit Program for treatment.

## ***Additional Compliance Tools Are Needed to Significantly Reduce the Payment of Erroneous Education Credit Claims***

In general, the IRS must audit most potentially erroneous education credit claims it identifies before it can adjust the claim, even when other data indicate the claim is likely erroneous. The IRS has developed various programs to identify potentially erroneous education credit claims including examination programs and an automated underreporter program that reviews AOTC claims with missing Forms 1098-T. However, these processes are primarily subsequent to the issuance of the refund. Furthermore, the IRS does not have the audit resources it needs to make any significant reduction in the loss of funds to the Government resulting from the paying of erroneous claims. For example, the IRS selected for examination approximately 0.5 percent (9,574 tax returns) of the more than 1.8 million questionable claims it identified for Tax Year 2012 with the conditions we identified in this report. Figure 9 shows the number of questionable education credit claims we identified and the number of tax returns the IRS examined by type for Tax Year 2012.



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**Figure 9: Number of IRS Examinations of Tax Year 2012 Questionable Education Credit Claims**

<b>Erroneous Education Credit Ineligibility Classification</b>	<b>Number of Tax Returns TIGTA Identified</b>	<b>Number of Tax Returns the IRS Identified</b>	<b>Tax Returns Selected for Examination</b>	<b>Tax Returns Examined and Closed</b>
<b>No Form 1098-T</b>	2,094,162	1,190,726	4,853	2,475
<i>Unlikely Age</i>	39,763	18,523	2,896	564
<i>Full-Time Prisoner</i>	3,500	1,352	1,352	1,352
<b>Did Not Attend an Eligible Educational Institution</b>	844,718	N/A	N/A	N/A
<b>Received the AOTC for More Than Four Tax Years</b>	319,069	426,427	3,530	1,712
<b>Received the AOTC But Attended Less Than Half-Time</b>	363,634	184,806	1,191	112
	<b>3,621,583</b>	<b>1,801,959</b>	<b>9,574</b>	<b>4,299</b>

Source: TIGTA analysis of Tax Year 2012 education credits received as of December 31, 2013.

The IRS has included a legislative proposal in its budget requests for Fiscal Years<sup>35</sup> 2013, 2014, and 2015 to obtain authority to disallow tax benefit claims when reliable third-party data indicate the claim is erroneous. This authority would enable the IRS to systemically deny all education credit claims for which third-party data show the claim is erroneous, adjust the tax return, and notify the taxpayer of the adjustment. In addition, the IRS's ability to detect and prevent erroneous education credit claims will continue to improve as it identifies additional sources of reliable third-party data with which to verify taxpayers' claims at the time tax returns are processed and prior to claims being paid.

<sup>35</sup> Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.



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## Appendix I

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

Our overall objective was to assess the IRS's efforts to improve the detection and prevention of questionable education credit claims. We conducted follow-up testing to evaluate the effectiveness of the IRS's actions to address recommendations made in five prior audit reports.<sup>1</sup> To accomplish our objective, we:

- I. Assessed the IRS's implementation of corrective actions to identify and prevent questionable education credit claims.
  - A. Obtained the results of the various initiatives, pilots, *etc.*, the IRS indicated it has taken in response to our prior recommendations, *e.g.*, examination results, number of notices issued, *etc.*
  - B. Identified 12,214,137 taxpayers<sup>2</sup> on the IRS Individual Return Transaction File<sup>3</sup> who claimed education credits for 13,351,478 students on Tax Year<sup>4</sup> 2012 returns. We verified the accuracy and reliability of the data obtained by comparing 30 tax returns to return information found on the Integrated Data Retrieval System.<sup>5</sup> The data were determined to be sufficiently reliable for the purposes of the audit.
  - C. Identified 1,167,119 students for which the AOTC was claimed for more than four tax years between Tax Year 2007 and Tax Year 2013.
    1. Selected and reviewed a statistically valid sample of 139 of the 1,167,119 students to determine the eligibility of the claims and project the results to the overall population. We reviewed a statistically valid sample because not all information needed to evaluate the eligibility of the claim was captured in our data extracts.

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<sup>1</sup> TIGTA, Ref. No. 2009-30-141, *Improvements Are Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions* (Sept. 2009); TIGTA, Ref. No. 2010-40-123, *Many Taxpayers Who Were Not Eligible Received Additional Education Credits Intended for Those Attending Schools in Midwestern Disaster Areas* (Sept. 2010); TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 2011); TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sept. 2012); and TIGTA, Ref. No. 2013-40-124, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Sept. 2013).

<sup>2</sup> This report uses the term "taxpayers" in lieu of "taxpayer accounts." Therefore, married taxpayers who file one return together are counted as "one taxpayer" for the purposes of this report.

<sup>3</sup> A database the IRS maintains that contains information on the individual tax returns it receives.

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



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Specifically, the amount of the credit received per student was not available for some of the earlier tax years. We selected our sample using a 95 percent confidence level, a  $\pm 5$  percent precision, and a 10 percent estimated error rate. We relied on TIGTA's contract statistician to verify our sampling methods and sample projections. We verified the accuracy and reliability of the data obtained as we evaluated information on the Integrated Data Retrieval System for each of the 139 students.

2. Selected a judgmental sample<sup>6</sup> of 20 of 1,712 tax returns that were examined by the IRS for AOTCs claimed for more than four tax years but were closed without an adjustment to the tax liability. We selected a judgmental sample to verify the accuracy of the IRS's reported examination change rate. We did not intend to project the results of our analysis to the population of examinations the IRS performed.
- D. Obtained and matched the Calendar Year 2012 Prisoner File (prisoners incarcerated during Calendar Year 2012) to the 13,351,478 students for which education credits were claimed on Tax Year 2012 tax returns and identified 3,500 tax returns that listed students who were prisoners incarcerated for the full calendar year and for which the IRS had no Form 1098-T, *Tuition Statement*.
- E. Identified 22,603 students under the age of 14 and 21,197 students over the age of 65 for which taxpayers received education credits and for which the IRS had no Forms 1098-T for Tax Year 2012. We selected and reviewed a statistically valid sample of 150 students under the age of 14 and 150 students over the age of 65 to determine the eligibility of the claims. We contacted the educational institution listed for each student to verify the student's participation.
- F. Evaluated revisions made to Form 8863, Education Credits (American Opportunity and Lifetime Learning Credits), and determined whether taxpayers provided complete and sufficient information (including the EIN of the educational institution) for the IRS to determine the eligibility of the claim. We identified 2,654,785 students for Tax Year 2012 for which an institution EIN was not provided on Form 8863.
- G. Assessed the IRS's efforts to obtain and utilize third-party information to validate education credit claims.
1. Matched the extract of Tax Year 2012 education credit claims for 13,351,478 students to all Forms 1098-T submitted by educational institutions and identified 2,094,162 taxpayers who claimed 2,219,763 students for which no Form 1098-T was provided to the IRS.

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<sup>6</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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2. Selected and reviewed a judgmental random sample of 54 “no change” IRS examinations for Tax Year 2012 for which checkboxes on Forms 1098-T indicated that the students may not qualify for the AOTC. We selected the sample to determine whether the IRS appropriately examined the eligibility of AOTC claims when the Form 1098-T indicated that the student did not qualify. The sample was selected to evaluate the adequacy of actions taken to address concerns we raised to the IRS in 2010 and 2011 regarding the eligibility of claims for students who did not attend an eligible institution at least half-time. We used a judgmental sample because we did not intend to project the results of the sample.
  3. Discussed with the U.S. Department of Education the availability of records the IRS could use to validate information provided by taxpayers on Forms 8863.
  4. Obtained and matched school information from the 12,214,137 Tax Year 2012 returns to information from the Department of Education and identified 1,610,661 tax returns claiming 1,695,518 students who did not attend eligible educational institutions.
- H. Identified 1,760,644 tax return preparers who submitted erroneous claims for education credits.
- II. Assessed IRS actions to ensure that claims from foreign students or expenses paid to foreign institutions were valid.

**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 that the following internal controls were relevant to our audit objective: the IRS’s policies, procedures, and practices in place to identify questionable education credit claims. To evaluate these controls, we interviewed IRS management, reviewed IRS procedures, and analyzed individual tax returns claiming education credits.



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## **Appendix II**

### *Major Contributors to This Report*

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## **Appendix III**

### *Report Distribution List*

Assistant Secretary of the Treasury for Tax Policy  
Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Operations Support OS  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Wage and Investment Division SE:W  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, Examination, Small Business/Self-Employed Division SE:S:E  
Director, Return Integrity and Compliance Services, Wage and Investment Division SE:W:RICS  
Director, Submission Processing, Wage and Investment Division SE:S:W:CAS:SP  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Chief, Program Evaluation and Improvement, Wage and Investment Division  
    SE:W:S:PEI  
    Program Manager, Policy and Strategic Planning, Communication, Liaison, and  
    Disclosure, Small Business/Self-Employed Division SE:S:CLD:PSP



*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

**Appendix IV**

*Outcome Measures*

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. The outcome measures presented below represent our estimate of the unique taxpayers<sup>1</sup> affected by each of the issues we identified. These benefits will be incorporated into our Semiannual Report to Congress.

The IRS did not capture the education credit amount received per student on Tax Year 2012 returns. Therefore, if a taxpayer claimed more than one student, we could not systemically determine the credit amount attributable to a particular student. In addition, education credit amounts received per tax return are allocated between refundable and nonrefundable portions. To ensure that our outcomes were distributed among refundable and nonrefundable education credits, we calculated the average refundable and nonrefundable credit per tax return. These estimated amounts were used to estimate the dollar value of all of our outcome measures.

To determine the amount of each refundable and nonrefundable education credit claimed, we calculated an estimated education credit amount per return based on the total number of returns filed and the total amount of education credits received for Tax Year 2012. Figure 1 shows how we computed the average refundable and nonrefundable education credit amount received per tax return.

***Figure 1: Computation of the Average Refundable and Nonrefundable Education Credit Received Per Tax Return***

	Total Tax Year 2012 Credits	Tax Year 2012 Returns	Average Credit Per Tax Return
Refundable Education Credits	\$8,574,962,925	÷ 12,214,137 Returns	<b>\$702.05</b>
Nonrefundable Education Credits	\$10,343,596,517		<b>\$846.85</b>
<b>Total Education Credits Received</b>	<b>\$18,918,559,442</b>		<b>\$1,548.90</b>

*Source: TIGTA analysis of Tax Year 2012 education credits received as of December 31, 2013.*

<sup>1</sup> This report uses “taxpayers” in lieu of “taxpayer accounts” for readability. Therefore, married taxpayers who file one return together will be counted as “one taxpayer” for the purposes of this report.



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$3,471,451,909 in refundable education credits over four years received by taxpayers who claimed students who did not appear to have attended a postsecondary educational institution (see page 7).

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

We used computer analysis to identify 2,094,162 taxpayers who claimed education credits for 2,219,763 students for Tax Year 2012 for which the IRS had no associated Forms 1098-T, *Tuition Statement*, to support the students' attendance at educational institutions. The IRS examined returns missing Forms 1098-T for Tax Year 2012 and found that 59.03 percent of returns examined resulted in adjustments to the tax assessed. We reduced the 2,094,162 taxpayers based on the 59.03 percent change rate, resulting in 1,236,184 taxpayers who had questionable claims for Tax Year 2012.

Because a prior TIGTA report<sup>2</sup> already included in its outcome measures any Tax Year 2012 returns for which Forms 1098-T were not present, we only included the tax returns and amounts associated with Tax Year 2013 through Tax Year 2016 in our outcome. We multiplied the 1,236,184 taxpayers by four years and multiplied the result by the previously calculated \$702.05 average refundable education credit per return to forecast that taxpayers would potentially receive \$3,471,451,909 in refundable education credits over four years.<sup>3</sup>

The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$4,187,449,682 in nonrefundable education credits over four years received by 1,236,184 taxpayers who claimed students who did not appear to have attended a postsecondary educational institution (see page 7).

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

We used computer analysis to identify 2,094,162 taxpayers who claimed education credits for 2,219,763 students for Tax Year 2012 for which the IRS had no associated Forms 1098-T to support the students' attendance at educational institutions. The IRS examined returns missing Forms 1098-T for Tax Year 2012 and found that 59.03 percent of returns examined resulted in adjustments to the tax assessed. We reduced the 2,094,162 taxpayers based on the 59.03 percent change rate, resulting in 1,236,184 taxpayers who had questionable claims for Tax Year 2012.

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<sup>2</sup> TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 2011).

<sup>3</sup> The four-year forecast is based on multiplying the base year by four (to account for previously claimed outcome measures) and assumes, among other considerations, that economic conditions and tax laws do not change.



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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Because a prior TIGTA report already included in its outcome measures any Tax Year 2012 returns for which Forms 1098-T were not present, we only included the returns and amounts associated with Tax Year 2013 through Tax Year 2016. We multiplied the 1,236,184 taxpayers by four years and multiplied the result by the previously calculated \$846.85 average nonrefundable education credit per return to forecast that taxpayers would potentially receive \$4,187,449,682 in nonrefundable education credits over four years.<sup>4</sup>

The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$2,965,171,360 in refundable education credits over five years received by taxpayers who claimed students who did not attend an eligible educational institution (see page 7).

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

We identified 1,610,661 taxpayers who claimed education credits for 1,695,518 students for Tax Year 2012 who did not appear to attend eligible educational institutions based on information from the U.S. Department of Education. We matched the EIN of the institution submitted on Forms 8863 for all 13,351,478 students claimed for Tax Year 2012 to the EIN of the institutions listed by the Department of Education to determine whether the student attended an eligible institution. We performed a subsequent name and address match for the institutions that did not originally match an eligible institution to account for possible invalid or missing EINs on the Form 8863, Education Credits (American Opportunity and Lifetime Learning Credits).

We reduced the 1,610,661 taxpayers by 765,943 duplicates from other categories of potentially erroneous education credit claims we identified to arrive at 844,718 taxpayers who appear to have erroneously received education credits for 893,767 students. We forecast that the IRS could pay \$2,965,171,360 in potentially erroneous refundable education credits to taxpayers who claim students who did not attend an eligible institution over the next five years.<sup>5</sup> We computed our forecast by multiplying the 844,718 taxpayers we identified by five years and multiplied the result by the previously calculated average refundable credit per tax return of \$702.05.

We understand that a portion of the 844,718 taxpayer returns that indicate the student did not attend an eligible institution may ultimately be found to be eligible after an IRS examination. However, we have no historical data from either the IRS or the Department of Education to provide a basis to reasonably adjust our outcome to reflect the number of potentially eligible claims.

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<sup>4</sup> The four-year forecast is based on multiplying the base year by four (to account for previously claimed outcome measures) and assumes, among other considerations, that economic conditions and tax laws do not change.

<sup>5</sup> The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$3,576,747,192 in nonrefundable education credits over five years received by 844,718 taxpayers who claimed students who did not attend eligible educational institutions (see page 7).

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

We identified 1,610,661 taxpayers who claimed education credits for 1,695,518 students for Tax Year 2012 who did not appear to attend eligible educational institutions based on information from the Department of Education. We matched the EIN of the institution submitted on Forms 8863 for all 13,351,478 students claimed for Tax Year 2012 to the EIN of the institutions listed by the Department of Education to determine whether the student attended an eligible institution. We performed a subsequent name and address match for the institutions that did not originally match an eligible institution to account for possible invalid or missing EINs on the Form 8863.

We reduced the 1,610,661 taxpayers by 765,943 duplicates from other categories of potentially erroneous education credit claims we identified to arrive at 844,718 taxpayers who appear to have erroneously received education credits for 893,767 students. We forecast that the IRS could potentially pay \$3,576,747,192 in nonrefundable education credits to taxpayers who claim students who did not attend an eligible institution over the next five years.<sup>6</sup> We computed our forecast by multiplying the 844,718 taxpayers we identified by five years and multiplied the result by the previously calculated average nonrefundable education credit per tax return of \$846.85.

A portion of the 844,718 taxpayer returns that indicate the student did not attend an eligible institution may ultimately be found to be eligible after an IRS examination. However, we have no historical data from either the IRS or the Department of Education to provide a basis to reasonably adjust our outcome to reflect the number of potentially eligible claims.

The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$765,869,153 in refundable AOTCs over four years received by taxpayers who claimed students who did not appear to attend educational institutions the required length of time (see page 7).

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<sup>6</sup> The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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

We identified 427,345 taxpayers claiming the AOTC for 431,622 students who appeared not to have attended an educational institution at least half-time as required. We reduced the 427,345 taxpayers by 63,711 duplicates from other exceptions to arrive at 363,634 taxpayers who appear to have erroneously received education credits for 379,396 students. The IRS examined returns for Tax Year 2012 with indications that the student did not attend the required length of time and found that 75 percent of returns examined resulted in adjustments to the tax assessed. We reduced the 363,634 taxpayers based on the 75 percent change rate, resulting in 272,726 taxpayers who had questionable claims for Tax Year 2012.

Because a prior TIGTA report already included in its outcome measures any Tax Year 2012 returns for which Forms 1098-T indicated that the students did not attend the required length of time, we only included the returns and amounts associated with Tax Year 2013 through Tax Year 2016. We multiplied the 272,726 taxpayers by four years and multiplied the result by the previously calculated \$702.05 average refundable education credit per return to forecast that taxpayers would potentially receive \$765,869,153 in refundable AOTCs over four years.<sup>7</sup>

The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$923,832,052 in nonrefundable AOTCs over four years received by 272,726 taxpayers who claimed students who did not appear to attend educational institutions the required length of time (see page 7).

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

We identified 427,345 taxpayers claiming the AOTC for 431,622 students who appeared not to have attended an educational institution at least half-time as required. We reduced the 427,345 taxpayers by 63,711 duplicates from other exceptions to arrive at 363,634 taxpayers who appear to have erroneously received education credits for 379,396 students. The IRS examined returns for Tax Year 2012 with indications that the student did not attend the required length of time and found that 75 percent of returns examined resulted in adjustments to the tax assessed. We reduced the 363,634 taxpayers based on the 75 percent change rate, resulting in 272,726 taxpayers who had questionable claims for Tax Year 2012.

Because a prior TIGTA report already included in its outcome measures any Tax Year 2012 returns for which Forms 1098-T indicated that the students did not attend the required length of time, we only included the returns and amounts associated with Tax Year 2013 through Tax Year 2016. We multiplied the 272,726 taxpayers by four years and multiplied the result by the

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<sup>7</sup> The four-year forecast is based on multiplying the base year by four (to account for previously claimed outcome measures) and assumes, among other considerations, that economic conditions and tax laws do not change.



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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previously calculated \$846.85 average nonrefundable education credit per return to forecast that taxpayers would potentially receive \$923,832,052 in nonrefundable AOTCs over four years.<sup>8</sup>

The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

**Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$1,921,702,510 in refundable AOTCs over five years received by taxpayers who claimed students for more than the four tax years allowed by law (see page 12).

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

We identified 1,167,119 students for which the AOTC was claimed for more than four tax years between Tax Year 2007 and Tax Year 2013. We selected and reviewed a statistically valid sample of 139 of the 1,167,119 students to determine the eligibility of the claims and project the results to the overall population.<sup>9</sup>

We determined that 130 of the 139 students in our sample erroneously received the AOTC for more than the four tax years allowed, of which 50 students (38.46 percent) erroneously received the AOTC for Tax Year 2012 and 94 students (72.31 percent) erroneously received the AOTC for Tax Year 2013.<sup>10</sup> We used the 50 Tax Year 2012 students for the Tax Year 2012 portion of the outcome and the 94 Tax Year 2013 students for the Tax Year 2013 through Tax Year 2016 portion of the outcome. We determined that each student was claimed by a unique taxpayer; therefore, our projection of students is the same as a projection of taxpayers.

Of the 50 questionable Tax Year 2012 returns identified, we determined that 12 returns (24 percent) were already included in other exceptions and projected our outcome on the remaining 38 returns. Based on the 38 Tax Year 2012 returns, we project that 319,069 taxpayers erroneously received AOTCs.<sup>11</sup> We multiplied the 319,069 taxpayers by the previously calculated \$702.05 average refundable education credit per return to determine that these taxpayers would potentially receive \$224,002,391 in refundable AOTCs for Tax Year 2012.

For the 94 questionable Tax Year 2013 returns identified, we applied the 24 percent overlap rate from Tax Year 2012 and subtracted 22 returns to account for potential overlap of exceptions in

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<sup>8</sup> The four-year forecast is based on multiplying the base year by four (to account for previously claimed outcome measures) and assumes, among other considerations, that economic conditions and tax laws do not change.

<sup>9</sup> We selected the sample using a 95 percent confidence level, a  $\pm$  5 percent precision, and a 10 percent estimated error rate.

<sup>10</sup> We identified 18 taxpayers who erroneously claimed the AOTC for the same students for both Tax Year 2012 and Tax Year 2013. In addition, four taxpayers who erroneously claimed the AOTC for students for Tax Year 2011 were not considered for purposes of our outcome measure.

<sup>11</sup> The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 232,285 and 405,852.



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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the future. Based on the remaining 72 Tax Year 2013 returns, we project that 604,551 taxpayers erroneously received the AOTC.<sup>12</sup> We multiplied the 604,551 taxpayers by four years and multiplied the result by the previously calculated \$702.05 average refundable education credit per return to forecast that these taxpayers would potentially receive \$1,697,700,118 in refundable AOTCs over four years.<sup>13</sup>

We added the \$224,002,391 in refundable AOTCs for Tax Year 2012 and the \$1,697,700,118 in refundable AOTCs for Tax Years 2013 through 2016 for a total of \$1,921,702,510 in refundable AOTCs over five years.

The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

**Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$2,318,059,640 in nonrefundable AOTC over five years received by 461,810 taxpayers who claimed students for more than the four tax years allowed by law (see page 12).

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

We identified 1,167,119 students for which the AOTC was claimed for more than four tax years between Tax Year 2007 and Tax Year 2013. We selected and reviewed a statistically valid sample of 139 of the 1,167,119 students to determine the eligibility of the claims and project the results to the overall population.<sup>14</sup>

We determined 130 of the 139 students in our sample erroneously received the AOTC for more than the four tax years allowed, of which 50 students (38.46 percent) erroneously received the AOTC for Tax Year 2012 and 94 students (72.31 percent) erroneously received the AOTC for Tax Year 2013.<sup>15</sup> We used the 50 Tax Year 2012 students for the Tax Year 2012 portion of the outcome and the 94 Tax Year 2013 students for the Tax Year 2013 through Tax Year 2016 portion of the outcome. We determined each student was claimed by a unique taxpayer; therefore, our projection of students is the same as a projection of taxpayers.

Of the 50 questionable Tax Year 2012 returns identified, we determined that 12 returns (24 percent) were already included in other exceptions and projected our outcome on the

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<sup>12</sup> The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 507,257 and 701,845.

<sup>13</sup> The four-year forecast is based on multiplying the base year by four and assumes, among other considerations, that economic conditions and tax laws do not change.

<sup>14</sup> We selected the sample using a 95 percent confidence level, a  $\pm 5$  percent precision, and a 10 percent estimated error rate.

<sup>15</sup> We identified 18 taxpayers who erroneously claimed the AOTC for the same students for both Tax Year 2012 and Tax Year 2013. In addition, four taxpayers who erroneously claimed the AOTC for students for Tax Year 2011 were not considered for purposes of our outcome measure.



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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remaining 38 returns. Based on the 38 Tax Year 2012 returns, we project that 319,069 taxpayers erroneously received the AOTC.<sup>16</sup> We multiplied the 319,069 taxpayers by the previously calculated \$846.85 average nonrefundable education credit per return to determine that these taxpayers would potentially receive \$270,203,583 in nonrefundable AOTCs for Tax Year 2012.

For the 94 questionable Tax Year 2013 returns identified, we applied the 24 percent overlap rate from Tax Year 2012 and subtracted 22 returns to account for potential overlap of exceptions in the future. Based on the remaining 72 Tax Year 2013 returns, we project that 604,551 taxpayers erroneously received the AOTC.<sup>17</sup> We multiplied the 604,551 taxpayers by four years and multiplied the result by the previously calculated \$846.85 average nonrefundable education credit per return to forecast that these taxpayers would potentially receive \$2,047,856,057 in nonrefundable AOTCs over four years.<sup>18</sup>

We averaged the projected 319,069 taxpayers for Tax Year 2012 and the 604,551 taxpayers for Tax Years 2013 through 2016 for 461,810 total taxpayers ( $923,620/2 = 461,810$  taxpayers). We added the \$270,203,583 in nonrefundable AOTCs for Tax Year 2012 and the \$2,047,856,057 in nonrefundable AOTCs for Tax Years 2013 through 2016 for a total of \$2,318,059,640 in nonrefundable AOTCs over five years.

The actual amount of erroneous education credits claimed is contingent upon the extent to which taxpayers could substantiate their claims if contacted by the IRS.

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<sup>16</sup> The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 232,285 and 405,852.

<sup>17</sup> The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 507,257 and 701,845.

<sup>18</sup> The four-year forecast is based on multiplying the base year by four and assumes, among other considerations, that economic conditions and tax laws do not change.



*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

**Appendix V**

*Prior Audit Recommendations and Actions Taken by the Internal Revenue Service to Address Recommendations*

Recommendation	Actions Taken to Date	TIGTA Report Number and Date Issued
The IRS should initiate a Tax Return Preparer Project to address those preparers associated with large volumes of erroneous education credit claims.	The IRS identifies, reviews, and sends notices to tax return preparers who file questionable AOTC claims.	<b>2011-41-083 Sept. 2011</b>
The IRS should revise Form 8863, <i>Education Credits (American Opportunity and Lifetime Learning Credits)</i> , to require taxpayers to provide identifying information for the educational institution and for the student's eligibility.	The IRS revised Form 8863 for Tax Year 2012 to include additional educational institution and student information.	<b>2011-41-083 Sept. 2011</b>
The IRS should coordinate with the U.S. Department of Education to acquire databases containing eligible educational institutions and student enrollment data and use that information to identify questionable claims for both tax return processing and post processing compliance programs.	The IRS held discussions with the Department of Education and determined that the information available was not adequate to verify return information.	<b>2011-41-083 Sept. 2011</b>
The IRS should develop a process to identify and notify educational institutions that are preparing inaccurate Forms 1098-T, <i>Tuition Statement</i> .	The IRS implemented a program to identify and penalize educational institutions that provide Forms 1098-T with missing or invalid student Taxpayer Identification Numbers.	<b>2011-41-083 Sept. 2011</b>
The IRS should develop processes to identify ineligible taxpayers erroneously claiming education credits using students allowed as dependents on other taxpayers' tax returns and prisoners erroneously receiving the credits.	The IRS implemented controls to identify and reject education credit claims for which the student Taxpayer Identification Number had already been used on another tax return to claim education credits. This included audit procedures and soft notices.	<b>2011-41-083 Sept. 2011</b>



*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

<b>Recommendation</b>	<b>Actions Taken to Date</b>	<b>TIGTA Report Number and Date Issued</b>
The IRS should determine whether legislation is needed to clarify whether refundable tax credits are Federal benefits and thus may be claimed only for students with a valid Social Security Number.	The Office of Tax Policy determined that the law allows students without a valid Social Security Number to claim education credits.	<b>2011-41-083 Sept. 2011</b>

*Source: TIGTA analysis of actions taken in response to prior audit report.*



*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

**Appendix VI**

*Management's Response to the Draft Report*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

FEB 24 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Debra Holland  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Billions of Dollars in Potentially Erroneous Education Credits Continue to be Claimed for Ineligible Students and Institutions (Audit # 201440015)

Thank you for the opportunity to review and provide comments on the subject draft audit report. The American Opportunity Tax Credit (AOTC) assists millions of individuals with the costs of higher education; however, the complexity of the statutory requirements defining eligibility for the AOTC, and its status as a refundable credit, renders it subject to erroneous claims by taxpayers making unintentional errors and by those knowingly making fraudulent claims.

The IRS has taken actions to promote and improve taxpayer compliance with the AOTC provisions by redesigning Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*, to assist taxpayers in determining eligibility for the credit when they prepare their tax returns, and by working with the Department of Education to develop a website and outreach projects that supplement our communications plan by promoting the credit and explaining the requirements for qualification. An Interactive Tax Assistant application is available on IRS.gov, along with other information and tools designed to assist taxpayers. During the last two years, we have made presentations at the Federal Student Aid Conference to inform and educate the thousands of financial aid professionals in attendance, and have provided outreach and education to tax professionals at the annual IRS Nationwide Tax Forums. In January 2015, we presented a webinar on education benefits for an audience of educators and tax professionals.

As noted in the report, the IRS is faced with significant challenges in administering the AOTC. Primarily, third-party information confirming enrollment in a qualified educational institution and verifying tuition expenses is generally not available at the time returns are filed and processed. Further, the ability to use Math Error Authority (MEA) to correct



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## *Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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obviously erroneous claims during return processing is limited, thus requiring any treatment to follow deficiency procedures, which draw on limited resources and are the most costly methods for addressing questionable claims. For Tax Year 2012, we redesigned Form 8863 to capture certain information reported to taxpayers on Form 1098-T, *Tuition Statement*, by the educational institutions, and to document taxpayer responses to questions posed to determine eligibility for the credit. The form changes served the dual purpose of clarifying student eligibility requirements for taxpayers and allowing the IRS to leverage MEA for inconsistent entries. We believe this change contributed, in part, to the reduction of total education credits claimed from \$23.6 billion for Tax Year 2011, to \$19.1 billion for Tax Year 2012, as shown in Figure 1, *Education Credits Claimed for Tax Years 2009 through 2012*.

We disagree with the Treasury Inspector General for Tax Administration's (TIGTA) finding that the IRS does not have effective processes to identify erroneous claims for education credits. To the contrary, as indicated in Figure 9, IRS identified 1.8 million questionable returns for potential audit through our exam filters. Of those identified, IRS selected almost 9,600 cases for examination and over 126,000 in its Automated Underreporter program for Tax Year 2012 that bore the same questionable characteristics as those the TIGTA reports (No Form 1098-T, Received the AOTC for More Than Four Years, and Received the AOTC But Attended Less Than Half-Time). Due to limited audit resources and the need to allocate those resources in a manner that ensures balanced support for all provisions of the Tax Code, our process for selecting returns for review is designed to choose those with the highest potential for error and considers the potential net tax effect that could result from a review. For the limited number of returns that can be reviewed, we strive to ensure those with the most significant impact are selected.

The IRS has worked with the Department of the Treasury to address the challenges that must be overcome before significant improvement can be achieved in stopping erroneous claims for education credits. Requests have been submitted for legislative changes that would enable the IRS to use internal and other governmental databases to validate student eligibility and, when students are found to be ineligible, to remove the credit outside of deficiency procedures. Requests have also been submitted to simplify the educational credit landscape and to accelerate the filing due date for information returns, including Form 1098-T, to January 31.

We disagree with the reported Outcome Measures of approximately \$20.1 billion in protected revenue and cost savings. Because the measures incorporate results of our examination of returns, we believe a bias is introduced into the computations that cause an overstatement of the results. Scoring criteria are applied when returns are evaluated for audit potential. Consequently, the population of returns we select for audit is biased toward those with a higher probability for error than would be found in the general population. We believe a randomly selected population of returns for audit would yield a more accurate projection.



*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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Attached is our response to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Jodi L. Patterson, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (404) 338-8961.

Attachment



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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Attachment

**Recommendations**

The Commissioner, Wage and Investment Division, should:

**RECOMMENDATION 1**

Coordinate with the Department of Education to determine the feasibility of using Department of Education data, including but not limited to the PEPS database, to verify the eligibility of educational institutions shown on tax returns for the purposes of claiming education credits. Coordination efforts should include an assessment of the reliability and sufficiency of the data available.

**CORRECTIVE ACTION**

We disagree with this recommendation because, under existing statutory authority, the IRS cannot use this third-party information to correct a tax return during processing. Without the authority to address the use of ineligible institutions when claiming education credits during return processing, appreciable gains over current treatment options that require we follow deficiency procedures could not be achieved. We agree that the Postsecondary Education Participants System database has the potential to be a useful tool in addressing erroneous claims for education credits and, in the event expanded authority is granted to permit the use of third-party data during return processing, we would be interested in discussing its use with the Department of Education. At this time, however, we do not intend to act on the recommendation.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 2**

If the IRS determines external data are sufficiently reliable, develop processes to verify education credit claims at the time tax returns are processed.

**CORRECTIVE ACTION**

Processes are already in place to use some external data in addressing questionable items on tax returns at the time of processing. The applicable treatment stream is determined by the statutory authority available to the IRS, the availability of resources, and the allocation of those limited resources to address compliance issues as effectively as possible. The IRS does not have the authority to use third-party data for verification of education credit claims at the time tax returns are processed. Instead, questionable



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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claims are addressed through deficiency procedures, which may be used in a pre-refund environment; however, that treatment is subject to the availability of limited resources.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**Legislative Recommendation**

**LEGISLATIVE RECOMMENDATION 3**

Coordinate with the Department of Treasury Office of Tax Policy to consider a legislative proposal to move the required filing date for Forms 1098-T to January 31 so that this information can be used at the time tax returns are processed to help identify improper education credit claims.

**CORRECTIVE ACTION**

A legislative proposal was submitted with the administration's Fiscal Years 2015<sup>1</sup> and 2016<sup>2</sup> budget requests, proposing that the filing date for information returns, with limited exceptions, would be established as January 31. The most recent proposed change would be effective upon enactment and includes Form 1098-T, *Tuition Statement*.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Return Integrity and Compliance Services, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

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<sup>1</sup> *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals*, March 2014, pg. 245, <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf>

<sup>2</sup> *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, February 2015, pg.267, <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf>



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*Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions*

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**Recommendations**

**RECOMMENDATION 4**

The Commissioner, Wage and Investment Division, should establish Automated Questionable Credit Program filters to identify tax returns on which the student claimed has already exceeded the four year AOTC limit for pre-refund treatment.

**CORRECTIVE ACTION**

In cases where students are not eligible for the American Opportunity Tax Credit (AOTC) because they have already claimed it for the maximum number of four years, they could be eligible for the Lifetime Learning Credit (LLC). The variable outcomes that could result from denying the AOTC and considering the effect of the LLC, on a case by case basis, puts this issue beyond the scope of the Automated Questionable Credit program. Processes are in place to evaluate the number of years for which students claimed the AOTC and direct those returns for further review. Consequently, we disagree with this recommendation.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**Recommendation**

**RECOMMENDATION 5**

The Commissioner, Wage and Investment Division, should modify existing filters used to identify erroneous education credit claims made by taxpayers to include all returns on which the students are prisoners and establish processes to identify and address such claims before the tax refunds are issued.

**CORRECTIVE ACTION**

A new prisoner filter was implemented for the 2015 filing season, to identify dependent students used to claim the AOTC and are imprisoned. Returns identified by this filter are directed to the AQC program for treatment.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Return Integrity and Compliance Services, Wage and Investment Division



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**CORRECTIVE ACTION MONITORING PLAN**  
N/A