

**Legislative Recommendation #66****Compensate Taxpayers for “No Change” National Research Program Audits****SUMMARY**

- *Problem:* To refine its audit selection formulas, the IRS audits a randomly selected group of taxpayers each year, effectively making them “guinea pigs” to help it improve the way it does its job. These National Research Program (NRP) audits impose burdens on the selected taxpayers, as they often incur fees for representation by a tax professional, must devote considerable time to gathering and organizing requested documentation, and experience the stress of an IRS audit.
- *Solution:* Absent fraud, compensate taxpayers who undergo NRP audits that do not result in changes to their tax liabilities and consider waiving any tax, interest, and penalties that result from these audits.

**PRESENT LAW**

There is no provision under present law that authorizes compensation of taxpayers who are audited under the IRS’s NRP or provides relief from the assessment of tax, interest, and penalties that may result from NRP audits.

**REASONS FOR CHANGE**

Through the NRP, the IRS conducts audits of randomly selected taxpayers. The NRP benefits tax administration by enabling the IRS to gather strategic information about taxpayer compliance behavior as well as information about the causes of reporting errors. This information helps the IRS update its workload selection formulas and thereby enables it to focus its audits on returns with a relatively high likelihood of error. It also helps the IRS to estimate the “tax gap.” In addition, NRP studies benefit Congress by providing taxpayer compliance information that is useful in formulating tax policies.

For the thousands of individual taxpayers (or businesses) that are subject to NRP audits, however, they impose significant burdens.<sup>1</sup> In essence, these taxpayers, even if fully compliant, serve as “guinea pigs” to help the IRS improve the way it does its job. They must contend with random and sometimes intensive audits that consume their time, drain resources (including representation fees), and may impose an emotional and reputational toll.

In 1995, the House Ways and Means Subcommittee on Oversight held a hearing on the NRP’s predecessor, the Taxpayer Compliance Measurement Program (TCMP).<sup>2</sup> Testimony provided during the hearing, and subsequent witness responses to questions-for-the-record, indicated that TCMP audits imposed a heavy burden on taxpayers and reflected a strong view that audited taxpayers were bearing the brunt of a research project intended to benefit the tax system as a whole. Proposals raised at the hearing included compensating taxpayers selected for TCMP audits as well as possibly waiving tax, interest, and penalties assessed during the audits.

1 IRS, Form 1040 – Individual Income Tax, National Research Program, <https://nrp.web.irs.gov/1040-study.html> (last visited Aug. 27, 2024).

2 *Taxpayer Compliance Measurement Program: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 104th Cong. (1995), <https://www.govinfo.gov/content/pkg/CHRG-104hhrg20681/pdf/CHRG-104hhrg20681.pdf>.

Following the hearing, the House Budget Committee included a proposal in its 1995 budget reconciliation bill to compensate individual taxpayers by providing a tax credit of up to \$3,000 for TCMP-related expenses.<sup>3</sup> Ultimately, this proposal was not adopted. Instead, the IRS was pressured to stop conducting TCMP audits. The inability to perform regular TCMP audits, however, undermined effective tax administration because it prevented the IRS from updating its audit selection formulas. Using older formulas likely meant that more compliant taxpayers faced (unproductive) audits and that audit revenue declined.

About a decade later, the IRS reinstated the TCMP under the new NRP name. Some procedures have since changed, but the burden on many of these taxpayers remains substantially unchanged. For the same reasons identified during the 1995 House hearing, the National Taxpayer Advocate believes it is appropriate to recognize that taxpayers audited under the NRP are bearing a heavy burden to help the IRS improve the effectiveness of its compliance activities. A tax credit or authorized payment would alleviate the monetary component of the burden. Further relief could be provided by waiving any assessment of tax, interest, and penalties resulting from an NRP audit.<sup>4</sup> However, this waiver should not apply where tax fraud or an intent to evade tax is uncovered in an NRP audit.

## RECOMMENDATIONS

- Compensate taxpayers for “no change” NRP audits through a tax credit or other means.<sup>5</sup>
- Consider waiving the assessment of tax, interest, and penalties resulting from an NRP audit, absent fraud or an intent to evade federal taxes.

<sup>3</sup> See H.R. REP. NO. 104-280, vol. 2, at 28 (1995).

<sup>4</sup> Alternatively, legislation could require NRP-audited taxpayers to pay any additional tax owed and limit relief to interest and penalties. However, to the extent the purpose of NRP audits is to identify areas where NRP-audited taxpayers are underreporting tax so the IRS can revise its audit selection formulas, a waiver of tax as well as interest and penalties may be more effective, as taxpayers might be more forthcoming with auditors if they are assured they will not face additional assessments (absent fraud).

<sup>5</sup> For legislative language that would allow a deduction for certain individual taxpayers of up to \$5,000 for qualified NRP expenses, see Small Business Taxpayer Bill of Rights Act of 2023, S. 1177 and H.R. 2681, 118th Cong. § 14 (2023).