

#34 COMPENSATE TAXPAYERS FOR “NO CHANGE” NATIONAL RESEARCH PROGRAM AUDITS

Present Law

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

Reasons for Change

Through the NRP, the IRS conducts audits of randomly selected taxpayers. The NRP benefits tax administration by gathering strategic information about taxpayer compliance behavior as well as information about the causes of reporting errors. This information assists the IRS in developing and updating its workload selection formulas and helps the IRS estimate the “tax gap.” NRP studies benefit Congress by providing taxpayer compliance information that is useful in formulating tax policy, and they help the IRS focus its audits on returns with a relatively high likelihood of errors, thereby building trust in the fairness of the tax system and helping the IRS to maximize revenue collection.

For the tens of thousands of individual taxpayers (or businesses) that are subject to NRP audits, however, they impose significant burden. 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 intensive audits that consume their time, drain resources (including representation costs), 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).¹¹⁸ Testimony provided during the hearing and subsequent witness responses to questions-for-the-record indicated that TCMP audits impose a heavy burden on taxpayers and a strong sentiment 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.

Subsequent to 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.¹¹⁹ 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 formulas. It was also bad for compliant taxpayers, because when the IRS is not able to accurately identify returns with a high likelihood of noncompliance, taxpayers who file compliant returns are more likely to face audits.

About a decade later, the IRS reinstated the TCMP under the NRP label. Some procedures were changed, but the random selection of taxpayers and the burden on many of these taxpayers remained 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

¹¹⁸ *Taxpayer Compliance Measurement Program: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 104th Cong. (1995).

¹¹⁹ See H.R. REP. NO. 104-280, vol. 2, at 28 (1995).

of tax, interest, and penalties resulting from an NRP audit. Such a waiver might also improve the accuracy of the NRP audits, as taxpayers might be more likely to be forthcoming with an auditor if they were assured they would not face additional assessments. However, this waiver should not apply where tax fraud or an intent to evade is uncovered in an NRP audit.

Recommendations

Amend the IRC to compensate taxpayers for no change NRP audits through a tax credit or other means (such as IRS user fees). Consider waiving the assessment of tax, interest, and penalties resulting from an NRP audit, absent fraud or an intent to evade federal taxes.