The Tax Law Center NYU LAW

February 9, 2024

Improving Categorical Non-Enforcement in the Tax System.[1]

By: Chye-Ching Huang

Introduction and Executive Summary

(Link to Full Version)

Within the past year or so, Treasury and the IRS have announced several decisions to delay the implementation of new tax rules beyond statutory deadlines or to not strictly enforce certain statutory provisions on a "categorical" basis (for broad-based swaths of filers or defined situations). These include (as described in more detail in the **Appendix**):

- non-enforcement of taxes on and reporting of certain state payments in 2022;
- delay in the implementation of changes to section 1099-K reporting requirements, which the statute generally required for transactions in 2022;
- delay in implementation of the requirement that brokers report on digital assets, which the statute generally required for transactions in 2023;[2] and
- delay of the requirement that plan sponsors designate certain catch-up contributions as Roth contributions, which has a statutory effective date of January 1, 2024.

Categorical non-enforcement decisions are not unprecedented, and this report does not claim that there has been an increase or expansion of this approach in tax (nor is it obvious how that could be measured).[3] Indeed, it is appropriate and important for Treasury and the IRS to have broad flexibility to determine how to implement and enforce the tax law, and there is authority for categorical non-enforcement in many circumstances.

Recent decisions, however, have drawn scrutiny for several reasons. In announcing these decisions, Treasury and the IRS often failed to cite specific authority and to explain why they believed the decisions came under that authority, and did not transparently set out the process and considerations that they use when they decide whether and how to exercise that authority. The decisions were also often late-breaking, effectively penalizing filers who had incurred costs when making good-faith attempts to come into compliance with new law, while rewarding those who had deliberately delayed and created confusion in the hope of undermining implementation. Estimates suggest that the recent decisions have cost some \$8 billion[4] which is small relative to

[1] Thalia Spinrad, Tax Law and Policy Fellow, provided excellent and extensive research support. Thank you to Professor Daniel Hemel, Professor Leigh Osofsky, and others generous reviewers for helpful feedback. All positions and errors in this report are solely attributable to the Tax Law Center.

[2] More recently, the reporting of transactions involving more than \$10,000 in digital assets received in a trade or business was delayed until regulations are published. *See* Transitional Guidance Under Section 6050I with Respect to the Reporting of Information on the Receipt of Digital Assets, Announcement 2024-04 (Jan. 16, 2024).

[3] Categorical non-enforcement is certainly not a new phenomenon. *See, e.g.*, Mark J. Mazur, Assistant Secretary for Tax Policy, Letter to the Honorable Fred Upton, Chairman, U.S. House of Representatives Committee on Energy and Commerce, at 2 (July 9, 2013); IRS Criminal Investigation Voluntary Disclosure Practice; Treatment of Amounts Paid to Section 170(c) Organizations Under Employer Leave-Based Donation Programs to Aid Victims of the Hawaii Wildfires that Began on August 8, 2023, Notice 2023-69, at 1 (Sept. 28, 2023) (invoking previous instance of similar relief).

[4] *See* Part II and note 45 for discussion of this figure.

the scale of the federal tax system, but, absent a set of limiting principles and a transparent process, raises the risk of decisions of larger fiscal magnitude in the future.

Lawmakers in both houses of Congress and of both parties have expressed concerns about Treasury's and the IRS's authority to make several of these non-enforcement decisions.[5] For example, Senator Mike Crapo noted that the Administration "has resorted to unilaterally walking back and diluting" some of the Inflation Reduction Act's "key provisions" and that the IRS has "simply disregarded statutory deadlines" for implementing provisions including "enhanced information reporting and EV tax credits."[6] Senator Elizabeth Warren and six other senators wrote that they were "alarmed by the self-inflicted two-year delay" for the implementation of reporting requirements for crypto brokers and called for an earlier effective date that would not delay implementation of the statute by two years.[7] Most recently, twenty-five members of Congress called upon Commissioner Danny Werfel to testify about the "rule of law violations" related to the IRS's "refusal to implement" the IRA's $600 1099-K reporting threshold.[8]

More broadly, Senator Crapo asked Chief Counsel nominee Marjorie Rollinson how she would "approach a situation where the statute is clear, but the administration seeks a different outcome, whether based on claims of administrative complexity or political expediency[.]"[9]

While there are potential sources of authority and rationales for Treasury and the IRS's enforcement discretion, they should more explicitly address issues raised by their recent uses of non-enforcement authority. This report identifies some sources of authority for categorical non-enforcement decisions. This report does not attempt to completely describe the boundaries of that authority – nor does this report argue that any of the recent decisions by Treasury and the IRS fall beyond those boundaries, but this report offers some observations that could form the basis for a more considered delineation. This report also explores what factors should be considered when determining whether and how to use this authority well.

Summary of the three parts of this report:

Part I: What is the source of Treasury and the IRS's authority for categorical non-enforcement of tax laws, and what are the limits of that authority?

Part I explains that it is important for Treasury and the IRS to be able to delay or not strictly enforce certain tax provisions against entire broad-based categories of filers, but that there must also be limits on that power. While there is no singular, bright-line test for the breadth of non-enforcement authority, a key question is whether the non-enforcement is inappropriately frustrating Congress's purposes in enacting the particular provision, in delegating authority to the Secretary of the Treasury to administer the tax code, and in funding the IRS to enforce it.

There are a number of circumstances that would tend to meet this test. For instance, non-enforcement may be appropriate when enforcement resources are constrained given Congress's

[5] For reporting on lawmakers' concerns, *see* Erin Slowey & Samantha Handler, *IRS 'Testing' of Statutory Boundaries Prompts Ire of Lawmakers*, Bloomberg Law (Oct. 30, 2023); Richard Rubin, *IRS Delays Tax Deadlines Set by Congress. It Could Cost $8 Billion*, Wall Street Journal (Nov. 24, 2023).
[6] Senator Mike Crapo, *Statement at IRS Chief Counsel and Social Security and Medicare Trustees Nomination Hearing*, at 2, Senate Finance Committee (Sept. 28, 2023).
[7] Senator Elizabeth Warren et al., Letter to the Treasury & IRS on Crypto Broker Reporting Rule (Oct. 10, 2023).
[8] Representative Jason Smith et al., Letter to the Honorable Daniel Werfel, at 1-2 (Dec. 21, 2023).
[9] *See* Senator Mike Crapo, *Hearing to Consider the Nomination of Marjorie A. Rollinson to be Chief Counsel for the Internal Revenue Service*, Senate Finance Committee (Sept. 29, 2023) (Video, at 00:48:20).

funding decisions and Treasury chooses not to enforce in a specific area because it would be resource intensive and do little to change tax liabilities relative to other enforcement areas. Another example would be when it is impossible for large swaths of filers making good faith efforts to comply by the statutory deadline, or when Treasury is practically unable to implement a complex set of rules by a particular deadline. Proactively announcing non-enforcement among broad classes of filers can provide more certainty, consistency, accountability, and efficiency in tax administration than not enforcing provisions on an ad hoc case-by-case basis.[10] For reasons such as these, categorical exemptions, including implementation delays, transition relief, and safe harbors, can be a practical way to administer tax law.

In distinguishing permissible versus non-permissible non-enforcement, it is important not to rely on pragmatism alone since that is not legal authority and Congress may or may not agree with the executive branch on what is good policy. Thus, even administrative decisions that represent wise policy must be grounded in the law. There must be some boundary between granting appropriate administrative relief to whole categories of taxpayers through non-enforcement and impermissibly rewriting the tax law and in a way that actually frustrates Congress's purposes in writing the law and delegating significant but limited tax administration authority. There is obviously no general ability for an administration to, say, decline to enforce a hypothetical statute increasing the corporate tax rate to 35 percent, and to opt to instead only enforce the pre-increase 21 percent rate, simply because the executive would prefer lower tax rates. While such extreme hypotheticals make it clear that a boundary must exist, it is important to attempt to identify at least the broad contours of the boundary, short of those extremes. Poorly-articulated and poorly-bounded categorical enforcement discretion could invite administrations to move toward those extremes or even intentionally circumvent laws that they have a duty to administer and enforce.

Part I outlines potential sources of authority – and their limits – for categorical non-enforcement of tax laws. These include constitutional and administrative law, general provisions of the tax code, and specific authorities and duties embodied by specific provisions of the relevant tax law.

These sources of authority do not draw a clear bright line between permissible non-enforcement discretion and impermissible disregard of the law, and this report does not attempt to fully delineate that boundary. However, the authorities and case law do establish that the authority for categorical non-enforcement is not limitless. These authorities suggest that agencies should carefully consider factors including resource constraints and the specific statutory text and legislative intent of the law that the agency is considering not enforcing to determine when non-enforcement is authorized. The courts have made clear that this inquiry, far from being austerely textualist, requires interrogating and giving due consideration and weight to the purposes of the provision of law that may or may not be enforced, and the degree to which the actions are frustrating rather than effectuating Congress's purposes.

It is also clear that limits to non-enforcement authority exist even when courts decline to review agency non-enforcement decisions. The judiciary can decline to review agency non-enforcement decisions when the Executive Branch is the institution most competent to identify and weigh the

[10] *See generally* Leigh Osofsky, *The Case for Categorical Nonenforcement*, 69 Tax L. Rev. 73, 75-76, 124, 132 (2015). One way transparent categorical non-enforcement decisions promote accountability is through communicating to lawmakers that the agency faces resource constraints or has adopted a particular policy position. *See id.* at 75-76, 124, 132. Lawmakers can then respond by providing more resources, modifying the scope of the statute or the agency's discretion, or using accountability mechanisms. *See id.*

administrative considerations surrounding non-enforcement and its limits. In other cases, there may be no plaintiff with "standing" – the ability to ask the court to review a non-enforcement decision. When Treasury and the IRS make decisions that are arguably outside of authority and that reduce tax revenues, this fact alone does not allow taxpayers to challenge those decisions in the courts, absent other more specific harms. The lack of potential judicial review of certain non-enforcement decisions does not mean that there are no limits to non-enforcement authority, but instead places the onus more squarely on agencies, rather than the courts, to carefully identify the bounds of authority. (There may also in fact be potential litigants who can challenge the bounds of recent non-enforcement decisions, as Part I discusses briefly.)

The often-asymmetric pressures that Treasury and the IRS face to take categorical non-enforcement relief makes it even more vital for Treasury and the IRS to have a firm grasp on the sources and scope of their authority, and to work to help current and future tax system participants understand those boundaries.[11] Treasury and the IRS have faced intense industry pressure and sometimes congressional pressure to offer relief from strict enforcement of the law. For instance, they cited "feedback from taxpayers, tax professionals, and payment processors" when delaying full implementation of 1099-K reporting.[12] Treasury and the IRS can also be assured of legal challenges to their decisions in cases where they arguably increase taxes or compliance burdens on filers outside of their authority. These are good reasons for Treasury and the IRS to be careful and explicit about understanding and articulating the bounds of their authority to take categorical non-enforcement decisions.[13]

This report does not argue that any specific recent non-enforcement decision lacks authority. However, it is understandable that Treasury and the IRS are facing questions about whether they may be running up against the boundaries of their non-enforcement authority, given that, when issuing recent decisions, they have not clearly stated the sources (and limits) of the authority relied upon to decline to enforce tax laws, or explained why those decisions fit within such authority in the face of explicit statutory requirements including effective dates.

Transparent and explicit reasoning about authority and its boundaries can help ensure that Treasury and the IRS in fact take decisions within authority, help secure public confidence in Treasury's and the IRS's commitment to the law, and guard against potential future abuses of authority.

Part II: When and how is it sound for Treasury and the IRS to exercise their discretion to issue categorical non-enforcement relief?

Part II clarifies that even where authority for discretionary non-enforcement exists, Treasury and the IRS should strive to ensure that they use it only when doing so would produce sound results, based on thorough consideration of relevant tax administration and statutory interests.

---

[11] *See, e.g.*, Brian Galle & Stephen Shay, *Admin Law and the Crisis of Tax Administration*, 101 N.C. L. Rev. 1645 (2023) (describing the tax system's "tilt" against revenue and toward inaction); Glen Staszewski, *The Federal Inaction Commission*, 59 Emory L.J. 369, 370-71 (2009); Melissa F. Wasserman, *Deference Asymmetries: Distortions in the Evolution of Regulatory Law*, 93 Texas L. Rev. 625, 628 (2015) (citing Leandra Lederman & Stephen W. Mazza, Tax Controversies: Practice and Procedure 8 (3d ed. 2009)); Lisa Schultz Bressman, *Judicial Review of Agency Inaction: An Arbitrariness Approach*, 79 N.Y.U. L. Rev. 1657, 1691-93 (2004).
[12] IRS Announces Delay in Form 1099-K Reporting Threshold for Third Party Platform Payments in 2023; Plans for a Threshold of $5,000 for 2024 to Phase in Implementation, IR-2023-221 (Nov. 21, 2023).
[13] *See*, *e.g.*, Emily Hammond & David L. Markell, *Administrative Proxies for Judicial Review: Building Legitimacy from the Inside-Out*, 37 Harv. Envt'l L. Rev. 313, 325-26 (2013).

In announcing some of their recent non-enforcement decisions, Treasury and the IRS have made broad statements that the decisions are good for "sound tax administration," but have not offered specific reasons for that conclusion beyond, in some cases, pointing to stakeholder input. Some taxpayers and filers – including well-resourced industry groups at the forefront of pushing for some of the granted relief – naturally welcomed these decisions. But the same decisions disadvantaged others, including filers who incurred costs making good-faith efforts to comply with the law. The decisions also had significant costs for tax administration, including reduced certainty and predictability in how and when future new tax provisions would be implemented.

These decisions by their nature also raised the specter of some harm to the purposes and intent of the tax law provisions that Treasury and the IRS temporarily declined to enforce, including reducing the tax gap and improving tax compliance, raising revenue, and advancing other legislative goals.

Additionally, in many recent decisions, hurriedly reversing other guidance or making last-minute non-enforcement decisions close to important deadlines led to disruption, uncertainty, and inequity between filers that a clear and timely decision could have avoided.

For instance, setting aside questions of authority, Treasury and the IRS's decisions delaying full implementation of statutory 1099-K reporting thresholds were of questionable wisdom, as it was unclear that significant downsides for tax compliance, administration, certainty, and revenue were considered alongside the stated upsides. And even when setting aside the wisdom of these decisions, repeatedly waiting until the verge of filing season to announce them had its own costs.

Part III: How can Treasury and the IRS ensure that exercise of non-enforcement discretion is transparent and consistent?

Part III recommends that Treasury and the IRS state clearly what they believe is the source and boundary of their non-enforcement authority and why they believe any non-enforcement decision sits within that authority. They should further state what factors they consider when exercising their non-enforcement authority, and clarify the processes governing how they will exercise it.

Even if Treasury and the IRS ultimately take a different approach to the substance of these issues than this report suggests, transparency could have independent value. Transparency can help place appropriate boundaries on Treasury and the IRS's non-enforcement authority by requiring justification for non-enforcement actions and then allowing stakeholders to assess whether Treasury and the IRS have acted consistently with their own stated approach across decisions. Transparency may also make it easier for filers to anticipate and plan for how tax laws (especially new laws) will be implemented.