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Submitted via electronic mail
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Re: Recommendations for the 2024-2025 Priority Guidance Plan (PGP)

The 2024-2025 Priority Guidance Plan (the "PGP") will be the first post-Inflation Reduction Act ("IRA") PGP developed from the start with a Senate-confirmed Internal Revenue Service ("IRS") Chief Counsel and IRS Commissioner in place. This is a good time to build on recent IRS and Treasury progress that has begun to clear PGP backlogs, and to increase consideration of proactive guidance projects (including those that target noncompliance by wealthy tax filers and corporations, bolster information reporting, and level access for all taxpayers), as well as improve how the guidance agenda is developed.

A strong tax guidance agenda and plan is critical to the goals of improving taxpayer services, modernizing IRS's technology, and expanding enforcement efforts against high-wealth filers, corporations, and complex partnerships.[1] Clear guidance that helps filers to understand their tax obligations can both reduce administrative burden for filers and can be more effective and efficient at ensuring compliance than relying on audits and disputes alone. This is why the Strategic Operating Plan (the "SOP") correctly emphasizes "front-end compliance." In particular, Initiative 1.7 of the SOP commits to "Expand[ing] capacity in the Office of Chief Counsel and with the Department of the Treasury Office of Tax Policy to address more taxpayer questions proactively using both formal and informal legal guidance and rulings."[2]

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[1] Press Release, Department of the Treasury, Remarks by Secretary of the Treasury Janet R. Yellen During a Press Call on IRS Filing Season 2024 (April 12, 2024); *see also* IRS, Inflation Reduction Act Strategic Operating Plan FY 2023-2031 (2023).
[2] IRS, *supra* note 1 at 32.

SOP implementation will include restoring capacity to implement needed guidance, but the SOP and SOP annual report do not yet set specific goals for improving regulations and other guidance. This comment offers some initial recommendations for how to do that in three parts:

Part I: Approaches to clearing existing PGP projects.
Part II: Broad principles for establishing a more robust guidance agenda.
Part III: Illustrative potential guidance projects.

Part I: Approaches to clearing existing PGP projects

The Tax Law Center continues to commend the administration for its work on the monumental task of issuing guidance implementing the IRA, and in developing novel approaches to generating broad stakeholder input on needed IRA guidance.[3] However, a significant guidance backlog still exists, in large part because of these statutory implementation priorities, a bottleneck caused by the Memorandum of Agreement (the "MOA") regarding Office of Information and Regulatory Affairs ("OIRA") review in effect from 2018 to 2023[4] and the multi-year process of rebuilding IRS capacity. The current PGP contains more than 200 items that have not yet been addressed, and many items on the PGP have been included for a number of years. For example, "[f]inal[ize] regulations under 469(h)(2) concerning limited partners and material participation" has been included in various PGPs dating back to 2014-15.[5]

Now that more appropriate funding for the guidance function and the 2023 MOA are both in place, it is a good time to address which items on the PGP could be cleared first. On this point, we offer three recommendations for approaches that may be useful:

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[3] For instance, "in implementing the IRA's climate tax credits, before issuing any NPRMs, Treasury and the IRS issued nine notices in October and November of last year, inviting stakeholders to comment on what guidance Treasury and the IRS should issue and prioritize, and undertook outreach including a series of stakeholder discussions. This responds to research highlighting that the provision of pre-NPRM comments in tax had been especially opaque relative to other agencies, and inaccessible to many stakeholders. Treasury received thousands of comments on these notices." Chye-Ching Huang, *Modernizing Tax Regulatory Review*, Yale Journal on Regulation Notice and Comment Blog (June 29, 2023) (citing Press Release, Department of the Treasury, Treasury Seeks Public Input on Implementation of the Inflation Reduction Act's Clean Energy Tax Incentives (October 5, 2022); Press Release, Department of the Treasury, Treasury Announces Information Timeline for Inflation Reduction Act Tax Implementation (December 19, 2022); News Release, IRS, IRS seeks comments on upcoming energy guidance (November 3, 2022); Shu-Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations*, 69 Emory Law Journal 209 (2019)).

[4] On June 9 the Treasury Department and the White House Office of Management and Budget entered into a Memorandum of Agreement ("2023 MOA") with the effect that tax and certain other Treasury regulations will not be subject to OIRA review under section 6 of EO 12866. *See* Memorandum of Agreement, Department of the Treasury & Office of Management & Budget, Review of Treasury Regulations Under Executive Order 12866 (June 9, 2023); Executive Order No. 12866, Regulatory Planning and Review, 58 Fed. Reg. 51,735 (September. 30, 1993). This reverses the course set by the 2018 Memorandum of Agreement ("2018 MOA"), which had sent many more tax regulations to OIRA for review. *See* Memorandum of Agreement, Department of the Treasury & Office of Management & Budget, Review of Tax Regulations under Executive Order 12866 (April 11, 2018).

[5] *See, e.g.,* Department of Treasury, Priority Guidance Plan 2014-2015, Partnerships, item 3 (Aug. 26, 2014); Department of Treasury, Priority Guidance Plan 2015-2016, Partnerships, item 2 (July 31, 2015); Department of Treasury, Priority Guidance Plan 2023-2024, Partnerships, item 3 (Sept. 29, 2023) ("2023-2024 PGP").

1. **Prioritize guidance that will reduce the need for use of categorical non-enforcement authority**. Treasury and the IRS have not met several statutory deadlines for implementing new legislation, instead using categorical non-enforcement relief (a policy of non-enforcement of statutory provisions for large categories of filers for set periods of time) in these circumstances.[6] We have previously written on how liberal use of categorical non-enforcement relief is a costly substitute for timely guidance because it raises serious legal and operational risks.[7] Recent IRS use of non-enforcement authority has also been exercised with little explanation as to sources of legal authority, and in ways that created unnecessary confusion and uncertainty.

   Improving prioritization and throughput of regulations in areas where categorical non-enforcement is being used currently or is being contemplated could help avoid delays in implementing statutory mandates and reduce reliance on categorical non-enforcement authority. When categorical non-enforcement authority is offered due to a lack of guidance, IRS should provide a clear timeline of when needed guidance will be released.

   For example, we have welcomed the long-awaited issuance of the bulk of required cryptocurrency broker reporting guidance, along with the stated intention to finalize additional regulations later this year.[8]

We **attach** our report setting out additional recommendations for improving the use of categorical non-enforcement authority in **Appendix A**.

2. **Complete projects, or parts of projects, that are already significantly developed.** We have noticed what appears to be a recent uptick in issuing or promising to imminently issue guidance that has been under substantial development and in a near-issuance stage.[9] This is a very positive step as many items, such as guidance on previously taxed earnings and profits, have been on the PGP for many years, repeatedly missing estimated delivery dates.[10]

   Some longstanding guidance issues are very difficult to finalize, purely because of the complicated legal analysis underlying the guidance project, making slow progress at times

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[6] Areas include non-enforcement of certain state payments in 2022 and delay in implementation of 1099-K reporting requirements, broker reporting requirements for digital assets, and delay of the requirement that plan sponsors designate certain catch-up contributions as Roth contributions. A more complete list is found in the attached report.

[7] Chye-Ching Huang, Tax Law Center at NYU Law, *Improving Categorial Non-Enforcement in the Tax System*, 6 (2024).

[8] Tax Law Center at NYU Law, *Statement on Release of Final Digital Asset Broker Reporting Regulations* (June 28, 2024).

[9] *See, e.g.* Erin Schilling, *Finalized IRS Estate Tax Regulations Expected This Summer*, Bloomberg Daily Tax Report (May 3, 2024) ("The Treasury Department and IRS are gearing up to drop several regulations related to estate and gift taxes in the next few months. . . . 'There are certain decisions that haven't been resolved, but I'm hopeful,' Hughes said regarding the timing of the final regulations. 'I think we've made a lot of really good progress on the current priority guidance plan this year.'").

[10] Tax Law Center at NYU Law, Recommendations for the 2022-2023 Priority Guidance Plan (June 2, 2022).

inevitable. However, significant delays can beget longer delays, as members of working groups and reviewers turn over and new members must get brought up to speed or offer different perspectives than prior personnel. These delays can result in a perpetual cycle of continually revisiting and updating partially-developed guidance for new market practices and judicial developments that may not ultimately lead to significant improvements in the guidance, with substantial costs as the system continues to operate in the absence of guidance.

However, in some cases certain long-standing projects could be moved forward by prioritizing parts of a guidance project that are either easier or more critical to get over the finish line on a "standalone" basis.[11] This could mean finalizing a discrete regulation when other related parts will require further consideration, are more controversial, or pose questions of regulatory authority that may delay implementation. This strategy may be particularly efficient and useful when finalizing a part of a guidance project in a standalone capacity could be accomplished quickly and would be helpful for taxpayer clarity and compliance. Treasury and IRS's bifurcated approach to cryptocurrency broker reporting guidance, discussed above, is one example of how this can be accomplished.

3. **"Omnibus" approaches to "good housekeeping" regulations and guidance.** While some guidance projects are too complicated or controversial to finalize quickly, other discrete guidance projects that are broadly agreed to be worthwhile and not particularly controversial can nevertheless fail to achieve completion if they are continually deprioritized behind larger or more deadline-driven projects. Over time, the cumulative lack of clarity and compliance can add up. To facilitate "good housekeeping" projects reaching completion, Treasury and the IRS could consider attempting to move or finalize packages of guidance projects of this type. For example, we have recommended such an omnibus approach to several longstanding partnership taxation guidance projects,[12] and a similar approach could be considered in other areas where helpful, non-controversial discrete guidance projects are delayed.

   Indeed, we commend recent proposed regulations providing guidance on a variety of issues impacting trusts—including information reporting of transactions with foreign trusts, reporting clarifications for foreign trust structures moving into trust-friendly states, receipt of large foreign gifts, and treatment of loans from and the usage of property belonging to foreign trusts—as a good example of this approach that could be considered in other issue areas.

Part II: Broad principles for establishing a more robust guidance agenda.

[11] *See* Tax Law Center at NYU Law, *supra* note 10.

[12] Tax Law Center at NYU Law, Suggestions for Partnership Regulations (December 13, 2023). While some of the items on this list may already be covered by existing entries in the PGP, the proposal provides an illustrative example of the types of proposals that could be grouped into an "omnibus" package.

IRA mandatory funding, ambitious SOP goals for IRS transformation, Senate-confirmed IRS leadership, and the 2023 MOA are all in place. Treasury and the IRS now have the opportunity to demonstrate progress towards the robust and proactive guidance agenda needed to achieve IRS transformation goals and to ensure that SOP buildout continues to adequately recognize, prioritize, and resource guidance as a key element. Building a robust and proactive guidance agenda will require:

a. **Continuing to make more specific and explicit SOP initiatives and milestones to improve guidance and increase staffing and resource for IRS Office of Chief Counsel and other functions that support guidance.** The SOP includes goals for improving guidance and corresponding commitments to increase staffing and resources at IRS Office of Chief Counsel needed to improve guidance, with the stated goal of providing "earlier legal certainty" to taxpayers by providing "guidance interpreting the tax law."[13] Additionally, the IRS has recently announced the creation of a new dedicated group in the IRS Office of Chief Counsel, specifically focused on developing partnership guidance and closing loopholes.[14]

   Acting on these guidance improvement goals and resourcing plans can help ensure that guidance – and the resource commitments needed to support guidance – continues to form an integral part of effective transformation.

   Additionally, research and evaluation to support efficient SOP implementation should examine the potential impact and efficiency of front-end guidance as a tool for achieving increased compliance and reductions in administrative burden, as compared to reliance on audits and disputes. Otherwise, research and evaluation frameworks could also skew resource allocation by leading to guidance being deprioritized even when it would be a more effective – including more cost-effective – tool than audits and other back-end sound tax administration goals.

b. **Progress towards selecting and executing on guidance projects that reduce tax non-compliance and administrative burden in accordance with SOP goals, and that go beyond those projects that are required to implement new statutes and clear backlogs of promised guidance.** This will be necessary to achieve SOP goals and alleviate undue pressure on audits and disputes as the sole strategies to mitigate non-compliance and administrative burdens.

   For instance, Objective 1 is to "dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible," and Initiative

[13] IRS, *supra* note 1 at 32.
[14] IRS, IRS announces new steps to combat abusive use of partnerships; agency's focus intensifies as new guidance closes loopholes worth tens of billions (June 17, 2024).

1.7 commits to providing "greater upfront clarity and certainty" through "additional guidance on tax issues."[15]

Even as it clears guidance backlogs, completes implementation of tax law provisions of the IRA, and looks forward to a more comprehensive revitalization of guidance processes, Treasury and the IRS can continue to demonstrate immediate movement towards a more robust ongoing guidance agenda. It can do so by prioritizing and executing on several guidance projects in areas including:

i. **Addressing substantive areas of non-compliance, especially at the high end.** It is encouraging that, in addition to announcing increased audit activity of large partnerships as well as litigation around the [mis]application of the limited partner exception to the Self-Employed Contributions Act (SECA) tax under section 1402(a)(13) to active limited partners in a partnership, the IRS is also exploring regulatory options to improve compliance.

   Outside partnership taxation, other areas of announced or ongoing audit and litigation activity could also be complemented by clear guidance. For instance, we have commended the IRS effort to increase compliance with tax law regarding inclusions in income of personal use of business aircraft,[16] and also note that the IRS has an opportunity to prevent executives from routinely dramatically understating the value of personal flights on their tax returns.[17] This is a relatively small issue in terms of numbers of filers and revenue affected, but it is illustrative of the many situations where "back end" compliance can be complemented by front-end guidance.

   The Tax Law Center and others have offered many specific suggestions for projects of these types across substantive issue areas. These include issuing important technical corrections and updates to partnership tax regulations,[18] republishing or finalizing proposed regulations and publishing related sub regulatory guidance addressing fee waivers under section 707 to curb partnerships' improper use of fee waiver arrangements,[19] addressing the

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[15] IRS, *supra* note 1 at 32. Other objectives and initiatives also rely on Objective 1.7 in order to be most effectively achieved, e.g. Objective 3, "Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap," and initiatives including for complex, "high-risk and emerging issues." *Id.* at 62-64.

[16] *See* Bloomberg Tax, *Inside Government Crackdown on Corporate Jet Tax Abuse*, Talking Tax (March 27, 2024); Erin Schilling & Erin Slowey, *Corporate Jet Industry Pushes Back on IRS Audit Campaign,* Bloomberg Law (February 26, 2024) ("The IRS should reconsider some regulations in concert with the enforcement, said Michael Kaercher, a senior attorney adviser at the Tax Law Center at New York University.").

[17] *How Treasury and the IRS have the authority to eliminate a little-known tax subsidy for executives' personal use of corporate jets,* Tax Law Center at NYU Law (February 22, 2024).

[18] John Rooney & Grace Henley, *Now holding 30 trillion dollars in assets, partnerships require increased scrutiny and broad reforms*, Tax Law Center at NYU Law (December 13, 2023).

[19] *Fee for services in partnerships,* Tax Law Center at NYU Law (last visited July 22, 2024).

"check-the-box" regulations that allow taxpayers to elect the tax status of their business entities for tax planning purposes, preventing inappropriate characterizations of income and other tax planning techniques by private equity and other investment funds, projects to collectively limit opportunities for estate, gift, and generation-skipping transfer tax avoidance, and repealing the use of the Standard Industry Fare Level method for calculating income inclusion for personal use of corporate jets.[20]

We therefore welcome some of the items newly included in the most recent PGP updates or the Treasury's Spring 2024 regulatory agenda, including guidance addressing divisive transactions to avoid *General Utilities* repeal, guidance addressing the application of section 382 to foreign corporations, guidance clarifying which transactions qualify as reorganizations under section 368(a)(1)(F), and guidance addressing fee waivers under section 707.

ii. **Bolstering information reporting.** Information reporting requirements, especially third-party information reporting, can support and simplify voluntary compliance, reduce reliance on audits, and help focus audit and other compliance activity on filers most likely to be non-compliant. For these reasons, guidance projects implementing new statutory information reporting requirements are particularly aligned with IRS transformation goals. This is why it has been especially disappointing that (as noted above in Part I) new information reporting requirements have not been implemented in a timely way.

Once guidance backlogs are cleared, additional regulatory projects improving information reporting would support compliance efforts and should be considered as part of a proactive regulatory agenda. The recently proposed foreign trust regulations, which are consistent with our previous 2022-2023 PGP comment, are an example of progress towards this objective. The proposed regulations provide guidance regarding information reporting of transactions with foreign trusts and receipt of large foreign gifts and loans from, and uses of property of, foreign trusts, and are an example of a regulatory package that aims to both clarify existing rules and improve tax administration and front-end compliance. Building on this momentum, Treasury and the IRS could also strengthen reporting requirements for art and antiquities brokers to prevent unscrupulous actors from artificially inflating

[20] *How Treasury and the IRS have the authority to eliminate a little-known tax subsidy for executives' personal use of corporate jets*, Tax Law Center at NYU Law (February 22, 2024).

the value of new acquisitions and improperly maximizing certain expenses or deductions on their tax returns.[21]

iii. **Improve accountability, transparency, and level access for taxpayers.** Several of our recommendations are related to improving transparency by formalizing guidance, rather than relying on ad hoc private letter rulings or "closing agreements," both of which often require significant taxpayer resources to obtain while providing no visibility to the public. We also recommend that the IRS continue to improve its processes related to frequently asked questions posted on its website.

We note opportunities to evaluate and continue to improve mechanisms for ensuring that the tax guidance agenda is sensitive to the needs of underserved communities in Part II, section d below.

In the 2024 annual update to the SOP, the IRS committed to track credit uptake and develop metrics to measure success in narrowing the participation gap.[22] This adds specificity to the commitment in the original SOP to "improve understanding of the credits and deductions gap."[23] We welcome this step, and as IRS and Treasury determine and implement metrics, there may be opportunities to prioritize aligned guidance projects that support tax credit access, research, and evaluation, similar to already-completed or underway guidance projects clarifying Premium Tax Credit access,[24] streamlining data analysis,[25] and facilitating simplified filing procedures.[26]

c. **Reviewing, evaluating, and improving the process for selecting and executing guidance, including how the IRS seeks and uses inter-agency and stakeholder input.** The most visible statement of how the IRS determines its guidance priorities is the Internal Revenue Manual (the "IRM"), Part 32, Chief Counsel Directives Manual — Published Guidance and Other Guidance to Taxpayers, which was last updated in 2019.[27]

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[21] *See* Tax Law Center, *supra* note 10 at 33-35 (detailing our prior suggestions with respect to reporting requirements for art and antiquities); Department of the Treasury, *Study of the Facilitation of Money Laundering and Terror Finance Tough the Trade in Works of Art (February, 2022).*
[22] IRS, IRA Strategic Operating Plan Annual Update 12-13 (2024).
[23] IRS, *supra* note 1 at 36.
[24] *See, e.g.,* Tax Law Center at NYU Law & Urban Institute, *Affordability of Employer Coverage for Family Members of Employees – NPRM Request for Comments* (June 6, 2022).
[25] *See, e.g.,* Disclosures of Return Information Reflected on Returns to Officers and Employees of the Department of Commerce, Including the Bureau of the Census, for Certain Statistical Purposes and Related Activities, Reg-123376-22, 89 Fed. Reg. 22101 (March 29, 2024).
[26] *See, e.g.,* Rev. Proc. 2021-24, 2021-29 I.R.B. 19.
[27] It likewise references a March 5, 2019 Department of the Treasury Policy Statement on the Tax Regulatory Process which also predates a number of relevant developments. *See* Department of the Treasury, Policy Statement on the Tax Regulatory Process (March 5, 2019).

It predates developments that should impact guidance selection and completion, including: new IRA resources and the SOP; changes to cross-agency requirements for regulations (including new Executive Orders); and changes in constitutional and administrative law.

Updating the IRM is neither necessary nor sufficient to improve guidance processes and outcomes, but it helps to flag some ways that Treasury and the IRS may be able to evaluate and consider how it can improve, such as:

i. **Generating projects for consideration.** To initiate the PGP, "Every summer, each of the IRS Offices of Associate Chief Counsel are required to identify and describe two or more priority tax guidance projects from the Priority Guidance Plan that the office expects to issue during the fiscal year."[28] A starting point of two projects per office may not be the most effective or efficient foundation for identifying high-value projects that are likely to be completed during the fiscal year, and IRS should consider whether there are more streamlined alternatives that may deliver projects aligned with tax administration priorities such as those in the SOP.

ii. **Identifying and considering relevant cross-agency Executive Orders ("EOs").** The IRM and notices calling for submissions on the PGP have been inconsistent (both over time and between these two public sources) when referencing cross-agency EOs that may set out important criteria for determining tax guidance priorities. For example, the IRM currently references EOs 13563 (January 2011, Improving Regulation and Regulatory Review), 13777 (February 2017, Enforcing the Regulatory Reform Agenda), and 13879 (July 2019, Advancing American Kidney Health) as setting out considerations relevant for selecting guidance, but does not reference more recent EOs with relevance for setting guidance priorities, including:

- EO 13985 "Advancing Racial Equity and Support for Underserved Communities Through the Federal Government."
- EO 14091 "Further Advancing Racial Equity and Support for Underserved Communities Through the Federal Government."
- EO 14008 "Tackling the Climate Crisis at Home and Abroad."
- EO 14058 "Transforming Federal Customer Experience and Service Delivery to Rebuild Trust in Government."

Notices calling for PGP submissions have also inconsistently referenced EOs. Recent notices requesting comments on the PGP did not mention the EOs listed

[28] Treasury Inspector General for Tax Administration, Department of the Treasury, *Inquiry on Revolving Door Between the Largest Accounting Firms and the Department of the Treasury* 7 (March 21, 2024).

above – yet prior calls for PGP comments have referenced similar cross-agency executive orders including EO 13563;13771; 13777; and 13789, superseded by Executive Order 13992.[29]

iii. **Clarifying that Treasury and the IRS are running sound processes for facilitating inter-agency input while maintaining Treasury and IRS control over rulemaking delegated to tax administrators**.
Lawmakers have required Treasury and the IRS to implement major legislation with aims that are not primarily about revenue collection, but rather about policy goals in areas where other agencies hold relevant analytical capacity or interpretive authority (such as healthcare and energy). The 2018 MOA was imposed upon the tax guidance process based on the incorrect view that interagency coordination and Presidential oversight of tax rulemaking could only be facilitated through OIRA (or the Office of Management and Budget). That unsound process did not improve regulatory analysis or outcomes and hampered sound tax guidance. The 2023 MOA replaced the 2018 MOA and relieved tax rulemaking of this burdensome process. But while requiring OIRA involvement was a poor mechanism for coordinating input and analysis from other agencies, the need for coordination remains.

To fill that need, Treasury and the IRS has solicited and considered relevant input from other agencies as part of its reasoned decision-making in various rulemakings.[30] The IRS could more expressly describe, in the IRM or elsewhere, some of the non-binding rules of thumb for when and how it solicits inter-agency input in the regulatory process while still ensuring guidance and rules are issued in a timely and rigorous manner. These rules could draw on experiences implementing the Affordable Care Act and the IRA, among other intensive interagency processes.

This could help make more evident to lawmakers and commentators that OIRA is not the only approach for running a sound inter-agency process, and that the IRS is indeed using various approaches to doing so even after the 2023 MOA. This could help guard against a potential repeat of the 2018 MOA or similar unsound policy, while providing more transparency on how Treasury and the IRS is approaching coordination.

Additionally, post *Loper Bright* and *Relentless,* there may be calls for increased judicial scrutiny of agency factfinding when it administers statutes, which may

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[29] We noted this inconsistency in our submission to the 2021-2022 PGP, but it has not been addressed. Tax Law Center at NYU Law, Notice 2021-28, 2021-2022 Priority Guidance Plan (PGP) Recommendations 2 (May 28, 2021).
[30] Letter from Janet G. McCabe, Deputy Administrator, Department of Environmental Protection, to Hon. Lily Batchelder, Assistant Secretary For Tax Policy, Department of the Treasury (Dec. 30, 2023).

make it more important for Treasury and the IRS to have clear processes for gathering interagency input while retaining and properly exercising authority delegated to tax administrators.

d. **Evaluate and improve methods for generating and considering input on guidance priorities from a wider range of stakeholders.** Research on the PGP and substantive regulations show that comments have tended to be dominated by well-resourced stakeholders such as industry and practitioners who primarily serve well-resourced private clients.[31] It is also unclear whether various IRS advisory committees substantially improve input into guidance project selection: in the three PGP rounds over 2018-2021, IRSAC submitted a very brief comment explicitly endorsing a request industry had already made, while IRPAC included a brief list of requests that also included an endorsement of an industry request. (IRPAC was folded into IRSAC in 2019.)[32]

Treasury and the IRS have more recently adopted novel approaches for generating input from a broader range of stakeholders in specific comment processes. For example, Treasury and the IRS issued nine notices in October and November of last year, inviting stakeholders to comment on what guidance Treasury and the IRS should issue and prioritize when implementing the IRA's climate tax credits, and undertook outreach including a series of stakeholder discussions.[33] IRS has also announced the creation of an IRS Advisory Council (the "IRSAC") subcommittee on fairness in tax administration, but as we have noted, the success of this mechanism will depend on whether the IRS is able to attract and appoint candidates to the IRSAC who have real-world experience with the stated focus of this subcommittee.[34]

Treasury and the IRS can consider what has been learned from these experiments, including whether some approaches have been better than others at generating broad and high-quality stakeholder input, and in ways that are both efficient for stakeholders and Treasury and the IRS.

IRS should also ensure that its guidance selection and prioritization appropriately prioritizes projects that are high-value for tax administration even in the absence of significant formal comment. These include projects that benefit low- and moderate-income taxpayers and other communities who, even with novel outreach methods in place, may be unable to engage in the formal tax regulatory process and bring attention to their concerns, due to lack of awareness, resources, or other systemic barriers.[35] Continuing to prioritize regulatory projects that may have diffuse benefits to filers or

[31] Emily Shi & Chye-Ching Huang, *Who Speaks Up About the Tax Regulatory Agenda?*, Tax Notes Federal (March 25, 2024).
[32] *Id.*
[33] Chye-Ching Huang, *supra* note *3*.
[34] Tax Law Center at NYU Law, *Statement on nominations for the IRS Advisory Council* (April 30, 2024).
[35] Tax Law Center, *supra* note 29.

benefits that are concentrated among groups who may be less likely to participate in formal requests for guidance for inclusion in the PGP is also consistent with EO 13985,[24] which asks federal agencies to pursue equity, meaning "consistent and systematic fair, just, and impartial treatment of all individuals," including those in various underserved communities as outlined by EO 13985.

Equally, project selection should not overly weight comment from well-resourced filers or industries that represent those filers. The IRM currently states:

> The Office of Chief Counsel receives suggestions for published guidance from many sources within the IRS, as well as from external sources, such as the American Bar Association, the Tax Executives Institute, the American Institute of Certified Public Accountants, industry representatives, and interested taxpayers. These suggestions should be given serious consideration in the process of selecting and prioritizing guidance initiatives for inclusion in the annual PGP.

Industry and professional input is appropriate and important, but the IRS should reconsider whether it is appropriate to explicitly mention in the IRM *any* specific external organizations in a way that suggests that they are *especially* deserving of serious consideration. There is longstanding concern about the extent to which professional organizations act independently of client and industry self-interest.[36] The professions have a view on the tax system that is inherently of those filers who are able to gain professional representation, but even with important pro bono filing assistance and representation efforts very many filers do not have filing assistance and are not represented in audit or controversy. Specifically naming some organizations but not others may also discourage less-sophisticated but equally important stakeholder communities from engaging in a process that may be perceived to explicitly privilege some perspectives.

Part III. Potential guidance items

This part of the comment responds specifically to the solicitation in Notice 2024-28 for items to be included on the PGP. The table of contents is below.

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[36] Joseph J. Throndike & Ajay K. Mehrotra, *"Who Speaks for Tax Equity and Tax Fairness?" The Emergence of the Organized Tax Bar and the Dilemmas of Professional Responsibility*, 81 Duke Journal of Law & Contemporary Problems, 203, 238-9 (2018).

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Corporations and their Shareholders

We were pleased to note the recent addition of the following items on Treasury's Spring 2024 regulatory agenda and/or recent Priority Guidance Plans that are responsive to our previous recommendations:

- Technical Amendment to Treasury Regulation Section 1.337(d)-7 for Certain Conversion Transactions;[37]
- Clarifications Regarding Corporate Reorganizations Under Section 368(a)(1)(F);[38] and
- Regulations and Other Guidance Regarding the Application of §382 to Controlled Foreign Corporations and Related Issues.[39]

These changes are welcome and we look forward to their implementation.

Prevent basis shifting by related parties through corporations

Priority: High

Regulations under section 302 provide that, when a redemption distribution described in section 302(d) is treated as a dividend, "proper adjustments" are made to the basis of the remaining stock with respect to the stock redeemed.[40] An example illustrates the case of a husband and wife who each own half of the shares of stock in a corporation.[41] When the husband is completely redeemed, the basis that would otherwise remain in his redeemed shares shifts to the wife's shares.[42]

Based on this regulation and example, corporate groups commonly use redemption distributions that are treated as dividends to shift basis from the redeemed shareholder to the surviving shareholder(s). This technique is facilitated by section 304, which makes it relatively easy for a corporate group to create a deemed redemption distribution. The enactment of P.L. 115-97 (known as the Tax Cuts and Jobs Act or "TCJA") changed, but did not eliminate, the incentives motivating this planning.[43]

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[37] Department of the Treasury, Technical Amendment to Treasury Regulation Section 1.337(d)-7 for Certain Conversion Transactions, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).
[38] Department of the Treasury, Technical Corrections and Clarifications Regarding Corporate Reorganizations Under Section 368(a)(1)(F), Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).
[39] Department of the Treasury, Second Quarter Update to the 2022-2023 Priority Guidance Plan 3 (Feb. 21, 2023).
[40] Treas. Reg. § 1.302-2(c).
[41] Treas. Reg. § 1.302-2(c), *Example 2*.
[42] *Id.*
[43] For example, the application of sections 951A and 965 has resulted in significantly more previously taxed earnings and profits ("PTEP"), and thus increased the need for basis in the stock of certain controlled foreign corporations ("CFCs") to avoid gain recognition under section 961(b)(2) upon distribution of such amounts.

On multiple occasions, Treasury and the IRS have proposed to address this issue with proposed regulations that were subsequently withdrawn.[44] Treasury and the IRS should again publish proposed regulations to prevent corporate basis shifting. The proposal, which could provide that the redeemed shareholder recognizes a capital loss that is suspended until the occurrence of certain future events, would complement the welcome recent guidance from Treasury addressing basis shifting in the partnership context.[45] Treasury and the IRS should consider issuing this guidance as a standalone proposal instead of waiting to develop a more comprehensive set of rules that address a wider array of basis issues.[46]

Revise the federal income tax treatment of certain corporate "buybacks"

Priority: Medium

A pro rata distribution by a publicly traded corporation typically yields ordinary income for shareholders, but an economically equivalent redemption (a "public buyback") typically yields capital gains (or losses).[47] Paragraphs (b)(1) through (5) of section 302 provide the five pathways to this capital gain (or loss) treatment.[48] While paragraphs (b)(2) through (5) contain relatively mechanical tests, the statutory language of section 302(b)(1), which provides that a redemption is treated as a sale or exchange if it is "not essentially equivalent to a dividend," is more open to interpretation. In Rev. Rul. 76-385, Treasury and the IRS relied on *US v. Davis*[49] to find that a public buyback that reduced a shareholder's interest from .0001118% to .0001081% was *not* essentially equivalent to a dividend.[50] Today, in significant part due to this ruling, virtually every public buyback is treated as resulting in capital gains (or losses), even if it only causes an infinitesimal reduction in a shareholder's interest.[51]

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[44] *See* Announcement 2006-30, 2006-1 C.B. 879 (withdrawing Redemptions Taxable as Dividends, REG-150313-01, 67 Fed. Reg. 64,331 (October 18, 2002)); The Allocation of Consideration and Allocation and Recovery of Basis in Transactions Involving Corporate Stock or Securities; Withdrawal, 84 Fed. Reg. 11,686 (March 28, 2019) (withdrawing The Allocation of Consideration and Allocation and Recovery of Basis in Transactions Involving Corporate Stock or Securities, REG-143686-07, 74 Fed. Reg. 3,509 (January 21, 2009)) ("2019 Withdrawal").

[45] *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals* (March 11, 2024) 13-14 ("FY2025 Green Book"); Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 89 Fed. Reg. 59,476 (June 18, 2024); Notice 2024-54, 2014-28 I.R.B. 24; Rev. Rul. 2024-14, 2024-28 I.R.B. 18.

[46] Treasury and the IRS should also consider proposing a standalone regulation confirming their view that a shareholder recovers its stock basis in a section 301 distribution using a share-by-share approach, consistent with *Johnson v. US*, 435 F.2d 1257 (4th Cir. 1971). *See* 2019 Withdrawal, 84 Fed. Reg. at 11,687. Due to the lack of regulatory guidance, taxpayers currently take positions inconsistent with *Johnson*.

[47] *See* Daniel J. Hemel & Gregg D. Polsky, *Taxing Buybacks*, 38 Yale J. on Reg. 246, 253 (2021) ("Two transactions—one denominated a buyback, the other characterized as a cash dividend—can achieve economically identical results both for the corporation and for its shareholders.")

[48] While almost all public buybacks result in capital gains (or losses), it is unclear how many are governed by section 302(b)(1) (i.e., as opposed to paragraphs (b)(2) through (5) of section 302).

[49] 397 U.S. 301 (1970). In *Davis*, the Court ruled that a redemption by a closely held corporation with a sole shareholder is not essentially equivalent to a dividend if it results in "a meaningful reduction of the shareholder's proportionate interest in the corporation." *Id.* at 313.

[50] 1976-2 C.B. 92.

[51] In rare circumstances, a public buyback may be treated as dividend-equivalent. *See* Rev. Rul. 81-289, 1981-2 C.B. 82 (percentage interest of a shareholder who participated in a public buyback was not changed because of simultaneous participation by other shareholders).

The overly broad interpretation of *Davis* in Rev. Rul. 76-385 effectively nullifies section 302(b)(1) for public buybacks and contributes to the divergent tax treatment of transactions with similar underlying economics.[52] Treasury and the IRS have clear authority to revoke this revenue ruling and publish regulatory guidance more appropriately interpreting section 302(b)(1).[53] Accordingly, in order to improve the federal income tax treatment of public buybacks, Treasury and the IRS should (i) revoke Rev. Rul. 76-385, (ii) revoke or clarify Rev. Rul. 81-289,[54] and (iii) propose regulatory guidance treating public buybacks that are not described in paragraphs (b)(2) through (5) of section 302 as dividend-equivalent.[55] This guidance could distinguish public buybacks from *Davis*, which addressed a redemption by a closely-held corporation.[56] Alternatively, this guidance could re-interpret the *Davis* concept of a "meaningful reduction" for purposes of public buybacks.[57]

Update outstanding guidance addressing the active trade or business requirement of section 355(a)(1)(C) and (b)

Priority: Medium

Historically, the IRS generally allowed a trade or business of de minimis size to satisfy the active trade or business requirement of section 355(a)(1)(C) and (b) (the "ATB Requirement"), regardless of the amount of other assets involved in the transaction, as a practical

[52] *See* Philip F. Postlewaite & Susan Rogers Finneran, *Section 302(b)(1): The Expanding Minnow*, Va. L. Rev. 561, 591 (1978) ("The generosity of [Rev. Rul. 76-385] is startling in light of the historical perspective of the continual efforts of Congress, the courts, and the Service to narrow the escape from dividend treatment under section 302(b)(1) […]."). *See also* Federal Income Taxation of Corporations and Shareholders, Thomson Reuters/Tax & Accounting, 7th Ed. 2000 & Supp 2020-3 ("While defensible in the abstract, it is not hard to imagine [the principle of Rev. Rul. 76-385] being stressed to the point of rupture.").

[53] Regulations under section 302(b)(1) are sparse and have not been substantively updated since 1955. *See* Treas. Reg. § 1.302-2(b). In addition, there is no meaningful judicial authority interpreting a "meaningful reduction" in the context of public buybacks. In *Brown v. US*, 345 F. Supp. 241 (S.D. Ohio 1972), *aff'd without opinion*, 477 F.2d 599 (6th Cir.), *cert. denied*, 414 U.S. 1011 (1973), the court applied *Davis* to evaluate the redemption by a corporation of preferred stock held by a family that controlled 99.3% of the vote of the corporation. While the facts are unclear, it appears that some of the stock of the corporation may have been held by the public.

[54] *See supra* footnote 51. Rev. Rul. 81-289 incorrectly asserts that the Tax Court "applied the meaningful reduction standard in a situation involving a publicly held corporation." *Id.* The ruling cites to *Sawelson v. Comm'r*, which involved a redemption by a closely-held corporation. *See infra* footnote 56.

[55] If this recommendation is pursued, Treasury and the IRS should consider whether additional changes are required to ensure that a public buyback does not result in a deemed dividend to the non-participating shareholders under section 305(c). *See* Treas. Reg. §§ 1.305-3 and -7; *but see* Treas. Reg. § 1.305-3(e), *Example 13* (providing that the non-participating shareholders in a series of public buybacks are not treated as receiving a deemed distribution under section 305 because there was no "plan to increase the proportionate interest of some shareholders and distribute property to other shareholders").

[56] *See supra* footnote 49. Courts have generally held that *Davis* is not limited to closely-held corporations with a single shareholder. *See Coates Trust v. Comm'r*, 480 F.2d 468 (1973) (applying the *Davis* standard to a closely-held corporation with multiple shareholders); *Sawelson v. Comm'r,* 61 T.C. 109 (1973) (same).

[57] The recommended guidance addressing section 302(b)(1) would interact with, but could complement, proposed legislation that would levy a 1% excise tax on public buybacks. *See* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 4501(e)(6).

accommodation of mechanical difficulties imposed under prior law.[58] In 2006 and 2007, however, Congress addressed this issue with the enactment of section 355(b)(3), which provides much greater flexibility in satisfying the ATB Requirement. Proposed regulations published in 2016 would replace the prior de minimis standard with a requirement that the fair market value ("FMV") of a trade or business represent at least 5% of the FMV of a corporation's total assets.[59]

In the guidance announced in the 2021-2022 PGP (and echoed in the 2023-2024 PGP),[60] Treasury and the IRS should raise this threshold to 33 1/3%[61] to better reflect legislative intent that a nontaxable divisive transaction "involve only the separation of assets attributable to the carrying on of an active business."[62] In light of this policy objective and the mechanical relief provided by section 355(b)(3), there is little justification for a standard as low as 5%.[63] However, the threshold should not be raised above 33 1/3% without legislative action in order to avoid conflict with section 355(g).[64] Consideration should also be given to concurrently finalizing the 5% standard of the proposed regulations, which are not effective until finalized,[65] because taxpayers continue to rely on de minimis trades or businesses to satisfy the ATB Requirement.[66]

In connection with this change, Treasury and the IRS should consolidate the outstanding regulatory and subregulatory guidance addressing the ATB Requirement[67] in one updated notice of proposed rulemaking in order to simplify compliance and administration. Among other modifications, the new proposed regulations should also (i) streamline the rules addressing

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[58] *See* Guidance Under Section 355 Concerning Device and Active Trade or Business, REG-134016-15, 81 Fed. Reg. 46,004, 46,007 (July 15, 2016). Under prior law, a corporation could generally satisfy the ATB Requirement only if it was directly engaged in an active trade or business or if substantially all of its assets consisted of stock or securities of corporations that were engaged in an active trade or business.

[59] This 5% standard was apparently based on the private letter ruling ("PLR") policy in place from 1996 to 2003 under which the IRS would not rule on a transaction unless (i) the FMV of the trade or business relied on to satisfy the ATB Requirement was at least 5% of the FMV of the gross assets of the relevant corporation, or (ii) the taxpayer could otherwise demonstrate that the trade or business was not de minimis. *See* Rev. Proc. 96-43, 1996-2 C.B. 330; Rev. Proc. 2003-48, 2003-2 C.B. 86.

[60] *See* Department of Treasury, Priority Guidance Plan 2021-2022, Corporations and Their Shareholders, item 4 (Sept. 9, 2021); 2023-2024 PGP, Corporations and Their Shareholders, item 3.

[61] *See* Joint Committee on Taxation, JCX-19-05R, Summary of Joint Committee Staff Options to Improve Tax Compliance and Reform Tax Expenditures 17 (April 12, 2005) (proposing a 50% standard); Michael L. S chler, *Simplifying and Rationalizing the Spinoff Rules*, 56 SMU L. Rev. 239, 264-265 (2003) (same); Herbert N. Beller, *Section 335 Revisited: Time for a Major Overhaul*, 72 The Tax Lawyer 131, 176 (Fall 2018) (same).

[62] *See* S. Rep. No. 83-1622, at 50 (1954).

[63] The position that a qualifying active trade or business may be small, or even de minimis, is generally based on an incomplete reading of Rev. Rul. 73-44, which states that there is "no requirement in section 355(b) that a specific percentage of the corporation's assets be devoted to the active conduct of a trade or business." 1973-1 C.B. 182. In the ruling, the relevant corporation's active trade or business represented more than a "substantial portion" of its total assets but less than half.

[64] Section 355(g) generally provides that section 355 does not apply to a non-pro rata distribution if, immediately after the distribution, 66 2/3% of the FMV of the assets of either the distributing or controlled corporation consists of investment assets. Thus, if the minimum percentage threshold for the ATB Requirement is raised above 33 1/3%, it could effectively nullify section 355(g).

[65] *See* Prop. Treas. Reg. § 1.355-9(e)(1).

[66] The finalized 5% standard would be replaced by the 33 1/3% standard when the latter is eventually finalized.

[67] *See* Guidance Regarding the Active Trade or Business Requirement Under Section 355(b), REG-123365-03, 72 Fed. Reg. 26,012 (May 8, 2007); *supra* footnote 58; Notice 2007-60, 2007-2 C.B. 466; Rev. Rul. 2019-09, 2019-14 I.R.B. 925.

section 355(b)(2)(C) and (D), with greater reliance on the regulatory authority of section 355(b)(3)(D), and (ii) limit the expansion rules in Prop. Treas. Reg. § 1.355-3(b)(3)(ii) (e.g., by providing that an acquisition is not treated as an expansion if the value of the acquired business exceeds that of the existing business or if the acquisition is part of a plan to distribute the stock of the acquired corporation (or the acquired business) in a section 355 distribution).

Address the use of divisive transactions to avoid the repeal of the *General Utilities* doctrine

Priority: Medium

In Notice 2015-59, Treasury and the IRS announced a study of issues under sections 337(d) and 355 relating to divisive transactions with certain characteristics including the ownership of substantial amounts of investments assets and the disproportionate allocations of investment assets between the distributing and controlled corporation.[68] The notice emphasized that these transactions raised concerns under various section 355 requirements as well as the Code provisions intended to implement repeal of the so-called *General Utilities* doctrine ("GU Repeal"). However, proposed regulations published in 2016 focused solely on the device prohibition of section 355(a)(1)(B) (the "Device Prohibition"), the ATB Requirement, and the business purpose requirement of Treas. Reg. § 1.355-2(b)(1). For reasons that were not explained, the proposed regulations did not directly address GU Repeal.

While the 2016 proposed regulations (along with Rev. Proc. 2015-43[69]) discouraged at least some of the transactions that prompted Notice 2015-59,[70] the rules addressing the Device Prohibition have created significant doctrinal and technical confusion.[71] Treasury and the IRS should propose regulations under section 337(d) that more narrowly target the use of divisive transactions to avoid GU Repeal.[72] If that guidance is published, Treasury and the IRS can significantly simplify the section 355 regulatory regime by withdrawing the rules addressing the Device Prohibition in the 2016 proposed regulations. Concurrently, Treasury and the IRS could also revise the final regulations under Treas. Reg. § 1.355-2(d) to more precisely focus on the stated policy concerns of the Device Prohibition – that is, preventing the use of section 355 distributions to avoid the dividend provisions of the Code (or to facilitate basis recovery). Such revisions could include providing that when the distributing corporation is widely-held and publicly-traded, the distribution is ordinarily considered not to violate the Device Prohibition.

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[68] 2015-40 I.R.B. 459.

[69] 2015-40 I.R.B. 467.

[70] *See, e.g.,* Amy S. Elliott, *Yahoo Drops Plans to Spin off Alibaba, Aims for Reverse Spinoff*, Tax Notes Federal (December 14, 2015).

[71] *See, e.g.,* Lauren Azebu, Robert Rizzi, and Lisa Zarlenga, *A New Role for the Device Test?*, Tax Notes Today Federal (March 22, 2016); New York State Bar Association, *Report No. 1342 – Report on Notice 2015-59 and Revenue Procedure 2015-43 Relating to Substantial Investment Assets, De Minimis Active Trades or Businesses and C-to-RIC Spin-Offs* Part V (April 12, 2016) ("NYSBA Report No. 1342"); New York State Bar Association, *Report No. 1356 – Report on Proposed Regulations under Section 355 Concerning the Device Prohibition and the Active Trade or Business Requirement* Part IV.B (October 14, 2016).

[72] *See* NYSBA Report No. 1342 (making the same recommendation).

Address the application of section 382 to foreign corporations

Priority: Medium

Section 382 limits the use of a "loss corporation's" net operating losses ("NOLs") and certain other tax attributes when the corporation undergoes an ownership change. When section 382 applies, the loss corporation can generally only use those attributes in an annual amount equal to its value multiplied by the long-term tax-exempt rate. Before the enactment of the TJCA, the relevance of section 382 to foreign corporations without income effectively connected with a US trade or business ("ECI") was limited.[73] Nevertheless, there were narrow circumstances when the application of section 382 could potentially affect a foreign corporation without ECI.[74] These situations raised a number of questions, including whether the foreign loss corporation should be treated as having a value of zero, as the statute suggests.[75]

The TCJA elevated the importance of this issue.[76] Today, if a foreign corporation with built-in losses or disallowed business interest expense under section 163(j) undergoes an ownership change, the application of section 382 will likely affect the corporation's subpart F income and tested income. As a result, there is greater pressure on a number of section 382 mechanics, including the determination of the foreign corporation's value.[77] Treating the value as zero under a direct application of section 382(e)(3) would produce a harsh result by effectively eliminating the foreign corporation's use of its attributes after an ownership change. Perhaps for this reason, many taxpayers are currently taking positions contrary to section 382(e)(3) under the prescription of Treas. Reg. § 1.952-2 that, for purposes of computing its subpart F income and tested income, a foreign corporation compute its taxable income as if it were a domestic corporation (and thus, presumably, without reference to section 382(e)(3)).[78]

Allowing multiple approaches to proliferate in the absence of clear guidance creates risks for both taxpayers and sound tax administration. Accordingly, after publishing the guidance under section 382 announced in the 2023-2024 PGP,[79] Treasury and the IRS should resolve the uncertainty in this area by exercising the regulatory authority in section 382(e)(3) to provide rules for determining the value of a foreign corporation without ECI in a manner consistent with the broader policy objectives of section 382.

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[73] A foreign corporation cannot have an NOL carryover unless it has ECI. Treas. Reg. § 1.367(b)-3(e); Rev. Rul. 72-421, 1972 C.B. 166. In addition, while a foreign corporation generally computes its taxable income as if it were a domestic corporation for subpart F purposes, NOL deductions are disallowed for this computation. Treas. Reg. § 1.952-2(c)(5)(ii).

[74] *See*, *e.g.*, CCA 200238025 (June 14, 2002); 1999 FSA Lexis 401 (February 22, 1999); 1997 FSA Lexis 17 (January 22, 1997).

[75] *See* section 382(e)(3). In addition, because section 382 arguably does not apply for purposes of computing earnings and profits ("E&P"), these situations also raised the question of whether a foreign corporation's recognized built-in-losses could be used to limit or eliminate its subpart F income. *See* David S. Miller, *How U.S. Tax Law Encourages Investment Through Tax Havens*, Tax Notes Federal (April 11, 2011); s*ee also infra* footnote 76, Part III.

[76] *See generally* Amanda P. Varma and Eric Solomon, *Loss Limitations as Applied to CFCs*, Tax Notes Federal (August 30, 2021).

[77] This pressure is expected to increase as corporations incur greater disallowed business interest expense due to (i) accounting for depreciation, amortization, and depletion for taxable years beginning before January 1, 2022, under section 163(j)(8)(A)(v), and (ii) rising interest rates.

[78] *See* New York State Bar Association, *Report No. 1457 – Report on the Application of Section 382 to Foreign Corporations* Part IV.B.8, 39 (January 18, 2022).

[79] *See* 2023-2024 PGP at Corporations and Their Shareholders, item 5.

Provide that inbound and outbound transactions cannot qualify as section 368(a)(1)(F) reorganizations

Priority: Low

Subchapter C has long permitted cross-border transactions to qualify as a "mere change" described in section 368(a)(1)(F) (an "'F' reorganization").[80] However, the significant differences in the federal income tax treatment of domestic and foreign corporations appear inconsistent with the principle that an "F" reorganization involve "only the simplest and least significant of corporate changes" and that the "surviving corporation is the same corporation as the predecessor in every respect, except for minor or technical differences."[81]

This inconsistency was highlighted by a recent case involving an outbound "F" reorganization.[82] The taxpayer argued that the foreign resulting corporation should be allowed to pay itself a deemed section 367(d) royalty under the theory that the resulting corporation is the same as the transferor corporation.[83] The court rejected this argument, finding that the foreign resulting corporation was "essentially different" from the domestic transferor. While this analysis avoided a nonsensical interpretation of section 367(d), the fact that the resulting corporation was "essentially different" is precisely the reason the transaction should not qualify as a "mere change." Cross-border "F" reorganizations have become more popular recently as special purpose acquisition companies expatriate or domesticate prior to combining with a target. The various motivations for undertaking these transactions (including the avoidance of the passive foreign investment company ("PFIC") regime) strains the notion that the transferor corporation and resulting corporation are the same "in every respect, except for minor or technical differences."[84]

Treasury and the IRS should resolve this doctrinal confusion by revising the regulations under section 368(a)(1)(F) to provide that neither an inbound nor an outbound transaction can qualify as an "F" reorganization.[85] If this recommendation is pursued, various conforming changes beyond section 368 will be required.[86]

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[80] *See*, *e.g.,* Rev. Rul. 87-27, 1987-1 C.B. 134 (outbound "F" reorganization); Rev. Rul. 88-25, 1988-1 C.B. 116 (inbound "F" reorganization).

[81] *See Berghash v. Comm'r*, 43 T.C. 743, 752 (1965) (citation and footnotes omitted), *aff'd*, 361 F.2d 257 (2d Cir. 1966). *See also* Reorganizations Under Section 368(a)(1)(F); Section 367(a) and Certain Reorganizations Under Section 368(a)(1)(F), T.D. 9739, 80 Fed. Reg. 56,904, 56,907 (September 21, 2015) ("[T]he Final Regulations are based on the premise that it is appropriate to treat the Resulting Corporation in an F reorganization as the functional equivalent of the Transferor Corporation and to give its corporate enterprise roughly the same freedom of action as would be accorded a corporation that remains within its original corporate shell.").

[82] *See TBL Licensing LLC v. Comm'r*, 158 T.C. No. 1 (2022).

[83] *See id.* at 22.

[84] *See Berghash,* 43 T.C. at 752.

[85] *See* 2023-2024 PGP, General Tax Issues, item 34.

[86] *See, e.g.*, Treas. Reg. § 1.367(a)-1(e)-(f) (containing certain operating rules for outbound "F" reorganizations); Treas. Reg. § 1.367(b)-2(f)(4) (containing certain operating rules applicable to inbound "F" reorganizations); Treas. Reg. § 1.367(b)-2(h) (treating a section 953(d) domestication election as an inbound "F" reorganization); Treas.

Employee Benefits

Revise methods for valuation of personal use of company aircraft under section 61

Priority: Low

When an employee (or an employee's family member) flies on a company aircraft for personal purposes, the employee must either pay the employer for their usage or have an income inclusion for the value of the flight. In many cases, federal regulation prohibits the employee from paying the employer, lest the employer become regulated as an airline. Current tax law effectively subsidizes personal use of corporate jets by executives by undervaluing the value of this benefit to the executive. This is reflected in the growing usage of personal usage of corporate jets, which has increased about 50% from prepandemic levels per the *Wall Street Journal*, with companies in the S&P 500 spending approximately $65 million on executives' personal flights in 2022.[87] Although the IRS has increased focus on personal use of corporate jets as of early 2024, regulations generally allow the income inclusion for personal use to be calculated using (1) the arm's-length price for a charter flight or (2) the Standard Industry Fare Level ("SIFL") method.[88] The SIFL method is commonly used. While highly administrable, the income inclusions are far below the market rate. Currently, the SIFL rates range between 22 cents and 30 cents per mile, far lower than charter rates which can be in the $8 to $29 per mile range.[89]

Treasury and the IRS should repeal or modify the use of the SIFL method under 26 CFR § 1.61-21(g). This can be done either legislatively or administratively – either through eliminating the use of SIFL rules entirely or increasing the "aircraft multiples" listed in 26 CFR § 1.61–21(g)(7) and instituting processes to make sure that they are regularly reviewing and updating the simplified method so that it keeps track with market values of private jet flights. A number of bills address taxation of corporate aircraft more completely by requiring straight-line depreciation.[90]

Gifts and Estates and Trusts

Require recognition for transactions between a grantor and certain grantor trusts

Priority: High

Reg. § 1.7874-2(j) (treating a deemed domestication by reason of section 7874(b) as an inbound "F" reorganization); Rev. Rul. 89-103, 1989-2 C.B. 65 (treating a deemed domestication by reason of section 269B as an inbound "F" reorganization).

[87] Theo Francis & Stephanie Stamm, *The $65 Million Perk for CEOs: Personal Use of the Corporate Jet Has Soared*, WSJ (Jan. 16, 2024).

[88] IRS, *IRS begins audits of corporate jet usage; part of larger effort to ensure high-income groups don't fly under the radar on tax responsibilities* (Feb. 21, 2024).

[89] *See* Rev. Rul. 2024-08, 2024-16 I.R.B. 877; Airstream Jets, *Jet Card Rates 2024* (last visited Jul. 22, 2024).

[90] *See, e.g.*, the Jobs! Jobs! Jobs! Act of 2015, H.R. 3555, 114th Cong. (2015); the Jets for Vets Act of 2012, H.R. 4199, 112th Cong. (2012); and the American Jobs Act of 2011, S. 1549, 112th Cong. (2011).

As a general rule, trusts are separate taxpayers for purposes of the federal income tax.[91] However, section 671 provides that if a trust is a "grantor trust," then the trust's income will be included in the grantor's income tax return. Neither the statutory provisions nor the regulations thereunder necessitate that the grantor and their grantor trust be treated as the same or a single taxpayer for all federal income tax purposes. Nevertheless, Rev. Rul. 85-13[92] (which declined to follow *Rothstein v. US*[93]) provides that a grantor and their grantor trust will not be treated as separate taxpayers for federal income tax purposes and as a result, transactions between a grantor and their grantor trust will not be recognized for federal income tax purposes. This ruling enables taxpayers to take advantage of the grantor trust rules[94] and engage in highly leveraged wealth transfer transactions, death-bed basis shifting transactions, and even perpetuities planning[95] with no federal income tax consequences. These transactions serve to minimize transfer tax obligations and maximize valuation discounts and tax-free basis step up on death.

Treasury and the IRS should revoke Rev. Rul. 85-13 and propose new regulations in Treas. Reg. § 1.671-1, -2, or -3 to generally align the treatment of transactions between grantors and certain grantor trusts with *Rothstein*.[96] The grantor trust rules were intended to confer special treatment on trust arrangements where a taxpayer retains a high degree of control over the trust property.[97] Accordingly, the new proposed regulations could further refine the grantor trust rules and provide special treatment for certain trust arrangements where there is a particularly high degree of control over the trust property. For example, the new proposed regulations could provide a special rule for grantor trusts that Treasury and the IRS consider appropriate to remain wholly disregarded for all federal income tax purposes, such as investment trusts, "rabbi trusts,"[98] liquidating trusts, environmental remediation trusts, and fully revocable trusts (collectively, "wholly disregarded trusts"). This special rule could consider any person treated as the grantor of

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[91] *See* section 641(b).
[92] 1985-1 C.B. 1984.
[93] 735 F.2d 704 (2d Cir. 1984).
[94] *See* sections 671-679.
[95] Trust assets held in trusts subject to a perpetuities period are subject to some transfer tax following the trust's termination. Tax planners avoid this outcome by utilizing the grantor trust rules to transfer assets out of an expiring trust and into a dynasty trust. For example, an expiring trust can be granted a section 678 power over a dynasty trust, and the trust assets can be sold to the dynasty trust at a substantial discount. Because the expiring trust is the grantor of the dynasty trust, the transaction is not recognized for federal income tax purposes. Further, this transaction is not reported on any returns and can be repeated as necessary to substantially shrink the value of a trust subject to a nearing perpetuities date.
[96] *See* Daniel J. Hemel, *How Treasury and the IRS Have Allowed High-Net-Worth Taxpayers to Exploit Stepped-Up Basis on Intergenerational Wealth Transfers, and How They Can Stop It: Answers to Question for the Record* (January 17, 2022) ("Ideally, after rescission of Revenue Ruling 85-13, Treasury and the IRS would promulgate regulations via notice-and-comment rulemaking that adopt Judge Friendly's position in *Rothstein*."); *see generally* Jonathan Curry, How Industry Pushback Sank the Grantor Trust Changes – For Now, Tax Notes Federal (January 31, 2022).
[97] For a comprehensive discussion of the history of the grantor trust rules and a detailed legislative proposal, *see* Mark L. Ascher, *The Grantor Trust Rules Should be Repealed*, 96 Iowa L. Rev. 885 (2011).
[98] This arrangement, where an employer funds a grantor trust with assets intended to satisfy its deferred compensation obligations to its employees, is so identified because it was first publicly used to secure benefits for a rabbi. *See* PLR 8113107 (December 31, 1980) and Rev. Proc. 92-64, 1992-2 C.B. 422 (providing model trust provisions for a "rabbi trust").

any portion of a wholly disregarded trust as directly owning the trust assets attributable to that portion of the wholly disregarded trust for all federal income tax purposes.[99]

For grantor trusts other than wholly disregarded trusts (if carved out), the revocation of Rev. Rul. 85-13 would cause common estate planning techniques (like sales to grantor trusts, deathbed basis planning, and perpetuities planning with expiring trusts) to be recognized for federal income tax purposes. The existing grantor trust rules would still apply to shift the federal income tax burden with respect to trust assets to the grantor. Finally, this proposal would have the added benefit of limiting the efficiency of grantor retained annuity trusts ("GRATs"), which are typically established as grantor trusts.[100]

Limit efficiency of GRATs for transfer tax avoidance

Priority: High

Section 2702(a) provides a method for valuing a grantor's retained interest in a split-interest trust. The regulations thereunder provide the method for determining the gift tax value of the remainder interest passing to the remainder beneficiaries.[101] The value of the remainder interest is calculated by subtracting the value of the taxpayer's retained interest as determined under section 2702(a) from the total value of the assets transferred to the trust.[102] Section 2702(a) provides that unless the retained interest is a "qualified interest," the value of the retained interest is zero. In effect, the entire value of the split-interest trust is subject to gift tax if the retained interest does not meet the requirements for a "qualified interest."

Treasury and the IRS should propose regulations clarifying that a "qualified interest" has a minimum required annuity term. The current definition of a "qualified interest" as one that pays an annuity "at least annually" does not specify what the minimum or maximum annuity term for a qualified interest may be. Clarifying under the authority provided in section 7805(a) that a "qualified interest" has a minimum and maximum term will eliminate the inappropriate planning opportunities created by very short-term or very long-term GRATs.

Treasury and the IRS could also adopt a rule prohibiting the trustee of a GRAT from converting a substantial portion or all of the GRAT assets into debt obligations through a sale of such assets to trusts created by the annuitant or other related parties. Taxpayers are prevented from allocating their exemption from the generation-skipping transfer ("GST") tax to assets in a GRAT until the earlier of the grantor's death or the end of the annuity term.[103] However,

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[99] This suggestion is a narrow version of Prop. Treas. Reg. § 1.671-2(f). The special rule for wholly disregarded trusts would present limited wealth transfer planning opportunities because of the applicable restrictions and tax attributes of wholly disregarded trusts. The assets of wholly disregarded trusts or the interests therein are generally subject to the creditors of the settlors or interest holders and estate tax on the interest holder's death. These features of wholly disregarded trusts are distinct from those of intentionally defective grantor trusts and indicative of a greater degree of dominion over the trust property, consistent with the intended purposes of the grantor trust rules.

[100] *See* "Limit efficiency of GRATs for transfer tax avoidance," *infra* at pg. 14.

[101] *See* Treas. Reg. § 25.2702-1(b). Arguably, this method could be adjusted through the regulations to measure the gift to the remainder beneficiaries, if any, at the time the annuity or unitrust term ends and property is actually transferred to the remainder beneficiaries.

[102] *Id.*

[103] *See* section 2642(f)(1) and (3).

taxpayers circumvent this restriction by having the GRAT sell assets to an existing GST exempt trust in exchange for a note amortized over the GRAT's annuity term. This sale transaction is not reported to the IRS and allows appreciation transferred through the GRAT structure to benefit from the existing trust's GST exempt status. Adopting a rule that prohibits the trustee of a GRAT from converting a substantial portion or all of the GRAT assets into debt obligations through such a sale would complement other additional regulatory requirements that govern qualified interests.[104]

Additionally, Treasury and the IRS should clarify the prohibition on "additional contributions"[105] as it applies to trusts with "qualified interests." Typically, taxpayers insulate their GRATs from market volatility by swapping appreciated assets out of the GRAT in exchange for promissory notes of equal value. Under the regulations, it is not clear what an additional contribution to a trust is and whether replacing appreciated assets in a GRAT with new assets is considered an additional contribution to the trust. By contrast, the regulations explicitly prohibit the grantor from swapping or selling trust property in a qualified personal residence trust ("QPRT").[106] Like GRATs, QPRTs are split-interest trusts and a creation of the regulations under section 2702. Consistent with the model provided for QPRTs under the authority of section 2702, Treasury and the IRS should consider expanding the prohibition on additional contributions to include asset sales and substitutions.

Finally, in the case of a remainder interest that is not a "qualified remainder interest," Treasury and the IRS should clarify that section 2702 does not apply to determine the value of the remainder interest for purposes of determining the value of such an interest on any transfer following its creation.[107] While this result follows from a strict reading of the rules in section 2702, a rule or example can be added to make this explicit.

Republish proposed regulations under section 2704 with technical clarifications

Priority: High

Transfer tax regulations provide that the applicable standard for determining the value of transferred property is FMV.[108] In determining an asset's FMV, appraisers often adjust the value based on factors that include form of ownership, restrictions on transferability, and prevailing market conditions. The application of valuation discounts to closely-held operating businesses has motivated taxpayers to create and fund non-operating limited liability companies or partnerships (sometimes referred to as "family limited partnerships" or "FLPs") solely to reduce the value of property for transfer tax purposes.

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[104] *See* Treas. Reg. § 25.2702-3(d)(2) and (6) (providing that a qualified interest cannot be satisfied either directly or indirectly through the issuance of a note or other debt instrument, nor can the payment of a qualified interest be subject to any contingencies).
[105] *See* Treas. Reg. § 25.2702-3(b)(5).
[106] *See* Treas. Reg. § 25.2702-5(c)(9).
[107] If section 2702 does not apply, any transfer of a remainder interest must be valued as an ordinary remainder interest under Treas. Reg. § 25.2512-5(d)(2) (without subtracting out the grantor's retained interest).
[108] *See* Treas. Reg. §§ 20.2031-1(b), 25.2512-1, and 26.2642-2(a)(1) and (b)(1).

In 2016, Treasury and the IRS published proposed regulations that identified restrictions that would be disregarded for purposes of valuing an entity.[109] The proposed regulations were subsequently withdrawn in 2017.[110]

Though valuation presents complex compliance issues for the IRS, Treasury and the IRS should still consider republishing the proposed regulations with some clarifications to deter the most abusive uses of FLPs for tax planning purposes. Technical revisions that clarify the impact of the proposed regulations could include:

- Clarifying the effect of a "disregarded restriction" on entity valuation by (i) indicating that the proposed regulations do not imply particular substantive rights (such as a right to have an interest redeemed), and (ii) addressing the relevance of default state laws that do not directly restrict a particular owner's ability to redeem or liquidate their interest, but that otherwise restrict the termination or liquidation of the entity itself; and
- Clarifying the meaning of "member of the family" for purposes section 2704(b) by providing that the cross-reference in Prop. Treas. Reg. §§ 25.2704-2(c) and -3(c) to Treas. Reg. § 25.2701-2(b)(5) is for the definition of "control" rather than for the definition of "controlled entity." These clarifications would respond to comments on the 2016 proposed regulations noting these as areas of significant uncertainty.[111]

Treasury and the IRS could also reconsider the treatment of lapses in voting or liquidation rights under Treas. Reg. § 25.2704-1(c)(1) and Prop. Treas. Reg. § 25.2704-4(b)(1) by removing the pre-existing exception to section 2704(a) altogether, or by clarifying the proper valuation date for the deemed gift under Prop. Treas. Reg. § 25.2704-4(b)(1) and providing an illustration of how double taxation at death is avoided if the proposed valuation rules apply.

Finally, Treasury and the IRS could clarify the meaning of "same type of entity" in Prop. Treas. Reg. § 25.2704-2(b)(4)(ii). An applicable restriction does not include a restriction imposed or required to be imposed by federal or state law.[112] However, Prop. Treas. Reg. § 25.2704-2(b)(4)(ii) provides that "a restriction is not imposed or required to be imposed by federal or state law if that law also provides . . . a different statute for the creation and governance of that same type of entity that does not mandate the restriction." As drafted, this language potentially poses administrability and enforcement concerns. It is not clear how an entity for which restrictions on liquidations are mandated can be the "same type of entity" as one for which they are not.

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[109] *See* Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, REG-163113-02, 81 Fed. Reg. 51,413 (August 4, 2016).

[110] *See* Executive Order 13789—Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, 82 Fed. Reg. 48,013, 48,014 (October 16, 2017) ("EO 13789 Report"); Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, 82 Fed. Reg. 48,779 (October 20, 2017).

[111] *See generally*, Howard M. Zaritsky, Jonathan G. Blattmachr, and Mitchell Gans, *Treasury Proposes New Regulations to Restrict Valuation Discount Planning*, 155 Trusts & Estates 15, 21 (2016); *see also* Kevin Matz, *Proposed Regulation Under IRC Section 2704*, NYS Society of CPAs (2016) (noting, "[s]ome commentators have speculated that the implication of the Proposed Regulations is to actually read 'deemed put rights' into the governing documents and local law for valuation purposes, as if the interest holder were granted the affirmative right to withdraw its interest in exchange for a pro rata share of the entity's 'minimum value' upon six months' notice. It does not appear, however, that the Proposed Regulations indicate such an interpretation . . . .").

[112] *See* section 2704(b)(3)(B).

Treasury and the IRS could, at a minimum, clarify that determining the "type of entity" entails consideration of the nomenclature used for the entity, as well as similarity of mandatory governing law provisions, particularly those that do not relate to restrictions on liquidations and redemptions.

Adopt required valuation assumptions

Priority: Medium

Because the FMV standard that applies for transfer tax purposes is based on parties dealing at arm's length, it can be difficult to apply to transfers among related parties. This difficulty creates many opportunities for inappropriate valuations and a significant burden for Treasury and the IRS. As an alternative or in addition to proposing additional regulations under section 2704 (concerning the definition of "value" for certain intra-family transfers),[113] Treasury and the IRS could revise the regulations providing the definition of "value" for transfer tax purposes to incorporate certain valuation "assumptions" or valuation "rules" that must be considered when determining the FMV of FLP interests transferred between family members.

New rebuttable valuation assumptions, as they relate to intrafamily transfers of FLP interests, could include the following:

- An assumption that, when determining the FMV of FLP interests for gift tax purposes, any discretionary liquidation, conversion, dividend, or put rights retained by the donor or the donor's spouse will not be exercised by them in a manner adverse to the donee's interest if the donee is a member of the donor's family unless the transfer is made pursuant to a divorce or other type of judicial settlement;
- An assumption for purposes of the "willing buyer, willing seller" construct of FMV that the willing buyer and the willing seller will be limited to individuals designated as permissible transferees in the governing documents, where the governing document limits transferability of interests in the FLP to family members; or
- An assumption that the "non-tax benefits" of forming an FLP confer real economic benefits to the owners and should be accounted for in valuation. This assumption would accept a taxpayer's assertion that putting passive assets in a FLP has substantial non-tax benefits such as keeping legacy investments in the family, permitting centralized and efficient investing, facilitating transfers of interests in real estate, and protecting assets from claimants and spendthrifts and intra-family disagreements. As a result, in effect, a valuation premium would be required on interests in FLPs before any discount for lack of marketability or control could be imposed. To the extent that the valuation premium would apply, it would only offset valuation discounts. The nature of this premium and the factors on which it is based would need to be reflected in determining the genuine size of valuation discounts.

Address basis of grantor trust assets at death under section 1014

Priority: Low

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[113] *See* "Republish proposed regulations under section 2704 with technical clarifications," *supra* at pg. 15.

The termination of grantor trust status during a grantor's lifetime is treated as a transfer by the grantor of trust assets to the trust, in exchange for any consideration provided by the trust to the grantor (i.e., a recognition event).[114] As a result, when grantor trust status is terminated, the trust becomes a separate taxpayer and taxable income to the grantor could potentially be generated if certain liabilities of (or deemed to be of) the trust exceed the basis of the trust's assets. There is no guidance concerning the income tax treatment of the termination of grantor trust status at the grantor's death.

Treasury and the IRS should propose regulations stating that assets in a grantor trust do not receive a tax-free basis step up when the grantor dies. Alternatively, if Rev. Rul. 85-13 is not revoked,[115] these proposed regulations could apply the same rules for termination of grantor status during the grantor's lifetime to the termination of grantor status on account of the grantor's death. In effect, this would treat the termination of grantor trust status at the grantor's death as a recognition event if certain liabilities of (or deemed to be of) the trust exceed the basis in the trust assets. Consistent with Treas. Reg. § 1.684-2(e)(2), *Example 2*,[116] regulations could provide that the grantor is treated as having transferred assets to the trust the moment before their death. Alternatively, the regulation could provide that a transfer occurs on the moment after the grantor's death.[117] Although Treasury's Spring 2024 regulatory agenda indicates a forthcoming supplemental NPRM that includes treatment of assets after death, the abstract indicates that this NPRM will only address them in the context of section 2032 alternate valuation elections.[118]

Clarify the bona fide sale exception of sections 2035 through 2038

Priority: Low

Many taxpayers minimize estate tax by selling assets at a valuation discount to their grantor trusts in exchange for an installment note. Section 2036(a)(1) includes in a decedent's gross estate any property transferred by the decedent in which the decedent retained the possession or enjoyment of, or the right to income from, the transferred property. The only exception to section 2036(a)(1) is for property transferred in a "bona fide sale for an adequate and full consideration." Case law suggests a sale to a grantor trust should be respected as having resulted in a transfer rather than a retained interest under section 2036(a)(1) only if the trust has assets, other than those sold to the trust in the sale transaction, available to satisfy the resulting promissory note.[119] Further, Treas. Reg. § 20.2043-1 defines a "bona fide sale" for purposes of sections 2035 through 2038 and section 2041 as a transfer "made in good faith." Courts have interpreted the

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[114] *See* Treas. Reg. § 1.1001-2(c), *Example 5*; Rev. Rul. 77-402, 1977-2 C.B. 222; GCM 37228 (August 23, 1977); *Madorin* v. *Comm'r*, 84 T.C. 667 (1985).
[115] *See* "Require recognition for transactions between a grantor and certain grantor trusts," *supra* at pg. 12.
[116] The example concludes that the termination of grantor trust status at the death of the US grantor of a foreign trust is treated as if the grantor had transferred the assets to the trust at the moment before death.
[117] *But see Crane v. Comm'r*, 331 U.S. 1 (1947) (indicating that death is not a recognition event).
[118] Department of the Treasury, *Gross Estate; Election to Value on Alternate Valuation Date*, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).
[119] *See Fidelity-Philadelphia Trust Co. v. Smith*, 356 U.S. 274 (1958).

"good faith" requirement to necessitate heightened scrutiny in the review of intra-family transfers.[120]

There is an informal standard that a sale to a grantor trust will be viewed as a bona fide sale made in good faith if, outside of the sale transaction, the trust owns assets with a value equal to at least 10% of the value of the assets sold (the "10% rule").[121] Because this standard is not reflected in formal guidance, taxpayers can structure their sales by selling assets to an empty trust or have themselves, family members, or trust beneficiaries guarantee a portion of the note used in the sale. The use of guarantees allows a transferor to avoid making a taxable gift while superficially following the 10% rule.

As an extension of the good faith requirement, Treas. Reg. § 20.2043-1 should be revised to apply, at a minimum, the 10% rule for intra-family sale transactions. By requiring that a purchasing trust has sufficient assets to issue a promissory note to the grantor, this revision would minimize situations where the purchasing trust's assets decline significantly in value and, mimicking the flexibility of a GRAT, the grantor and the grantor trust simply unwind the transaction with no income tax or gift tax consequences because the trust has no other assets from which to pay.[122] Finally, Treasury and the IRS should also limit the use of specific parties as guarantors for purposes of determining whether a sale was bona fide.[123]

Limit availability of discounts on gift loans at death

Priority: Low

Under section 7872, if a promissory note bears interest at a rate at least equal to the applicable federal rate ("AFR"), the lender will not be considered to make a gift as result of the loan that gave rise to the promissory note. The AFR is generally well below the prevailing market interest rate for arm's length loans. Under estate tax regulations, the value of a note includable in a decedent's estate is the unpaid principal plus accrued interest, unless the evidence shows that the note is worth less (e.g., due to a low interest rate or inability to collect).[124] When a decedent dies holding a promissory note bearing interest at the AFR, the executor of the decedent's estate may take a valuation discount on the value of the note because the note bears a below market interest rate. As a result, while the note bears sufficient interest during the taxpayer's life to not cause gift tax implications, under estate tax valuation rules, the note can be discounted for bearing interest at a rate well below market norms.

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[120] *See Estate of Raab v. Comm'r*, T.C. Memo 1985-52; *US v. Allen*, 293 F.2d 916 (10th Cir. 1961).

[121] *See* Bloomberg BNA Portfolio 838-2nd: Dynasty Trusts, V. Funding Issues, E. Installment Sale to Grantor Trust (indicating that the 10% rule has only been indicated by the IRS informally).

[122] In this situation, the grantor typically takes back the assets as a nominal payment on the note and forgives the remaining balance on the note. Where the grantor trust has no other assets, it is unclear whether the grantor has made any gift to the trust beneficiaries by terminating the note.

[123] For example, guarantees of payments on a note by the grantor of the trust, the grantor's spouse, or an entity involved in the sale transaction could be disregarded in determining whether the trust had sufficient economic substance for a sale to be respected.

[124] *See* Treas. Reg. § 20.2031-4.

A long-outstanding proposed regulation under section 7872 addresses the valuation of a term loan made with donative intent by providing that it equals the lesser of (i) the unpaid principal and accrued interest; or (ii) the sum of the present value of all payments due under the note using the AFR in effect on the decedent's death.[125] Although this proposed regulation project has not appeared in recent PGPs, Treasury and the IRS should republish the proposed rule and consider broadening its application to demand and term loans regardless of donative intent. These revised rules could resemble the FY2023 Green Book proposal to limit the discount rate on notes for estate tax valuation purposes to the greater of the note's actual interest rate and the AFR in effect on the date of the decedent's death.[126] Such regulations could be promulgated under the authority of sections 2031, 7872, and 7805(a) as necessary for appropriately determining the FMV mandated for estate tax purposes consistent with the standards for valuation reflected under section 7872.

International

Address foreign corporation ownership by partnerships and partners

Priority: High

Section 958 sets forth stock ownership rules for purposes of implementing the subpart F regime. However, the regulations under section 958 provide insufficient guidance for determining ownership in fact patterns involving partnerships, and particularly limited partnerships and those in which there is variation in interests in profits, loss, and capital. In the absence of guidance, taxpayers may take positions that are inconsistent with the purpose of the section 958 rules in an effort to exclude foreign corporations from the subpart F regime or minimize the amounts included with respect to CFCs. Such positions could be facilitated by the fact that section 958(b) incorporates the principles of section 318, with ambiguous results for section 958. This is because section 318 attributes stock ownership by a partnership to its partners proportionately, but without specifying whether such attribution is based on legal control or economic interests, or both, and if on economic interests, how such economic interests are measured. Although these are longstanding issues, the extension of the aggregate treatment of partnerships from foreign partnerships to domestic partnerships[127] has increased their importance.

There is substantial commentary about the need for detailed guidance under section 958 addressing partnerships.[128] If Treasury and the IRS anticipate a significant delay in the issuance of such guidance, consideration should be given to interim, more limited guidance that would address potential inappropriate taxpayer planning. Such guidance could address the treatment of general partners' voting rights and the possibility of inconsistent positions being taken over time,

[125] *See* Prop. Treas. Reg. § 20.7872-1 in Below-Market Loans, LR-165-84, 50 Fed. Reg. 33,553 (August 20, 1985).
[126] See FY2025 Green Book, at 134.
[127] *See* Treas. Reg. § 1.958-1(d)(1).
[128] *See* Greg W. Featherman, *Tax Issues Raised by the Use of Cross-Border Partnerships,* Tax Notes Today International (January 31, 2022), Part IV.A; Jonathan S. Brenner & Josiah P. Child, *I'm Looking Through You, You're Not the Same: Partnership-Held CFCs,* Tax Notes Today Federal (October 22, 2019), Part B; New York State Bar Association, *Report No. 1423 – Report on June 2019 GILTI and Subpart F Regulations* Part III.A.6, 49 (September 18, 2019).

along with any more substantive issues on which Treasury and the IRS have a developed view or could use additional input.[129]

Clarify interaction of section 959 with general E&P and dividend rules

Priority: Medium

The interaction between the rules governing PTEP of a CFC in section 959 and the general rules governing corporate distributions in subchapter C raises a number of coordination issues. For example, section 959(c) provides that in order to determine whether a distribution is made out of PTEP, section 316(a)(2) (relating to current year E&P), and then section 316(a)(1) (relating to accumulated E&P), is applied to three categories of a foreign corporation's earnings – two related to PTEP, and one related to non-PTEP E&P.[130] This rule could be interpreted in multiple ways, and it is not clear whether section 959(c) requires that each category be further divided between current and accumulated subcategories.[131] In addition, Notice 2019-1 suggests a limited role for section 316 in determining PTEP distributions.[132]

Separately, Notice 2019-1 provides that a CFC's current year deficit in E&P does not affect the amount of its PTEP.[133] This rule is consistent with Rev. Rul. 86-131,[134] which coordinates the general rules for reducing E&P on a distribution of property[135] with the three section 959(c) categories. However, the notice does not reference Rev. Rul. 86-131.

Treasury and the IRS should publish the proposed regulations announced in Notice 2019-1 expeditiously.[136] Although Notice 2024-16 and Treasury's Spring 2024 regulatory agenda indicates proposed PTEP regulations are forthcoming, it is not clear whether they will explicitly address the issues above. [137] Specifically, Treasury and the IRS should clearly address the coordination of section 959(c) and section 316 with a discussion of which interpretations are rejected, how the interpretation that is adopted aligns with the introductory language in section 959(c), and how that interpretation relates to the "PTEP-first" approach reflected in the notice.

In addition, the proposed regulations should confirm the point illustrated by Rev. Rul. 86-131 that distributions of loss property do not reduce PTEP in excess of the FMV of the property, and

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[129] Such guidance would be described in, and could accompany guidance already planned under the 2023-2024 PGP, International A. Deemed Inclusion from Foreign Entities, etc., item 2.
[130] Section 316(a) defines a dividend as a distribution of property made by a corporation to its shareholders first out of current E&P (described in section 316(a)(2)) and then accumulated E&P (described in section 316(a)(1)).
[131] Section 316(a)(2), and then section 316(a)(1), could be applied to each category, in turn, before moving on to the next category. Alternatively, section 316(a)(2) could be applied to all three categories before then applying section 316(a)(1) to all three categories.
[132] *See* 2019-2 I.R.B. 275, section 3.02 (stating that the reference to section 316 merely indicates that a distribution of PTEP requires E&P otherwise sufficient to support a dividend).
[133] *See id.,* at section 3.03.
[134] 1986-2 C.B. 135.
[135] *See* section 312(a)(3) and Treas. Reg. § 1.312-1(b).
[136] This guidance is described in the 2023-2024 PGP, International, A. Deemed Inclusions from Foreign Entities, etc., item 4.
[137] Notice 2024-16, 2024-05 I.R.B. 622; Department of the Treasury, , *Exclusion from Gross Income of Previously Taxed Earnings and Profits*, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).

thus must reduce non-PTEP E&P to the extent of the loss. Finally, the proposed regulations should clarify that (i) the interaction of section 959(a) and (b) with section 316 means PTEP can be distributed before earnings that generate the PTEP have been earned, and (ii) reductions to E&P under section 312(a)(3) are made to accumulated, rather than current, E&P, and accordingly do not affect current year PTEP. When Treasury and the IRS publish these proposed regulations, they should also announce the intent to withdraw Rev. Rul. 86-131 upon finalization.

Republish proposed regulations under section 1291

Priority: Medium

A US person owning shares of a Passive Foreign Investment Company ("PFIC") is generally subject to the "excess distribution" rules of section 1291 when it receives certain distributions from or disposes of the stock of the PFIC. These rules are intended to capture the deferral benefit of investing through PFICs and thereby deter their use. In 1992, the IRS published proposed regulations under section 1291, which address a number of topics.[138] Taxpayers and their representatives have consistently requested final guidance on the topics addressed by these proposed regulations, including the treatment of options under section 1298(a)(4) and nonrecognition transactions under section 1291(f).

Under the proposed regulations, excess distributions allocated to prior PFIC years are explicitly excluded from gross income in the year of an "excess distribution" (i.e., the current year).[139] However, this treatment is not required by the statute.[140] Although section 1291(a)(1)(B) might be read to suggest that it describes the "only" amounts included in gross income for the current year, it could be read more narrowly to simply limit the amounts included as ordinary income for such year. This interpretation is consistent with the fact that paragraphs (a)(1)(C) and (c) of section 1291 provide for a special computation of the tax on amounts allocated to the prior PFIC years. Furthermore, treating such amounts as gross income for the year of an "excess distribution" pursuant to the default rule of section 61 would make it more likely that the statute of limitations for the year would be extended under section 6501(e)(1)(A), improving the government's ability to enforce the application of section 1291.

Treasury and the IRS should republish proposed regulations under section 1291, and expediently finalize them, with modifications to Prop. Treas. Reg. § 1.1291-2 to make clear that prior PFIC year amounts that are subject to the "excess distribution" rules are nevertheless included in gross income under section 61 in the current year for purposes of the statute of limitations. The forthcoming finalization of PFIC regulations proposed in January 2022 (as described in Treasury's Spring 2024 regulatory agenda) should address these issues.[141]

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[138] *See* Treatment of Shareholders of Certain Passive Foreign Investment Companies, INTL-941-86, INTL-656-87, INTL-704-87, 57 Fed. Reg. 11,024 (April 1, 1992).

[139] *See* Prop. Treas. Reg. § 1.1291-2(a) and (e)(2)(iii).

[140] *Contra Toso v. Comm'r,* 151 T.C. 27 (2018) (rejecting the government's argument in this regard).

[141] Department of the Treasury, *Guidance on Passive Foreign Investment Companies Held through Domestic Partnerships*, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).

Overhaul the "check-the-box" regulations

Priority: Medium

The so-called "check-the-box" regulations issued in 1996 (the "CTB Regulations")[142] expanded taxpayers' ability to elect the tax status of an entity (a "CTB Election").[143] Since then, the relevance of the CTB Regulations to international tax planning has evolved as legislative developments have modified the broader system. Although planning opportunities have decreased since the CTB Regulations were issued, the CTB Regulations continue to facilitate tax-motivated planning today. Most prominently, taxpayers may use a CTB Election before a disposition to elect into or out of subpart F income[144] or otherwise alter the consequences of the disposition.[145] The optionality facilitated by CTB Elections also allows taxpayers to claim stock losses that can offset income at the general US corporate rate while ensuring that any gains are subject to the reduced GILTI rate. In addition, taxpayers may use a CTB Election to minimize a US shareholder's global intangible low-taxed income ("GILTI") inclusion or increase the amount of foreign tax credits that may be claimed as a result of a GILTI inclusion.[146]
In the domestic context, taxpayers may combine a CTB Election with a state law conversion statute to "strip" assets out of a lower-tier corporation while avoiding GU Repeal.[147] This planning complies mechanically with (but arguably departs conceptually from) the rule that an entity generally cannot elect to change its classification more than once in a 60-month period.[148]
Given the centrality of entity classification to the taxation of business activities, it is axiomatic that the CTB Regulations affect many other rules and regimes beyond those identified here, creating planning opportunities, complexity, and administrative burden. Treasury and the IRS should revise the CTB Regulations to provide that (i) a foreign entity is not eligible to make a

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[142] Treas. Reg. §§ 301.7701-1 through -3.
[143] While this regime enhanced certainty regarding the previously unsettled area of entity classification, it also created many opportunities for tax planning and avoidance (many of which were identified soon after the issuance of the CTB Regulations). *See* Joint Committee on Taxation, JCS-6-97, *Review of Selected Entity Classification and Partnership Tax Issues* (April 8, 1997). Within a decade, scholars identified the CTB Regulations as playing a critical role in profit shifting out of the US. *See* Rosanne Altshuler & Harry Gruber, *The Three Parties in the Race to the Bottom: Host Governments, Home Governments and Multinational* Companies, 7 Fla. Tax. Rev. 152 (2005); Lawrence Lokken, *Whatever Happened to Subpart F – U.S. CFC Legislation after the Check-the-Box Regulations*, 7 Fla. Tax. Rev. 185 (2005).
[144] *See* sections 954(c)(1)(B) and 964(e); *cf.* Notice 2003-46, 2003-28 I.R.B. 53.
[145] *See, e.g.,* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals* 16 (May 2021) ("FY2022 Green Book") (providing background for the rule contained in Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138124(f)).
[146] *See generally* Moshe Spinowitz and Robert Stevenson, *To Check or Not to Check? The TCJA's Impact on Entity Classification Decisions*, International Tax Journal (March-April 2019). While this GILTI planning generally allows US shareholders to achieve results that align more closely with "aggregate" treatment of its CFCs, it is inconsistent with the mechanics of section 951A. Thus, these issues should be addressed, if at all, under the GILTI regime and not by giving sophisticated taxpayers the optionality for "self-help" under the CTB Regulations.
[147] For example, a corporation with a single corporate shareholder may (i) convert to a limited liability company under a state law conversion statute (treated as a disregarded entity under the default classification rules), (ii) distribute assets to the shareholder in a transaction that is disregarded for federal income tax purposes, and then (iii) elect to be treated as a corporation. *See* IRS, *IRS statement regarding private letter rulings on certain corporate transactions* (October 13, 2017), item 4 (stating that "substantial scrutiny" will be applied to such transactions in the PLR program).
[148] *See* Treas. Reg. § 301.7701-3(c)(1)(iv).

CTB Election,[149] and (ii) state law conversions and similar techniques[150] are treated as CTB Elections for purposes of the 60-month rule.[151]

Republish proposed regulations under section 898

Priority: Low

Section 898 sets forth rules for determining the required taxable year for certain foreign corporations based on the taxable years of their owners. The general statutory rule is that testing for purposes of identifying the required taxable year occurs on the first day of the foreign corporation's taxable year determined without regard to section 898.[152] However, under proposed regulations published in 1993 and never finalized,[153] additional testing days would include days on which a substantial change in US ownership of a foreign corporation occurs.[154]

The IRS has recently issued PLRs that imply (but do not state) that taxpayers can rely on the proposed rules concerning testing days,[155] notwithstanding the prospective applicability of those proposed rules[156] and their lack of reliance language, creating uncertainty and the potential for disparate treatment among taxpayers. Treasury and the IRS should republish proposed regulations under section 898 (with updates as necessary to reflect any legislative changes[157]), and permit taxpayers to rely on them.

Synchronize treatment of subpart F inclusion basis

Priority: Low

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[149] *See also* S. 991, Corporate Tax Dodging Prevention Act, section 5 (proposing repeal of the CTB Regulations for many foreign entities); H.R. 1786, Stop Tax Haven Abuse Act, section 101 (similar); Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* 30 (May 2009) (similar); *How U.S. International Tax Policy Impacts American Workers, Jobs, and Investments*, Hearing Before the Senate Committee on Finance, 117th Cong. (2021) (Testimony of Chye-Ching Huang). As suggested by legislative proposals that have generally prescribed rules for the classification of foreign entities, consideration would need to be given to a suitable replacement for the CTB Regulations in order to avoid reverting to the state of uncertainty that existed before them. *See supra* footnote 143. However, defaulting to corporate treatment, as some of the legislative proposals would do, could potentially facilitate planning through the creation of reverse hybrid entities. Accordingly, consideration should be given to conforming the US tax treatment of foreign entities with their local country treatment. Such treatment would be consistent with other recent international tax rules that seek to conform US and foreign tax treatment to reduce disparities and planning opportunities. *See, e.g.,* Treas. Reg. § 1.861-20. Where such treatment is of no consequence in the entity's local country, such as because it is formed in a jurisdiction that does not impose tax, consideration could be given to a default US treatment.

[150] For example, a corporation may also merge into a disregarded entity with the disregarded entity surviving.

[151] *See also* 2023-2024 PGP, General Tax Issues, item 34.

[152] *See* section 898(c)(3)(B)(i).

[153] *See* Taxable Year of Certain Foreign Corporations Beginning after July 10, 1989, INTL-0848-89, 58 Fed. Reg. 290 (January 5, 1993).

[154] *See* Prop. Treas. Reg. § 1.898-3(a)(5)(iii).

[155] *See, e.g.,* PLR 202012009 (November 13, 2019).

[156] *See supra* footnote 153, at 291.

[157] *See* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138122.

Under section 961(a) and (b), adjustments are required to be made to the basis of a US shareholder of stock in a CFC or property by reason of which the US shareholder is treated under section 958(a)(2) as owning stock of a CFC. Under section 961(c), if a US shareholder is treated under section 958(a)(2) as owning stock of a CFC ("CFC 2") owned by another CFC ("CFC1"), under regulations, similar adjustments are required to the basis of the CFC2 stock and the basis of any other CFC stock by reason of which the US shareholder is treated under section 958(a)(2) as owning CFC2 stock. However, the basis adjustments under section 961(c) apply only for purposes of determining inclusions under section 951.

Provided that section 961(c) basis adjustments are not expanded to apply for all purposes,[158] as do section 961(a) and (b) basis adjustments, is it important to ensure that movements of CFC stock do not prevent basis adjustments that would have been allowed had a CFC always been a first-tier CFC or allow basis adjustments that would not have been allowed had a CFC always been a lower-tier CFC.[159]

One way to address the issue without requiring extensive rules addressing all the circumstances in which CFC stock might be transferred would be to deviate from the approach of the current and previously proposed regulations, which require basis adjustments to be made in connection with the event that triggers the basis adjustment. Nothing in section 961 specifies when basis adjustments are to be made, so regulations could instead require a notional accounting of basis adjustments separate and apart from CFC stock. Basis in a notional account with respect to specific CFC stock would only attach to that CFC's stock at the time that the basis is relevant (e.g., upon a distribution with respect to the stock or disposition of the stock), based on the holding of the CFC at such time. Such a system would allow an evaluation of the basis adjustments that should be taken into account based on the organizational structure when the basis is relevant and thus prevent inappropriate allowance or disallowance of basis. Although

[158] *See* Amendment in the Nature of a Substitute to the Committee Print Offered by Mr. Neal of Massachusetts, September 12, 2021, section 138129(d). (This change was consistent with a proposed change included among proposed technical corrections to the TCJA. *See* Tax Technical and Clerical Corrections Act Discussion Draft, January 2, 2019, section 4(hh)(6).) *See also* Senate Finance Committee Draft, section 128129(c)(5) (providing authority for Treasury to prescribe the purposes for which section 961(c) basis adjustments apply). All of the versions of the Build Back Better Act would clarify the scope of the section 961(c) cross-reference to section 961(b). *See, e.g.,* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138129(c)(5). However, notably, their retention of the introductory language of section 961(c) would arguably prevent them from expanding the scope of section 961(c) basis adjustments to both interests in partnerships directly held by a US shareholder and stock in CFCs held by a US shareholder only through partnerships. The unmodified section 961(c) introductory language could also arguably prevent section 961(c) adjustments from applying to other partnership interests, but presumably, in light of the clear expansion of the scope of section 961(c) beyond CFC stock, the reference in such language to CFC stock "owned by another" CFC would be interpreted expansively in regulations to include ownership within the meaning of section 958(a)(2).

[159] Suppose, for example, that an individual owns CFC2 directly at the time that CFC2 accumulates 100x of PTEP. If the resulting basis in the CFC2 stock continues to be respected as basis for all purposes after the individual contributes CFC2 to CFC1, there could be no subpart F or E&P consequences upon a subsequent sale of the CFC2 stock by CFC1 to a third party. As a result, the duplication of section 961(a) basis through the contribution would permit the individual and the CFC2 buyer to collectively recover 200x of basis from a single 100x inclusion by the individual (and its consequent section 961(a) basis adjustment).

Notice 2024-16 and Treasury's Spring 2024 regulatory agenda indicates regulations under section 961 are forthcoming, they should comprehensively address the issues raised above.[160]

Revisit measurement of assets under section 1297

Priority: Low

Section 1297(a)(2) provides that a foreign corporation is a PFIC if the average percentage of its assets that produce passive income or are held for the production of passive income is at least 50%. This determination is made using the value of the assets for (i) publicly traded corporations, and (ii) corporations that are not CFCs that do not make an election to use adjusted basis.[161] For CFCs or any other non-publicly traded corporations that elect the application of section 1297(e)(2), the assets are measured using adjusted basis.[162]

The proposed regulations published in 2019[163] would have provided that if a foreign corporation is not publicly traded for the entire year, assets are measured by value for the entire year if the corporation was publicly traded during the majority of the year or if section 1297(e)(2) did not apply to the corporation during the majority of the year.[164] Otherwise, assets would be measured by adjusted basis for the entire year.[165] By contrast, the final regulations promulgated in 2021[166] provide that if the corporation was a CFC during the year, assets are measured by adjusted basis only for the periods during which it was a CFC, potentially allowing measurement by value for other periods.[167] The final regulations further provide that not only must lower-tier subsidiaries generally use their upper-tier parent's method for measuring assets for the determination of the upper-tier parent's PFIC status, but that such method applies even for the determination of the lower-tier subsidiaries' PFIC status.[168]

Given that, as noted in the preamble to the 2019 proposed regulations, using a combination of methods for measuring assets of a corporation within a year (as would be allowed under the final regulations) could be distortionary,[169] consideration should be given to returning to the "one method per year rule" contained in the 2019 proposed regulations. Furthermore, consideration should be given to reversing the rules binding lower-tier subsidiaries to their upper-tier parent's asset measurement method for the lower-tier subsidiaries' PFIC determination, as requiring a method would seem inconsistent with the optionality provided by section 1297(e). The final regulations seem to go beyond the modifications requested by comments on the 2019 proposed

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[160] *See* Notice 2024-16, 2024-05 I.R.B. 622; Department of the Treasury, , *Exclusion from Gross Income of Previously Taxed Earnings and Profits*, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).
[161] Section 1297(e)(1).
[162] Section 1297(e)(2).
[163] Guidance on Passive Foreign Investment Companies, REG-105474-18, 84 Fed. Reg. 33,120 (July 11, 2019).
[164] *See* Prop. Treas. Reg. § 1.12971-1(d)(1)(v)(A).
[165] *Id.*
[166] Guidance on Passive Foreign Investment Companies, T.D. 9936, 86 Fed. Reg. 4,516 (January 15, 2021).
[167] *See* Treas. Reg. § 1.1297-1(d)(1)(v)(B) and (C).
[168] *See* Treas. Reg. § 1.1297-1(d)(1)(v)(C)(*2*)(*i*), (*ii*), and (*iii*) (second sentence).
[169] *See supra* footnote 163, at 33,125 (noting that electivity between multiple methods "could facilitate the avoidance of the PFIC rules, and that the rule in the proposed regulation imposes the least administrative burden").

regulations.[170] Thus, Treasury and the IRS should propose modifications to the final regulations, either in connection with the open guidance project concerning the asset test[171] or on a standalone basis.[172]

Partnerships

We are pleased to note the recent addition of the Disguised Payments for Services item on Treasury's Spring 2024 regulatory agenda, which is responsive to our previous recommendation.[173] This is a welcome change and we look forward to its implementation.

Consider addressing the treatment of carried interest

Priority: High

Managers of private investment funds (including hedge funds, venture capital funds, and private equity funds) are often compensated through a combination of "management fees" taxed at ordinary income rates and "carried interest" taxed at low capital gains rates.[174] Many argue that carried interests should be taxed as ordinary income, similar to most other service income.[175]

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[170] The only comment on the rules described in the preamble to the final regulations seems to have requested rules providing for asset measurement on the basis of value throughout a year to the extent possible (not a mix of value and adjusted basis measurement) and rules for measuring a subsidiary's assets solely for purposes of the parent corporation's PFIC determination (not for all purposes). *See supra* footnote 166, at 4,523.

[171] *See* Prop. Treas. Reg. § 1.1297-1(d) in Guidance on Passive Foreign Investment Companies and the Treatment of Qualified Improvement Property Under the Alternative Depreciation System for Purposes of Sections 250(b) and 951A(d), REG-111950-20, 86 Fed. Reg. 4,582 (January 15, 2021).

[172] The Tax Law Center at NYU Law believes that it would also be appropriate to reconsider other recent regulatory decisions addressing international tax, such as the issuance of regulations providing for a "high-tax" exception from tested income and the treatment of CFC stock as an "exempt asset" on the basis of section 250. *See* Treas. Reg. §§ 1.951A-2(c)(1)(iii) and (7) and 1.861-8(d)(2)(ii)(C), respectively. However, unlike the section 1297 regulations discussed herein, these issues have already been addressed extensively in public commentary. *See* Stephen E. Shay, *A GILTI High-Tax Exclusion Election Would Erode the U.S. Tax Base*, Tax Notes Today Federal (December 4, 2019); Mindy Herzfeld, *Reconciliation Proposals: The Big Deal About Expense Allocation*, Tax Notes Today International (August 16, 2021) ("Writing the rule in that manner generally means that less interest expense is allocated to the GILTI basket, leading to a larger FTC limitation in the GILTI category. In the absence of [Treas. Reg. § 1.861-8(d)(2)(ii)(C)], allocating expenses under the pre-TCJA rules would have meant an even lower FTC GILTI limitation…"). In addition, Treasury and the IRS appear to have at least considered whether these regulations implement sound policy. *See* Foreign Tax Credit Guidance Related to the Tax Cuts and Jobs Act, Overall Foreign Loss Recapture, and Foreign Tax Redeterminations, T.D. 9882, 84 Fed. Reg. 69,022, 69,024 (December 17, 2019) ("One comment argued that the full allocation of expenses to the section 951A [sic] is needed to prevent base erosion. The comment recommended that the rules in proposed § 1.861–8(d)(2)(ii)(C) that treat income offset by the section 250 deduction as exempt income and the assets that give rise to that income as exempt assets are inappropriate and should be withdrawn"); FY2022 Green Book, at 7-8.

[173] Department of the Treasury, , *Disguised Payments for Services From Gross Income of Previously Taxed Earnings and Profits*, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).

[174] *See* section 702.

[175] *See, e.g.,* Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 49 (2008); Jonathan H. Choi, *Democrats should finally close the carried interest loophole for the wealthy*, Wash. Post (September 14, 2021) (citing his survey of all American tax law professors, in which 86.7% of respondents supported taxing carried interest as ordinary income). ***But see, e.g.,*** Steven B. Klinsky, *The Carried Interest Loophole? What Loophole?*, N.Y. Times (July 15, 2016) and *Private Equity and the Treatment of Carried*

Over the years, there have been many attempts to address the advantageous treatment of compensation derived from carried interests.[176] The FY2025 Green Book proposes to apply ordinary income treatment to income received with respect to an "investment services partnership interest."[177]

In the absence of legislative action, Treasury and the IRS should consider guidance to improve the tax treatment of carried interest. There is a broad menu of options Treasury and the IRS could consider. Revocation of Rev. Proc. 93-27[178] and Rev. Proc. 2001-43[179] is one way to start the reversal of the status quo.[180] An additional option is to illustrate by example that the anti-abuse rule under Treas. Reg. § 1.701-2 applies to preclude capital gains treatment for carried interests.[181] If this option is pursued, consideration should be given to distinguishing between the treatment of carried interests and the treatment of other interests in a partnership, such as those of passive investors.[182] While each of the administrative options for addressing the treatment of

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Interest: An Overview, American Investment Council (May 4, 2007) (arguing that capital gains treatment for carried interest is appropriate).

[176] For recent legislative examples, see, *e.g.*, S. 1639, the Ending the Carried Interest Loophole Act, and H.R. 1068, the Carried Interest Fairness Act of 2021. As part of the TCJA, Congress enacted section 1061 to extend the holding period required to receive long-term capital gains treatment with respect to partnership profits interests from one year to three years. *See* P.L. 115-97, section 13309. While it would not eliminate the incentives to seek capital treatment for carried interests, the surcharge on high income individuals contained in the Build Back Better Act would increase the rate on capital income, including carried interest income, by up to 8%. *See* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138203. In addition, the FY2023 Green Book would reduce the rate preference for capital income for high-income taxpayers. *See* 30-33. If the proposal were to become law, the benefit of capital gains treatment for carried interest would be reduced.

[177] *See* FY2025 Green Book, at 137-138.

[178] 1993-2 C.B. 343.

[179] 2001-2 C.B. 191.

[180] This could be accompanied by guidance treating a carried interest as compensation, causing an income inclusion of the FMV of the carried interest at issuance. If this option is pursued, a strong valuation regime should be considered.

[181] *See Carried Interest, Part II*, Hearing Before the Senate Committee on Finance, 110th Cong. (2007) (Testimony of Charles I. Kingson at footnote 4) ("If the partnership anti-abuse rule has any bite, use of partnership to claim capital gain from performing services should be high on the list [of abusive arrangements]."); Andrea Monroe, *What's In A Name: Can the Partnership Anti-Abuse Rule Really Stop Partnership Tax Abuse?*, 60 Case W. Rsrv. L. Rev. 401, 465 (2010) ("Remarkably, the most promising candidate to sustain subchapter K is perhaps its least successful, most controversial provision… a revised [partnership anti-abuse rule] could more effectively challenge partnership tax shelters and provide subchapter K with much needed structural support."). However, some argue that the anti-abuse rule exceeds Treasury's delegated authority. *See, e.g.,* Linda D. Jellum, *Dodging the Taxman: Why the Treasury's Anti-Abuse Regulation is Unconstitutional*, 70 U. Mia. L. Rev. 152 (2015); Richard M. Lipton, *The Partnership Anti-Abuse Regs. Revisited: Is There Calm After the Storm?*, 83 J. Tax'n 68 (1995).

[182] Without such a distinction, this proposal could be viewed as analogous to proposals to clarify the definition of capital asset under section 1221 to exclude property held by private equity funds. *See* Steven M. Rosenthal, *Taxing Private Equity Funds as Corporate 'Developers,'* Tax Notes Today Federal (January 22, 2013). Significantly, the "developer" approach would be both broader than approaches focused solely on carried interest, as it would impact the tax treatment of all investors in such funds (not just those with profits interests related to services), and likely narrower, in that it might be most appropriately tailored to private equity funds and not other types of funds. The "developer" approach would also be analogous to, but an expansion on, the holding in *Dagres v. Comm'r* that carried interests are compensation related to a trade or business rather than capital assets. 136 T.C. 263, 289 (2011). *Cf.* Laura Saunders, *'Carried Interest' in the Cross Hairs*, Wall St. J. (August 6, 2011) ("Prof. Graetz says Treasury officials could use the decision to do administratively what Congress hasn't done legislatively—tax carried interest as ordinary income").

carried interest has technical strengths and weaknesses, Treasury and the IRS should evaluate these options both on their own terms and in comparison to the deficiencies of current law.

Republish or finalize proposed regulations and publish related subregulatory guidance addressing fee waivers under section 707

Priority: High

Section 707(a)(2) provides Treasury broad authority to recharacterize certain transactions involving disguised fee for service arrangements based on "Congress's concern that partnerships and service providers were inappropriately treating payments as allocations and distributions to a partner even when the service provider acted in a capacity other than as a partner."[183] Pursuant to this authority, Treasury and the IRS published proposed regulations in 2015[184] to address "fee waivers," a common planning technique used by private equity firms that purport to convert their partners' annual management fees (which would otherwise be taxed as ordinary income) into additional allocations of long-term capital gain without meaningfully altering the economics of the deal between the managers and their investors.[185] The proposed regulations would provide a framework and operating rules for determining whether a fee waiver arrangement should be treated as a disguised payment for services. The proposed regulations also announced modifications to Rev. Proc. 93-27 to clarify that the administrative safe harbor provided by the revenue procedure does not apply to fee waiver arrangements. Treasury and the IRS should republish the proposed regulations, or finalize them (if it is determined that no significant changes are warranted)[186] and publish the new revenue procedure, in order to curb the ongoing improper use of fee waiver arrangements.[187] Such proposal or finalization would publicly confirm the IRS's understanding of current law.[188]

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[183] *See* Disguised Payments for Services, REG-115452-14, 80 Fed. Reg. 43,652, 43,653 (July 23, 2015) (internal citations omitted).

[184] *See id*.

[185] *See* Saba Ashraf & Alyson K. Pirio, *Management Fee Waivers: The Current State of Play*, 27 J. Tax'n & Reg. Fin. Institutions 5, 18 (2013) ("The reality is that most partners engaging in fee waivers want to do so on terms that do not meaningfully alter their right to receive the underlying funds, or subject it to greater risk."); Karen C. Burke, *Back to the Future: Revisiting the ALI's Carried Interest Proposals*, Tax Notes Today Federal (October 12, 2009) (noting that fee waiver arrangements "may be intended solely to transmute the manager's current ordinary-income compensation into deferred capital gain."). *See also* Jesse Drucker and Danny Hakim, *Private Inequity: How a Powerful Industry Conquered the Tax System,* N.Y. Times (June 21, 2021).

[186] *See* Monte A. Jackel, *Top Suggestions for Partnership Guidance*, Tax Notes Today Federal (September 9, 2019) ("The 2015 proposed fee waiver regulations should be either re-proposed or finalized"); *see also* Lee Sheppard, *News Analysis: Current Developments for Investment Funds*, Tax Notes Today International (June 5, 2017) (discussing hedge funds' reliance on example 2 of Treas. Reg. § 1.707-1(c), which led to modifications of that example in the proposed regulations).

[187] New proposed regulations could potentially also address carry waivers. While the preamble to the proposed section 1061 regulations warned that "[t]axpayers should be aware that these and similar arrangements may not be respected and may be challenged under section 707(a)(2)(A), §§ 1.701-2 and 1.704-1(b)(2)(iii), and/or the substance over form or economic substance doctrines," the final regulations were silent on carry waiver arrangements. *See* Guidance under Section 1061, REG-107213-18, 85 Fed. Reg. 49,754, 49,758 (August 14, 2020).

[188] *See* Eric Yauch, *Fee Waiver Regs on Back Burner, but IRS Enforcement Continues*, Tax Notes Today Federal (May 7, 2018) (quoting statement of an OCC official that the IRS does not need the 2015 proposed regulations to challenge the most aggressive fee waiver arrangements, and is, in fact, doing so). *See also* Gregg D. Polsky, *A Compendium of Private Equity Tax Games*, Tax Notes Today Federal (February 3, 2015), Strategy 2.

Republish debt allocation proposed regulations

Priority: Medium

Under the partnership disguised sale rules, transfers to and by a partnership that are more properly characterized as transactions between the partnership and a non-partner or between two or more partners are treated as such.[189] Like any transaction involving a partnership, the tax consequences of a disguised sale depend in part on a partner's basis in its partnership interest,[190] which depends in part on the partner's share of the partnership's liabilities.[191] Under regulations in effect before 2016, as well as current regulations, the rules for allocating partnership debt for purposes of the disguised sale rules differ depending on whether a liability is recourse or nonrecourse.[192] Because such rules provide for the allocation of recourse liabilities to partners based on their economic risk of loss,[193] taxpayers can engage in transactions with a partnership without triggering gain under the disguised sale rules by assuming the risk of loss with respect to partnership liabilities (for example, by guaranteeing them). For example, a partner may contribute appreciated assets to the partnership, which then borrows cash to distribute to the partner. Despite the contributing partner effectively selling their interest in the contributed asset, as long as the amount borrowed by the partnership is treated as recourse and allocated to the partner, the consequent increase in the partner's basis in the partnership interest means there is no taxable gain upon the distribution to the partner.

In 2016, Treasury and the IRS published temporary and proposed regulations under section 707 to prevent deferral of gains by a partner contributing liabilities to a partnership through transactions like the one described above.[194] However, these regulations were subsequently removed and replaced.[195] The above issues could be addressed as part of broader change, either through finalization of the proposed regulations under section 752[196] or guidance on disguised sales under section 707[197], both of which are listed in Treasury's Spring 2024 regulatory agenda. However, in the absence of broader change, Treasury and the IRS should republish the proposed regulations under section 707, which would, for disguised sale purposes, treat all liabilities as

[189] *See* section 707(a)(2).
[190] *See, e.g.,* section 731(a).
[191] *See* section 752(a) and (b).
[192] *See* Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, T.D. 9788, 81 Fed. Reg. 69,282, 69,283 (October 5, 2016) ("2016 Temporary Regulations"); Removal of Temporary Regulations on a Partner's Share of a Partnership Liability for Disguised Sale Purposes, T.D. 9876, 84 Fed. Reg. 54,027 (October 9, 2019) ("2019 Removal").
[193] *See* Treas. Reg. §§ 1.707-5(a)(2)(i) and 1.752-2(a).
[194] 2016 Temporary Regulations; Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, REG-122855-15, 81 Fed. Reg. 69,301 (October 5, 2016) ("2016 Proposed Regulations").
[195] *See* EO 13789 Report, 82 Fed. Reg. at 48,016; 2019 Removal.
[196] Department of the Treasury, *Section 752 Recourse Liabilities (Related Parties)*, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024). Previous proposals under section 752 have obviated the need for disguised sale rules addressing nonrecourse liabilities. *See, e.g.,* proposed section 752(e) in section 12 of draft legislation released by Senator Ron Wyden (September 10, 2021).
[197] Department of the Treasury, *Disguised Payments for Services*, Unified Agenda of Federal Regulatory and Deregulatory Actions (Spring 2024).

nonrecourse liabilities that must be allocated among all partners in accordance with their respective interests in partnership profits.[198]

Update outdated recapture regulations in Treas. Reg. § 1.1245–1(e)(3)

Priority: Medium

Treas. Reg. §1.1245-1(e)(3) provides separate rules for allocating section 1245 recapture gain among partners in situations where (i) a partner has a special basis adjustment under section 743 in any section 1245 property or (ii) the partnership had a section 754 election in effect on the date the partner acquired its partnership interest. Under this special rule, if a partner acquires its interest when a section 754 election was in effect, any depreciation that was allocated to the transferring partner does not carry over to the transferee partner. As a result, the transferee partner does not recognize any recapture gain with respect to this prior allocated depreciation.

This special rule will generally ensure that the transferee partner is allocated the proper amount of recapture gain. The problem arises because the special rule in Treas. Reg. § 1.1245-1(e)(3)(ii) can conceivably be read as applying to any transfer of a partnership interest, including nonrecognition transfers, as long as a section 754 election was in place at the time of the transfer. There is no requirement that the section 754 election actually resulted in a basis adjustment; the special rules of Treas. Reg. § 1.1245-1(e)(3)(ii) seem to apply as long as a section 754 election was made.

Treas. Reg. § 1.1245-1(e)(3) was promulgated in 1965—well before many of the current statutory Subchapter K provisions, such as section 704(c), were enacted and well before many of the most important partnership regulations were issued. This regulation should be updated to remove any uncertainty as to the treatment of nonrecognition transfers on the allocation of recapture gain.[199]

Finalize Prop. Treas. Reg. § 1.751-1(a)(2) on a stand-alone basis

Priority: Medium

The proposed section 751(b) regulations are a necessary update to the current outdated regulations. While finalizing the entire regulation would provide helpful guidance, the entire regulation is complex and may require additional time and effort to finalize. These proposed regulations also include a provision related to section 751(a) that could be finalized on its own. Under section 751(a), the amount received by a partner on the sale of its partnership interest attributable to the unrealized receivables and inventory items of the partnership ("hot assets") is treated as an amount realized from the sale or exchange of property other than a capital asset. In certain circumstances, often due to partnership revaluations and reverse section 704(c) allocations, the amount received by a partner on the sale of its interest can be less than the partner's share of the partnership's hot assets. As the preamble to the proposed regulation notes:

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[198] *See* Prop. Treas. Reg. § 1.707-5(a)(2)(i) in 2016 Proposed Regulations.

[199] For additional details, *see* Tax Law Center at NYU Law, *supra* note 12.

> Some commentators interpret section 751(a) as limiting the amount of ordinary income that a transferor partner may recognize upon a transfer of a partnership interest to the amount of any money or property received by the transferor partner, without taking into account the total amount of ordinary income attributable to the partnership interest transferred that relates to section 751 property. However, interpreting section 751(a) as limiting ordinary income in this way would contravene Congress's intent to tax partners on their shares of partnership ordinary income as determined by applying section 704(c) principles.[200]

This proposed regulation is intended to be effective for sales on or after November 3, 2014, but given the length of time since the regulation was proposed, there may be some concern that the effective date might be changed to the date of publication of the final regulation. This may lead some practitioners to take the position that the amount of ordinary income recognized is still limited to the amount realized until final regulations are issued. The section 751(a) portion of the proposed regulations could be finalized separately with the current proposed retroactive effective date on a stand-alone basis to eliminate any ambiguity.[201]

Tax Administration

Clarify treatment of digital assets as specified foreign financial assets under section 6038D

Priority: High

Under section 6038D(a) and Treas. Reg. § 1.6038D-2(a)(1), a "specified person" that has any interest in a "specified foreign financial asset" during the taxable year must disclose certain information about each specified foreign financial asset on Form 8938 if the aggregate value of all such assets exceeds the relevant threshold amount.

Some practitioners believe certain digital assets could qualify as "specified foreign financial assets"[202] and have requested guidance in the past.[203] Though Treasury and the IRS asked for comments on the proper treatment of virtual currency under section 6038D in 2014, it has yet to release any guidance on applying section 6038D to digital assets.[204] Treasury and the IRS should

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[200] Certain Distributions Treated as Sales or Exchanges, 79 Fed. Reg. 65151, 65158 (Nov. 3, 2014).
[201] For additional details, *see* Tax Law Center at NYU Law, *supra* note 12.

[202] *See* New York State Bar Association, *Report No. 1433 – Report on the Taxation of Cryptocurrency* 33-34 (January 26, 2020) ("NYSBA Report No. 1433"); Mindy Herzfeld, *Beyond Digital: Is Cryptocurrency the Next Tax Frontier?*, Tax Notes Today International (June 15, 2020).

[203] *See* NYSBA Report No. 1433, at 30-34; American Institute of Certified Public Accountants, *Comments on Revenue Ruling 2019-24, the New Question on Schedule 1 (Form 1040), and the Internal Revenue Service's Frequently Asked Questions on Virtual Currency Transactions* 21 (February 28, 2020).

[204] *See* Reporting of Specified Foreign Financial Assets, T.D. 9706, 79 Fed. Reg. 73,817, 73,821 (December 12, 2014).

issue guidance under the grant of regulatory authority in section 6038D(h) that describes the circumstances in which a digital asset would qualify as a "specified foreign financial asset." The FY2025 Green Book recognizes that "[t]he global nature of the digital asset market offers opportunities for U.S. taxpayers to conceal assets and taxable income by using offshore digital asset exchanges and wallet providers."[205] The FY2025 Green Book then proposes adding certain digital assets to the section 6038D reporting regime. This proposal is sound. However, Treasury and the IRS have clear authority today under sections 7805 and 6038D(h) to provide clarifying guidance on the treatment of digital assets without additional legislation. Issuing such guidance would combat tax evasion and offer clarity to taxpayers.

Extend section 6045 broker reporting to certain art and antiquities transactions

Priority: High

Section 6045 provides that the Secretary of the Treasury can require a "broker" to submit an information return that identifies the name and address of each customer and provides details regarding gross proceeds and other information prescribed by the Secretary.[206] A "broker" includes a dealer, barter exchange, "any person who (for consideration) regularly acts as a middleman with respect to property or services," and "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."[207] This provision affords broad discretion to Treasury and the IRS to define the scope of broker reporting.

Regulations under section 6045 have not extended broker reporting requirements to art and antiquities brokers. Treasury has concluded that "[i]n schemes to defraud the IRS by means of fraudulent expenses or deductions, the art is typically purposefully overvalued to improperly maximize the deduction. In this context, additional reporting from due diligence programs may be beneficial . . . ."[208] Treasury and the IRS should exercise the regulatory authority under section 6045(a) to require broker reporting on art and antiquities transactions above an

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[205] FY2025 Green Book, at 227.

[206] Section 6045(a).

[207] Section 6045(c)(1), as in effect for returns required to be filed, and statements required to be furnished, after December 31, 2023. *See* P.L. 117-58, section 80603(c).

[208] Department of the Treasury, *Study of the Facilitation of Money Laundering and Terror Finance Through the Trade in Works of Art* 28 (February 2022); *see also* Jason Felch, *Beverly Hills antiquities dealer sentenced to jail for smuggling scheme*, Art News (December 16, 2015) (two individuals were "sentenced to probation for their role in a related tax evasion scheme in which looted antiquities were donated to local museums in exchange for inflated tax write-offs."). Individuals may also use transactions in high-value art and antiquities to evade sanctions and launder money. *See* Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *The Art Industry and U.S. Policies that Undermine Sanctions* (July 27, 2020) ("[C]ertain Russian oligarchs appear to have used transactions involving high-value art to evade sanctions imposed on them by the United States . . . ."); Anti-Money Laundering Regulations for Dealers in Antiquities, 86 Fed. Reg. 53,021, 53,022-23 (September 24, 2021) ("Certain characteristics of the trade in antiquities may be exploited by money launderers and terrorist financiers to evade detection by law enforcement."); Tom Mashberg, *The Art of Money Laundering*, 56 Finance & Development 30 (September 2019).

appropriate threshold to focus reporting where the greatest risk of non-compliance lies and minimize filer and administrative burden.[209] Art and antiquities broker reporting would improve voluntary tax compliance and likely raise revenue in a progressive manner that is consistent with the President's stated anti-corruption goals.[210]

The regulations would need to define "art" and "antiquities" in a manner suitable for this information reporting. Treasury and the IRS could draw on definitions of "art" and "artist" in existing tax statutes and guidance and other areas of law to craft a definition of "art" for the art and antiquities broker reporting regulations.[211] Treasury and the IRS should consider using an illustrative list, similar to the structure of the "art" definition in Rev. Proc. 96-15, with a goal of ensuring that all transactions that implicate similar tax evasion and money laundering risks are subject to similar reporting.[212]

In determining the scope of art market participants who are covered brokers, Treasury and the IRS should develop rules that minimize duplicative reporting while ensuring that as many covered transactions as possible are subject to reporting.[213]

Publicize closing agreements entered into by Associate Chief Counsel offices

Priority: Medium

The IRS regularly enters into closing agreements under section 7121 with taxpayers to dispose of issues related to their tax liability. Many closing agreements are entered into by the exam and appeals functions of the IRS. However, subject matter experts within Associate Chief Counsel ("ACC") offices periodically enter into closing agreements[214] that "interpret[] and appl[y] tax laws to a specific set of facts," in lieu of issuing PLRs that would be subject to disclosure rules under section 6110.[215] Use of closing agreements in lieu of PLRs to address the application of the law to particular sets of taxpayer facts prevents disclosure that could apprise other taxpayers or other stakeholders of potential IRS views of the law, including those that may contradict

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[209] Thresholds could be applied on an asset-by-asset basis, a transaction-by-transaction basis, or on an annual basis. A transaction-by-transaction basis is likely easiest to administer but allows for more gaming than an annual threshold (which would require more tracking). Treasury and the IRS can look to other reporting thresholds to determine an appropriate level. *See, e.g.,* sections 6041(a), 6050I(a), and 6050W(e).

[210] *See* White House Anti-Corruption Strategy, at 24.

[211] *See* Rev. Proc. 96-15, 1996-1 C.B. 627, section 4.01 (defining "art"); section 263A(h)(3) (defining "artist" and "photographer"); United States International Trade Commission, *2024 Harmonized Tariff Schedule of the United States Revision 5, Section XXI* (2024) (specifying what articles qualify as "works of art, collectors' pieces and antiques").

[212] Treasury and the IRS should also consider requiring broker reporting on other collectibles because collectibles present similar tax evasion and money laundering concerns as art and antiquities. If this recommendation is pursued, an administrable definition of "collectible" would need to be developed. *Cf.* section 408(m).

[213] Appropriate exceptions may be warranted, such as for certain charity auctions.

[214] *See* Internal Revenue Manual 32.3.4.1 and 32.3.4.2.

[215] *See* Treas. Reg. §§ 301.6110-1(a) and 2(a) and (d).

guidance or other public statements.[216] Although the dearth of information created by use of closing agreements instead of PLRs could potentially be addressed by announcements of IRS willingness to consider taxpayers' facts, the effectiveness of that possibility is hampered by inconsistency in the use or form of such announcements, as well as the lack of specificity provided by a full document setting forth the relevant law and the IRS's analysis thereof. ACC offices should consider treating closing agreements that analyze the application of the law to taxpayer facts as constituting rulings subject to disclosure under section 6110.[217] If such a change is not undertaken, the Office of Chief Counsel ("OCC") should consider compiling and regularly releasing high-level information about closing agreements entered into by ACC offices. Such information should at least be sufficient to apprise the public of substantive topics on which the IRS is creating what would otherwise be private law and would ideally contain a high-level description of the legal position taken in the closing agreement and its relationship to existing guidance.

Revise guidance addressing extensions of time to make elections

Priority: Medium

Treas. Reg. §§ 301.9100-1 through -3 describe how a taxpayer can obtain an extension of time to make an election if it has missed certain deadlines ("9100 relief"). However, these regulations (and the PLRs granting extensions) do not clearly distinguish between the different types of 9100 relief. If the taxpayer intended to make the election and has filed consistently therewith, but simply failed to make the actual election, only 9100 relief should be necessary; no other adjustments are appropriate or required. On the other hand, if the taxpayer did not know about the availability or advisability of an election at the time it was due, the taxpayer likely has not filed consistently with the election having been made. Thus, 9100 relief should require that the taxpayer simultaneously but separately also obtain any other relief necessary, such as permission to change its accounting methods and adjust its attributes.[218] The failure to distinguish between the different types of 9100 relief has created significant administrative burden and facilitated inappropriate planning by well-advised taxpayers.

In addition, sophisticated taxpayers have used Rev. Proc. 2009-41[219] to inappropriately extend the period of time for making a CTB Election. The revenue procedure, which permits a missed CTB Election to be made up to three years and 75 days late if certain conditions are satisfied, departs from the general regulatory standards that prohibit a taxpayer from using hindsight in

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[216] *Cf.* Libin Zhang, *Double Taxation Trouble with Transition Tax*, Tax Notes Today Federal (December 2, 2019) ("If Treasury and the IRS have reconsidered their view … , it would be helpful for any relief to be provided in broadly available guidance, instead of case-by-case determinations that may result in disparate and unequal treatment of similarly situated taxpayers.").

[217] Such treatment would also permit disclosure of redacted versions of requests that led to such agreements. *See* section 6110(a) and (b)(2). By contrast, closing agreements and underlying documents generally may not be disclosed, although data that cannot be identified with a particular taxpayer may be released. *See* section 6103(b)(2)(D).

[218] *See, e.g.,* PLR 202037010 (July 17, 2020), supplementing PLR 201924005 (March 19, 2019).

[219] 2009-39 I.R.B. 439.

making the election.[220] Based on this difference, taxpayers have taken the position that Rev. Proc. 2009-41 supplants the applicable regulatory requirements. As the revenue procedure provides for 9100 relief without OCC review,[221] taxpayers have considerable latitude to liberally interpret the reasonable cause standard as well as other requirements.[222] Separately, although the IRS has informally announced that the hindsight prohibition is violated if 9100 relief is motivated by a change in law occurring after the due date for making the election,[223] it is not clear if that standard has been consistently applied.

In the guidance announced in the 2023-2024 PGP,[224] Treasury and the IRS should (i) revise Treas. Reg. §§ 301.9100-1 through -3 (and the OCC should revise its PLR standards) to distinguish between the different types of 9100 relief and their ancillary requirements, (ii) revoke Rev. Proc. 2009-41 or revise it to ensure consistency with the general requirements of Treas. Reg. § 301.9100-3, and (iii) clarify the hindsight prohibition and its application in connection with changes in law.

Continue to improve FAQ practice and revise regulations to reflect FAQ policy

Priority: Low

The IRS issues frequently asked questions ("FAQs") to expeditiously address potential tax issues and concerns from taxpayers and to clarify the application of certain rules. In 2021, the IRS announced a new process for significant FAQs, under which such FAQs and later updates thereto will be announced in news releases, as well as dated and archived in separate fact sheets on IRS.gov.[225] The IRS also indicated that a taxpayer who reasonably relies on FAQs (whether subject to the significant FAQ process or not) in good faith will have a reasonable cause defense against any accuracy-related penalty, even if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case.

While this is an improvement on prior practice, the limited and relatively undefined scope of the new significant FAQ process continues to create potential burdens and confusion for taxpayers.[226] Furthermore, because the new significant FAQ process only applies to future FAQs, taxpayers are still subject to uncertainty concerning reliance with respect to older FAQs

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[220] Treas. Reg. § 301.9100-3(b), which conditions 9100 relief on the taxpayer acting "reasonably and in good faith," provides that a taxpayer that uses hindsight in requesting relief is deemed not to have acted reasonably and in good faith. *See* Treas. Reg. § 301.9100-3(b)(3). However, Rev. Proc. 2009-41 only requires "reasonable cause" for making the election. *See supra* footnote 219, at section 2.08. *Compare* Rev. Proc. 2003-33, 2003-1 C.B. 803.

[221] *See supra* footnote 219, at section 4.03.

[222] *See id.*, at section 4.01(2)(a)-(b) (requiring that either no return has been filed with respect to the entity or returns have been filed consistent with the election).

[223] *See* Nathan J. Richman, *TCJA Doesn't Justify Missed Election Relief*, Tax Practice Expert (July 1, 2019).

[224] *See* 2023-2024 PGP, General Tax Issues, item 37.

[225] *See* IRS, IR-2021-202.

[226] *See* Marie Sapirie, *How to Improve the Archiving of FAQs*, Tax Notes Today Federal (February 22, 2022).

that have not been archived and may be subject to change without notice. There also remains potential for confusion about whether taxpayers acting in good faith will have a reasonable cause defense against accuracy-related penalties, because regulations indicate that reasonable cause may not exist where a taxpayer's knowledge conflicts with provided information.[227]

Accordingly, all future and still relevant pre-existing FAQs should be released and archived in a consistent manner, with changes over time in the pre-existing FAQs documented to the extent possible.[228] While developing a system for FAQs, consideration could also be given to developing a more taxpayer-friendly system for searching other guidance, including Internal Revenue Bulletin guidance, on the IRS website.[229] Furthermore, the regulations should be updated to incorporate the concept of reasonable cause reliance on FAQs. While resource constraints are likely an important factor in determining how quickly some of these practical changes can be adopted, there may be substantial downstream savings in other parts of IRS operations if filers and advisors are able to more quickly identify and reasonably rely upon relevant FAQs or other guidance.

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[227] *See* Treas. Reg. § 1.6664-4(b).

[228] *See also* Joshua D. Blank & Leigh Osofsky, *The Inequity of Informal Guidance*, 75 Vand. L. Rev. 1093, 1147 (2022) (similarly suggesting that "[i]n the interest of fairness and government transparency, the IRS should provide taxpayers with notice of changes that it makes to its informal guidance") and at 1153-1154 (noting that the focus on "significant" FAQs "will likely do little to help unrepresented taxpayers, who rely on a broad swath of informal guidance...because they lack the ability to access formal law"). Blank and Osofsky also suggest providing effective dates for FAQs and providing warnings when the law is unsettled or in conflict with an FAQ and explanations as to how and why an FAQ is changed. *See id.* at 1146-1147.

[229] *See also id.,* at 1147 (suggesting that "the IRS should... create a searchable database that taxpayers can use to research previous IRS statements."). *Cf. supra* footnote 226.

Appendix A

The Tax Law Center NYU LAW

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

By: Chye-Ching Huang

Introduction and Executive Summary

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

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[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

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[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.

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[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.

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?

Examples of how recent guidance describes the authority or rationale for non-enforcement are included in the Appendix. Again, to be clear, this report does not argue that any specific decision lacks authority.

Why is it appropriate for Treasury and the IRS to have categorical non-enforcement authority – and why is that authority bounded?

To effectively implement the tax laws enacted by Congress, it is appropriate that Treasury and the IRS have broad flexibility to make tax administration decisions, which may include sometimes delaying implementation of new provisions beyond statutory deadlines or offering other types of broad-based administrative relief. Lawmakers may enact provisions that are impossible to implement, enforce, fully interpret, or comply with within statutory deadlines given the resources that filers and the IRS have available, or that would require the IRS to divert too many resources away from enforcing other laws. Broad-based administrative relief can bring certainty and clarity to affected taxpayers and the IRS, helping to facilitate tax filing. It can help the IRS prioritize its work and navigate resource constraints, including in emergencies. Categorical non-enforcement decisions may also be preferable to non-enforcing on a case-by-case basis or "systematically" deprioritizing enforcement because, in addition to being less arbitrary, categorical non-enforcement is more predictable and tends to receive greater public scrutiny.[14] Indeed, it is routine for the IRS to offer transition relief or safe harbors, delay implementation of certain new laws, or offer other categorical non-enforcement relief.

But however pragmatic, the use of categorical non-enforcement discretion must also be rooted in legal authority. Recent Treasury and IRS decisions often did not cite the specific authority that they relied on or explain why they believed the decision fell within the relevant authority. The concern is not only about the formalities of missing boilerplate citations, but, rather, is a substantive concern about whether Treasury and the IRS can reach and set out a solid and consistent understanding of the sources and boundaries of their non-enforcement authority for tax system stakeholders to understand.

Authority for categorical non-enforcement cannot be unbounded, and a place to start—and a key question even as there is not a single bright-line rule—is whether the action taken is furthering or instead frustrating Congress's purposes in enacting the relevant provision, delegating authority to the Secretary to administer the laws, and funding the IRS to enforce them. Suppose lawmakers enacted a statute raising the corporate tax rate. There would clearly be no authority for the administration to grant "relief" from the new rate, and instead only enforce the old corporate rate, whether temporarily or on a permanent basis, simply because the Executive preferred lower taxes. Such a hypothetical would correctly be considered extreme because it is so clearly inconsistent with the basic rationales for enforcement discretion, as articulated by the Supreme Court in a seminal non-enforcement case, *Heckler v. Chaney* (discussed more below).[15]

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[14] Osofsky, *supra* note 10, at 103.
[15] 470 U.S. 831-33 & n.4 (1985).

Lowering the statutory corporate tax rate by announcing a non-enforcement policy would clearly, in *Chaney's* terms, be a "consciously and expressly adopted" general policy that disregards legislative direction—frustrating Congress's purposes.[16] There is no gap in the statute that leaves room for agency interpretation and implementation decisions. Moreover, enforcing only the lower rate would be contrary to the IRS's fundamental purpose of collecting revenue according to the tax law. Even if a hypothetical administration tried to pursue and justify such an approach on the basis of lacking enforcement resources, such a justification should fail given that the difference in resources needed to enforce a higher corporate tax rate is minimal, or at least minimal in comparison with presumed revenue effects.[17]

While such extreme hypotheticals make it clear that a boundary on categorical non-enforcement authority exists, it is also important to attempt to identify at least the broad contours of the boundary, short of those extremes. 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.

Sources of authority and boundaries on categorical non-enforcement

Authority for – and boundaries on – categorical non-enforcement lies in sources including general constitutional and administrative law, general provisions of the tax code, and the specific authorities and duties embodied in the specific provisions of the relevant tax law.

The Take Care clause of the Constitution states the President "shall take Care that the Laws be faithfully executed"[18] and empowers executive discretion over enforcement decisions while at the same time requiring the executive to comply with and execute clear statutory directives.[19] The dual purposes of the Take Care clause are mirrored in general tax code provisions that establish both obligations and powers for the Secretary of Treasury and other members of the Executive Branch to enforce and administer the Code.[20] The Administrative Procedure Act

[16] *Id.* at 833 n.4.
[17] *Id.* at 831-32.
[18] U.S. Constitution, Art. II, § 3.
[19] *See* Todd Garvey, Congressional Research Service, The Take Care Clause and Executive Discretion in the Enforcement of Law, at 3 (2014); *see also Chaney*, 470 U.S. at 832. The Article II Vesting Clause, Art. II, § 1, has also been understood to contribute to executive enforcement discretion. *See* Garvey, at 4.
[20] Section 7801(a) provides that "[e]xcept as otherwise expressly provided by law, the administration and enforcement of [Title 26] shall be performed by or under the supervision of the Secretary of the Treasury." Section 7805(a) specifies that except where Title 26 provides otherwise, "the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." When Treasury and the IRS delayed the effective date of the ACA's employer mandate in 2013, they stated it was "an exercise of the Treasury Department's longstanding administrative authority to grant transition relief when implementing new legislation" under section 7805(a). Mazur, *supra* note 3; Transition Relief for 2014 Under §§ 6055 (§ 6055 Information Reporting), 6056 (§ 6056 Information Reporting) and 4980H (Employer Shared Responsibility Provisions), Notice 2013-45, 2013-31 I.R.B. Section 7803(a)(2)(A) provides the IRS Commission broad authority to administer application of the code. *See* Rubin, *supra* note 5 (noting that the IRS cited the authority in section 7803(a)(2)(A) in a statement justifying recent decisions). And the Code specifically empowers the Chief Counsel, subject to delegation by the Commissioner, "to determine which civil actions should be litigated under the laws relating to the Internal Revenue Service[.]" Section 7803(b)(2)(E).

("APA") provides a framework for assessing unreasonable delay of agency action,[21] and procedural requirements for notice-and-comment rulemaking when a non-enforcement policy is a "legislative rule."[22]

These sources of authority and case law do not give bright-line boundaries to non-enforcement discretion and leave much unclear. They do establish, however, some fundamental points:

- **There are boundaries to proper use of categorical non-enforcement.** Establishing where these boundaries lie can require balancing factors. Congress has a number of different goals in enacting particular provisions, delegating administrative authority to the Secretary, and funding the IRS to enforce the laws. As the *Chaney* court explained, most agency non-enforcement decisions are committed to agency discretion because agencies are best-positioned to balance complicated factors including assessing when there has been a violation, assessing when there are sufficient resources to pursue enforcement, prioritizing use of agency resources, determining when enforcement is feasible, and considering non-enforcement decisions in the context of "the agency's overall policies[.]"[23] But that authority does not extend to situations where Congress has limited agency discretion by statute and so expressed its view clearly of the balance of factors at play or where an agency has "'consciously and expressly adopted a general policy' that is so extreme as to amount to an abdication of its statutory responsibilities"[24] – effectively working to frustrate Congress's aims.
- **Resource constraints** are a key set of factors that are proper for an agency to consider on the administrative flexibility side of the equation. Congress after all sets the budget constraint on the agency, and that naturally creates trade-offs in enforcement. So, it then falls into the purview of the agency to determine whether or not the agency has enough resources to undertake the action, and the best use of scarce resources.[25] Among other things, this can help justify an agency temporarily non-enforcing on a category of taxpayers where they are unable to comply with the law in a certain timeframe despite good faith efforts – the agency can reasonably weigh the effect of enforcement on that category of taxpayer versus deploying those efforts elsewhere.
- **The specific statutory text and legislative intent** can limit the extent of non-enforcement discretion. Of course, some inconsistency with the letter of the law is a hallmark of exercises of categorical non-enforcement discretion.[26] But judicial decisions indicate that the clearer and more explicit the relevant statutory law is with respect to enforcement of statutory requirements then the less leeway – if any – the executive has to not enforce those

[21] *See* 5 U.S.C. § 706(1); *Telecommunications Research and Action Center (TRAC) v. FCC*, 750 F.2d 70, 79-80 (D.C. Cir. 1984); Todd Garvey, Congressional Research Service, A Primer on the Reviewability of Agency Delay and Enforcement Discretion, at 2-3 (2014). By contrast, most other agency non-enforcement decisions are "committed to agency discretion" under 5 U.S.C. § 701(a)(2). *See Chaney*, 470 U.S. at 828. *But see* 5 U.S.C. § 706(2). Still, case law suggests that Congress can limit an agency's discretion "either by setting substantive priorities, or by otherwise circumscribing an agency's power to discriminate among issues or cases it will pursue." Chaney, 470 U.S. at 833.

[22] *See* 5 U.S.C. § 553; *see also* Peter Richman & Taylor Cranor, *Legislative and Interpretive Tax Rules and Rulemaking*, Tax Notes (Mar. 8, 2023) (discussing different approaches to determine when a rule is "legislative").

[23] *Chaney*, 470 U.S. at 831-32.

[24] *Id.* at 832-33 & n.4 (quoting *Adams v. Richardson*, 480 F.2d 1159, 1162 (D.C. Cir. 1973)).

[25] See *id.* at 831-32; *TRAC*, 750 F.2d at 80.

[26] *See Chaney*, 470 U.S. at 831-32.

provisions.[27] Additionally, it appears proper and sometimes required[28] for the agency, when establishing whether it has categorical non-enforcement authority, to consider the legislative intent of the provision with respect to the interests that it seeks to secure. Understanding the interests that the particular provision of law seeks to secure requires interrogating the purposes and intent of that provision. That is, far from representing an unduly textualist approach to interpretation and enforcement discretion, the authorities and case law suggest that it is important to give due weight to the purposes of the provision of law that an agency is considering not enforcing, as well as the broader purposes of delegating authority to the Secretary to administer the system and funding the IRS to enforce it.

- **Courts are more apt to *review* the agency's decision to exercise non-enforcement authority in certain circumstances – but that does not mean that authority is unbounded when the courts do not review.** The courts more readily review categorical non-enforcement decisions than case-by-case non-enforcement,[29] and are more apt to review cases of delayed implementation of statutory mandates. In cases of delay, courts will explicitly engage in identifying and balancing factors on either side of the tension between administrative flexibility and the law subject to a non-enforcement decision (*TRAC*).[30] Longer delays beyond statutory deadlines are subject to more scrutiny than shorter delays.[31] Other non-enforcement decisions not involving delay are not generally reviewable, but there are various exceptions to that general rule (*Chaney*).[32]

  When the courts decline to review an agency's non-enforcement decision, this does not mean that the Executive's authority is boundless; it simply means that the courts recognize that in many circumstances, the Executive is the most competent institution to identify and assess the factors that determine when non-enforcement is appropriate. Similarly, the courts may also decline to review non-enforcement decisions when there is no plaintiff who has been sufficiently injured[33] – a dynamic that is acute in tax given the general lack of standing to challenge tax guidance that *lowers* administrative burdens or taxes.[34]

  The limited prospects for judicial review add gravity to the duty and responsibility of Treasury and the IRS to identify and explain the boundaries of their authority. It increases the need to establish limits in a way that forestalls abuse of that authority by any future administrations that may wish to try to decline to enforce tax laws simply because they do not like them.

  Moreover, although doctrines limit judicial review, Treasury and the IRS may not be immune from all challenges to non-enforcement decisions. Some recent cases suggest various routes

[27] *See id.* at 833 & n.4; Garvey, *supra* note 21, at 4-8. *See also, e.g.*, Impoundment Control Act, Pub. L. 93-344, 88 Stat. 297-339 (1974); *Train v. City of New York*, 420 U.S. 35, 44 (1975) (finding statutory limitation on discretion to impound funds predating more general limitation created by the 1974 Act).

[28] See below as to jurisprudence requiring balancing of such factors in the case of delay.

[29] *See* Garvey, *supra* note 19, at 24 (citing *Crowley Caribbean Transportation v. Pena*, 37 F.3d 671, 676 (D.C. Cir. 1994); *Nader v. Saxbe*, 497 F.2d 676, 679 n.19 (D.C. Cir. 1974)).

[30] *TRAC*, 750 F.2d at 79-80; Garvey, *supra* note 21, at 2-3.

[31] *See TRAC*, 750 2d. at 79-80 (interpreting 5 U.S.C. § 706(1)).

[32] *Chaney*, 470 U.S. at 828-35 & n.4; Osofsky, *supra* note 10, at 108-11; Garvey, *supra* note 21, at 3-8.

[33] Garvey, *supra* note 19, at 16 n.115; *see also* Osofsky, *supra* note 10, 108-111, 129.

[34] *See* Daniel J. Hemel & David Kamin, *The False Promise of Presidential Indexation*, 36 Yale J. on Reg. 693, 720-32 (2019); Osofsky, *supra* note 10, at 108-111, 129; Galle & Shay, *supra* note 11.

for challenges to overly generous agency actions.[35] With respect to Treasury and the IRS's recent non-enforcement decisions, there are potential parties who may have specific grounds for standing.[36]

- **There is a difference between non-enforcement and interpretation**. A categorical non-enforcement decision is a decision to not enforce statutory provisions against broad-based swaths of filers or in defined situations *even though* the filers or situations are clearly within the scope of the provision. By contrast, a decision not to enforce a statute against certain filers or in situations because they are not within the scope of the statute can be a question of interpretation, which has different implications for the boundaries of agency authority. Whether Treasury and the IRS are interpreting or not enforcing a statute may sometimes be difficult to tell in practice, especially when Treasury and the IRS are working through the proper interpretation of a statute; where there is uncertainty about the scope of a statute, questions around the margins could often be framed either as interpretation or as non-enforcement. This makes it more, not less, important that Treasury and the IRS approach these difficult cases with a clear framework and explain the authority for their decision. As an example, in issuing an announcement and later a notice regarding the excludability of certain state payments, Treasury and the IRS were not clear whether they believed they were issuing substantive guidance or not enforcing the statute.[37] This led to confusion about whether specific state payments were or were not excludable,[38] and to a decision that Colorado Taxpayer's Bill of Rights ("TABOR") refunds were excludable in 2023, even though their connection to exclusions for general welfare payments, disaster relief payments, or any other exclusion referenced in the notice is questionable.[39]
- **Agency delay or non-enforcement of regulations has fewer implications for separation of powers** but still has some boundaries and may be reviewable in some circumstances.[40] The power delegated by Congress to agencies creates a zone of enforcement discretion within which agencies have more flexibility to make adjustments for administrability, resource constraints, and other considerations. However, when an agency revises its regulations in response to statutory changes, the non-enforcement or delay of these revised regulations may amount to failing to enforce or delaying the revised statute. Delay or non-enforcement decisions in such cases may have implications for separation of powers. Even so, as with direct non-enforcement or delay of a statute, an agency may nonetheless have authority to not

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[35] *See* Hemel & Kamin, *supra* note 34; *see also CIC Services, LLC v. Internal Revenue Service*, 593 U.S. 209, 216 (2021).

[36] For example, taxpayers may have suffered harm if they would have received 1099-Ks from third-party settlement organizations if the $600 threshold were fully implemented, or if they would have received statements under section 6045 but for the delay of the digital asset broker reporting requirements. While one purpose of third-party information reporting requirements is raising revenue, another purpose is lowering compliance burdens for taxpayers seeking to accurately report their taxable income.

[37] *See* IRS Issues Guidance on State Tax Payments to Help Taxpayers, IR-2023-23 (Feb. 10, 2023); Federal Income Tax Consequences of Certain State Payments, Notice 2023-56 (Aug. 30, 2023).

[38] *See* Appendix and *infra* note 69.

[39] *See* Emily Hollingsworth, *Colorado DOR Confirms IRS Won't Tax 2023 TABOR Refunds*, Tax Notes (Jan. 16, 2024).

[40] *See generally, e.g.*, *Natural Resources Defense Council v. National Highway Traffic Safety Administration*, 894 F.3d 95 (2d Cir. 2018).

enforce or to delay revised regulations under certain circumstances or for a certain length of time.

In light of these principles, scrutiny of some recent non-enforcement decisions is reasonable. For instance, in delaying full implementation of the 1099-K information reporting provisions enacted in the American Rescue Plan ("ARP") Act of 2021, the IRS did not enforce the provision at all for transactions made in 2022 and 2023 and announced a $5,000 transitional threshold for third-party settlement organizations ("TPSOs") reporting on transactions made in 2024, which is neither the $600 threshold mandated by the ARP, nor the $20,000 threshold that preexisted the ARP. Instead, it is a threshold created by the IRS, in an announcement that did not explain why the IRS had the authority to create this threshold in the face of an explicit and specific statutory alternative and deadline.[41] Again, it is beyond the scope of this report to fully analyze or draw conclusions about any specific non-enforcement decision, but it is unsurprising that given some of these aspects of the statutory framework, Treasury and the IRS are being asked to share more of their reasoning. (As discussed further in Part II, it is also unclear that this decision furthered sound tax administration on net, and whether and how key statutory goals were weighed). There may be other factors that go to authority beyond those this report has raised here. If other factors are influencing Treasury and IRS decisions as to authority, they should explain what they are as well as their source in law.

II. WHEN AND HOW IS IT SOUND FOR TREASURY AND THE IRS TO EXERCISE THEIR DISCRETION TO ISSUE CATEGORICAL NON-ENFORCEMENT RELIEF?

Even where Treasury and the IRS have authority to make a categorical non-enforcement decision, they should ensure they are using that authority as wisely as possible. The following considerations could help inform that goal:

Sound tax administration means more than relieving certain groups of filers of compliance burdens.

In each of the recent non-enforcement decisions, Treasury and the IRS did not fully explain what factors they considered, but made broad statements that the decisions were good for "sound tax administration," and in some cases based on "stakeholder input." Sound tax administration, however, is not necessarily furthered simply because a non-enforcement decision reduces compliance burdens on some categories of filers, because those decisions may have other countervailing costs for tax administration. This justification alone also clearly sweeps too broadly. If reducing compliance burdens sufficed to justify non-enforcement, that could justify mass non-enforcement of the tax system and commensurate loss in revenue, which clearly is outside Treasury and the IRS's discretion and does not represent sound administration of the tax system.

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[41] As is common across announced categorical non-enforcement decisions, Treasury and the IRS were clear and transparent about *when* they would enforce, which can help promote accountability and prevent arbitrariness. *See* Osofsky, *supra* note 10, at 75-76, 124, 132. They did not, however, explain the authority behind that decision.

In weighing how non-enforcement affects taxpayer compliance costs and behavior, it is important to consider the risks associated with non-enforcement.

It is appropriate and important that Treasury and the IRS consider impacts on filers and other stakeholders most directly affected when granting categorical administrative relief, including the extent to which it is even possible to comply with the law under statutory deadlines. But it should also recognize that this input is often inherently one-sided because other factors also important to tax administration and to the law do not tend to have loud and organized stakeholder constituencies. Treasury and the IRS should be careful to ensure – and clearly demonstrate – that they are not underweighting these other considerations when exercising non-enforcement discretion.

For instance, the recent announcement of 1099-K transition relief begins by stating that it is made "Following feedback from taxpayers, tax professionals, and payment processors."[42] Indeed, industry groups lobbied heavily and spread confusion among customers and encouraged them in turn to request delay.[43] Those groups naturally welcomed the non-enforcement decision.[44] But the decision also generated deleterious effects when it comes to how taxpayers interact with the tax system and its administrators. Some filers made good faith attempts to comply with the law before the non-enforcement announcement, meaning that they incurred compliance costs, while competitors who were subject to the same law and who did not make those efforts did not bear such costs. Even if all filers subject to the new requirements were ultimately happy with the relief, the lesson that they might take in the future is that there is no benefit to making good faith efforts to come into compliance with the law, despite statutory deadlines, because the IRS may fail to enforce anyway – and that joining those loudly failing to comply might increase the chances of relief. The decision also reduced certainty and predictability generally about how tax provisions will be implemented.

Non-enforcement decisions can undercut important legislative goals, intents, and purposes core to sound tax administration—including revenue, compliance, and equity between filers and industries.

Non-enforcement decisions can also harm the legislative intent and interests underlying the provision of law that Treasury and the IRS is declining to enforce. For recent non-enforcement decisions, these include: improving tax compliance and improving parity between different types of payment platform (e.g. 1099-K reporting); improving certainty, tax compliance and parity between different forms of economic income (e.g., cryptocurrency broker reporting); other policy goals; and revenue. In announcing their decisions, Treasury and the IRS have not explained which of these types of factors they considered.

As to revenue, Treasury and the IRS have not publicly issued estimates of the revenue cost of their recent non-enforcement decisions, but other estimates suggest that the recent delay and non-

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[42] IR-2023-221, *supra* note 12.

[43] *See* Erin Slowey & Samantha Handler, *Urgency Mounts to Avert 1099-K EBay, Paypal Tax Form Chaos*, Bloomberg Law (Nov. 20, 2023).

[44] *See* Coalition for 1099-K Fairness, The Coalition for 1099-K Fairness Praises IRS Announcement of One-Year Delay for 1099-K Reporting Threshold and Calls on Congress to Pass Permanent Relief for Taxpayers (Nov. 21, 2023).

enforcement decisions will, very roughly, add at least $8 billion to deficits.[45] For example, analysts estimate that excluding state tax payments from income reduced revenue by $3 billion to $4 billion in 2023.[46] Delay of the revised 1099-K reporting requirement may have cost around $1.2 billion over two years,[47] not accounting for costs of the "transitional" threshold for 2024 transactions, and the delay to implementing the crypto broker reporting requirement will likely cost about $1.5 billion in FY2024 and $2.9 billion in FY2025.[48] The two-year delay of the requirement that plan sponsors designate certain catch-up contributions as after-tax, Roth contributions will likely cost around $4 billion in upfront revenue.[49]

Late and confusing announcements.

Some of the recent Treasury and IRS decisions came within days or weeks of a statutory deadline or of a requirement going into effect, generating both inequities and confusion after some filers had already taken steps to comply. In addition to ensuring that any non-enforcement decisions are wise, Treasury and the IRS should improve when and how it announces them.

For example, the IRS announced the first delay in implementing the new 1099-K reporting threshold on December 23, 2022, just a month before the start of the filing season for tax year 2022.[50] The Tax Law Center noted that this would spark further confusion,[51] and other commentators predicted that some customers of TPSOs with between $600 and $20,000 of transactions would still receive forms, causing confusion both for the taxpayers and the IRS.[52] KPMG issued a report on the confusion that had in fact resulted for payors, payees, and state agencies.[53] The second delay, this time issued two months before the filing season for Tax Year

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[45] This figure includes only the costs of the non-enforcement decisions listed in the Executive Summary, not the other non-enforcement decisions listed at the end of the Appendix. The upfront cost of the delay of the mandatory Roth provision is not included.

[46] *See* Linda Qiu & Alan Rappeport, *I.R.S. Decision Not to Tax Certain Payments Carries Fiscal Cost*, The New York Times (Feb. 27, 2023).

[47] *See id.*; Estimated Revenue Effects of H.R. 1319, The "American Rescue Plan Act of 2021," As Amended by the Senate, Scheduled for Consideration by the House of Representatives (Mar. 9, 2021), JCX-14-21, at 2 (modifications of exceptions for reporting of third-party network transactions).

[48] Joint Committee on Taxation, Estimated Revenue Effects Of The Provisions In Division H Of An Amendment In The Nature Of A Substitute To H.R. 3684, Offered By Ms. Sinema, Mr. Portman, Mr. Manchin, Mr. Cassidy, Mrs. Shaheen, Ms. Collins, Mr. Tester, Ms. Murkowski, Mr. Warner And Mr. Romney, The "Infrastructure Investment And Jobs Act", JCX-33-21 (Aug. 2, 2021); *see also* Chye-Ching Huang, U.S. Will Likely Lose Billions Due to Unacceptably Long Delay for Digital Asset Reporting Requirements, Tax Law Center at NYU Law (Aug. 25, 2023)**Error! Bookmark not defined.**; Taylor Cranor & Mike Kaercher, *Treasury and the IRS Should Issue Digital Asset Broker Reporting Guidance Quickly*, Tax Law Center at NYU Law (Jun. 21, 2023).

[49] Joint Committee on Taxation, Estimated Revenue Effects of H.R. 2617, the "Consolidated Appropriations Act" as Passed by the Senate, JCX-21-22, at 4 (Dec. 22, 2022) ("elective deferrals generally limited to regular contribution limit"); *see also* Congressional Budget Office, S. 4808 Enhancing Retirement Now Act, at 12 (Sept. 23, 2022) (describing revenue effects of an earlier version of this provision). Because the difference between after-tax and pre-tax contributions is a matter of timing, the delayed implementation of this provision causes an upfront loss that is greater in magnitude than the long-term revenue effects of the delay.

[50] Naomi Jagoda, *Confusion Still Expected After Delay of Lower 1099-K Threshold*, Bloomberg Law (Jan. 19, 2023).

[51] Grace Henley et al., The Tax Law Center at NYU Law, *Undermining Information Reporting Requirements For "Gig" Companies and Other Online Platforms Would Hurt Honest Filers, Cost Revenue, and Reward Tax Evaders* (June 12, 2023).

[52] *Id.*

[53] KPMG, Form 1099-K Delayed Reporting Thresholds (Jan. 24, 2023).

2023, will likely create yet more confusion with its administratively-created phase-in that yields different thresholds for each of tax years 2023, 2024, and 2025.

Similarly, guidance regarding 2022 state tax payments was issued weeks after the filing season, with the lateness causing avoidable confusion. For example, California sent tax forms suggesting that the state's payments were taxable income before the IRS guidance determined that the payments from California did not need to be reported.[54]

III. ENSURING TRANSPARENT AND CONSISTENT CATEGORICAL NON-ENFORCEMENT DECISIONS

Treasury and the IRS have not been clear about the sources of their non-enforcement authority, why the actions taken are within its boundaries, and the considerations and processes they use to decide when to exercise that authority. They should be more transparent on these points. While Treasury and the IRS have offered some justification of their authority in response to questions that lawmakers and others have raised,[55] proactive explanation of reasoning would be preferable.

Transparency may have value independent of the content of the positions that Treasury and the IRS ultimately take (within reason). It can help promote consistency across a large agency. Stakeholders will be able to assess whether Treasury and the IRS are acting consistently with their own stated approach and across decisions. Predictability may be improved by making it easier for stakeholders to anticipate and plan for how laws may be implemented.[56] This report recommends that with respect to decisions to not enforce certain tax laws on a categorical basis, Treasury and the IRS seek to be explicit and transparent about:

Authority: Treasury and the IRS should clearly articulate the sources of authority relied upon when granting administrative relief and why the actions taken are within the bounds of that authority. Treasury and the IRS should also attempt to be as clear as possible about whether (and to what extent) they believe they are exercising authority to categorically non-enforce against filers statutory obligations that are clear, or, alternatively, using non-enforcement authority in addition to, or in anticipation of, exercising interpretive authority clarifying the underlying statutory obligations. This can help reduce the potential for later confusion among filers who may benefit from non-enforcement one year, but could then be surprised to later find that they have obligations.

Process: Treasury and the IRS should clearly articulate who will be involved and have decision-making authority for categorical non-enforcement of or delays in implementation of provisions of the Code or of implementing regulations. They will need to consider the role of the IRS,

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[54] Kate Dore, *IRS Says Many State Rebates Aren't Taxable at the Federal Level. Some May Face Filing Struggle, Tax Pros Warn*, CNBC (Feb. 10, 2023).

[55] *See* Rubin, *supra* note 5; Samantha Handler, *Republicans Demand Werfel Testify on Delay of 1099-K Change*, Bloomberg Law (Dec. 21, 2023).

[56] On the other hand, transparency about non-enforcement authorities and considerations may make it easier for well-resourced stakeholders to intensify pressure for relief that is narrowly beneficial to them but has larger costs for the tax system overall. But recent decisions seem likely to encourage such pressure anyway, and Treasury and the IRS will continue to be confronted with disasters, new laws, and other situations in which they must determine whether to grant categorical administrative relief.

Treasury, and the broader Executive Branch in making such determinations, and to develop internal procedures and guidance to avoid haphazard or late announcements of any such relief.

Factors to consider when deciding whether to exercise authority: Treasury and the IRS should state generally and prospectively factors they will consider when making categorical non-enforcement decisions under broad grants of authority. They should also clearly state the "sound tax administration" and other factors that went into any announced non-enforcement decision. These may include:[57]

- **Resource constraints in enforcement.** The administration should clarify what types of resource constraints might result in a non-enforcement decision. Resource considerations that may affect full implementation of a statute include: temporary constraints on funding or administrability (including external factors such as disasters or shutdowns); the resource intensity of fully implementing the provision; how easily resources can be shifted to make the provision easier to implement and enforce; and the costs of such resource shifts.
- **Considerations flowing from the text and legislative purpose of the relevant provision of tax law.** These considerations will depend on the tax provision at issue, embodied by the text of the law, sometimes supplemented by official legislative history. As noted in Part I, identifying the interests that the relevant law sought to advance will require an appropriately purposive approach to interpretation. For instance, some of the recently non-enforced provisions listed in the Appendix sought to improve tax compliance, increase equity between different tax filers and industries, and raise revenue. Non-enforcement may also be used to respond to drafting errors or oversights inconsistent with the purpose of a provision.[58]
- **Fiscal cost.** Revenue collection is a core function of the tax system and of tax administration, and often also of the relevant provision that Treasury and the IRS are deciding whether to enforce. Revenue costs should therefore be considered, either as an impact on "sound tax administration," a cost of non-enforcement with respect to legislative intent, or both.
- **Stakeholder impacts, input, and access.** It is important and appropriate for the IRS to consider the impact on directly-affected filers and other stakeholders. Requests for relief may be especially consistent with sound tax administration when factors out of filers' control, including emergencies and disasters, impose high compliance burdens, or make it impossible to comply under statutory deadlines. Treasury and the IRS should also be more inclined to offer relief when deadlines for implementation are inherently unreasonable even if the administration and filers had made good faith efforts to comply, as compared to when difficulties complying arise only because stakeholders failed to take reasonable and timely

[57] As noted above, when delay or non-enforcement decisions are challenged in court, clear and transparent consideration of these factors by the agency in making these decisions may help the court find that the agency action was proper. Further, note that identification and weighing of factors and tradeoffs does not necessarily imply a requirement for any formal or quantified welfare or cost-benefit analysis. Indeed, as this report starts with the relevant sources of authority for categorical non-enforcement, this report focuses on factors most relevant to tax administration and the intent of relevant statutory provisions, which in some cases may be just a subset of factors included in a full welfare analysis.
[58] *See* Leigh Osofsky, *Agency Legislative Fixes*, 105 Iowa L. Rev. 2107, 2151-52 (2020) (considering the benefits and drawbacks of using non-enforcement to fix drafting mistakes).

actions in the face of a clear statutory duty.[59] As part of this assessment, Treasury and the IRS should consider that non-enforcement can undermine certainty in how tax laws will be administered, adversely affect those who have planned for implementation, or create filer expectations for routine non-enforcement and implementation delays that can be undesirable in a tax system that relies on voluntary compliance.

Treasury and the IRS should be less inclined to offer delays and non-enforcement to allow for stakeholder input if there have already been prior opportunities for input, and Treasury and the IRS should carefully interrogate whether delays or non-enforcement would in fact improve the ability of stakeholders to give input. Indeed, some recent delays or non-enforcement decisions were combined with delays in issuing proposed regulations that would have *begun* the process of transparently collecting stakeholder comments.

In weighing stakeholder input, Treasury and the IRS should consider that compared to disadvantaged communities, well-resourced and sophisticated filers may be both better situated to implement new requirements – but also to request administrative relief. Treasury and the IRS should evaluate requests for relief understanding that disadvantaged communities may be less likely to have formal or informal input into guidance and regulatory processes, and should take care not to view volume and intensity of lobbying as a proxy for the potential benefits of administrative relief or for tax administration more broadly.[60]

- **Other relevant administrative frameworks.** There are several administration-wide Executive Orders that Treasury and the IRS are subject to in their administration of the tax law, including on racial equity, reducing administrative burden, and climate change.[61] Treasury and the IRS should review and consider how these orders and other executive-wide frameworks should influence determinations of non-enforcement relief in tax.

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[59] The particular statutory framework may, of course, imply or explicitly require a higher standard than reasonable or good faith efforts, and, as discussed in Part I, that should be considered when determining whether there is authority for categorical non-enforcement, as well as when determining whether to exercise any such authority.
[60] *See* Shu-Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations*, 69 Emory L.J. 209, 216, 259 (2019); Clinton G. Wallace, *Congressional Control of Tax Rulemaking*, 71 Tax L. Rev. 179, 217-21 (2017).
[61] *See, e.g.*, Executive Order No. 14091, Further Advancing Equity and Support for Underserved Communities Through the Federal Government, 88 Fed. Reg. 10825, 10832 (Feb. 22, 2023); Executive Order No. 14058, Transforming Federal Customer Experience and Service Delivery to Rebuild Trust in Government, 86 Fed. Reg. 71357, 71357 (Dec. 16, 2021); Executive Order No. 14008, Tackling the Climate Crisis at Home and Abroad, 86 Fed. Reg. 7619, 7620 (Feb. 1, 2021); Executive Order No. 13985, Advancing Racial Equity and Support for Underserved Communities Through the Federal Government, 86 Fed. Reg. 7009, 7009 (Jan. 25, 2021). For further discussion of the role of different elements of the Executive in non-enforcement, *see generally* Kate Andrias, *The President's Enforcement Power*, 88 N.Y.U. L. Rev. 1031 (2013).

APPENDIX

Recent decisions by Treasury and the IRS to grant categorical administrative relief include:

- **Non-enforcement of taxability of state payments and special tax refunds**. In February 2023, the IRS announced after filing season had already begun that it would not challenge the non-reporting of, and exclusion of certain payments made by many states in 2022.[62] The reason offered was that this was "*in the best interest of sound tax administration*."[63] In August 2023, the IRS followed up with a notice laying out more guidance on how it will address these payments going forward.[64] The notice provides some additional reasoning as to why the IRS determined many of these 2022 state payments qualified as excludable disaster relief payments under section 139.[65] However, the IRS provided limited explanation or authority for its approach, and provided elaboration only several months after the initial non-enforcement decision. Moreover, although the portions of the notice related to the pandemic emergency declaration mentioned that the emergency ended in May 2023, the notice implied that the COVID-related state payment issue only pertained to the 2022 tax year.[66] This resulted in confusion about how the guidance would apply to certain state payments made in 2023.[67] Further, the IRS has reportedly confirmed that taxpayers would not need to report certain additional 2023 state refunds, even when these refunds do not clearly fall under either the general welfare exception or the exclusion for income for qualified disaster relief payments.[68]
- **Delay in the implementation of changes to section 1099-K reporting requirements (6050W).** For third-party settlement organizations—which include organizations such as Etsy, eBay, PayPal, Venmo, Uber, and DoorDash—the American Rescue Plan of 2021 lowered the threshold for sending a Form 1099-K to customers and to the IRS to $600.[69] By law, this new threshold generally applied for transactions made during 2022.[70] On December 23, 2022, the IRS announced a one-year delay in implementing the new $600 threshold.[71]

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[62] IR-2023-23, *supra* note 37.
[63] *Id.*
[64] Federal Income Tax Consequences of Certain State Payments, Notice 2023-56 (Aug. 30, 2023).
[65] *Id.* at 6-8.
[66] *Id.* at 2.
[67] Maine viewed certain state Winter Energy Relief payments as excludable from federal taxes, even though the IRS later determined that they would not qualify for the general welfare exception. Kirsten LC Figueroa, Letter to William M. Paul, Acting Chief Counsel (Dec. 12, 2023). After hearing from the state, the IRS Acting Chief Counsel concluded that these early 2023 payments could be excluded under the section 139(b)(4) exclusion for income for qualified disaster relief payments because of references to addressing the impact of the pandemic in the state legislation providing for these payments. *Id.*; William M. Paul, Acting Chief Counsel, Letter to Kirsten LC Figueroa (Dec. 15, 2023). Arizona has recently requested that certain 2023 state tax rebates be excluded from federal income under the general welfare exception. Kris Mayes, Letter to the Honorable Daniel Werfel (Jan. 25, 2024). Although the February 2023 announcement is less clear, the August 2023 notice and the Acting Chief Counsel's December 15 letter are framed as categorical *applications* of statutory exclusions rather than exercises of categorical non-enforcement. Along the same lines, Arizona's letter requests a determination that the 2023 Arizona state rebates fall under the general welfare exclusion rather than that the IRS not enforce the law. Mayes, supra.
[68] *See* Hollingsworth, *supra* note 39.
[69] American Rescue Plan Act of 2021, Pub. Law 117-2, § 9674(c), 135 Stat. 185 (Mar. 11, 2021); Grace Henley et al., *supra* note 51.
[70] *Id.*
[71] IRS Announces Delay for Implementation of $600 Reporting Threshold for Third-Party Payment Platforms' Forms 1099-K, IR-2022-226 (December 23, 2022).

The explanation for the last-minute delay by then Acting IRS Commissioner Doug O'Donnell was: "The IRS and Treasury heard a number of concerns regarding the *timeline* of implementation of these changes. . . . To help *smooth the transition* and *ensure clarity* for taxpayers, tax professionals and industry, the IRS will delay implementation of the 1099-K changes. The additional time will help *reduce confusion* during the upcoming 2023 tax filing season and provide more time for taxpayers to prepare and understand the new reporting requirements."[72] On November 21, 2023, the IRS announced an additional delay "[f]ollowing feedback from taxpayers, tax professionals, and payment processors and to reduce taxpayer confusion[.]"[73] In doing so, the IRS not only kept the pre-ARP $20,000 threshold in place for transactions made during 2023; it also announced a threshold of $5,000 for transactions made during 2024, with the statutorily-mandated threshold of $600 only fulling phasing in for transactions made in 2025.[74]

- **Delay in implementation of the requirement that brokers report on digital assets (6045).** The Infrastructure Investment and Jobs Act imposed a new reporting requirement on crypto brokers.[75] The law generally required reporting beginning on January 1, 2024, for transactions occurring in 2023.[76] However, by December 23, 2022, Treasury and the IRS had announced only that they intended to issue a notice of proposed rulemaking for regulations to implement this section of the Code.[77] They explained that the notice and comment process would "allow the Treasury Department and the IRS to accept comments from affected taxpayers, industries, and other interested parties and enable the public to *meaningfully participate in the regulatory process*."[78] In the months following this announcement, stakeholders expressed increasing doubts that Treasury and the IRS could finalize regulations under section 6045 before January 1, 2024.[79] The IRS ultimately released the proposed

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[72] *Id.* (emphasis added). For further exploration of the questions raised by this first delay, *see* Daniel Hemel & Steven M. Rosenthal, *The IRS's Christmas Gift to Airbnb and PayPal Is a Loss for Law-Abiding Taxpayers*, Tax Policy Center (Jan. 11, 2023).
[73] IR-2023-221, *supra* note 12; Revised Timeline Regarding Implementation of Amended Section 6050W(e), Notice 2023-74 (Nov. 21, 2023).
[74] *Id.* A GAO report published shortly before the delay recommended that the IRS "work to determine the most appropriate thresholds for payment information reporting, including Form 1099-K." GAO, Tax Enforcement: IRS Can Improve Use of Information Returns to Enhance Compliance, GAO-24-107095 (Nov. 15, 2023). However, some commentators questioned Treasury and the IRS's authority to rewrite a threshold written into the statute. *See* Jonathan Curry & Cady Stanton, *Relief, Cheers Greet IRS's Further Delay of New 1099-K Regime*, Tax Notes (Nov. 22, 2023); Representative Smith et al., *supra* note 8; National Federation of Independent Business, *IRS Delays $600 Reporting Threshold for Payment Platform Transactions* (Dec. 6, 2023).
[75] Infrastructure Investment and Jobs Act, Pub. L. 117-58, § 80603, 135 Stat. 1339-41 (2021).
[76] *Id.* § 80603(c); Joint Committee on Taxation, Estimated Revenue Effects of the Provisions in Division H of an Amendment in the Nature of a Substitute to H.R. 3684, JCX-33-21, at 2 (Aug. 2, 2021).
[77] Transitional Guidance Under Sections 6045 and 6045A With Respect to the Reporting of Information on Digital Assets by Brokers, Announcement 2023-2 (Dec. 23, 2022).
[78] *Id.* at 4 (emphasis added).
[79] *See, e.g.*, Senator Elizabeth Warren et al., Letter to Treasury and IRS re Crypto Reporting Requirements (Aug. 1, 2023).

regulations on August 25, 2023.[80] The proposed regulations delay the implementation of this reporting requirement by two years to 2026, for sales and exchanges made in 2025.[81]

- **Delay of changes to designation of certain catch-up contributions (414(v)).** Under the SECURE 2.0 Act, catch-up contributions to tax-qualified retirement plans by individuals earning over $145,000 must be designated as after-tax Roth contributions, not pre-tax contributions.[82] The Act required plan sponsors to implement this change by January 1, 2024.[83] However, after having "been made aware of taxpayer concerns" with timely implementing the changes,[84] on August 25, 2023, the IRS announced a two-year "administrative transition period" to "help taxpayers transition smoothly" to the new requirement, and to "facilitate an orderly transition[.]"[85]

Other potential examples of categorical administrative relief since late 2022 include:

- Transitional Guidance Under Section 6050I with Respect to the Reporting of Information on the Receipt of Digital Assets, Announcement 2024-4 (Jan. 16, 2024); Treasury and the IRS Announce That Businesses Do Not Have to Report Certain Transactions Involving Digital Assets Until Regulations Are Issued, IR-2024-12 (Jan. 16, 2024)[86];
- Anticipated Direction of Forthcoming Proposed Guidance on Critical Mineral and Battery Component Value Calculations for the New Clean Vehicle Credit (Dec. 29, 2022);
- Temporary Relief Under Sections 901 and 903 of the Internal Revenue Code, Notice 2023-55, at 5 (July 21, 2023); Guidance Regarding the Foreign Tax Credit and Dual Consolidated Losses in Relation to the GloBE Model Rules, and Modification of Temporary Relief in Notice 2023-55, Notice 2023-80, at 26 (Dec. 11, 2023);
- Additional Time for Partnerships to Provide Complete Forms 8308 for Section 751(a) Exchanges Occurring in Calendar Year 2023, Notice 2024-19 (Jan. 11, 2024);
- Relief from Additions to Tax for Certain Taxpayers' Failure to Timely Pay Income Tax for Taxable Years 2020 and 2021, Notice 2024-7 (Dec. 19, 2023);
- 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 7, 2023 (2023 Hawaii Wildfires), Notice 2023-69 (Sept. 28, 2023);
- Employee Retention Credit Voluntary Disclosure Program, Announcement 2024-23 (Dec. 21, 2023);

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[80] U.S. Dep't of Treasury, IRS Release Proposed Regulations on Sales and Exchanges of Digital Assets by Brokers (Aug. 25, 2023); Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, REG-122793-19, 88 Fed. Reg. 59576-59659 (Aug. 29, 2023); *see* also Huang, *supra* note 48. Treasury and the IRS subsequently prolonged this process by extending the comment period through November 13, 2023. Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, REG-122793-19, 88 Fed. Reg. 73300-01 (Oct. 25, 2023).

[81] Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, 88 Fed. Reg. 59596, *supra* note 80; *see also* Tax Law Center, Recommendations for Guidance Regarding Broker Reporting of Digital Asset Transactions, REG-122793-19 (Nov. 13, 2023).

[82] Consolidated Appropriations Act of 2022, Pub. L. 117-328, § 603, 136 Stat. 5391-92 (Dec. 29, 2022).

[83] *Id.* § 603(c), 136 Stat. 5392.

[84] Guidance on Section 603 of the Secure 2.0 Act with Respect to Catch-Up Contributions, Notice 2023-62, 2023-37 I.R.B. 817 (Aug. 25, 2023).

[85] IRS Announces Administrative Transition Period for New Roth Catch Up Requirement; Catch-Up Contributions Still Permitted After 2023, IR-2023-155 (Aug. 25, 2023).

[86] *See* note 2.

- Transition Relief and Guidance Relating to Certain Required Minimum Distributions, Notice 2023-54 (July 14, 2023);
- Transitional Guidance With Respect to Stock Repurchase Excise Tax, Announcement 2023-18 (June 29, 2023);
- Relief from Certain Additions to Tax for Corporation's Underpayment of Estimated Income Tax Under Section 6655, Notice 2023-42 (June 7, 2023);
- Extension of Temporary Relief Related to the Penalty for Failure to Deposit Superfund Chemical Taxes, Notice 2023-28 (June 29, 2023);
- Lookback Periods for Claims for Credit or Refund for Returns with Due Dates Postponed by Notice 2020-23 or Notice 2021-21, Notice 2023-21 (Apr. 20, 2023); and
- Foreign Financial Institution Temporary U.S. Taxpayer Identification Relief, Notice 2023-11 (Apr. 10, 2023).