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The Surprising Significance of De Minimis Tax Rules

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The Surprising Significance of De Minimis Tax Rules

Leigh Osofsky[*] & Kathleen DeLaney Thomas[**]

Abstract

De minimis tax rules—rules that eliminate tax burdens for low-income taxpayers or low-dollar transactions—abound in the tax law. Despite the prevalence of such rules, legal scholarship has treated them as—well—de minimis, or as mere rounding errors that do not merit sustained attention. This perspective is understandable. If de minimis rules address insignificant taxpayers or tax liabilities, aren't the rules themselves likely to be insignificant?

Recent tax law developments have revealed that this conception of de minimis tax rules is deeply misguided. Major allocations of tax law liability, as well as accompanying questions about the fairness, efficiency, and administrability of the tax system, turn on the existence and design of de minimis

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tax rules. In the wake of the recent Tax Cuts and Jobs Act, for example, astute industry players successfully lobbied the Treasury Department to create de minimis tax rules, thereby scoring significant monetary victories. De minimis tax rules like these not only serve as low-salience giveaways but are also poorly designed in a way that undermines the integrity of the tax system.

The lack of scholarly attention to de minimis tax rules has left this lobbying largely unchecked. There is no scholarly framework evaluating existing de minimis tax rules. There is no policy framework to help lawmakers decide why, when, or how such rules should be made. And there is no separation of powers framework analyzing when the Treasury Department has the authority to create de minimis tax rules without express Congressional authorization. This Article seeks to fill this gap by analyzing de minimis tax rules along all of these dimensions. It provides a framework for considering when de minimis tax rules are preferable to other policy options and offers important design considerations. Scholars can apply this analysis to the de minimis tax rules that already pervade the Internal Revenue Code and policymakers can use it to guide the many more they will consider in the future.

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INTRODUCTION

The tax law purports to tax all income, from whatever source derived.[1] But as students of the tax law quickly learn, that seemingly simple tenet gives way to numerous complications and exceptions. Imagine, for example, that your employer offers free coffee and pastries every Friday at the office. Technically, the snacks constitute "income" and, as such, should be taxable.[2] But taxing an occasional croissant borders on the absurd. Must the employer keep track of how many pastries each employee eats? What about employees that don't drink coffee? Does the payroll department have to process the value of the pastries and add it to the employee's biweekly paycheck? Will the employee pay Social Security taxes on a portion of the coffee consumed?

The answer to all of these questions is "no"—because the tax law treats the coffee and pastries as de minimis. Although noncash compensation paid to employees is generally taxable, the Internal Revenue Code ("Code") exempts any "de minimis fringe," defined as property or services with a value so small "as to make accounting for it unreasonable or administratively impracticable."[3] In other words, de minimis fringes are small benefits provided by an employer, like doughnuts in a company break room, that are so minor that they are not worth keeping track of for tax purposes.[4]

De minimis rules abound in the tax law. Like the rule for de minimis fringes, many other de minimis rules exempt taxpayers from a tax burden when the revenue at stake is not worth the cost of complying with the law. Other de minimis tax rules exempt taxpayers from particularly complex tax regimes that are targeted at more sophisticated parties. For example, the new "pass-through deduction" enacted as part of sweeping tax reform in 2017 allows taxpayers below a certain income threshold to avoid some of its most complicated provisions.[5] The

1. I.R.C. § 61(a).

2. *See id.* § 61(a)(1) (stating that gross income includes any compensation for services including fringe benefits).

3. *Id.* § 132(a)(4), (e).

4. *Id.* § 132(e)(1).

5. *See infra* notes 73–79 and accompanying text.

Code and Treasury Regulations are replete with other examples of de minimis exceptions.

Yet, despite their prevalence in the tax law, there is no scholarly framework for analyzing de minimis tax rules. While scholars have at times focused on particular de minimis tax rules,[6] they have not more generally examined the phenomenon: Why do de minimis rules pervade the tax law? Why, when, and how should they be created? And which actors have the authority to create them?

At first blush, this lack of scholarly attention makes sense. These are de minimis rules after all. Since de minimis rules exempt insignificant taxpayers or transactions from otherwise generally applicable law,[7] scholars can be excused for thinking that the rules themselves are relatively insignificant—the equivalent of rounding errors in the design of the tax law. Application of a de minimis rule may help a particular taxpayer, the thought process would go, but comprehensively understanding de minimis rules may not seem like it is of particular importance to the tax system. But this conception is deeply misguided. As this Article will illustrate, while de minimis rules can serve an important role in the tax system, they are also subject to significant problems with systemic effects, which scholars and commentators have failed to recognize.

This Article fills this gap in the literature. First, the Article surveys existing de minimis tax rules and the various functions of those rules. We find that most de minimis tax rules are

6. The de minimis fringe benefit rule has attracted particular attention. *See, e.g.*, Susan C. Morse & Leigh Osofsky, *Regulating by Example*, 35 YALE J. ON REG. 127, 171–75 (2018) (exploring how Treasury has elaborated the meaning of de minimis fringe benefits, which are excluded from gross income). Another issue that has received some sustained focus is how to prevent states from imposing use or sales taxes on de minimis activity that occurs in the state. *See, e.g.*, Charles E. McLure, Jr., *Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?*, 2000 B.Y.U. L. REV. 77, 132–33 (exploring imposition of state use taxes for sales in excess of de minimis amounts); Adam B. Thimmesch, *The Tax Hangover: Trailing Nexus*, 33 VA. TAX REV. 497, 503–04 (2014) (proposing "a new trailing-nexus standard" that "protects against the retained jurisdiction over taxpayers with de minimis activity in a state").

7. I.R.C. § 132(e)(1).

intended to reduce administrative and compliance costs for both taxpayers and the government when those costs are not justified by the revenue at stake. Some de minimis tax rules are aimed specifically at relieving taxpayers of compliance burdens like filling out tax forms (what we call "procedural de minimis tax rules"), while other de minimis tax rules are aimed at relieving taxpayers of substantive tax obligations (what we call "substantive de minimis tax rules"). De minimis tax rules may exempt taxpayers and transactions from relatively simple rules that impose high compliance burdens, or they may exempt taxpayers from complex tax regimes when such taxpayers lack sophistication. Finally, we find that some de minimis tax rules appear to be more motivated by political considerations than concerns about disproportionate compliance costs.

Having surveyed the function of existing de minimis tax rules, we then turn to the drawbacks of such rules. We argue that de minimis tax rules impose a number of unappreciated costs on the tax system. First, by excepting out insignificant taxpayers or transactions, de minimis tax rules also enable the law that remains to be more burdensome than it otherwise would be. This increased burden in the generally applicable law has both efficiency and distributive implications. Second, de minimis tax rules, such as the exclusion for de minimis fringes, often fail to capture changes in industry and tax planning practices, undermining the rule's administrative benefits and even supercharging inefficient tax planning.

In addition to these costs, de minimis tax rules are also particularly prone to lobbying and may thus disproportionately benefit insiders. Indeed, recent events have driven this point home. At the end of 2017, Congress enacted the most sweeping tax reform in over thirty years.[8] While the legislation was ambitious in scope, it left many fundamental design questions unanswered.[9] The legislation thus opened the door for industry insiders to score even more victories than usual in the

8. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (codified as amended in scattered sections of the Internal Revenue Code).

9. Shu-Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the Section 199A Regulations*, 69 EMORY L.J. 209, 211 (2019).

administrative process.[10] One way that insiders did so was by lobbying for more advantageous, underlying tax rules.[11] But another way that such insiders did so was by arguing for de minimis exceptions to the tax rules themselves. By lobbying for, and getting, various de minimis tax rules, industry insiders quietly, but significantly, changed the reach of the legislation.[12]

Finally, Congress clearly has the authority to craft statutory de minimis rules, but many also exist in Treasury regulations.[13] We believe there is a strong argument that Treasury actually does not have the authority to create many of the regulatory de minimis tax rules that exist across the tax law. This point may have a critical impact on tax administration. Moreover, aside from questions of administrative authority, as the 2017 tax reform reveals, Treasury crafting de minimis tax rules can be problematic on political economy grounds. Creating de minimis tax rules in the administrative process is a particularly low salience way for industry insiders to gain significant victories, undermining the integrity of the tax system.

These issues with de minimis tax rules do not mean they should be abandoned. Rather, policymakers should carefully weigh the benefits of each de minimis tax rule against its costs and consider whether a de minimis tax rule is preferable to using less formal administrative discretion. We provide a framework for making these evaluations and suggest particular considerations that should apply in specific contexts. Moreover, when policymakers do decide to adopt a de minimis tax rule, this Article offers important design considerations. Among other lessons, we explain that, based on our study, de minimis tax rules should be subject to particular scrutiny when they benefit sophisticated parties, they should be routinely evaluated for

10. *See TCJA's Business Tax Provisions: Design Flaws and Undemocratic Implementation: Hearing on the Disappearing Corporate Income Tax Before the H. Ways & Means Comm.*, 116th Cong. 3 (2020) ("This opened the door for taxpayers with resources to influence significant influence over the regulatory process, which lacks safeguards against such abuse.").

11. *See infra* note 189 and accompanying text.

12. *See infra* notes 190–193 and accompanying text.

13. Nonenforcement of small violations is discussed separately *infra* Part IV.B.

change over time, and procedural de minimis tax rules should be more carefully crafted to minimize impacts on substantive tax law.

At bottom, we argue that, far from being insignificant, de minimis rules play an important role in the design of the tax law and thus who bears the burdens and benefits of taxation. Indeed, the notion that de minimis tax rules are relatively insignificant serves only to perpetuate their proliferation. The result, paradoxically, is a series of rules that, precisely by professing to address insignificant taxpayers and transactions, together have a profound, but largely unexamined, effect on the tax system.[14]

This Article proceeds as follows. Part I provides background on de minimis tax rules and the existing scholarly framework for such rules. Part II discusses de minimis tax rules in more detail; it describes the functions of different types of de minimis tax rules and illustrates these functions through a non-exhaustive survey of existing rules. Part III then turns to the drawbacks of de minimis tax rules, focusing particularly on the unintended costs imposed by such rules. Part IV explores when and how de minimis rules should be adopted, followed by a brief conclusion.

I. OVERVIEW OF DE MINIMIS TAX RULES

A. *What Are De Minimis Tax Rules?*

De minimis tax rules exempt small taxpayers or small transactions from certain tax burdens. Perhaps the most well-known of such rules is the exclusion for de minimis fringe benefits under § 132 of the Internal Revenue Code.[15] As discussed above, that rule exempts both employers and employees from having to keep records of and report small fringe

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14. *Cf.* Alfred E. Kahn, *The Tyranny of Small Decisions: Market Failures, Imperfections, and the Limits of Economics*, 19 KYKLOS 23, 23 (1966) (exploring, in the context of market economics, how a series of small, seemingly insignificant decisions, can yield large, undesirable effects).

15. I.R.C. § 132.

benefits when the administrative burden of doing so does not appear to justify the cost.[16]

Many de minimis tax rules carve out exceptions to tax regimes that are otherwise complex, often to protect less sophisticated parties from application of the complex rules. Consider, as an example, the rules for interest-free loans under Code § 7872. Imagine that a mother decides to give an interest-free loan to her child who has recently graduated from college. As a general rule, the tax law will pretend that the foregone interest on such a loan has been gifted to the borrower (the child) and repaid to the lender (the mother).[17] This means that, under the general rule for so-called "below-market loans," the mother's generosity will actually generate a tax bill based on phantom interest payments.[18] As callous as this seems, this is conceptually the right result. Without the rules, more sophisticated taxpayers could transfer value to others without the transfer being subject to taxation. For example, an employer might extend an interest free loan to its employee to provide compensation while avoiding employment taxes.[19] The below-market loan rules serve as a guardrail against this potentially abusive tax planning.[20]

However, even if the below-market loan rules make sense as an anti-abuse measure, they are far from intuitive. Many taxpayers cannot understand an imaginary transfer of foregone interest from the lender to the borrower, along with an imaginary payment of interest by the borrower back to the lender. And while the below-market loan rules might be necessary in certain circumstances to prevent overly clever tax planning, they are downright absurd as applied to others. Imagine the unenviable job of an accountant who has to explain to her client that the small loan made to a struggling adult child

16. *Id.*

17. *Id.* § 7872.

18. *Id.*

19. STAFF OF THE J. COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 528 (J. Comm. Print 1984) (1984 TRA Bluebook).

20. *See id.* ("Under prior law, a transaction structured as a loan and a payment in the nature of compensation often did not result in any tax consequences for either the lender or the borrower.").

creates tax liability on foregone interest that the child imaginarily paid.

To take such scenarios into account, de minimis rules exempt many small transactions from the below-market loan rules. For instance, interest is not imputed on gift loans between individuals if the loan doesn't exceed $10,000.[21] This de minimis rule, and others like it,[22] except relatively insignificant taxpayers or transactions from the general tax law that would otherwise apply.[23]

Other de minimis rules exempt taxpayers from reporting obligations, rather than substantive tax rules. For example, consider the $600 reporting threshold for Form 1099-MISC.[24] When businesses hire independent contractors to perform services, the business generally must issue a Form 1099 to the contractor and send a copy to the Internal Revenue Service (IRS); this allows the IRS to ensure that the income gets properly reported on the contractor's tax return.[25] The 1099 requirement is sensible but it is not without costs for the payor, who must collect tax information from the contractor and remit the forms.[26] These administrative costs make the requirement harder to justify for small transactions; consider, for example, a one-time payment to a contractor of $25. Accordingly, a de minimis rule exempts payments from the 1099 requirement if

21. I.R.C. § 7872(c)(2). The de minimis rule applies only if the aggregate of all loans between the individuals does not exceed $10,000. *Id.* It does not apply if the loan is used to purchase income-producing property, such as stock or bonds. *Id.*

22. Another de minimis rule provides that, for loans between individuals that do not exceed $100,000, imputed interest will not exceed the borrower's net investment income for the year. *Id.* § 7872(d). Further, if the borrower's net investment income is not over $1,000, the net investment income is treated as zero for purposes of § 7872. *Id.* § 7872(d)(1)(E)(ii). This is a sensible result: borrowers with minor amounts of investment income (less than $1,001) are entitled to ignore it for purposes of triggering imputed interest on loans that exceed the $10,000 de minimis threshold but do not exceed $100,000.

23. *See id.* § 7872(c)(2).

24. *See id.* § 6041(a).

25. Certain exceptions apply, such as payments made to a corporation. *See* Treas. Reg. § 1.6041-3(p)(1) (2006); *infra* Part II.

26. *See infra* Part II.

the aggregate amount paid to the contractor is less than $600.[27] The $600 reporting threshold protects infrequent and low dollar transactions from a filing burden when neither the circumstances nor the tax revenue at issue seem to merit it.

De minimis rules are often statutory, but can be found in Treasury regulations as well.[28] Sometimes they are explicitly described as "de minimis" (as in the case of de minimis fringe benefits),[29] and sometimes they function as de minimis without use of the moniker (as in the case of the $600 threshold for Form 1099-MISC).[30] Whether or not explicitly named as such, de minimis tax rules include all statutes or regulations in which Congress or Treasury has carved out a specific exemption from a stated tax rule for an insignificant transaction or taxpayer.[31] In most cases, the de minimis exemptions are defined by reference to a dollar threshold that measures either the size of the transaction (e.g., below-market loans under $10,000) or the income of the taxpayer.

B. *Scholarly Framework*

Despite the pervasiveness and variety of de minimis tax rules, tax scholarship generally has not focused on them. There are thousands of practitioner-oriented articles explaining the details of particular de minimis tax rules.[32] However, there is no broad-based, theoretical examination of de minimis tax rules or their role in the tax system.[33]

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27. I.R.C. § 6041(a).

28. *See, e.g.*, Treas. Reg. § 301.6721-1(c) (2014) (exempting "inconsequential errors or omissions" on information returns from penalties).

29. *See id.* § 1.132-6.

30. *See* Treas. Reg. § 1.6041-2 (2020).

31. Similar action can be taken through less formal administrative discretion (such as nonenforcement in certain situations). De minimis rules are compared to less formal administrative discretion in *infra* Part IV.B.

32. A search of "'de minimis' w/10 tax" on Westlaw on April 13, 2020 produced 2,668 secondary sources. By and large they produced practitioner-oriented articles that discussed particular de minimis rules, generally in passing.

33. Limited articles attempt to draw any more general conclusions about de minimis tax rules. *See, e.g.*, Walter Hellerstein, *State and Local Taxation of Electronic Commerce: Reflections on the Emerging Issues*, 52 U. MIA. L. REV. 691, 719 (1998) ("Implementing any sensible tax regime for electronic

To be sure, de minimis tax rules do connect with a broader literature about how legal commands can be calibrated. This literature suggests that not just the underlying legal content, but also the form of that legal content takes, matters.[34] For instance, a legislature may wish to ban a certain type of pollution. How this ban is crafted in legal terms will be consequential. Early, canonical work suggested that such a ban may be more rule-like or standard-like, with rules determining legal content ex ante and standards determining such content ex post.[35] Under this framework, if the pollution is likely to be a routine problem, rules are preferable, whereas if the pollution is likely to be a variable issue, a standard may be preferable.[36]

The "rules/standards" literature is extensive, with many nuances. Many have suggested a wide variety of implications of rules versus standards. For instance, rules allocate more decision-making power to the rule-maker, whereas standards allocate more decision-making power to the adjudicator or enforcer.[37] Precise rules and vague standards also may have different impacts on compliance.[38] Or the two may be used

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commerce would be facilitated by adopting de minimis safe harbor rules to protect small vendors and to assure that the compliance costs do not exceed the tax revenues at stake."); Aaron Hsieh, Note, *The Faceless Coin: Achieving a Modern Tax Policy in the Changing Landscape of Cryptocurrency*, 2019 U. ILL. L. REV. 1079, 1094–100 (asking how the existence of de minimis tax rules should impact the taxation of cryptocurrency).

34. *See, e.g.*, Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1687 (1976) ("[T]he choice between standards and rules of different degrees of generality is significant, and can be analyzed in isolation from the substantive issues that the rules or standards respond to.").

35. *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559–60 (1992).

36. *See id.* at 621–22 ("The central factor influencing the desirability of rules and standards is the frequency with which a law will govern conduct.").

37. *See* FREDERICK SCHAUER, PLAYING BY THE RULES 159 (1991); Adrian Vermeule, *Interpretive Choice*, 75 N.Y.U. L. REV. 74, 93 (2000) ("Rules thus require more information and decisional competence ex ante, at the time the rule formulators decide what the content of the rule should be. Standards require more information and decisional competence *ex post*, at the time of application.").

38. Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65, 73 (1983) (stating that rate of compliance is one of the "principal

together, with background standards, such as anti-abuse standards, reducing the need for rules to be more complex to address uncommon transactions.[39] Some scholars have sought to move beyond the rules/standards dichotomy entirely, exploring how many hybrid forms of legal commands play an important role in the legal system.[40]

Just like rules, standards, and other rule/standard hybrids, de minimis rules are one way to fit an underlying legal command to particular situations. As already described, de minimis rules fill this function throughout the tax system by excepting out insignificant taxpayers or transactions from rules of general applicability. In this way, de minimis tax rules can be seen as a sort of rulification of exceptions that could otherwise take more ad hoc, or less tailored, forms.

The fact that de minimis tax rules overlap with other possibilities may help explain why scholars have not focused on de minimis tax rules in particular. As one possibility, in lieu of an official de minimis tax rule, the government may reach a similar result through nonenforcement of the law in circumstances it deems to be de minimis.[41] For example, there is no de minimis rule that says small cash prizes do not need to be reported as income. However, it seems unlikely that the IRS would pursue and penalize someone who didn't report a prize of, say, $50.

Other formally adopted rules, like safe harbors, look similar to de minimis rules in other ways. A safe harbor is a rule/standard hybrid that provides "safety" to taxpayers who fit within its boundaries, without deciding the law for taxpayers

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subcategories of potential costs and benefits" of the degree of care with which a rule is articulated).

39. David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 870–72 (1999) (explaining the means by which standards and rules can be used simultaneously to avoid unnecessary complexity).

40. *See, e.g.*, Gideon Parchomovsky & Alex Stein, *Catalogs*, 115 COLUM. L. REV. 165, 165 (2015) (exploring the law's use of catalogs).

41. For a discussion of nonenforcement as a tax law tool, see generally Leigh Osofsky, *The Case for Categorical Nonenforcement*, 69 TAX L. REV. 73 (2015).

who do not.[42] Like nonenforcement, safe harbors have some similarities to de minimis rules because they *may* apply to small transactions.[43] However, safe harbors are distinct from de minimis rules because their principal function is providing certainty regarding how ambiguous law will apply in certain circumstances, not exempting transactions from generally applicable law on the basis of relative insignificance.[44] For example, under one safe harbor, taxpayers who pay quarterly estimated taxes equal to 100 percent of their prior year's tax liability can be assured they will not owe late payment penalties if they owe additional tax with their tax return, regardless of how much additional tax they owe.[45]

Recently, tax scholarship has abstracted away from particular design tools, in order to consider how the law, in many ways, may except certain parties. For instance, recent scholarship has emphasized that there are many forms of informal leeway that result in nonapplication of the law, and has discussed how data is likely to affect all of these forms of leeway.[46] Other important work is focusing broadly on the problem of IRS inaction and its deregulatory consequences.[47] This work, which analyzes the many offramps to the application of the tax law, helps conceptualize the extent to which the general tax law actually applies, to whom, and under what circumstances.[48]

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42. *See* Susan C. Morse, *Safe Harbors, Sure Shipwrecks*, 49 U.C. DAVIS L. REV. 1385, 1387, 1391 (2016); Emily Cauble, *Safe Harbors in Tax Law*, 47 CONN. L. REV. 1385, 1387–88 (2015).

43. *See* Morse, *supra* note 42, at 1402 (providing an example of a safe harbor applying to a "cup-of-coffee" worth less than ten dollars).

44. *See* Cauble, *supra* note 42, at 1399 ("A safe harbor reduces risk and ambiguity for taxpayers who operate within the safe harbor's parameters.").

45. *See* I.R.C. § 6654(d)(1)(B). Taxpayers over an income threshold must pay 110 percent of their prior year's tax penalty to avoid a penalty. *See id.* § 6654(d)(1)(C)(ii).

46. Shu-Yi Oei & Diane M. Ring, Falling Short in the Digital Age 11–20 (June 12, 2020) (unpublished manuscript) (on file with authors).

47. *See generally* Brian Galle & Stephen Shay, Administrative Law and the Crisis of Tax Administration (July 3, 2020) (unpublished manuscript) (on file with authors).

48. *See id.* at 2–4.

This Article stands for the proposition that *how* exceptions are created matters as well.[49] The fact that there are many potential ways to create exceptions in the law makes each tool no less important. Rather, given the existence of other options, the choice to use a particular tool becomes even more significant. We believe that de minimis tax rules merit particular attention because they both legitimize ignoring insignificant transactions through the official sanction of a statute or regulation, while at the same time, they appear to justify the exceptions through a claim of insignificance. We argue that this dual facet of de minimis tax rules: their formal entrenchment, combined with the sense of their insignificance, has far-reaching consequences well beyond the insignificant transactions the rules purport to address. Essentially, the use of this widespread tax exception tool largely flies under the radar of scholarly attention, at the same time as its pervasiveness across the tax system yields widespread effects.

II. THE ROLE OF DE MINIMIS TAX RULES

The notion that de minimis tax rules are insignificant is belied by their pervasiveness across the tax law. As this Part explores, de minimis tax rules exist in a number of different types and serve numerous different functions, under the general umbrella of exempting out insignificant taxpayers and transactions. Indeed, the multiplicity and variety of de minimis rules across the tax law suggest that, far from inconsequential exceptions, these exceptions are, in some ways, the rule.

A. *Substantive/Procedural De Minimis Tax Rules*

De minimis tax rules come in a variety of different types. Paradigmatically, it is easiest to think of de minimis tax rules as exempting insignificant taxpayers and transactions from the

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49. *Cf.* Stephen E. Shay, *A GILTI High-Tax Exclusion Election Would Erode the U.S. Tax Base*, 165 TAX NOTES FED. 1129, 1145 (2019) (arguing that many important decisions, such as the role of the tax system in facilitating income inequality, in fact arise from a series of low-salience, seemingly merely technical decisions, like the reach of certain international tax regulations).

burdens of the tax law.[50] What we refer to as "substantive de minimis tax rules" do this most clearly by exempting taxpayers from substantive (and possibly procedural) tax obligations, often if a transaction is below a certain dollar threshold or, less commonly, if the taxpayer's income is below a certain amount. For example, a substantive de minimis tax rule provides that gifts to an individual under $15,000 are not subject to gift tax or the accompanying gift tax return obligation.[51] This rule ensures that modest gifts—picture a grandparent gifting his or her grandchild $100 at graduation—do not trigger burdensome tax and reporting requirements on the part of the donor. If a gift qualifies for this substantive de minimis tax rule, the taxpayer is relieved of all tax law burdens—both procedural and substantive—that would otherwise be associated with the gift.[52]

While substantive de minimis tax rules may be the norm, there is another type of de minimis tax rule that pervades the law as well. These rules, which we refer to as "procedural de minimis tax rules," relieve taxpayers only of the procedural, but not substantive, burdens of the tax law. Consider again the $600 threshold for filing Form 1099-MISC. For a taxpayer without a payroll administrator or an automated payroll system, filing a 1099-MISC may be time consuming and complicated. The payor must collect tax identification and other personal information from the payee on a Form W-9,[53] and must remit the 1099 Form at the end of the year to both the payee and the IRS.[54] Even for taxpayers with sophisticated payroll systems already in place,

50. *See* I.R.C. § 132 (e)(1) (defining fringe benefits as property or services with a value "so small as to make accounting for it unreasonable or administratively impracticable").

51. *See id.* § 2503 (establishing the gift exclusion, subject to inflation adjustments); *id.* § 6019 (stating that gifts excluded under § 6019 are exempt from the gift tax return requirement). The gift tax exclusion is adjusted annually for inflation; $15,000 is the limit for 2020. *See* Rev. Proc. 2019-44, 2019-47 I.R.B. 1100 (stating that the amount of the annual exclusion is $15,000 for calendar year 2020).

52. *See* I.R.C. § 6019(1) (exempting transfers below the annual exclusion amount from reporting requirements).

53. INTERNAL REVENUE SERV., INSTRUCTIONS FOR THE REQUESTER OF FORM W-9 2 (2018), https://perma.cc/227W-KETP (PDF).

54. INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 1099-MISC AND FORM 1099-NEC 4 (2020), https://perma.cc/6C49-EUFA (PDF).

the administrative costs of gathering tax information from a single payee for a one-off transaction might not justify the cost, especially for low dollar, non-recurring transactions.[55] The $600 de minimis threshold for Form 1099-MISC alleviates this reporting obligation for such transactions.[56] However, by nature, such rules are not supposed to change the substantive tax liability of the payee.[57] As an example, imagine that a lawyer pays a gardener $300 to perform a one time job, and assume the gardener's marginal tax rate is 20 percent. The gardener has $300 of income and $60 of tax liability as a result of the payment, notwithstanding the fact that the $600 de minimis threshold relieves the lawyer of the obligation to issue a Form 1099-MISC.[58] Indeed, since procedural de minimis tax rules like this one do not purport to change the substantive tax law, they seem like a can't lose proposition: they reduce administrative costs, without reducing revenue owed.[59]

Most other information reporting rules in the Code also have procedural de minimis exemptions. Rules for payments made by certain third party intermediaries are subject to an even larger de minimis threshold than the $600 threshold for Form 1099-MISC. Specifically, if a payment is made through an online intermediary like PayPal, the intermediary must issue a 1099-K to the payee only when the aggregate payments to the payee exceed both $20,000 and two hundred transactions during the year.[60] It is unclear what the justification for such a high de minimis threshold is in the context of Form 1099-K and third party intermediaries. It is possible that Congress did not want to overburden online intermediaries like PayPal that facilitate payments with large volumes of customers; the higher threshold

55. *See id.* at 1–7 (setting forth the instructions for filing form 1099-MISC).

56. I.R.C. § 6041(a).

57. However, as discussed further *infra* Part III.B.1, procedural de minimis tax rules may create de facto substantive law.

58. *See* I.R.C. § 61 ("Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including . . . [c]ompensation for services . . . .").

59. But see *infra* Part III.B.1, for problems presented by procedural de minimis tax rules.

60. I.R.C. § 6050W(e).

reduces the reporting burden. However, as discussed further below, Congress may have failed to anticipate the scope of the $20,000 de minimis threshold given the prevalence of transactions that take place through online platforms.[61]

Other information reporting rules have much lower procedural de minimis thresholds. For example, a Form 1099-INT is required to be issued when a payee's interest income is at least $10 in the aggregate.[62] Similarly, a Form 1099-DIV is required whenever dividend income is at least $10.[63] These much lower thresholds appear justifiable to the extent the payors are most likely to be financial institutions with the scale to issue information returns on an inexpensive basis.

Although payors are subject to penalties if they fail to file required information returns,[64] de minimis rules apply in this context, too. Specifically, payors can avoid penalties if the failure is corrected and if the missed or inaccurate returns do not exceed the greater of ten information returns; or 1/2 of 1 percent of the total number of required information returns for that year.[65]

Another example of procedural de minimis rules is the substantiation requirement for deducting charitable contributions, which requires taxpayers to obtain a written acknowledgement from the donee organization in order to deduct any contribution of $250 or more.[66] Like with the above-mentioned rules, this procedural de minimis rule does not change the underlying tax law. Taxpayers can only take charitable deductions that comply with all the requirements in the Code.[67] But this procedural de minimis rule does change who

61. *See infra* notes 146–156 and accompanying text; *see also* Kathleen DeLaney Thomas, *Taxing the Gig Economy*, 166 U. PA. L. REV. 1415, 1436–37 (2018) (arguing that Congress did not contemplate the pervasiveness of internet platform transactions when it enacted the de minimis threshold).

62. I.R.C. § 6049(a).

63. *Id.* § 6042(a).

64. *See id.* § 6721 (subjecting failures to file to "a penalty of $250 for each return with respect to which such a failure occurs").

65. *Id.* § 6721(c)(1)–(2).

66. *Id.* § 170(f)(8).

67. *See id.* § 170.

bears the burden of administrative requirements that are designed to help the IRS enforce the substantive law embedded in the Code.[68]

B. *Different Functions of De Minimis Tax Rules*

Whether substantive or procedural, de minimis tax rules serve a variety of functions, under the general umbrella function of exempting out insignificant taxpayers and transactions. To some extent, these exemptions are designed to reduce inordinate costs to taxpayers. To some extent, they are designed to reduce inordinate costs to the government. And to some extent, de minimis tax rules seem to serve political functions that do not seem principally motivated by cost reduction.

1. Reducing Inordinate Costs to Taxpayers

a. Rules That Apply to Very Low Stakes Scenarios

Some de minimis rules are designed to eliminate tax burdens in very low stakes scenarios. For instance, the gift tax rules allow taxpayers of any income or sophistication level to avoid both substantive gift tax liability and the procedural requirements of filling out a gift tax return when the transaction is a low dollar amount.[69] Several other de minimis rules work the same way. For example, individuals who earn less than $400 in net self-employment income do not have to pay self-employment taxes or file a Schedule SE with their tax return.[70] Nor does a homeowner who pays a household employee less than $2,200 during the year have to report and pay employment taxes.[71] These rules generally recognize that, when small amounts of tax revenue are at stake, the administrative costs of reporting certain taxes are not justified. This is particularly true for taxes that aren't included in the ordinary

68. *See id.* § 170(f)(8) (placing the burden on the taxpayer).

69. *See id.* § 2503.

70. *Id.* § 1402(b)(2); *see Instructions for Schedule SE (2019)*, INTERNAL REVENUE SERV., https://perma.cc/7G83-4PXZ (last updated July 18, 2020) (explaining when a Schedule SE must be filed).

71. INTERNAL REVENUE SERV., PUBLICATION 926, HOUSEHOLD EMPLOYERS TAX GUIDE 2 (2020), https://perma.cc/43C6-ZJ6T (PDF).

course of preparing an individual's income tax return. In other words, it's not overly burdensome to ask a taxpayer to report an additional $50 of prize income on their tax return when they must already file the return and report other sources of income. But it does impose significant costs to require an individual to file an additional schedule or a different return, and possibly learn a different set of rules (like calculating household employment tax).

b. Rules that Protect Unsophisticated Parties from Complex Tax Regimes

Another specific function of de minimis tax rules is preventing unsophisticated taxpayers from inadvertently being subject to a complex tax regime, such as the rules for below-market loans. As discussed above in the example of the mother making a small interest free loan to her adult child, complex rules designed to prevent abuse make little sense when applied to small, non-abusive transactions.[72] Based on this function of de minimis tax rules, we would expect to see higher de minimis exemptions for more complex regimes. For example, the relatively low $400 threshold for triggering a self-employment tax obligation might reflect the idea that, although paying self-employment tax does impose additional administrative costs, it is not an overly complex regime. By way of contrast, the rules for imputing interest on below-market loans are highly complex, and a higher de minimis threshold of $10,000 seems appropriate.

Another example of a rule that exempts small and potentially unsophisticated taxpayers from highly complex rules is the statutory de minimis rule found in § 199A of the Code. Section 199A provides a deduction of up to 20 percent of the qualified business income of certain pass-through businesses, such as partnerships or S corporations.[73] For larger businesses, the deduction does not apply to taxpayers who work in a "specified service trade or business" ("SSTB"), which includes industries like law, health, accounting, and actuarial sciences,

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72. *See supra* Part I.A.
73. I.R.C. § 199A(a).

among others.[74] The deduction is also limited to a percentage of wages the taxpayer pays to employees or to a certain percentage of depreciable property the taxpayer holds.[75] However, a de minimis rule in the statute provides that taxpayers below a certain threshold of taxable income (adjusted annually for inflation) can claim the deduction without regard to whether they are in an SSTB and without regard to the wage and depreciable property limitations.[76] For 2020, the de minimis threshold begins at $163,300 for single taxpayers and $326,600 for taxpayers who are married filing jointly.[77] The effect of the rule is to exempt "small" taxpayers (measured by income) from the immense complexity of the 199A limitations.[78] This would mean, for example, a self-employed plumber earning $100,000 per year wouldn't have to decide if his business was an SSTB and wouldn't have to calculate a limitation based on wages paid or depreciable property. This exemption makes sense because the amount of the deduction claimed by a lower-income taxpayer will necessarily be modest[79] and the complexity of the 199A rules would likely impose disproportionate costs on lower income taxpayers with lower ability to manage the complexity.

c. *Rules that Shield Both Sophisticated and Unsophisticated Parties from Complex Tax Regimes*

Other de minimis rules provide exemptions for small transactions even when the rule might benefit sophisticated parties. Consider, for example, the de minimis rules for reporting original issue discount ("OID"). In general, OID arises when a debt instrument pays more at maturity than the original

74. *Id.* § 199A(d).

75. *Id.* § 199A(b)(2).

76. *Id.* § 199A(b)(3)(A), (e)(2)

77. Rev. Proc. 2019-44, 2019-47 I.R.B. 1099. For taxpayers over the de minimis threshold, the deduction phases out until the taxpayer exceeds the threshold by $50,000 ($100,000 for married filing jointly). I.R.C. § 199A(b)(3)(B).

78. *See* Rev. Proc. 2019-44, 2019-47 I.R.B. 1099.

79. The deduction will generally be no more than 20 percent of the taxpayer's taxable income. I.R.C. § 199A(a).

face amount of the debt.[80] Whereas the gift loan scenario typically involves parties offering interest-free loans because they are not acting at arm's length, the OID rules apply to scenarios where parties may collude to defer interest income until maturity.[81] For example, an interest-free bond that was issued for $1,000 but pays $1,200 at maturity has $200 of OID, measured by the difference between the issue price and maturity price. The tax laws treat the OID as interest income to the lender (i.e., the bondholder) that must be spread out over the term of the debt instrument.[82] OID treatment is generally not favorable because lenders must report interest income before they have actually received the interest.[83] In the preceding example, the extra $200 payable at maturity is likely meant to compensate the bondholder (lender) for the interest-free aspect of the loan, but the bondholder must report the $200 in increments as if she had received interest payments. This results in phantom interest income, much like the below-market loan scenario.

Like the rules for below-market loans, calculating and reporting OID is complicated, and the Code provides de minimis rules. First, the OID rules don't apply to loans of $10,000 or less made between individuals.[84] Second, if the OID on any loan is below a certain amount (which varies by the size and term of the loan), it is treated as zero, which means it does not have to be accrued over time as interest income.[85] Instead, the lender can report the interest at the loan's maturity, generally as capital gain.[86]

The OID de minimis thresholds function slightly differently than the gift loan rules and the 199A de minimis threshold.

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80. *Id.* § 1273(a)(1). Interest must be as high as the applicable Federal rate to be considered adequate. *Id.* § 1274(b).

81. *See id.* § 1273(b)(1).

82. *Id.* § 1272(a)(1).

83. *Id.* § 1272.

84. *Id.* § 1272(a)(2)(D). The loan must not be a trade or business loan and must not have a principal purpose of tax avoidance for the rule to apply. *Id.*

85. *Id.* § 1273(a)(3). The de minimis threshold is calculated as: 0.0025 x the stated redemption price at maturity x the number of years to maturity. Treas. Reg. § 1.1273-1(d)(2) (as amended in 2012).

86. Treas. Reg. § 1.1273-1(d)(5)(ii)(A) (as amended in 2012).

Because OID is less likely to arise in everyday transactions (like an intra-family gift loan or earning business income as a sole proprietor), an unsophisticated taxpayer is less likely to become subject to the OID rules inadvertently.[87] Further, even individual investors who are deemed to receive OID will likely receive information returns reporting it,[88] and thus will not be burdened by the complexity of calculating it (which generally falls on the borrower/issuer[89]). The de minimis rules in this context are likely aimed at exempting parties from the complexity of calculating and reporting OID when little tax revenue is at stake, regardless of the sophistication of the parties. The revenue stakes are particularly relevant because OID is largely about timing, so the tax revenue will be based on the time value of money for modest amounts of interest.[90] On the other hand, the administrative costs of imputing interest may be high in comparison, even for sophisticated parties.[91]

Other de minimis rules similarly exempt parties from tax burdens when the tax regime is complex and the tax revenue is small by comparison, even when the party benefitted is possibly high income and/or sophisticated. For example, we might assume that taxpayers who can afford vacation homes can also afford the tax preparation assistance to properly report income and expenses when they use the home for a mix of personal and rental purposes. For taxpayers who split their homes between personal use and rental use, the Code requires bifurcation of

87. *See* Treas. Reg. § 1.108(i)-3(a) (as amended in 2013).

88. *See* INTERNAL REVENUE SERV., FORM 1099-OID 5 (2019), https://perma.cc/RA5R-L2L8 (PDF).

89. *See* INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORMS 1099-INT AND 1099-OID 5 (2021), https://perma.cc/D2JD-ZCB9 (PDF).

90. *See* I.R.C. § 1272 (stating that gross income includes "an amount equal to the sum of the daily portions of the original issue discount for each day during the taxable year on which such holder held such debt instrument").

91. Of course, the below-market loan de minimis rules may apply to sophisticated parties, as well. We do not suggest that different de minimis rules can neatly be placed in separate categories or do not have overlapping functions, but rather intend this discussion simply to illustrate a range of functions that de minimis rules serve. Also, see *infra* discussion accompanying notes 176–179 for a critique of OID de minimis exceptions.

expenses according to the length of time used for each purpose.[92] However, a de minimis rule in § 280A provides that for taxpayers who rent their vacation home for less than fifteen days during the year, the rental use can be disregarded.[93] This means that the rental income need *not* be reported (regardless of amount), nor can any expenses be claimed. This allows taxpayers who use their vacation homes primarily for personal purposes, and who rent their homes for only a small portion of the year, to avoid the administrative hassle of tracking expenses that are otherwise nondeductible.

De minimis rules that allow taxpayers to deduct rather than capitalize certain business assets similarly seek to avoid administrative hassle in low stakes scenarios, even though the taxpayers are often sophisticated. Capitalizing the cost of business assets creates administrative complexity for taxpayers because they must calculate and report annual depreciation deductions on an asset-by-asset basis.[94] Regulations under § 263 allow taxpayers to deduct the cost of certain tangible business assets that meet a de minimis test.[95] Specifically, the rule provides that taxpayers can elect to deduct the cost of any individual item that costs $5,000 or less.[96] Taxpayers who do not have publicly filed or independently certified financial statements are limited to items that cost $2,500 or less.[97]

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92. Taxpayers that use their vacation rentals for personal purposes for a significant portion of the year can only deduct property expenses to the extent of their rental income. I.R.C. § 280A(c)(5). However, taxpayers that use the property primarily for rental income may qualify as a "business" and be able to deduct expenses in excess of rental income. *Id.* § 280A(c).

93. *Id.* § 280A(g).

94. *See id.* § 168.

95. When taxpayers acquire new property for their business or for investment purposes, § 263 of the Code generally requires them to capitalize the cost of the property, rather than deducting it. *See id.* § 263.

96. Treas. Reg. § 1.263(a)-1(f) (as amended in 2014). Certain limitations apply; for example, the safe harbor does not apply to the purchase of inventory or land. *Id.* § 1.263(a)-1(f)(2). The rule applies regardless of the aggregate cost of such items. *Id.* This means a taxpayer who purchases 100 small machines that cost $5,000 each could deduct $500,000 as a business expense.

97. *Id.* § 1.263(a)-1(f)(1)(ii). The regulations provide a ceiling of $500 "or other amount as identified in published guidance," and the IRS has raised that ceiling to $2,500 in Notice 2015-82. *See* I.R.S. Notice 15-82, 2015-50 I.R.B. 859.

d. Rules that Benefit Sophisticated Parties in Relatively Low Stakes Scenarios

Finally, some de minimis rules are clearly intended to address sophisticated taxpayers who voluntarily undertake complex transactions. In these cases, Congress (or Treasury) may still concede that a complex or stringent rule should not be applied to a low-stakes scenario. These rules often have more generous de minimis thresholds, which may seem high in isolation but aim to exempt transactions that are modest on a relative scale. For example, a de minimis rule exists for real estate investment trusts ("REIT"s), which allow individuals to invest in a pool of real estate assets through a specialized corporation.[98] REITs generally are not taxed at the entity level provided they meet specific requirements under the Code,[99] including distributing most of their income to investors and investing mostly in real estate.[100] Among other stringent investment requirements, at least 75 percent of a REIT's assets must be real estate, cash, or government securities;[101] further, not more than 5 percent of the REIT's assets can be made up of securities of one issuer and the REIT cannot own more than 10 percent of any one issuer.[102] Although REITs generally must continually meet these requirements to avoid disqualification and an entity-level tax, the Code allows for de minimis infractions of the 5 percent and 10 percent rules without consequences.[103] Specifically, if the value of the disqualifying assets does not exceed the lesser of 1 percent of the REIT's total assets or $10 million, the REIT can correct the failure and avoid

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98. I.R.C. § 856.

99. REITs are not technically pass-through entities but, rather, can deduct all dividends paid to investors for federal income tax purposes. *Id.* § 857(b)(2)(B).

100. *Id.* §§ 856(c), 857(a).

101. *Id.* § 856(c)(4). Additionally, REITs must distribute 90 percent of their income each year to investors, at least 75 percent of their income must come from things like rent (and other real estate-related sources), and 95 percent of their income must be passive investment income (e.g., interest or dividends). *Id.* § 857(a)(1), (c)(3)–(4).

102. *Id.* § 857(c)(4)(B).

103. *Id.* § 856(c)(7)(B).

a penalty.[104] These rules give managers some leeway for inadvertent missteps that may be perhaps due to the changing nature of the company's investments.

A de minimis rule also exists under Code § 382, which generally limits a corporation's ability to claim net operating losses after a change in ownership.[105] For example, a profitable corporation cannot acquire an insolvent corporation and immediately claim all of the acquired corporation's losses against its operating income to avoid tax.[106] The statute provides a complex set of rules for calculating allowable losses and gains in various circumstances after an ownership change.[107] Some of these rules involve how to treat assets with built-in gains or losses (i.e., where the fair market value of the asset is either greater or less than the asset's basis).[108] A de minimis rule in § 382(h) allows built-in gain or loss to be disregarded—treated as zero—when the amount of built in gain or loss is not more than the lesser of $10 million or 15 percent of the total fair market value of the corporation's assets.[109] Although the parties who are subject to § 382 have already taken on transaction costs and tax complexity by virtue of the change in ownership transaction, this de minimis rule exempts transactions that are "small" on a relative scale from some of the more onerous and burdensome parts of the statute.

2. Reducing Inordinate Costs to the Government

The government is also a beneficiary of de minimis tax rules in several respects. First, the IRS clearly avoids administrative and enforcement costs when a rule exempts small transactions,

104. *Id.* § 856(c)(7). The failure must be due to reasonable cause and not willful neglect, and the disqualifying assets must be disposed of within six months. *Id.* Non de minimis failures can also be cured in the six-month time period but will subject the REIT to a financial penalty. *Id.*

105. *See id.* § 382(h)(B) (stating that losses are limited "in the same manner as if such loss were a pre-change loss" and by the amount of "net unrealized built-in loss, reduced by recognized built-in losses for prior taxable years").

106. *See id.* § 382(b).

107. *Id.*

108. *Id.* § 382(h).

109. *Id.* § 382(h)(3)(B).

particularly if those transactions are frequent. For example, not requiring a gift tax return every time Grandma sends a $100 check to Grandson means the IRS does not have to process millions of extra gift tax returns each year, and does not have to monitor whether taxpayers are complying with the rules for reporting gifts.[110] Similarly, the IRS does not have to expend resources to audit and potentially initiate enforcement activities against taxpayers for violations of requirements like the requirement to report imputed interest on small below-market loans or the requirement to report rental income on a few days of renting a vacation home. Since relatively small de minimis thresholds ensure only modest tax revenue is at stake, audit and enforcement would likely be unjustified in those cases, in the same way that taxpayer compliance costs are likely unjustified.

The same logic also applies to higher de minimis thresholds that apply to more sophisticated transactions and parties. For example, even though more revenue may be at stake in the context of § 382's de minimis rule for built in gain and loss, the complexity of § 382 likely means more IRS enforcement costs are also at stake, and the tradeoff of a higher de minimis threshold may make sense.[111]

3. Political Economy

Finally, some de minimis rules no doubt come about due to rent-seeking, political pressure, or public perception about the tax law. Such rules may be appropriately motivated by a cost-benefit tradeoff, or they may fail to accomplish the various roles discussed above.

One relatively benign example is the exclusion for de minimis fringe benefits.[112] As discussed above, the purpose of the rule is to exclude small fringe benefits from income when the administrative cost of valuing them is not worth the revenue at stake. This cost-based justification was likely mixed with a more political one: Congress in part enacted the rule to prevent the

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110. *See id.* § 6019.

111. *See id.* § 382 (stating that the loss may not be deducted if it exceeds "the value of the old loss corporation, multiplied by the long-term tax-exempt rate").

112. *See id.* § 132(a).

perception that the IRS is willing to tax the small pleasures in life.[113] In other words, it may be feasible in practice for employers to value weekly doughnuts in the breakroom and report a small amount of additional income on their employees' Form W-2.[114] But taxing people on their free doughnuts may just be a step too far, and may engender negative views about the tax system and the IRS.[115]

Perhaps a less benign example is the "small business" exemption from the accrual method accounting requirements. Although individual taxpayers can elect between the cash method and accrual method of accounting, the tax law generally requires corporations (and certain partnerships) to report on the accrual method.[116] The accrual method is generally more accurate but also requires more compliance costs on the part of the taxpayer.[117] Notwithstanding the general requirement that corporations use the accrual method, a de minimis rule in § 448 allows smaller corporations to use the cash method.[118] Until recently, the de minimis threshold was $5 million in gross receipts;[119] this reflected the idea that corporations earning less than $5 million are smaller in scale and should not have to undergo the added complexity of accrual method accounting. Relatedly, with fewer than $5 million in gross receipts, the tax

113. *See* Jay A. Soled & Kathleen DeLaney Thomas, *Revisiting the Taxation of Fringe Benefits*, 91 WASH. L. REV. 761, 762–63 (2016) (listing the reasons Congress enacted § 132(a)).

114. *See id.* at 810 (discussing the feasibility of taxing certain fringe benefits with modern technologies).

115. *See id.* at 788, 810 (discussing strong public support for not taxing employee perks).

116. *See* I.R.C. § 448(a) (prohibiting C corporations, partnerships with a C corporation partner, and tax shelters from using the cash receipts and disbursements method of accounting in computing taxable income).

117. *See* Chizoba Morah, *Accrual Accounting vs. Cash Basis Accounting: What's the Difference?*, INVESTOPEDIA, https://perma.cc/4D5L-TMAZ (last updated Mar. 7, 2020).

118. I.R.C. § 448(c).

119. Colleen M. O'Connor et al., *Tax Accounting for Businesses After the TCJA: Some Widely Applicable and Lesser-Known Changes*, TAX ADVISOR (June 1, 2019), https://perma.cc/8QH8-YSJ6.

revenue at stake would be modest.[120] However, 2017 tax reform—the so-called "Tax Cuts and Jobs Act" (TCJA)—raised the de minimis threshold from $5 million to $25 million in gross receipts.[121] This means that corporations with gross receipts under $25 million are now eligible to report on the cash method, allowing for favorable income deferral.[122] The $25 million rule extends to other accounting rules, as well, allowing corporations that fall under the threshold to deduct rather than capitalize certain costs[123] and to avoid less favorable accounting methods that apply to specific situations.[124] It is unclear what the justification for such a drastic increase in the small business threshold is, other than to provide a tax benefit to the impacted businesses. The role of lobbying in the creation of de minimis tax rules is discussed further in the next Part.

III. PROBLEMS WITH DE MINIMIS TAX RULES

Having surveyed the roles and functions of the de minimis rules that pervade the tax law in the preceding Part, this Part now turns to the potential pitfalls of de minimis tax rules. In short, de minimis tax rules may not always accomplish the functions described in Part II and may impose unintended costs. These drawbacks include increased complexity in other parts of the tax law, the tendency to take on unintended scope, particular susceptibility to lobbying, and administrative authority issues when such rules are created outside of the legislative process.

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120. Note that the tax is applied to *net* business income and that accounting methods merely reflect the timing rather than amount of tax reported.

121. *See* STAFF OF J. COMM. ON TAX'N, 115TH CONG., GEN. EXPLANATION OF PUB. L. 115-97 (Comm. Print 2018).

122. The gross receipts test is applied over a three-year period. *See* I.R.C. § 448(c)(1).

123. *See id.* § 263A(i).

124. *See, e.g.*, *id.* §§ 460(e)(1)(B), 471(c) (providing long-term completion method for construction contracts and inventories, respectively).

A. *De Minimis Tax Rules Allow the Tax Law to be More Complex*

While one of the principal functions of de minimis tax rules is reducing costs for taxpayers and the government, an under-appreciated feature of such rules is that they allow the rest of the tax law to be more complex. Specifically, by allowing certain taxpayers to avoid application of an underlying tax rule, de minimis rules also allow the law to be *more* burdensome than it otherwise would be for the taxpayers and transactions left in the generally applicable tax system. The intuition here is the same intuition behind the economic theory of price discrimination. Price discrimination involves charging different amounts for similar goods in a way that cannot be explained fully by differences in the marginal costs of producing the goods.[125] By charging different prices, price discrimination allows producers to segment the market into consumers with different willingness to pay.[126] This segmentation then enables the producer to earn more profit than if the producer were confined to average price across the entire market.[127]

The analogue in the tax system is that, although not typically described this way, the tax system has different markets of taxpayers and transactions.[128] Some taxpayers are very sophisticated taxpayers, often advised by specialized tax counsel, capable of understanding and responding to complex tax rules.[129] Indeed, many such taxpayers need to be subject to

125. Lars A. Stole, *Price Discrimination and Competition*, *in* 3 HANDBOOK OF INDUS. ORG. 2221, 2224–25 (2007).

126. *Id.* at 2226.

127. *Id.* at 2224.

128. *See, e.g.*, Michael Abramowicz & Andrew Blair-Stanek, *Contractual Tax Reform*, 61 WM. & MARY L. REV. 1537, 1549–50 (2020) (proposing a move beyond one-size-fits-all taxation to better accommodate diverse taxpayers); Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 COLUM. L. REV. 689, 690 (2009) (imagining different tax compliance and enforcement regimes to target different types of taxpayers); *see also* Joshua D. Blank & Leigh Osofsky, *Simplexity: Plain Language and the Tax Law*, 66 EMORY L.J. 189, 242–45 (2017) (exploring the differential impact of tax law "simplexity" on different taxpayers).

129. *See, e.g.*, *Tax Overview*, FENWICK, https://perma.cc/2F4V-SD2H ("Fenwick has achieved a reputation as having one of the nation's leading

complex tax rules, both to capture the complexity of the taxpayer's transactions and to prevent such taxpayers from engaging in sophisticated transactions to lower their tax liability.[130] Other taxpayers have lower ability to understand complex tax rules.[131] Moreover, the latter group may engage in simpler transactions, which may not merit application of complex rules. These dissimilarly situated taxpayers can be thought of as different segments of the taxpayer market.[132]

De minimis rules help differentiate complexity across the taxpayer market. For instance, the $10,000 de minimis threshold for below-market loans not only exempts relatively insignificant taxpayers or transactions from the complex below-market loan rules, but also helps enable these non-intuitive and complex rules to remain in the Code for others. Put another way, de minimis tax rules help avoid the extreme alternatives of applying complex rules to all taxpayers or eliminating those rules entirely.

While this very feature of de minimis tax rules can serve as an underappreciated benefit in some circumstances, such rules may inadvertently preserve or encourage too much tax law complexity in others. For instance, the rules regarding the 199A deduction have been decried as inordinately complex and, in

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domestic and international tax practices [which] stems from its client base [including] over 100 Fortune 500 companies.").

130. *See* Sloan G. Speck, *Tax Planning and Policy Drift*, 69 TAX L. REV. 549, 573 (2016) ("Sophisticated targets often view the law as a tool rather than an imperative, and they may hire specialized experts to plan and structure their activities.").

131. *See, e.g.*, Joseph Bankman, *Simple Filing for Average Citizens: The California ReadyReturn*, 107 TAX NOTES 1431, 1431 (2005) (explaining how even basic tax return requirements outpace many taxpayers' reading levels).

132. The dichotomy described in taxpayer markets in the text is stylized rather than an accurate portrayal of what is a complicated set of circumstances. For instance, many taxpayers with relatively straightforward tax situations nonetheless engage in behavior to unjustifiably reduce their tax liability. This is quite common with cash business taxpayers. *See, e.g.*, Susan Cleary Morse et al., *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL'Y REV. 37, 38 (2009) (providing a foundational account of cash business tax evasion). The idea here is not that all sophisticated taxpayers create compliance problems whereas all less sophisticated taxpayers do not, or that there is even an uncontroversial understanding of what it means to be a sophisticated taxpayer. Rather, the idea is that there are clearly different markets of taxpayers that the tax law ideally needs to treat differently.

some ways, fundamentally nonsensical.[133] While the de minimis threshold in § 199A blunts these costs for lower income taxpayers,[134] it is not clear that blunting such costs is actually a desirable outcome, if it helped preserve seemingly nonsensical complexity for others, and avoided wholesale rethinking of the rules.

Another, related point is that de minimis tax rules have important, underappreciated distributive consequences. When a particular constituency gains the benefit of a de minimis tax rule, that constituency is clearly subject to a lower tax burden than otherwise would have applied. But, by getting a de minimis tax rule in the law, the constituency also enables tax law drafters to make the generally applicable tax law more burdensome than it otherwise would have been. The constituency that gains the benefit of a de minimis tax rule thus has not only won for itself. In some ways, it has also ensured that other taxpayers and transactions will lose. Here, too, lack of attention to de minimis tax rules has obscured hidden costs that the rules impose on at least some taxpayers, and a careful consideration of when the benefits of the rules are worth the costs.

B. *De Minimis Tax Rules May Take on an Unintended Scope*

De minimis tax rules impose unintended consequences that that go beyond preserving or even increasing the complexity of the general tax law. De minimis tax rules often take on an unintended scope, including creating de facto substantive rules when only procedural rules were intended, and locking in permanent fixes when a temporary and/or flexible approach is in order.

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133. *See, e.g.*, Daniel Shaviro, *Evaluating the New US Pass-Through Rules*, 2018 BRIT. TAX REV. 49, 56–59 (harshly critiquing the 199A deduction and the lack of clear justification for it).

134. *See supra* notes 76–79 and accompanying text.

1. Procedural Rules May Create De Facto Substantive Law

As discussed previously, procedural de minimis rules pervade the tax law.[135] Although these rules do not purport to alter substantive tax obligations, in practice they do so. Consider again the $600 threshold for 1099-MISC reporting. Technically, this is a procedural de minimis tax rule that does not purport to change a contractor's obligation to report service income. But in practice, the de minimis rule heavily impacts how much income gets reported.

Whereas the vast majority of income reported on a Form 1099 is reported accurately to the IRS, income that is not subject to third-party information reporting is far less likely to be reported by the recipient.[136] Returning to the example of a lawyer paying a gardener $300 for a one-off service with no Form 1099 obligation, there is a high probability that the gardener will not report the $300 of income, even though the tax law is clear that payments to contractors of any size are taxable.[137] There are several possible explanations for this. Without information from a third party (like the lawyer), the IRS is unlikely to discover the gardener's income.[138] Thus, the gardener may knowingly fail to report it on his return, understanding that his odds of getting caught and penalized are extremely low.[139] Second, it is possible that at least some taxpayers will fail to keep good records of their income, and without a Form 1099 as a reminder, forget to report it. Finally, and most critically with respect to the use of procedural de minimis tax rules, the $600 de minimis threshold may send a false signal to taxpayers that there is no legal obligation to

135. *See supra* notes 62–67 and accompanying text.

136. *See* BARRY W. JOHNSON ET AL., INTERNAL REVENUE SERV., PUBL'N 1415 (REV. 9-2019), FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013 at 13 (2019).

137. *See* I.R.C. § 61.

138. An individual taxpayer's chance of being audited is less than 1 percent. *Compliance Presence*, INTERNAL REVENUE SERV., https://perma.cc/MU76-QHRQ (last updated Oct. 22, 2020).

139. *See* Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1738–39 (2010) (describing the deterrence function of information reporting).

report income for which there is no Form 1099.[140] In other words, the procedural de minimis tax rule may unintentionally lead the gardener to falsely believe that income under $600 is not reportable at all.

Anecdotal evidence suggests that procedural de minimis tax rules do, indeed, tend to confuse taxpayers, making them believe that what is really only a procedural de minimis threshold in fact changes substantive tax law. Tax advisors report online that a "myth that refuses to die more than any other" is that payments under $600 are not subject to tax liability,"[141] and that "[i]t is commonly believed that you do not have to report your earnings unless they meet or exceed $600."[142] Other online advisors try to explain that tax liability is still owed for payments below the threshold amount, even though the procedural de minimis exception "can make things a little confusing for the taxpayer . . . since logic can easily lead you to conclude that you don't have to file taxes if you don't receive a form."[143] Still other websites catalog taxpayers wrestling with the question and expressing confusion about whether they have to pay tax on less than $600.[144]

Viewed in this context, the $600 threshold for reporting independent contractor income has changed perceptions of the law in a way that exceeds the intended impacts on procedure only. Indeed, to the extent that the procedural de minimis threshold changes perceptions of the law, it expands well beyond procedure into the realm of substantive tax collection. For those

140. *See, e.g.*, Kelly Phillips Erb, *Ask the Taxgirl: Reporting Income Under $600*, FORBES (Feb. 9, 2012, 4:28 PM), https://perma.cc/A69K-EWDL (explaining that only a $600 and above payment triggers the issuance of a federal form 1099, but it does *not* mean that taxpayers are permitted to exclude income payments less than $600 from their taxes).

141. *Have You Fallen for the $600 Tax Reporting Myth?*, ARTISTIC CONSPIRACY, https://perma.cc/TBD9-CXDM.

142. *Do You Have to Report Freelance Income if You Make Less Than $600 a Year?*, CHRON, https://perma.cc/AGC4-XUDD (last updated Sept. 10, 2020).

143. Stephanie Faris, *Do I Have to Report Earnings Under $600?*, ZACKS, https://perma.cc/S2WP-B6DP (last updated Mar. 9, 2019).

144. *See, e.g.*, *If I Had a Job that I Made Less Than $600 Do I Have to Claim That?*, INTUIT TURBO: REAL MONEY TALK (June 7, 2019, 3:32 PM), https://perma.cc/5TWN-NYGG.

taxpayers who do not pay tax on their income, it has facilitated a de facto, substantive tax law exemption.

A de facto exemption for income under $600 may not be undesirable, at least at first glance. Given the low amount of tax revenue at stake for a one-off transaction under $600, the compliance costs on the part of the taxpayer and enforcement costs on the part of the IRS may not be justified. But this assumes that unreported transactions happen infrequently for each taxpayer, which is not necessarily the case. Consider again a gardener who is paid $300 by a lawyer for removing a tree. Assume the gardener's business primarily consists of one-time tree removal transactions, and that he conducts 300 of such transactions a year, all of which cost $300. Suddenly, the revenue at stake is much higher (the tax on $90,000 of income in this example). Yet, if each transaction involves a different payor, the gardener will not receive any 1099s. If the gardener views the de minimis threshold on 1099 reporting as a substantive tax exemption, his tax liability will have changed significantly, with attendant consequences on the fairness and efficiency of the tax system overall.

It is also not clear that Congress, in enacting procedural de minimis tax rules, intends to create de facto substantive tax exemptions. Indeed, if Congress did think that income below a certain threshold amount should not be taxed, it would be more straightforward for Congress to explicitly say so (along with ancillary changes to any reporting requirements). Doing so would create a more transparent sense of how much revenue the government can expect to raise, and, critically, would make actual expectations about tax liability more transparent to taxpayers. The fact that Congress has not created substantive exemptions should thus be read as an indication that Congress did not intend to make them. This means that procedural de minimis tax rules are creating de facto substantive exemptions inconsistent with Congress's intentions for the tax law.

A de facto tax exemption is problematic for other reasons, as well. Some gardeners will underreport income when they don't receive a Form 1099, but others will report honestly, violating horizontal equity between taxpayers. A widespread practice of not reporting income under the $600 threshold may also perpetuate confusion about the rules among taxpayers or resentment from honest taxpayers. Finally, broad

noncompliance in certain sectors may distort the market by encouraging oversupply of de facto "tax-exempt" jobs (like gardeners, in this example).[145]

The rules for reporting on Form 1099-K provide a relatively recent illustration of these problems. The Form 1099-K rules were enacted in 2008 to require information reporting by credit card companies and other financial intermediaries.[146] As discussed in Part II, for certain parties, the threshold for issuing a Form 1099-K is $20,000 and two hundred transactions.[147] These rules generally apply to payments made through online intermediaries.[148] Consider, for example, an internet platform like Airbnb. Renters who rent homes on the platform remit payment to Airbnb, the online intermediary.[149] Airbnb collects a fee and remits the remainder of the renter's payment to the owner; the owner, in turn, is obligated to report the payment as rental income.[150] Because the transaction takes place through Airbnb (an online intermediary) and not directly between two parties (as in the gardener-lawyer example), the Form 1099-K rules apply rather than the Form 1099-MISC rules.[151] Those

145. *See* Joseph Bankman, *Eight Truths About Collecting Taxes from the Cash Economy*, 117 TAX NOTES 506, 506–08 (2007) ("To the extent workers and investors experience disutility in underreporting, there will be less tax-induced movement to the cash sector and lower welfare costs. We know that underreporting is the norm in the cash sector.").

146. *See* STAFF OF J. COMM. ON TAX'N, 111TH CONG., TECH. EXPLANATION OF DIV. C OF H.R. 3221, THE "HOUSING ASSISTANCE TAX ACT OF 2008" AS SCHEDULED FOR CONSIDERATION BY H.R. ON JULY 23, 2008, at 60–61 (Comm. Print 2008) (discussing the purpose of § 6050W to require credit card information reporting).

147. *See* I.R.C. § 6050W(e).

148. *See id.* § 6050W(a), (b)(3); *see also Third Party Network Transactions FAQs*, INTERNAL REVENUE SERV., https://perma.cc/T8PL-YT3P (last updated Aug. 17, 2020) (outlining the characteristics of third-party settlement organizations and citing the most common example as an "online auction-payment facilitator").

149. *See Why Should I Pay and Communicate Through Airbnb Directly?*, AIRBNB, https://perma.cc/3P58-Z8JF.

150. *See What Are Airbnb Service Fees?*, AIRBNB, https://perma.cc/K8XK-7DVK.

151. *See* Treas. Reg. § 1.6041-1(a)(1)(iv) (2010) ("Transactions that are described in paragraph (a)(1)(ii) of this section [third-party network transactions] that otherwise would be subject to reporting under both sections 6041 and 6050W are reported under section 6050W and not section 6041.").

rules require Airbnb to issue a Form 1099-K to the owner only if Airbnb facilitated payments exceeding $20,000 for that owner *and* over two hundred payment transactions took place.[152] The threshold is, of course, much higher than the $600 threshold that applies to the gardener.

The much higher 1099-K threshold arguably applies to all sorts of gig economy transactions that take place through online platforms.[153] In another work, one of us argued that Congress did not contemplate the pervasiveness of internet platform transactions when it enacted the de minimis threshold and that the threshold should be made much lower.[154] In the meantime, we can expect the same de facto income exemption to exist in this context as in the Form 1099-MISC context. In other words, there is a high likelihood that people earning under $20,000 from internet platforms will not report their income. The much larger Form 1099-K threshold makes this de facto exemption significantly more problematic. Not only are higher dollar amounts at stake, but the $20,000 threshold expands the reach of the de facto exemption significantly. For example, one study of gig economy workers showed that the majority of such workers do not earn more than $10,000 per year.[155] This potentially means that a significant number of gig economy workers do not receive 1099s, and many likely fail to report their gig income accurately.[156]

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152. *See* I.R.C. § 6050W(e).

153. "Arguably" because the application of the Form 1099-K threshold to gig economy platforms has been debated, and some platforms (e.g., Uber) have taken the position that they will use the $600 threshold. *See, e.g.*, Shu-Yi Oei & Diane M. Ring, *Can Sharing Be Taxed*?, 93 WASH. U. L. REV. 989, 1034–38 (2016).

154. *See* Thomas, *supra* note 61, at 1436–37 (suggesting that developments in technology and tax enforcement should prompt a revision in how the gig economy is taxed).

155. *See* DIANA FARRELL & FIONA GREIG, JP MORGAN CHASE & CO. INST., PAYCHECKS, PAYDAYS, AND THE ONLINE PLATFORM ECONOMY 24 (2016), https://perma.cc/4UUN-HW3S (PDF) (finding that the "Online Platform Economy" was a secondary source of income for the average participant, and the vast majority relied on it for only 25 percent of their income).

156. *See* Thomas, *supra* note 61, at 1428.

Finally, consider again the $250 threshold for substantiating charitable contributions.[157] Although the $250 threshold does not impact the deductibility of charitable contributions, in practice, this threshold may function like the Form 1099 rules. In other words, because taxpayers are not required to substantiate charitable contributions to a particular donee under $250, we can expect to see more noncompliance under the threshold, based in part on mistaken taxpayer beliefs about the impact of the substantiation threshold. Whereas Form 1099 noncompliance looks like non-reporting of income, noncompliance in this context might mean claiming deductions for donations that were not made or that were not made to qualifying tax-exempt organizations.

2. Lock-In of a Temporary Solution

De minimis tax rules may also create permanent fixes to problems that continue to evolve over time. By virtue of being statutory or regulatory rules, de minimis tax rules are inherently "sticky" compared to alternatives like an administrative nonenforcement policy. This stickiness can prevent administrative solutions from evolving over time to match the underlying problem.

One context in which this problem arises is when Congress fails to index de minimis tax rules. To be sure, some de minimis tax rules, like the statutory income threshold in § 199A, are adjusted annually for inflation.[158] But many de minimis tax rules are not indexed. Consider the $600 threshold for issuing Form 1099-MISC, which has been in place without adjustment since 1954.[159] Based on inflation alone, the threshold requires information reporting for much smaller transactions today than it did previously, which may not make sense from a compliance cost perspective.[160] But failing to index the threshold has also

157. *See supra* Part II.A.

158. *See supra* note 79 and accompanying text.

159. MARK P. KEIGHTLEY, CONG. RSCH. SERV., R41400, ECONOMIC ANALYSIS OF THE ENHANCED FORM 1099 INFORMATION REPORTING REQUIREMENTS 10 (2011).

160. For example, a $600 payment in May of 1954 would be equivalent to a $5,719 payment in May of 2020. *See CPI Inflation Calculator*, BUREAU LAB. STAT., https://perma.cc/7GVQ-LSZJ. On the other hand, technological

made it significantly harder for Congress to implement sensible expansions to the scope of the Form 1099-MISC requirement.

The current 1099-MISC rule contains numerous exceptions. For instance, the reporting requirement only applies to payments by persons engaged in a trade or business and does not apply to payments for goods (rather than services).[161] In 2010 and 2011, as part of healthcare reform legislation, Congress expanded the reporting requirement in various ways, including by applying it to payments for goods and rent payments even if the lessor was not in the "trade or business" of renting property.[162] This set off a rallying cry of opposition, with opponents arguing that these increased reporting requirements hurt small businesses and unsophisticated taxpayers.[163] This opposition was successful, and the increased reporting requirements were repealed.[164]

This repeal occurred in part because the relatively low de minimis threshold of $600 enabled opposition to argue convincingly that the new reporting requirements were too burdensome for taxpayers, such as small businesses.[165] A higher de minimis threshold would have made it harder to attack the law as too burdensome for small businesses and other similarly situated taxpayers.[166] Indeed, one Congressional Research Service analyst explored raising the threshold amount,

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advances have likely made the cost of information reporting significantly cheaper than it was in the 1950s, in which case a lower threshold in today's dollars may make sense.

161. *See* KEIGHTLEY, *supra* note 159, at 2.

162. *Id.* at 1.

163. *See, e.g.*, Robb Mandelbaum, *Why the New 1099 Rules Aren't that Bad for Small Businesses*, N.Y. TIMES (Mar. 14, 2011, 1:00 PM), https://perma.cc/LX5V-6HW9 (asserting that "nobody in Washington" has anything good to say about the increased reporting requirements).

164. *See* Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, I.R.C. § 6041.

165. *See, e.g.*, KEIGHTLEY, *supra* note 159, at 6 (explaining concern over small businesses and low exemption amount as main source of opposition).

166. Raising the threshold amount to $5,000 and adding an additional de minimis exemption for small business with twenty-five or fewer employees was explicitly considered in response to small business gripes about the burdens of the new reporting requirements. 156 CONG. REC. S7,053 (daily ed. Sept. 14, 2010) (statement of Sen. Bill Nelson).

explaining, "A higher threshold would ease the burden many small businesses claim the new requirements impose, since it would presumably reduce the number of transactions that require a 1099-MISC to be completed."[167] The role that a higher threshold could have played illustrates the more general phenomenon: the ability to revisit de minimis rules over time can blunt criticisms that the generally applicable law is too burdensome for certain constituencies. But the very promulgation of a de minimis rule in the form of a statute or regulations can tend to preclude such re-visitation in a way that makes it harder to change the generally applicable law.

The de minimis fringe benefits rule under § 132 provides another illustration of this administrative lock-in problem. When the IRS first recognized an exclusion for de minimis fringe benefits in the 1950s, it referred to "the value of a turkey, ham, or other item of merchandise of similar nominal value, distributed by an employer to an employee at Christmas, or a comparable holiday."[168] Congress codified this result when it enacted § 132 in 1984, and regulations cite occasional cocktail parties, holiday gifts, coffee, doughnuts, and soft drinks as examples of de minimis fringes.[169] But the landscape of fringe benefits in 2020 looks vastly different than it did in the twentieth century.[170] Today, companies (often technology companies in Silicon Valley) offer a vast array of workplace perks that range from onsite haircuts, yoga classes, gourmet cafeterias, to laundry.[171] It appears many of these benefits go unreported, arguably, because they are hard to value and thus may be considered tax-free de minimis fringes.[172] But in the aggregate, such benefits far exceed the value of an occasional cocktail party or ham, and Congress clearly did not contemplate the compensation regimes we see today.[173]

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167. KEIGHTLEY, *supra* note 159, at 10.

168. Rev. Rul. 59-58, 1959-1 C.B. 17.

169. Treas. Reg. § 1.132-6(e)(1) (1984).

170. *See generally* Soled & Thomas, *supra* note 114 (exploring the "fringe benefit evolution" that has occurred over the last seventy years).

171. *Id.* at 779.

172. *Id.* at 814.

173. *Id.* at 765, 813.

In its current form, § 132 is ill-equipped to handle the taxation of many modern-day fringe benefits. The result is confusion about the state of the tax law, inequities in terms of who benefits from the rule, and potential revenue loss and inefficiencies from the nonreporting of many fringe benefits.[174] The upside of codifying the exclusion for de minimis fringes (and other fringe benefits) in 1984 was that it provided clarity for taxpayers at that time.[175] But with new, uncontemplated benefits recently emerging, the static nature of the statute reveals drawbacks.

Likewise, the de minimis rules for OID made more sense when enacted as a way protect taxpayers from the complexity of calculating hidden interest on small loans or on small hidden interest amounts.[176] Calculating original issue discount as it accrues ratably over the life of a debt instrument requires advanced mathematical tools and thus, without the use of sophisticated computational tools, can be quite burdensome.[177] Congress was cognizant of such burdens, especially as it significantly expanded the scope of the OID rules to cover a larger and larger swath of transactions over several decades.[178] As a result, in 1984, when Congress extended application of the rules, Congress added the de minimis rules to ensure that the complexities would not "apply to most routine transactions of individual taxpayers, or to *de minimis* transactions of

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174. *Id.* at 814–15.

175. *Id.* at 769–70.

176. *See supra* notes 80–91 and accompanying text (discussing OID rules and de minimis exceptions).

177. *See* Jaime Cuevas Dermody & R. Tyrrell Rockafellar, *Mathematics of Debt Instrument Taxation*, *reprinted in* 3 FINANCIAL MARKETS, INSTITUTIONS & INSTRUMENTS 4 (1994) (exploring the mathematics of debt instruments, as applicable to original issue discount, market discount, and other tax principles).

178. Codification of the ratable accrual rules occurred as part of the Tax Reform Act of 1969. *See* STAFF OF JOINT COMM. ON TAX'N, 91ST CONG., SUMMARY OF H.R. 13270, THE TAX REFORM ACT OF 1969, at 60–61 (Comm. Print) (describing the issue). The IRS successfully argued for treatment of hidden interest as interest (albeit not ratably accrued) prior to this time. *See* United States v. Midland-Ross Corp., 381 U.S. 54, 61–65 (1965).

individuals or others."[179] While this may have made sense in 1984, the advent of sophisticated computerized computational tools since that time has made the actual calculation significantly less burdensome. And yet, the de minimis threshold enacted as part of the statute continues to exempt small loans and hidden interest, arguably creating a much less justifiable giveaway for many transactions.

To be sure, this problem is not unique to de minimis tax rules or even to the tax law; legislation tends to be sticky[180] and that stickiness can impose costs. In the criminal law context, for instance, scholars have lamented outdated criminalization of offenses such as adultery, fornication, sodomy, and railroad trespass.[181] In some ways the problem of outdating is similar, but exacerbated, in the context of de minimis tax rules. This is not to say that attitudes cannot change rapidly regarding criminalized offenses. Rather, the claim is that, inherently, what is deemed "insignificant" from an administrative point of view is likely to change more rapidly over time than shifting mores regarding crimes like adultery. In any event, lock-in matters in both cases.

More significantly, the inflexibility of de minimis tax rules is particularly problematic because de minimis rules are intended to resolve administrative problems. But they do so by locking in forbearance from the generally applicable approach. In so doing, de minimis rules undermine the very administrative flexibility they are designed to promote. Police, prosecutors, and judges, for instance, can simply fail to enforce outdated criminal laws (though they will not always do so, and there may be questions about whether nonenforcement is the best way to achieve removal of such laws from practice).[182] But tax law

179. STAFF OF JOINT COMM. ON TAX'N, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 (Comm. Print).

180. Jason Oh, *The Pivotal Politics of Temporary Legislation*, 100 IOWA L. REV. 1055, 1067 (2015).

181. Darryl K. Brown, *Democracy and Decriminalization*, 86 TEX. L. REV. 223, 229 (2007).

182. There is a large and growing literature on administrative forbearance, in particular in the criminal law context. *See, e.g.*, Roger Fairfax, Jr., *Prosecutorial Nullification*, 52 B.C. L. REV. 1243, 1244–46 (2011) (analyzing generally the phenomenon of prosecutorial nullification); W. Kerrel

administrators are more hamstrung by de minimis tax rules that actually dictate the administrative practices they have to take and, more problematically, those they are no longer entitled to take. The Code, for instance, tells taxpayers that de minimis OID simply does not constitute OID.[183] As a result, it need not be reported on information returns, or to the IRS, or considered at all in the calculation of OID.[184] The enactment of this rule, meant to alleviate undue administrative burdens, thus actually precludes the IRS, the tax administrator, from adjusting when such administrative burdens change. The more general lesson is that lock-in, a problem that is inherent to the creation of formal law, may be particularly problematic when administrative forbearance is the point, as with de minimis tax rules, rather than a potential solution to the lock-in effect, as is the case with criminal law.

C. *De Minimis Tax Rules Are Particularly Susceptible to Rent-Seeking that Benefits Insiders*

Aside from being inflexible, de minimis tax rules are also particularly susceptible to the type of problematic rent-seeking that can disproportionately benefit insiders. While tax scholarship has not paid particular attention to the phenomenon of de minimis tax rules, industry insiders know well the value such rules can confer. Indeed, the fact that de minimis tax rules may fly beneath the radar as seemingly insignificant makes them particularly valuable to knowledgeable insiders. This is evident from the regulatory process that followed the recent enactment of the TCJA.[185] The legislation itself was passed through Congress extraordinarily quickly, leaving many

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Murray, *Populist Prosecutorial Nullification*, 96 N.Y.U. L. REV. (forthcoming 2021) (exploring state prosecutors' categorical nonenforcement); James Vorenberg, *Decent Restraint of Prosecutorial Power*, 94 HARV. L. REV. 1521, 1551 (1981) (critiquing vastness of prosecutorial discretion).

183. *See* I.R.C. § 1273(a)(3) ("If the [OID] is less than 1/4th of 1 percent of the stated redemption price at maturity, multiplied by the number of complete years to maturity, then the [OID] shall be treated as zero.").

184. *Id.*

185. Pub. L. No. 115-97, 131 Stat. 2054 (2017) (codified as amended in scattered sections of the Internal Revenue Code).

uncertainties and downright mistakes that needed to be ironed out in the regulatory process.[186]

One of the principal areas of regulatory action focused on § 199A and what would constitute a "specified service trade or business" ("SSTB") which, under the statute, will not produce the valuable qualified business income deduction.[187] Great uncertainty as to what would constitute SSTBs created particularly robust lobbying opportunities in the regulatory process.[188]

Industries ultimately won some major victories about the definition of SSTBs in the regulatory process. For instance, in a heavily watched and much discussed win for the banking industry, Treasury concluded that "financial services" does not include "taking deposits or making loans."[189] As a result, engaging in such activities would not make banks ineligible for the deduction.

Alongside these major definitional decisions was another, less salient, but arguably no less important regulatory decision: Treasury offered a de minimis rule for SSTBs. Under this de minimis rule, if a business has gross receipts of $25 million or less, the business will not be considered an SSTB if less than 10 percent of the business's gross receipts are attributable to the performance of services that constitute an SSTB.[190] If a business has gross receipts in excess of $25 million, then the de minimis rule uses a 5, rather than 10 percent, threshold.[191]

The statute itself did not seem to call for or contemplate such a de minimis rule. Nonetheless, in offering the de minimis rule, Treasury explained that,

> Although the statute, read literally, does not suggest that a certain quantum of specified service activity is necessary to

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186. *See, e.g.*, Oei & Osofsky, *supra* note 9, at 256.

187. I.R.C. § 199A(d) (providing that "qualified trade or business" does not include "specified service trade or business" and defining "specified service trade or business"). A statutory de minimis rule allows taxpayers with income below threshold amounts to qualify for the deduction even if the business is an SSTB, as discussed in *supra* Part II.B.1.

188. Oei & Osofsky, *supra* note 9, at 217–20.

189. Treas. Reg. § 1.199A-5(b)(2)(xiv) (as amended in 2019).

190. *Id.* § 1.199A-5(c)(1)(i).

191. *Id.* § 1.199A-5(c)(1)(ii).

> find an SSTB, the Treasury Department and the IRS believe that requiring all taxpayers to evaluate and quantify any amount of specified service activity would create administrative complexity and undue burdens for both taxpayers and the IRS. Therefore . . . it is appropriate to provide a *de minimis* rule, under which a trade or business will not be considered to be an SSTB merely because it provides a small amount of services in a specified service activity.[192]

With this explanation, Treasury offered a de minimis rule, seemingly out of whole cloth, for the stated purpose of eliminating "administrative complexity and undue burdens."[193]

While Treasury presented the de minimis rule as in some ways a rounding error for "small amount[s] of services," the reality was that this de minimis rule has substantial impacts on tax burdens. Take, for instance, a business with gross receipts of $100 million. Imagine that 4.5 percent of the business's gross receipts are attributable to the performance of services that would clearly constitute an SSTB under the statute (such as, for instance, the performance of "financial services").[194] As a result of the de minimis rule, the entire $100 million of the business's gross income would remain eligible for the qualified business income deduction.[195] Under the statute, however, it is not clear this is the right result.[196] Indeed, one possibility under the statute (ultimately rejected by the de minimis rule), could have been that, to the extent the business engages in *any* activities that constitute an SSTB, the business would not be eligible for *any* qualified business income deduction. The facts of this example reveal the potentially extreme consequences of the different choices. In this case, the de minimis rule results in

192. U.S. Dep't of Treasury, *Qualified Business Income Deduction*, REG-107892-18, at 51, https://perma.cc/4PS2-7AJR (PDF).

193. *Id.*

194. I.R.C. § 1202(e)(3)(A) (as incorporated by reference and altered by I.R.C. § 199A(d)(2)(A)).

195. The calculation of what income is actually eligible for the qualified business income deduction is quite complicated and is not a straight deduction from gross income. *See id.* § 199A(a)–(c).

196. No de minimis exception is mentioned or specifically contemplated in the statute's definition of SSTB. *See id.* § 199(d)(2) (defining SSTB).

$100 million of the business's gross income being eligible for the deduction, relative to an alternative in which the business is entirely disqualified from the deduction![197] Multiplied across taxpayers, the de minimis rule, rather than a mere rounding error, has huge revenue and allocative implications.

Industry insiders inherently understood the value of the de minimis rule, repeatedly engaging with it in the regulatory process. For instance, the most common comment submitted during the regulation's notice-and-comment process was a form letter by S corporation banks asking for beneficial treatment under the SSTB rules.[198] These letters asked for two things: a more favorable definition of which banking activities should be excluded from the SSTB definition and a more favorable de minimis rule.[199] Of the two, the letters focused more on the de minimis rule.[200] With respect to the de minimis rule, the form letter argued, among other things, that "[t]he proposed rule's de minimum thresholds for revenues derived from specified service trades or businesses (SSTBs) are unreasonably low and will trip up hundreds of community banks in their ability to use the tax relief as intended as intended [sic] by Congress."[201] As detailed by Treasury in the preamble to the final regulations, commentators also made many more specific requests about the de minimis rule in the notice-and-comment process.[202]

The fact that the de minimis rule conferred a substantial benefit on taxpayers, in some cases equal to or greater than major definitional decisions is not to say that it was unjustified. But the lack of a framework around de minimis tax rules meant there was little basis for making such an evaluation. There were also fundamental, unanswered questions about whether the de minimis rule could be justified at all, at least based on the

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197. Another, middle-ground possibility could have been disallowance only to the extent of SSTB activity.

198. *See, e.g.*, Kenan Warren, Comment Letter on Proposed Qualified Business Income Deduction (Sept. 13, 2018), https://perma.cc/EX9P-23LQ (providing one example of many form letters submitted as a comment).

199. *Id.*

200. *Id.*

201. *Id.*

202. Qualified Business Income Deduction, 84 Fed. Reg. 2952-01, 2975–76 (Feb. 8, 2019) (to be codified at 26 C.F.R. pt. 1).

proffered reasons offered by Treasury. If the point of the de minimis rule was to alleviate "administrative complexity and undue burdens for both taxpayers and the IRS," would the de minimis rule, as crafted, accomplish that goal? Wouldn't it be the case that, as drafted, the de minimis rule would actually make it *more* important for taxpayers to keep track of small amounts of SSTB activity to ensure they were below the de minimis threshold?[203] The fact that de minimis rules are often subject to little searching review likely helped avoid careful consideration of such questions and ensure a big industry win.

D. *The Administrative Authority for Non-Statutory De Minimis Rules is Uncertain*

The prevalence of de minimis rules in the tax regulatory process raises a final issue. Congress, by virtue of its legislative power,[204] certainly has the authority to make de minimis rules in tax statutes. But what about the many de minimis rules contained in tax regulations? Does Treasury have the authority to make them? As this Part illustrates, Treasury is actually on shaky ground in promulgating these rules. There are a number of canons of statutory interpretation which, while not conclusively, suggest limits on the ability of Treasury or courts to create de minimis tax rules. Judicial authority about the role of Congress, the agency, and courts sheds even more doubt on Treasury's de minimis authority. Thus, even though de minimis tax rules may play an important role in the tax law, it may be incumbent on Congress to play the dominant role in making them.

1. Statutory Interpretation

Congress can make de minimis tax rules and does, indeed, make them. Even when Congress does not itself supply a de

203. At least one commentator raised this as an issue in a public hearing about the regulations. *Public Hearing on Proposed Regulations: 'Qualified Business Deduction,' United States Department of Treasury*, TAXNOTES Doc. 2018-41216, Oct. 16, 2018, at 28 ("If everyone out there has to run through the De Minimis test then it appears to be contrary to some of the announced purposes of the guidance in the preamble.") (on file with author).

204. U.S. CONST. art. I, § 1.

minimis tax rule, Congress sometimes explicitly asks Treasury to do so. For instance, in setting out the rules regarding employee retirement plans, Congress declared that, "[t]he Secretary shall by regulations provide that this subparagraph shall not apply to any plan amendment . . . unless such amendment adversely affects the rights of any participant in a more than de minimis manner."[205]

These and other examples beg the question: does the fact that Congress explicitly provides or requests de minimis tax rules in some cases indicate an intent not to have them in others? A number of canons of construction would suggest as much. Canons are interpretive presumptions regarding the meaning of statutes. A number of canons could support an inference that Congress's explicit provision of or request for de minimis tax rules in some places indicates Congress's intent (or at least assumption) that they will not exist in others.

For instance, courts often apply a "rule against superfluities," under which no part of the statute is deemed "superfluous, void or insignificant."[206] Applying this rule, Congress's explicit request in some places for Treasury to create a de minimis rule may be superfluous if Treasury always has this authority. Likewise, another canon of construction, *expressio unius est exclusio alterius*, provides that expressing one thing excludes another.[207] Court have even applied this canon specifically to statutory exceptions. In doing so, courts have explained that "[w]here Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent."[208] Applying this canon, explicit provision of or request for de minimis exceptions in some cases again implies they will not exist in others. Or, even more sweepingly, when Congress provides *any* exceptions to a general

205. I.R.C. § 411(d)(6)(B).

206. Hibbs v. Winn, 542 U.S. 88, 101 (2004).

207. Chevron U.S.A. Inc. v. Echazabal, 536 U.S. 73, 80 (2002).

208. Andrus v. Glover Constr. Co., 446 U.S. 608, 616–17 (1980); *see Expressio unius est exclusio alterius*, BLACK'S LAW DICTIONARY (6th ed. 1990) ("[I]f [sic] statute specifies one exception to a general rule or assumes to specify the effects of a certain provision, other exceptions or effects are excluded.").

rule, providing those exceptions may imply that no other exceptions, including de minimis exceptions, exist.[209]

However, there are a number of reasons why these canons are not conclusive. First, at a high level, it is not clear that we should embrace the canons at all as a means of determining whether Treasury or courts can make de minimis rules in situations in which Congress has not spoken. While canons have long played an important role in statutory interpretation, scholars have also long questioned their utility. Karl Llewellyn famously illustrated how each canon of construction has a counter-canon, undermining the canons' credibility as objective tools to make meaning of a statute.[210] Since Llewellyn's work, many scholars have deepened the critique, arguing, among other things, that courts may use canons as a cover to disguise ideologically driven decisions.[211] Recently, some scholars have questioned the extent to which courts' use of canons makes sense in light of the realities of the legislative process.[212] Legislative drafters have varying understanding of the canons, and often the canons make assumptions that do not map onto legislative realities.[213] For instance, the fact that Congress

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209. *See, e.g.*, Sierra Club v. EPA, 705 F.3d 458, 468 (D.C. Cir. 2013) (rejecting the EPA's authority to create a de minimis rule, in part by explaining, "[t]hat Congress provided only one exception to this monitoring requirement—a shorter monitoring period—suggests that Congress did not intend any other exceptions").

210. Karl N. Llewellyn, *Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to Be Construed*, 3 VAND. L. REV. 395, 401–06 (1950). *But see, e.g.*, William N. Eskridge, Jr. & Philip P. Frickey, *Foreword: Law as Equilibrium*, 108 HARV. L. REV. 26, 66–67 (1994) (exploring benefits of interpretive regimes).

211. *See, e.g.*, Stephen F. Ross, *Where Have You Gone, Karl Llewellyn? Should Congress Turn Its Lonely Eyes to You?*, 45 VAND. L. REV. 561, 562 (1992) (summarizing view of some prominent scholars and judges that "canons have actually been abused as part of the judiciary's systematic attempt to frustrate legislative policy preferences").

212. For some foundational work in this area, see Abbe R. Gluck & Lisa Schultz Bressman, *Statutory Interpretation from the Inside—An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part I*, 65 STAN. L. REV. 901, 904 (2013); Lisa Schultz Bressman & Abbe R. Gluck, *Statutory Interpretation from the Inside—An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part II*, 66 STAN. L. REV. 725, 731 (2014).

213. *See* Gluck & Bressman, *supra* note 212, at 904 (exploring throughout how canons make assumptions that may not map onto legislative process).

explicitly referred to the possibility of a de minimis tax rule in one part of the Code but not another may reflect different drafting styles by different drafters at different times, not a conscious decision to allow de minimis rules in one place but not the other.

Second, even assuming canons have value in some contexts, it is not clear that they apply indiscriminately to all interpreters. Canons historically have been judicial interpretive tools.[214] While it is debatable whether legislative drafters actually mean for courts to apply them, legislative drafters may at least expect at some level that courts will use these judicially fashioned tools.[215] In contrast, it is even less clear that legislative drafters intend or expect agencies to rely on canons of construction. Agency officials and legislative drafters often work in close relationships to develop statutes.[216] As a result, legislative drafters may expect that agency officials have an inside understanding of their intention with respect to the statute. This inside understanding may include a sense that Congress did not mean for the agency to apply a tax provision when the tax liability or taxpayer were insignificant.[217] Even absent a claim of inside information, Congress generally expects implementing agencies to exercise discretion in carrying out

214. *See, e.g.*, Jonathan R. Macey, *The Canons of Statutory Construction and Judicial Preferences*, 45 VAND. L. REV. 647, 671 (1992) ("The canons are attractive judicial tools simply because they permit judges to decide cases without invoking substantive principles of right and wrong.").

215. *See* Gluck & Bressman, *supra* note 212, at 929 (finding varying degrees of familiarity by legislative drafters with judicial canons of construction).

216. *See* Christopher J. Walker, *Legislating in the Shadows*, 165 U. PA. L. REV. 1377, 1377 (2017).

217. *See, e.g.*, Adirondack Med. Ctr. v. Sebelius, 740 F.3d 692, 697 (D.C. Cir. 2014) ("And when countervailed by a broad grant of authority contained within the same statutory scheme, the canon is a poor indicator of Congress' intent."). On the other hand, many have argued that canons help create objective meaning for statutes. *See* Anita S. Krishnakumar, *Backdoor Purposivism*, 69 DUKE L.J. 1275, 1305 (2020) (explaining that the "linguistic canons are widely heralded as 'rule-like,' 'predictable,' and 'objective' interpretive tools"). It is arguably problematic for an agency to be able to defeat objective meaning that can be understood through the use of canons. As already mentioned, however, the notion that canons do in fact create objective meaning is widely subject to debate.

statutes.[218] Courts have suggested that canons of construction may be "especially feeble . . . where Congress is presumed to have left to reasonable agency discretion questions that it has not directly resolved."[219]

Finally, even assuming that canons are useful tools of construction that a specific interpreter should apply, it is often unclear what interpretation the canons should yield in the given context.[220] In the case at hand, the fact that Congress explicitly creates or asks for a de minimis tax rule in some instances does not necessarily mean that Congress means to preclude de minimis tax rules in others. Rather, explicitly creating or requesting de minimis rules in some places may simply mean that Congress is requiring them in these places while leaving the matter to the discretion of the implementing agency in other places.

2. Separation of Powers

Rather than being a straightforward statutory interpretation question, regulatory de minimis tax rules raise more fundamental questions about separation of powers and administrative and judicial authority: When Congress has provided general rules and has not explicitly authorized an agency or court to create exceptions, do agencies or courts still have the authority to do so? Is providing such exceptions inherent in administrative or judicial powers? Or would creating exceptions to the general law set down by Congress undermine Congress's lawmaking power?

As an initial matter, it is worthwhile to note that courts rarely create their own de minimis tax law exceptions. There are some cases in which courts do so, or at least seem to encourage

218. *See* Walker, *supra* note 216, at 1417 (quoting Smiley v. Citibank (S.D.), N.A., 517 U.S. 735, 740–41 (1996) ("Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows.").

219. Waterkeeper All. v. EPA, 853 F.3d 527, 534 (D.C. Cir. 2017) (citing Cheney R. Co. v. ICC, 902 F.2d 66, 69 (D.C. Cir. 1990)).

220. *See, e.g.*, Marx v. Gen. Revenue Corp., 568 U.S. 371, 381 (2013) ("The force of any negative implication, however, depends on context.").

legislative creation of such exceptions. For instance, courts have long wrestled with the question of when states can impose obligations to collect and remit sales tax on out-of-state sellers.[221] In a 2018 opinion, the Supreme Court found that states can impose such obligations on out-of-state sellers even when such sellers do not have a physical presence in the state, at least under certain conditions.[222] The Court was careful to point out that these conditions were met in the case in part because the state at issue only imposed such obligations on "sellers that deliver more than $100,000 of goods or services into [the State] or engage in 200 or more separate transactions for the delivery of goods and services into the State on an annual basis."[223] The Court also indicated that the outcome might be different for "small businesses with only de minimis contacts" with the state.[224] The Court thus seemed to require some sort of de minimis exception to imposition of state tax obligations. However, this decision was not as much an issue of tax law as it was an interpretation of the Commerce Clause of the Constitution.[225] Pursuant to that clause, federal courts have long had power to ensure that states do not unduly burden interstate commerce.[226] The Court's almost singular turn to a de minimis tax rule in the context of interstate commerce thus underscores the general phenomenon: courts do not tend to craft their own de minimis tax law exceptions.

This makes sense in light of the framework that courts have adopted for statutory interpretation and administrative deference. Under *Chevron U.S.A. Inc. v. Natural Resources*

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221. *See generally, e.g.*, Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298 (1992); Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753 (1967) (prior treatments by the Court).

222. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018).

223. *Id.*

224. *Id.*

225. *Id.* at 2087 ("The question is whether the out-of-state seller can be held responsible for its payment, and this turns on a proper interpretation of the Commerce Clause.").

226. *See* S. Pac. Co. v. Arizona *ex rel.* Sullivan, 325 U.S. 761, 770 (1945) ("[I]n general Congress has left it to the courts to formulate the rules thus interpreting the commerce clause in its application . . . .").

Defense Council, Inc.,[227] where the statute permits multiple interpretations, courts will defer to the interpretation of the implementing agency as long as the interpretation is reasonable.[228] Accordingly, if a tax statute does not require a de minimis tax rule, and the agency has decided not to create one, courts would tend to defer to the agency's decision as a reasonable exercise of administrative authority. As a result, it would be unusual for courts in the tax context to create de minimis rules when the agency has not already done so.

Instead, Treasury is the principal creator of non-statutory de minimis tax rules. Treasury does so by making many regulatory de minimis tax rules, such as the SSTB de minimis rule.[229] However, as it turns out, it is not clear whether Treasury has the authority to make such exceptions.

Judicial doctrine has repeatedly recognized implicit administrative authority to create regulatory de minimis exceptions. In a seminal case, *Alabama Power Co. v. Costle*,[230] the D.C. Circuit Court of Appeals explained,

> Categorical exemptions may also be permissible as an exercise of agency power, inherent in most statutory schemes, to overlook circumstances that in context may fairly be considered de minimis. It is commonplace, of course, that the law does not concern itself with trifling matters, and this principle has often found application in the administrative context.[231]

Indeed, the *Alabama Power* court even suggested that the administrative authority to create de minimis exceptions "is a cousin of the doctrine that, notwithstanding the 'plain meaning' of a statute, a court must look beyond the words to the purpose of the act where its literal terms lead to 'absurd or futile

227. 467 U.S. 837 (1984).

228. *See id.* at 843 ("If . . . the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute . . . . Rather . . . the question for the court is whether the agency's answer is based on a permissible construction of the statute.").

229. *See supra* notes 190–193 and accompanying text.

230. 636 F.2d 323 (D.C. Cir. 1979).

231. *Id.* at 360.

results.'"[232] In support of such ideas, some scholars have underscored the role of de minimis authority as part of a cost-benefit balancing approach to regulation.[233]

Notwithstanding this support for agency authority to create de minimis rules, under longstanding judicial doctrine there are also clear exceptions to such authority. First, the *Alabama Power* court itself explained that agencies could not create de minimis exceptions when the statute itself is "extraordinarily rigid,"[234] a suggestion that has precluded the ability of agencies to create de minimis exceptions in important cases.[235]

More significantly for the tax context, courts have explained that "de minimis power is strictly limited; an agency can't use it to create an exception where application of the literal terms [of the statute] would 'provide benefits, in the sense of furthering the regulatory objectives, but the agency concludes that the acknowledged benefits are exceeded by the costs.'"[236] In other words, an agency cannot create a de minimis rule, even if such a rule is justified on cost-benefit grounds, if the rule undermines a benefit provided by the statute. As a result, in *Waterkeeper Alliance v. EPA*,[237] the D.C. Circuit struck down a regulatory exception the EPA had created to statutory reporting requirements, even though the EPA had concluded that such exception was justified because it "could not foresee a situation where the Agency would initiate a response action as a result of such notification" and that "federal response is impractical and unlikely."[238]

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232. *Id.* at 360 n.89 (quoting United States v. Am. Trucking Ass'ns, 310 U.S. 534, 543 (1940)).

233. *See, e.g.*, Cass R. Sunstein, *Cost-Benefit Default Principles*, 99 MICH. L. REV. 1651, 1668–72 (2001) (exploring de minimis rules as part of a more general cost-benefit approach).

234. *Ala. Power*, 636 F.2d at 360.

235. *See, e.g.*, Pub. Citizen v. Young, 831 F.2d 1108, 1122 (D.C. Cir. 1987) (finding that Congress adopted an "extraordinarily rigid" position in the Delaney Clause, which does not allow the FDA to create "an implicit de minimis exception for carcinogenic dyes with trivial risks to humans").

236. Waterkeeper All. v. EPA, 853 F.3d 527, 535 (D.C. Cir. 2017) (quoting *Ala. Power*, 636 F.2d at 360–61).

237. 853 F.3d 527 (D.C. Cir. 2017).

238. *Id.* at 535–36.

The fact that agencies do not have authority to create de minimis exceptions (or exceptions generally) when literal application of the statute would "provide benefits" places in doubt Treasury's authority to create de minimis exceptions in regulations. At one level, it is somewhat difficult to map the existing judicial authority onto the tax context. Generally, judicial analysis of de minimis exceptions has occurred in contexts like environmental or health regulation, in which costs and benefits of regulation are somewhat apparent: the cost of the regulation is typically a quantifiable private compliance cost, while the benefit of the regulation is typically a readily apparent public benefit, such as improved public health or environmental remediation. In some ways, the tax context differs from these other regulatory regimes because the benefit of the tax law is not as obvious. No lives are saved (at least not directly) through improved healthcare or reduced environmental contaminants as a result of the tax law.[239] Notwithstanding this difference, however, it is clear that there is a public benefit from the tax law, and that public benefit is raising revenue.[240]

And yet, the de minimis rules Treasury creates in regulations often seem to undermine the regulatory benefit of revenue raising. Take, as just one example, the de minimis exception to the definition of SSTBs in the § 199A regulations. As illustrated previously, creating the de minimis exception engendered significant reductions in revenue.[241] For example, under a strict interpretation of the statute with no de minimis exception, a business with gross receipts of $100 million, 4.5 percent of which are attributable to the performance of services that would clearly constitute an SSTB under the statute, would

239. *See* Alex Raskolnikov, *Accepting the Limits of Tax Law and Economics*, 98 CORNELL L. REV. 523, 533–37 (2013) (exploring "Why What's Good for Environmental Law Isn't Good for Tax").

240. As scholars have noted, the tax law is also used to do other things, such as promote certain government policies. *See generally* David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955 (2004) (exploring the use of the tax law to conduct non-tax programs as a matter of institutional design). To the extent that the tax law is being used to do other things in a given instance, the benefit would have to be evaluated in terms of these other objectives.

241. *See supra* notes 194–197 and accompanying text.

not have been eligible for the qualified business income deduction.[242] In contrast, under the de minimis rule adopted by Treasury, the entire $100 million of the business's gross income would remain eligible for the qualified business income deduction.[243] In this case, and other cases in which regulatory de minimis tax rules except seemingly insignificant taxpayers or transactions from the generally applicable tax law, the de minimis tax rules undermine the revenue raising benefit that would have been conferred by a strict application of the statute. In so doing, they seem to violate the judicial stricture that "an agency can't use [a de minimis rule] to create an exception where application of the literal terms would 'provide benefits, in the sense of furthering the regulatory objectives.'"[244]

Some might argue that, with the SSTB de minimis rule, Treasury was actually defining what is an SSTB, which is ambiguous under the statute, rather than exempting taxpayers from the generally applicable law under the statute. Under this reasoning, Treasury would arguably have the authority to issue the de minimis rule, notwithstanding the revenue reduction.[245] In some cases it may be true that a de minimis rule is Treasury's interpretation of the generally applicable law, rather than an exception Treasury is putting in place for administrative reasons. However, in the case of the SSTB de minimis rule, Treasury itself actually justified the de minimis rule as a departure from the statute on the basis of administrative burdens, not an interpretation of what is an SSTB under the statute.[246] Such an exception, judicial authority tells us, is unjustified if it undermines the benefit of the statute,[247] as the revenue-reducing SSTB de minimis rule does.

Others might argue that revenue raising was not the goal of the SSTB rule. As a result, Treasury may have been

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242. *See supra* notes 194–197 and accompanying text.

243. *See supra* notes 194–197 and accompanying text.

244. *Waterkeeper*, 853 F.3d at 535 (quoting Ala. Power Co. v. Costle, 636 F.2d 323, 360–61 (D.C. Cir. 1979)).

245. *See* I.R.C. § 7805(a) (providing the Secretary of the Treasury the authority to "prescribe all needful rules and regulations" for enforcement of the tax law).

246. *See supra* note 192 and accompanying text.

247. *See supra* note 236 and accompanying text.

authorized to create the de minimis exception even to the extent it reduced revenue. This is a tough argument to make, however, because it was notoriously unclear what the goal of the SSTB rule was.[248] In the absence of any clear justification, the default assumption that the Code is designed to raise revenue makes the most sense, and the de minimis rule clearly undermined such revenue raising, as already explored. In any event, Treasury did not attempt to justify the de minimis rule as being consistent with the overall goal of the SSTB rules.[249]

Of course, Treasury often has good justifications for making regulatory de minimis tax rules. These justifications are generally a sense that, even if strict application of the tax law would raise revenue, it simply is not worth the effort in a given context. Strict application may require too much of the agency's own enforcement resources, or the problem may be that the compliance costs would be too high for taxpayers, or some combination of these concerns. Indeed, as alluded to previously, Treasury justified the § 199A de minimis rule on just these bases.[250]

However, judicial doctrine is clear that costliness of enforcing the statute will have little power to justify a de minimis rule when strict application of the statute would produce regulatory benefits.[251] For this reason, the *Waterkeeper* court required strict application of statutory reporting requirements even when the EPA concluded that "federal response [to such reporting] is impractical and unlikely."[252] Likewise, other courts have similarly concluded that agencies may not create de minimis exceptions when there are benefits engendered by strict application of the statute, even if costs outweigh benefits.[253] As applied in the tax context, for example, Treasury should presumably not be entitled to create a de

248. *See supra* note 133 and accompanying text.

249. *See supra* note 192 and accompanying text.

250. *See supra* note 192 and accompanying text.

251. *See supra* note 236 and accompanying text.

252. Waterkeeper All. v. EPA, 853 F.3d 527, 530 (D.C. Cir. 2017).

253. *See, e.g.*, Env't Def. Fund v. EPA, 636 F.2d 1267, 1283 (D.C. Cir. 1980) ("It is not sufficient that the agency may believe that the costs outweigh the benefits, for Congress has already made the judgment that the benefits of regulation are sufficient.").

minimis rule on its own that raises the reporting requirements for independent contractors, even if the IRS would never audit taxpayers below a much higher threshold amount than $600. Likewise, Treasury would seem not to have the authority to eliminate from the definition of an SSTB a business that would qualify, simply because it would be too burdensome for Treasury and taxpayers to be subject to the rule.

To be sure, some courts, including the *Alabama Power* court, have indicated that, separate from de minimis authority, "[c]onsiderations of administrative necessity may be a basis for finding implied authority for an administrative approach not explicitly provided in the statute."[254] As a result, for instance, "[c]ourts frequently uphold streamlined agency approaches or procedures where the conventional course, typically case-by-case determinations, would, as a practical matter, prevent the agency from carrying out the mission assigned to it by Congress."[255] However, the agency's burden of justifying such an approach is "especially heavy" when, as with de minimis exceptions in tax regulations, the exception prospectively excuses a group of transactions or taxpayers from statutory application.[256] Thus, while administrative necessity may, in some cases, justify certain de minimis tax rules, it would be an uphill battle for Treasury to claim authority to create such rules prospectively in regulations. In any event, Treasury is not routinely providing any sort of justifications that attempts to meet such "especially heavy" burdens.

IV. LESSONS FOR THE DESIGN OF DE MINIMIS TAX RULES

As illustrated in the prior Parts, de minimis rules play a pervasive and important role in the tax system. However, they are subject to a number of underappreciated problems that threaten their efficacy and legitimacy. This does not mean that de minimis tax rules should be abandoned. Rather, they should be put in place only when policymakers determine that their benefits outweigh their costs and that they are preferable over

254. Ala. Power Co. v. Costle, 636 F.2d 323, 358 (D.C. Cir. 1979).

255. *Id.*

256. *Id.* at 359.

less formal administrative discretion. They should also be designed with the lessons from this Article in mind.

A. *Cost-Benefit Analysis Generally*

De minimis tax rules should be the product of a careful weighing of costs and benefits. Even without considering some of the unintended costs of de minimis tax rules (such as inequities for taxpayers left subject to the generally applicable tax law), excepting certain taxpayers or transactions from the tax law reduces revenue. As a result, at a minimum, the reduction in taxpayer compliance costs and government enforcement costs from de minimis tax rules should outweigh the reduction in tax revenue. At present, not all de minimis tax rules reflect such an analysis.

As an example, consider the de minimis rule that excepts certain "small" businesses from having to report on the accrual method, which was originally defined by a threshold of $5 million of gross receipts.[257] The legislative history to § 448, enacted in 1986, describes the small business exception as follows:

> The Congress believed that small businesses should be allowed to continue to use the cash method of accounting in order to avoid the high costs of compliance which will result if they are forced to change from the cash method.[258]

In other words, Congress carved out a business size threshold ($5 million) under which it believed the compliance costs did not merit the more complex rules for accrual method accounting. Over thirty years later, Congress expanded the de minimis threshold to $25 million as part of the TCJA.[259] This fivefold increase of the de minimis threshold far exceeds what an increase based on an inflation adjustment would have

257. *See supra* notes 118–121 and accompanying text.

258. STAFF OF JOINT COMM. ON TAX'N, 99th CONG. GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 475 (Comm. Print 1987).

259. *See supra* note 121 and accompanying text.

been.[260] Additionally, the TCJA legislative history does not indicate that the expansion of the threshold was due to any increase in costs or complexity in the accrual method of accounting for taxpayers over time.[261] The TCJA expansion thus took a de minimis rule originally justified by cost-benefit analysis and expanded its scope with no clear justification, other than to benefit affected businesses.

As a broader design point, when considering de minimis exceptions, policymakers should look for a clearly favorable tradeoff between compliance and administrative savings from the rule, relative to the resulting revenue loss. Taxpayer claims that a tax rule is burdensome should not automatically give way to a de minimis rule; all taxes create "burdens" by design. The regulatory de minimis exception for SSTBs in the wake of the TCJA serves as another example of when such a cost-benefit analysis did not appear to happen; rather, industries simply (and successfully) claimed the law would harm them to avoid application of the SSTB limitations.[262]

In addition to a general cost-benefit analysis of all de minimis tax rules, policymakers should use more granular cost-benefit analysis to determine what type of de minimis rule might make sense in a given context. First, the size of a de minimis threshold should correspond to the complexity of the underlying tax rule. As discussed above, a relatively small de minimis threshold for reporting and paying self-employment tax ($400) might sensibly reflect the fact that reporting self-employment taxes is not a significant burden.[263] More complicated regimes justify larger exemptions. Along similar lines, although exemptions should be adjusted to account for inflation or other increasing costs, de minimis thresholds shouldn't otherwise be raised without justification.

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260. Five million dollars in 1986 would be worth roughly $11.5 million in 2019. *See CPI Inflation Calculator*, BUREAU OF LAB. STAT., https://perma.cc/37X2-L5PJ (calculated from January 1986 to January 2019).

261. The Joint Committee explanation merely states: "The provision expands the universe of taxpayers that may use the cash method of accounting." STAFF OF JOINT COMM. ON TAX'N, GENERAL EXPLANATION OF PUBLIC LAW 115-97, at 112 (Comm. Print 2018).

262. *See supra* notes 198–201 and accompanying text.

263. *See supra* Part II.B.1.

Second, the cost of applying the de minimis threshold should be taken into account in weighing the benefits of a de minimis rule. Some rules impose clear de minimis thresholds—for example, the $15,000 de minimis threshold for gift tax.[264] But other de minimis rules are more complicated to apply—for example, the regulatory de minimis rule for determining SSTB status under § 199A.[265] Recall that the rule allows taxpayers to avoid SSTB classification if less than 10 percent (5 percent for larger businesses) of their gross receipts are attributable to services that constitute an SSTB.[266] This rule requires businesses to understand the very complicated rules about which business segments may constitute SSTBs, even if they meet the de minimis exception. Moreover, as alluded to previously, businesses still have to carefully monitor their receipts to see if they qualify for the exception.[267] If taxpayers have to incur costs to monitor their compliance with a de minimis threshold, this runs directly counter to the benefits conferred by de minimis rules. De minimis thresholds like these, which do little to alleviate compliance costs and may even increase them, should be viewed as suspect and subject to particularly careful cost-benefit analysis.

In contrast, policymakers should generally strive for de minimis rules that are easy to apply. This is particularly important if the purpose of a de minimis rule is to protect unsophisticated parties from complex tax regimes. Consider again the de minimis rule for below-market gift loans, which exempts small loans from the complicated imputed interest rules of § 7872.[268] At first, application of the $10,000 threshold appears easy to apply; a parent can disregard the imputed rules for loans below the threshold. But the statute layers in complexities that undercut the threshold's simplicity. For example, the statute states that the $10,000 de minimis rule will *not* apply to loans that are used to purchase income producing

264. *See* I.R.C. § 2503 (gift exclusion); *id.* § 6019 (gift tax return requirement); *Frequently Asked Questions on Gift Taxes*, INTERNAL REVENUE SERV., https://perma.cc/B9FT-8534 (last updated Nov. 9, 2020).

265. *See supra* notes 190–195 and accompanying text.

266. *See supra* notes 190–195 and accompanying text.

267. *See supra* note 203 and accompanying text.

268. *See* I.R.C. § 7872(c)(2).

property.[269] Further complicating the de minimis exception is another rule that says the gift loan can actually be up to $100,000 without imputed interest, as long as the borrower does not have net investment income over $1,000.[270]

In isolation, these rules might make sense. However, query whether the goal of a de minimis rule for gift loans is thwarted by these backstops, at least in some cases. We can imagine, for example, a parent gifting a child $10,000 to make a down payment on a property, and because the property yields income, unwittingly ending up subject to the imputed interest rules.

Complicated de minimis rules—those with anti-abuse measures, for example—are more justifiable when the de minimis rules primarily benefit sophisticated parties. However, to the extent some complexity is necessary in applying a de minimis tax rule, it should be weighed against the overall compliance costs saved by having a de minimis exception.

Third, where possible, de minimis rules should be designed to minimize behavioral distortions. If taxpayers alter their behavior to avoid application of a tax rule and qualify for a de minimis exception, this distortion imposes further costs on the tax system. In particular, the use of a "cliff" —a set dollar threshold under or over which the rule changes suddenly[271] —should be avoided when taxpayers are likely to change their behavior to avoid application of the cliff. In those situations, phase-ins/phase-outs may be a better policy choice. For example, if taxpayers lose the benefit of a deduction over a certain income threshold, the deduction could be reduced gradually for each dollar over the income threshold a taxpayer earns, until it phases out completely at a certain level. Such a phase out makes the marginal cost of exceeding the threshold much lower.

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269. *Id.* § 7872(c)(2)(B).

270. *See id.* § 7872(d) (listing special rules for gift loans). The rule states that, for individual loans not exceeding $100,000, imputed interest will not exceed net investment income. *Id.* However, net investment income of $1000 or less is treated as zero for purposes of this rule. *Id.* § 7872(d)(1)(E)(ii).

271. *See* Manoj Viswanathan, *The Hidden Costs of Cliff Effects in the Internal Revenue Code and Proposals for Change*, 164 U. PA. L. REV. 931, 933 (2016) (explaining that "cliff effects" can cause two similarly situated taxpayers to face different liabilities).

Legislators seemed to take this cost into account in drafting the statutory de minimis exception to § 199A; recall that rule imposes a taxable income threshold over which the statute's more complex provisions apply.[272] For taxpayers whose income is over the de minimis threshold, however, the deduction phases out gradually.[273]

On the other hand, as some commentators mentioned in practical analysis of the 199A regulations, the regulatory de minimis rule for SSTBs does create a cliff effect, whereby crossing the line into having just a bit more gross receipts from SSTB activity would disqualify the business from the § 199A deduction entirely.[274] This was a consequential design decision that may have outsized impacts on taxpayer behavior. Tax scholarship offers a robust "efficiency" framework for analyzing these very sort of design decisions that impact taxpayer behavior, but it was not brought to bear in this case.[275] Future de minimis tax rules should be created with more cognizance of the costs they may create, and a clearer weighing of such costs against benefits.

B. *Comparison with Less Formal Administrative Discretion*

When considering de minimis tax rules, policymakers should also compare them with the use of less formalized administrative discretion, including policies of nonenforcement for insignificant violations. As suggested previously, while de minimis tax rules are designed to solve administrative problems, they actually somewhat perversely (or at least

272. *See supra* note 79 and accompanying text.

273. *See supra* note 77 and accompanying text.

274. *See, e.g.*, Eric Yauch, *Fiscal-Year Passthroughs Get a Break in Final 199A Rules*, 162 TAX NOTES 547, 547 (2019) (detailing Treasury's acknowledgement of cliff effect as well as resulting concern and planning ideas by taxpayers).

275. For one canonical article describing the application of efficiency analysis to tax law, see generally David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627 (1999). Joel Slemrod has examined in depth the type of "notches" that create cliff effects. *See generally* Joel Slemrod, *Buenas Notches: Lines and Notches in Tax System Design*, 11 EJ. OF TAX RSCH. 259 (2013).

unexpectedly) do so by hampering administrative discretion.[276] This results in many of the problems identified previously with locking in a permanent solution to a temporary problem.[277] For instance, when Congress codified the OID rules to alleviate the burden of tracking small amounts of hidden interest, Congress also foreclosed the role of the tax administrator in developing, or changing, administrative solutions as the underlying tracking problem changed. While Congress of course could revisit the de minimis rules it created, formally enacting de minimis rules creates substantial barriers to flexible policy changes over time.

In contrast, similar decisions can be made through less formal administrative guidance. For instance, there is no fringe benefit rule under § 132 or elsewhere that excludes from income the free personal use of an employer-provided smartphone.[278] Such a benefit is not contemplated by Treasury Regulations under § 132, and does not clearly fit under the statutory definition of de minimis fringes, given the potential frequency of personal smartphone use.[279] Yet the IRS has stated, in informal guidance, that it will treat employer-provided cellphones as de minimis (and nontaxable) as long as the primary purpose of the phone is business use.[280]

Given that similar objectives can be achieved through less formal enforcement discretion, when should Congress choose to enact de minimis rules? When should Treasury do so in regulations? Or when should both Congress and Treasury avoid formal adoption, in favor of providing more discretion to the administrator through less formal policies and procedures?

As a general matter, formal legislation and regulation have some benefits that, while far from perfect, still have some advantages over less formal administrative action. The regulatory process is supposed to be imbued with procedures,

276. *See supra* Part III.B.2.

277. *See supra* Part III.B.2.

278. *See* I.R.C. § 132.

279. *Id*. § 132(e)(1) ("[A]fter taking into account the frequency . . . .").

280. *See Tax Treatment of Employer-Provided Cell Phones*, INTERNAL REVENUE SERV. (Sept. 19, 2011), https://perma.cc/HU49-9YQQ ("The value of the business use of an employer-provided cell phone is excludable from an employee's income . . . .").

like notice and comment, that stand in the stead of some of the inherent legitimacy of congressional procedures.[281] In theory, at least, transparency and participation in the formal legislative and regulatory process provide constituents a means of holding elected leaders accountable for the law Congress passes and its administration by the agency.[282] Less formal administrative action lacks many of these hallmarks. And, as many barriers as there may be to challenging regulations as being in violation of a statute,[283] it is even harder to challenge tax enforcement policy, or, more specifically, administrative decisions not to enforce the law.[284] Pushing de minimis tax rules into less formal enforcement policy thus has downsides, including making it less likely that decisions will be subject to judicial review.[285]

On the other hand, the stakes of informal enforcement policies are likely to be much lower, and possibly less subject to

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281. *See, e.g.*, Lisa Schultz Bressman, *Beyond Accountability: Arbitrariness and Legitimacy in the Administrative State*, 78 N.Y.U. L. REV. 461, 541–44 (2003) (exploring role of notice-and-comment procedures in legitimizing administrative action).

282. *See, e.g.*, Clinton G. Wallace, *Tax Policy and Our Democracy*, 118 MICH. L. REV. 1233, 1250 (2020) (exploring how transparency is necessary for accountability, which is a fundamental tenet of democracy).

283. As scholars and courts have long noted, pro-taxpayer regulations are rarely struck down, because of standing issues: taxpayers benefitted by the regulation are unlikely to challenge it and standing generally does not exist to challenge the lowered tax burdens of others. *See* Simon v. E. Ky. Welfare Rights. Org., 426 U.S. 26, 46 (1976) (Stewart, J., concurring) (lack of standing to challenge taxpaying of others); Allen v. Wright, 468 U.S. 737, 740 (1984) (same). Other procedural challenges also stand in the way of challenging tax regulations. *See, e.g.*, Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 VA. L. REV. 1683, 1707–12 (2017) (exploring the role of the Anti-Injunction Act in stymieing challenges to tax regulations).

284. *See, e.g.*, Heckler v. Chaney, 470 U.S. 821, 831 (1985) (internal citations omitted)

> This Court has recognized on several occasions over many years that an agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion. This recognition of the existence of discretion is attributable in no small part to the general unsuitability for judicial review of agency decisions to refuse enforcement.

285. Urska Velikonja, *Accountability for Nonenforcement*, 93 NOTRE DAME L. REV. 1549, 1552 (2018) ("As long as a change in enforcement policy is not prospective and categorical, it is immune from judicial review.").

industry lobbying. Most informal de minimis rules, like the employer-provided mobile phone example, involve the nonreporting of relatively small amounts of income. It would be highly unlikely, based on precedent at least, for the IRS to announce an informal policy exempting multi-million-dollar transactions from a tax rule. It would certainly be unusual to see an informal nonenforcement policy on the same scale as the SSTB de minimis rule lobbied for under the § 199A regulations. Thus, it is possible that limiting Treasury's authority to make de minimis rules would actually reduce or eliminate de minimis rules that reflect special interests. Moreover, it is important to remember that many regulatory de minimis tax rules are not easily justified as a matter of administrative authority.[286] They often reduce revenue in a way that judicial authority suggests cannot be justified easily as a matter of avoiding administrative cost.[287]

All of this suggests the following: Congress and Treasury should think hard about whether an announced form of administrative discretion would suffice to meet a current administrative problem before locking in a more permanent administrative solution in the form of a statutory or regulatory de minimis rule. It may well be the case that, as a definitional matter, Congress believes that a certain subset of taxpayers or transactions should not be subject to the generally applicable tax law. If that is the case, and Congress wants that decision to remain the same over time, Congress may very well want to embrace the rule as a de minimis exception in a tax statute. Moreover, if Congress does not do so, and Treasury believes that interpreting the statute *requires* such a de minimis exception, it would be more legitimate for Treasury to adopt such an approach in notice-and-comment regulations, rather than through a less formal policy of nonenforcement. However, if Congress has not embraced the exception as a definitional matter in the statute and Treasury does not feel the statute otherwise compels such an exception as a matter of interpretation, then Treasury should think hard about when it really needs a de minimis tax rule. When pressed for de minimis

286. *See supra* Part III.D.2.
287. *See supra* Part III.D.2.

tax rules in regulations, Treasury's default approach should not be to grant such rules whenever they would make administration easier. As judicial authority has indicated, when strict application of the statute would result in greater revenue raising, it should only be the exceptional administrative burden or very little revenue at stake that convinces Treasury that a de minimis tax rule is actually justified in a regulation.[288] And, as a matter of administrative flexibility, if the de minimis rule is addressing a current, administrative problem, informal discretion may be preferable, to allow the agency to revisit the problem as it changes over time. The agency can announce its nonenforcement policy, thereby salvaging at least some of the transparency that would otherwise be lost by moving from a de minimis rule to nonenforcement.[289]

C. *Design Considerations*

Finally, when Congress or Treasury decides that the cost-benefit analysis points in favor of de minimis rules, such rules should be designed with the lessons of this Article in mind. In particular, three such design principles are highlighted below: De minimis tax rules that benefit sophisticated parties should be subject to particularly high scrutiny, de minimis rules that rely on dollar thresholds should be periodically adjusted, and policymakers should consider how to more carefully tailor procedural de minimis tax rules to reduce the impact on substantive law.

1. De Minimis Tax Rules that Benefit Sophisticated Parties Should Be Subject to Particularly High Scrutiny

First, any de minimis tax rule aimed at sophisticated parties should be subject to extra scrutiny. As discussed in Part II, de minimis rules serve a variety of functions, with many such rules protecting smaller and/or less sophisticated parties from complicated tax schemes. In this way, de minimis rules sort different types of taxpayers into different tax regimes. The

288. *See supra* note 256 and accompanying text.

289. *See supra* note 41 and accompanying text (discussing some of the transparency benefits of categorical nonenforcement).

justification for de minimis tax rules that primarily benefit sophisticated parties is not always readily apparent, as presumably these are the very taxpayers more complex tax schemes are intended to capture.

However, even for sophisticated parties, policymakers may choose to carve out (relatively) modest transactions where the compliance costs associated with a particular tax scheme cannot be justified by the revenue. This can be seen in rules like the fifteen-day de minimis exception for reporting vacation homes or the built-in loss rules under § 382, as well as the de minimis exceptions for REITs.[290] Although such rules are not justified by the parties being unfairly subjected to an overly complex regime, they may very well be justified by the tradeoff of tax revenue for compliance costs and IRS enforcement costs.

However, there are particular risks associated with de minimis rules in the context of sophisticated transactions. One, which we have highlighted above, is that sophisticated parties are more likely to lobby for favorable de minimis rules that may not be justified on cost-benefit grounds.[291] These parties have the resources to engage in this lobbying and more at stake in securing the protection of a de minimis rule. Further, describing a special benefit as a "de minimis rule" may be a low salience way for sophisticated players to gain tax benefits that are unjustified by general cost-benefit tradeoffs. Again, the cost-benefit tradeoff should be a tradeoff between tax revenue lost by the de minimis rule and compliance and enforcement costs saved, *not* the tax liability savings to the taxpayer. As stated above, all tax rules impose burdens and will impose costs on taxpayers. The regulatory process leading to the SSTB de minimis rule serves as a stark example of how sophisticated parties may use the term "de minimis" to simply avoid application of an unfavorable rule.[292] Going forward, policymakers would be wise to require a detailed cost-benefit analysis before creating de minimis rules that benefit sophisticated parties.

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290. *See supra* notes 98–109 and accompanying text.

291. *See supra* Part III.C.

292. *See supra* Part III.C.

2. De Minimis Rules that Rely on Dollar Thresholds Should Be Periodically Adjusted

Next, as we have highlighted throughout this Article, many de minimis tax rules rely on a dollar threshold to define the taxpayer or transaction that is small enough to be considered de minimis.[293] However, as discussed above, what constitutes "small" is likely to change over time due to inflation and/or other factors. The $600 threshold for issuing a Form 1099-MISC is a perfect example of a de minimis rule that has never been indexed and arguably should be adjusted.[294]

One obvious way to make adjustments to de minimis tax rules is to write into the original rule that the threshold will be indexed for inflation. Many, but not all, de minimis thresholds do this; and there appears to be no rhyme or reason as to why some are indexed and others are not. For example, the threshold for reporting and paying household employment taxes (currently $2,200) is indexed for inflation,[295] as is the gift tax threshold.[296] However, the threshold for reporting and paying self-employment tax ($400) is not;[297] arguably this threshold could now be much higher.

Many, perhaps most, de minimis thresholds related to more complex rules are also not indexed for inflation. For example, the $10,000 de minimis thresholds for both below-market loans and OID have been in place for decades without adjustment.[298] A notable exception is the statutory de minimis threshold for application of § 199A. The complex provisions in § 199A relating to wages and depreciable property apply only to taxpayers over a taxable income threshold, which is indexed annually for inflation.[299]

Indexing all dollar thresholds for inflation would mean each rule maintained the scope originally intended by Congress, at

293. *See supra* Part II.A.
294. *See supra* note 167 and accompanying text.
295. *See supra* note 71 and accompanying text.
296. *See supra* note 51 and accompanying text.
297. *See supra* note 70 and accompanying text.
298. *See supra* notes 21, 84 and accompanying text.
299. *See supra* note 76 and accompanying text.

least in dollar terms, over many years. But there are tradeoffs to consider when indexing de minimis rules. One is complexity—a de minimis rule that does not change is simpler than a rule that does. Making the inflation adjustment itself is relatively simple; the tax law does this in numerous places and Treasury simply relies on a preset inflation index to do so.[300] However, changing thresholds may make it harder for taxpayers to plan as they have to keep track of a moving target. A taxpayer may also inadvertently fall subject to the non-de minimis regime by failing to keep track of the moving threshold. For example, we can imagine a taxpayer might have heard at some point that the gift tax threshold was $14,000, and not realize that in a later year the threshold is $15,000.

Another consideration is that the compliance costs that de minimis thresholds are designed to avoid may also change over time. In particular, technological advancements may make certain procedural compliance requirements—like issuing tax forms—significantly easier and cheaper. This makes the desirability of raising de minimis thresholds uncertain. Returning to the example of the $600 threshold for Form 1099, it is clear that the threshold captures transactions that are much "smaller" in real dollar terms than Congress intended in 1954.[301] If compliance costs were unchanged since then, this would likely be a bad result. If Congress deemed the revenue at stake for a $599 transaction unworthy of the compliance costs related to a Form 1099, then the revenue at stake for a $600 transaction today would clearly not justify those compliance costs.

However, it is likely far easier to issue a Form 1099 to a payee in the twenty-first century than it was in the 1950s when Congress enacted the $600 de minimis rule. Forms can be distributed to taxpayers electronically, and payroll software can make IRS filings on a relatively low-cost basis.[302] With much

300. *See* I.R.C. § 199A(e)(2)(B)(i–ii) (detailing how to adjust the threshold amount for inflation).

301. *See supra* note 160 and accompanying text.

302. *See* Kathleen DeLaney Thomas, *The Modern Case for Withholding*, 53 U.C. DAVIS L. REV. 81, 96 (2019) (comparing withholding costs by larger payers to individual payees).

lower compliance costs, a threshold that had been indexed annually for inflation since 1954 may be too high.

How should policymakers account for this uncertainty? One response may be to vary the adjustment to a de minimis rule according to the type of complexity the rule was intended to address. De minimis rules that exempt taxpayers from complex substantive tax rules are rules where periodic adjustments probably make sense, because the procedural cost of applying the tax law is less relevant to the calculus, but the threshold for what is a small taxpayer or transaction will naturally go up in tandem with inflation. Yet, ironically, these rules appear to be the least often adjusted. For example, if the purpose of a $10,000 de minimis rule for below-market loans is to exempt small loans from the complicated below-market loan rules, that threshold should be indexed. Today, a relatively small $11,000 intra-family loan would no longer fall below the threshold, and the imputed interest rules are no easier to understand today than when they were when enacted. On the other hand, adjustments to procedural de minimis rules—rules that protect taxpayers from administrative compliance burdens rather than complex substantive rules—should be subject to closer review, rather than just relying on a default indexing approach. Because compliance burdens may go down over time (particularly as technology evolves), inflation indexing or other adjustments may be unnecessary, or may not need to happen frequently.

Another way to deal with uncertainty regarding how to adjust de minimis thresholds is to require periodic revisiting of the threshold without automatic annual inflation adjustments. For example, Congress could write a rule that requires Treasury to adjust the Form 1099-MISC threshold every five years, without specifically tying it to inflation.[303] That would allow a more nuanced weighing of inflation versus changing compliance costs. Less frequent adjustments may also make it easier for taxpayers to assess what the law is at a given time. A downside of this approach, however, is giving Treasury discretion for how to adjust thresholds will inevitably lead to lobbying for lower

303. *Cf.* James R. Hines Jr. & Kyle D. Logue, *Delegating Tax*, 114 MICH. L. REV. 235, 238 (2015) (arguing for more congressional delegation of tax lawmaking power to Treasury).

thresholds, an approach that mechanical inflation adjustments avoid.

3. Policymakers Should More Carefully Tailor Procedural De Minimis Tax Rules to Reduce the Impact on Substantive Law

Finally, policymakers should more carefully construct procedural de minimis tax rules to target costs, while minimizing impacts on substantive tax law. As discussed previously, taxpayers often confuse procedural de minimis tax rules with a change in the underlying tax law.[304] Many other taxpayers, who are aware of the distinction, simply use the lack of a filing requirement as a reason to cheat, knowing that there will be no paper trail of the unreported income.[305] This yields inequity in addition to lack of transparency about the true obligations imposed by the tax law.

One alternative would be for policymakers to instead enact substantive changes to the tax law. For instance, instead of a rule that alleviated a Form 1099-MISC requirement for payments below $600, the underlying tax law could provide that payments to independent contractors below $600 are not income at all. This would make the tax law more consistent with underlying expectations by taxpayers who are otherwise confused and would alleviate some of the inequities that currently favor taxpayers who use the lack of information reporting as an opportunity to cheat.

However, such changes would present many of their own problems. While getting a payment that falls below the reporting threshold is currently advantageous to taxpayers because it provides enhanced opportunities to cheat, actually changing the underlying tax law would create significant behavioral distortions. The new substantive law would heighten the value of receiving consecutive payments that fall below the threshold, or of being an independent contractor who was potentially eligible for the exclusion. This would incentivize taxpayers to engage in all sorts of inefficient planning to ensure that payments are not subject to tax. It would also put more

304. *See supra* notes 141–144 and accompanying text.

305. *See supra* notes 138–139 and accompanying text.

pressure on the distinction between independent contractors and employees (the latter of whom would not be eligible for the exclusion), in a way that is somewhat nonsensical and, in any event, would be difficult to police given the blurry line between the two.[306] Similar issues would apply in other contexts if procedural de minimis tax rules were replaced with substantive exemptions, resulting in great, overall revenue and efficiency costs to the tax system.

Nonetheless, without a wholesale switch to substantive tax law exemptions, policymakers can still craft many procedural de minimis tax rules to reduce inordinate costs in a more targeted way. For instance, in order to file a Form 1099-MISC, payors must fill out multiple copies of the form, including many details such as the social security or employer identification number of the payee.[307] The payor must then transmit these forms to multiple parties, including to the payee and the IRS.[308] And the payor must also file a Form 1096 with the IRS that summarizes the various information returns submitted by the payor in the year.[309] The steps involved are onerous for taxpayers making an isolated number of small payments, hence the de minimis threshold.

However, rather than eliminating any filing requirement at all, policymakers could instead consider making the requirements easier for small payments. As one possibility, the IRS might provide on its website a printable sheet of paper that says, "You received an independent contractor payment that is less than $600. This is taxable and will be reported by the payor to the IRS. Failure to report and pay tax on the payment on your own tax return is tax fraud and is punishable by the IRS." Payors who make payments below the de minimis threshold could be required to provide this printable statement to the payee, and to report the payment on a Form 1096, along with

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306. *See, e.g.*, David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1464 (2019) (discussing difficulty IRS has policing the line).

307. *See* INTERNAL REVENUE SERV., 2020 INSTRUCTIONS FOR FORMS 1099-MISC AND 1099-NEC 3–4 (2019), https://perma.cc/53L3-EZML (PDF).

308. *Id.* at 1, 7.

309. *See* INTERNAL REVENUE SERV., 2020 FORM 1096 AND INSTRUCTIONS, https://perma.cc/RE9T-L6MZ (PDF).

other payments that the payor made in that year. Or, if the payor makes no other reportable payments that year, the payor could be required to report the payment on her annual income tax return, rather than having any separate filing requirement just for the payment. Eliminating additional steps, such as filling out and appropriately distributing multiple copies of the 1099, should reduce many payors' costs of providing the information to payees and the IRS, while still notifying the payees that tax liability is owed and providing the IRS some information to track the payment.

Of course, there are costs to this alternative system. For one, having different filing requirements for payments below the $600 threshold makes the overall system more complex. On the other hand, there are already different regimes for payments below the threshold, relative to payments at or exceeding the threshold amount. The proposed solution, or a different alternative regime, may better achieve burden reduction while being more mindful of potential impact on substantive tax law. While policymakers will want to carefully consider tradeoffs in devising particular solutions, they should at the least be more cognizant of how, at present, procedural de minimis tax rules create de facto substantive tax law. In this, and the many other ways described above, more careful attention to the role of de minimis tax rules can lead to more sensible design.

CONCLUSION

This Article has set forth a comprehensive analysis of de minimis tax rules, which pervade the Code, but which have been the subject of little examination. As this Article has revealed, de minimis rules can and do play an important role in allocating the costs of the tax system. At best, they can except insignificant taxpayers and transactions from inordinate burdens.

But they can also have significant, deleterious effects. In some ways, the de minimis rule in the § 199A regulations is a glaring example of a de minimis rule gone wrong. It was adopted in the regulations, even though Treasury acknowledged the exception conflicted with the statute. The de minimis rule likely had a significant, negative impact on revenue, thereby threatening claims that Treasury had the administrative authority to make it. It was adopted as part of an

extraordinarily complex legal regime and did little to actually reduce the complexity or burden of such regime. Indeed, if anything, it actually exacerbated the complexities of the tax law, by making it even more important to keep track of and define "SSTB" income. Moreover, the rule conferred great advantage on certain insider constituencies, who lobbied heavily for it. And the drafting of the rule, with a cliff effect, is likely to engender significant efficiency costs.

How did such a flawed de minimis rule come to pass? It is possible that it was a badly designed fluke. But this Article suggests there is a more problematic story: the very belief that de minimis tax rules are insignificant has long enabled insiders to lobby for them while others assume that they do not matter that much. This can result in significant, and poorly construed, giveaways to powerful taxpayers, with little pushback. Even when the story is not one of well-organized insiders getting their way, policymakers and commentators alike have not thought much of de minimis rules one way or the other, leading to suboptimal drafting and impacts on the tax system.

This Article has surveyed the extensive and varied de minimis rules throughout the tax system. The Article has displayed that collectively, and even individually, they matter, no matter how "de minimis" they might seem. Hopefully, this Article will help policymakers and commentators think carefully about the many de minimis rules that are likely to be requested in the future. Paying attention to these seemingly small decisions has important, systemwide effects.