September 22, 2020

Hon. Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224  

Re: Comments on Proposed Regulations under Section 162(f) and Section 6050X

Dear Commissioner Rettig:

Enclosed please find comments regarding the proposed regulations under section 162(f) and section 6050X. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Joan C. Arnold  
Chair, Section of Taxation

Enclosure

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AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on the Proposed Regulations under
Section 162(f) and Section 6050X

These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation (the "Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these comments for the Tax Accounting Committee was exercised by Susan Grais and Rayth Myers. Significant contributions were made by David Schneider, Scott Rabinowitz, Kristen Martin, Engin Nural, and Heather Harman of the Tax Accounting Committee as well as Rochelle Hodes of the Administrative Practice Committee. These Comments have been reviewed by Ellen McElroy of the Committee on Governmental Submissions, and Kurt Lawson, the Section’s Vice Chair of Government Relations.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of, one or more specific issues addressed by these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Executive Summary

These Comments are in response to proposed regulations published on May 13, 2020 (the “Proposed Regulations”), under sections 162(f) and 6050X with respect to changes made by Pub. L. No. 115-97 (the “Act”). We commend the U.S. Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) for their commitment to providing substantive guidance on these changes.

Prior to the amendments made by the Act, section 162(f) disallowed a deduction under section 162(a) for any fine or penalty paid to a government for violating the law. The Act amended section 162(f) to apply more broadly to any amount paid or incurred to, or at the direction of, a government or governmental entity related to the violation or potential violation of a law. It also provided exceptions to the general disallowance rule for amounts that the taxpayer establishes are restitution, remediation, or paid to come into compliance with a law (referred to in the Proposed Regulations as the “establishment requirement”), if the amounts are identified as such in the court order or settlement agreement (referred to in the Proposed Regulations as the “identification requirement”).

The Act also added new section 6050X to require any governmental entity involved in certain suits or agreements regarding the violation or potential violation of a law over which the governmental entity has authority to report certain information if the reporting threshold is satisfied.

Amended section 162(f) and new section 6050X apply to amounts paid or incurred on or after December 22, 2017, unless the amount is paid or incurred under an agreement or order that was entered into prior to December 22, 2017.

On March 27, 2018, Treasury and the Service released Notice 2018-23, which provided transitional guidance for meeting the identification requirement under amended and delayed reporting under section 6050X until a date to be specified in proposed

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2 Unless otherwise specified, all “section” and “§” references are to the Internal Revenue Code of 1986, as amended (the “Code”), and all “Treas. Reg. §” references are to the Treasury Regulations promulgated thereunder, all as in effect (or, in the case of proposed regulations, as proposed) as of the date of these Comments.


4 Act § 13306(a)(1). We refer to section 162(f), as amended by the Act, as “amended section 162(f).”

5 I.R.C. § 162(f)(1).


7 Act § 13306(b)(1).

8 Act § 13306(a)(2), (b)(3).
Under the transitional guidance, the identification requirement is satisfied if the settlement agreement or court order specifically states on its face that the amount is restitution, remediation, or for coming into compliance with the law.

As discussed in more detail below, we believe that further clarification and/or revision of the Proposed Regulations would assist taxpayers meaningfully in applying these provisions. Specifically, we recommend that the Proposed Regulations, when finalized:

- remove the presumption that a forfeiture or disgorgement is, per se, not restitution or remediation or a cost of coming into compliance, and replace it with a facts and circumstances test aimed at determining whether an amount paid or incurred meets the description in Prop. Treas. Reg. § 1.162-21(f)(3)(i), i.e., whether the amount is to restore, in whole or in part, a person or property harmed by a violation or potential violation of law;

- broaden the scope of the terminology that presumptively satisfies the identification requirement to include, for example, synonymous terms such as “accounting” and “compensatory,” as well as other variations of restitution or remediation; and apply a similar approach to expand the terminology related to costs of coming into compliance;

- expand the list of documents deemed to meet the establishment requirement under Prop. Treas. Reg. § 1.162-21(b)(3), clarify the requirement by including examples of situations in which the requirement has been met and situations in which it has not been met, and add a presumption that it has been met if a court order provides that a payment is restitution, remediation, or a cost to come into compliance;

- clarify that amended section 162(f) applies only to the amended portion of certain orders and agreements entered into prior to December 22, 2017, and provide a clearer and more narrowly delineated definition for “material change”;

- clarify that the term “governmental entity” encompasses all local (e.g., city, town, municipal) governments and subdivisions thereof;

- increase the threshold amount under Prop. Treas. Reg. § 1.6050X-1(g)(5) to $1 million or more;

- clarify that the reporting threshold under section 6050X applies on an order-by-order or agreement-by-agreement basis except where multiple settlements arise as a result of proceedings for the same violation or potential violation of law initiated by the same party or parties, and that only the amounts required to be reported...
paid to the same government or entity, or group of governments or entities, that brought the proceeding resulting in the settlement need to be aggregated;

• to avoid future confusion, make it clear that the date for filing the Form 1098 F (or any successor form) is not the date the settlement is entered into, but rather the due date determined by the Secretary; and

• include language to provide that if a payor asks for a copy of the Form 1098-F (or any successor form), the filer must provide the payor with a copy within ten days of the request.

We appreciate all consideration given to our recommendations concerning the Proposed Regulations, and we would be pleased to discuss these Comments further if that would be helpful.

## Detailed Comments

### I. Section 162(f)

#### A. Background

As noted above, prior to the amendments made by the Act, section 162(f) disallowed a deduction under section 162(a) for any fine or penalty paid to a government for violating the law. Amended section 162(f)(1) now applies the disallowance rule more broadly to amounts “paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government, governmental entity, or nongovernmental entity in relation to the violation of a law or the investigation or inquiry by such government or governmental entity into the potential violation of a law.”

Amended section 162(f)(2) provides exceptions to the disallowance rule for amounts that the taxpayer establishes are restitution, remediation, or paid to come into compliance with a law. However, it provides that an amount paid to reimburse a government for investigation or litigation costs does not constitute restitution, remediation, or an amount paid to come into compliance with a law. It also requires that the amount constituting restitution or remediation, or paid to come into compliance with a law, be identified in the court order or settlement agreement to be deductible. Further, amended section 162(f)(3) provides that the disallowance rule does not apply to amounts paid or incurred related to private suits or agreements where no government, governmental entity, or nongovernmental entity is a party.

Amended section 162(f) applies to amounts paid or incurred on or after December 22, 2017, unless the amount is paid or incurred under an agreement or order that was entered into prior to December 22, 2017.

10 I.R.C. § 162(f)(1).
On May 13, 2020, Treasury and the Service published the Proposed Regulations to implement the changes enacted by the Act.

B. *Per Se Rule that Forfeiture and Disgorgement Are Not Restitution or Remediation or Cost of Coming into Compliance*

1. **Recommendation**

We recommend that the Proposed Regulations, when finalized, remove the presumption that a forfeiture or disgorgement is, *per se*, not restitution or remediation or a cost of coming into compliance, and replace it with a facts and circumstances test aimed at determining whether an amount paid or incurred meets the description in Prop. Treas. Reg. § 1.162-21(f)(3)(i), *i.e.*, whether the amount is to restore, in whole or in part, a person or property harmed by a violation or potential violation of law.

2. **Discussion**

   a. **Background**

   Prop. Treas. Reg. § 1.162-21(a) would disallow a deduction for certain amounts paid or incurred to, or at the direction of, a government or governmental entity in relation to the violation, or investigation or inquiry into the potential violation, of any civil or criminal law. Prop. Treas. Reg. § 1.162-21(b) would provide that paragraph (a) does not apply to amounts paid or incurred for restitution, remediation, or to come into compliance with a law, as defined in paragraph (f)(3), provided that certain requirements are met.

   Prop. Treas. Reg. § 1.162-21(f)(3)(i) would provide that, generally, an amount is paid or incurred for restitution or remediation pursuant to paragraph (b)(1) if it “restores, in whole or in part, the person, as defined in section 7701(a)(1); the government; the governmental entity; or property harmed by the violation or potential violation of law described in paragraph (a)(3).”11 Prop. Treas. Reg. § 1.162-21(f)(3)(iii) would go on to provide that certain amounts specifically are not considered to be restitution, remediation, or an amount paid to come into compliance with the law, including “any amount paid or incurred . . . [a]s forfeiture or disgorgement” (emphasis added).

   b. **Disgorgement**

   Treasury and the Service explain the *per se* exclusion in Prop. Treas. Reg. § 1.162-21(f)(3)(iii) in the preamble, stating that forfeiture and disgorgement “focus on

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11 Prop. Treas. Reg. § 1.162-21(f)(3)(ii) would provide, further, that an amount is paid or incurred to come into compliance with a law that the taxpayer has violated, or is alleged to have violated, by performing services; taking action, such as modifying equipment; providing property; or doing any combination thereof.
the unjust enrichment of the wrongdoer, not the harm to the victim.”12 The preamble cites Kokesh v. Securities and Exchange Commission for this proposition.13 In Kokesh, the Supreme Court held that disgorgement imposed by a court on a defendant in a Securities and Exchange Commission (“SEC”) civil enforcement action was a “penalty” for purposes of the five year statute of limitations applicable to any “action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise” under 28 U.S.C. § 2462. The preamble, citing the majority opinion in Kokesh, states that “[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains.”14

We respectfully disagree with the preamble that Kokesh supports the per se exclusion in Prop. Treas. Reg. § 1.162-21(f)(3)(iii) of an amount paid as a disgorgement. Prior to the Kokesh decision, the Service had recognized in its internal memoranda that disgorgement may be primarily punitive or primarily compensatory, depending on the particular case. In these memoranda, issued under section 162(f) prior to its amendment by the Act, the Service stressed that for disgorgement to be primarily compensatory, the disgorged profits must, at minimum, be given over to allegedly harmed parties.15 The preamble to the Proposed Regulations, however, suggests that Treasury and the Service believe that Kokesh supports a more absolute view of disgorgement, namely that it never can be primarily compensatory, in any context, presumably even where the disgorged profits are given over to allegedly harmed parties.

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12 Preamble to Prop. Treas. Reg. § 1.162-21, 85 Fed. Reg. at 28,527. The preamble goes on to state:

Section 162(f)(2)(A)(i)(I) provides that restitution and remediation payments relate to the damage or harm caused, or that may be caused, by the violation or the potential violation of a law. The statute does not characterize restitution or remediation in connection with an unjust enrichment to a wrongdoer. Consistent with the statutory language, proposed §1.162-21(f)(3)(i) provides that the purpose of restitution or remediation is to restore the person or property, in whole or in part, to the same or substantially similar position or condition as before the harm caused by the taxpayer’s violation, or potential violation, of a law.

Id.


15 CCA 201825027 (June 22, 2018); CCA 201619008 (May 6, 2016). Note that although CCA 201825027 was released in 2018, after the Supreme Court issued its opinion in Kokesh, it was written in November 2016. Compare CCA 201748008 (Dec. 1, 2017) (in which the Service made no statement that disgorgement could be either compensatory or punitive, but rather concluded, citing Kokesh, that disgorgement paid for violating federal securities laws was primarily for the purpose of deterrence, and therefore nondeductible under former section 162(f)).
The preamble also cites *Nacchio v. United States*\(^\text{16}\) and *United States v. Joseph*.\(^\text{17}\) We believe that, like *Kokesh*, neither of these cases supports a *per se* exclusion under which forfeiture and disgorgement never can be restitution, remediation, or an amount paid to come into compliance with law, regardless of authority or context. *Nacchio* involved court-ordered forfeiture of insider trading profits pursuant to certain SEC statutes as part of a criminal proceeding; the forfeited profits were paid over to the Justice Department, not to any victims. In *Joseph*, the court held that a criminal defendant accused of defrauding the Service was not entitled to have forfeited amounts credited against the amount of court-ordered restitution, because under the specific statutes at issue, forfeiture and restitution served different purposes.

Shortly after the Proposed Regulations were published, the Supreme Court decided *Liu v. Securities and Exchange Commission*, which held that a disgorgement award under 15 U.S.C. § 78u(d)(5) in an SEC enforcement action constitutes equitable relief that is permitted under that statute, provided that: (i) the disgorgement does not exceed the wrongdoer’s net profits (i.e., revenue less legitimate expenses), and (ii) it is awarded for the benefit of victims.\(^\text{18}\) The Court remanded the case to the lower court to address these points. In *Liu*, the Court observed that long-standing principles of equity practice called for restricting the disgorgement remedy to the individual wrong-doer’s net profits and requiring that such amounts be awarded to victims. These principles, the Court observed, avoid “transforming an equitable remedy into a punitive sanction.”\(^\text{19}\) In so holding, the Court rejected Mr. Liu’s argument that *Kokesh*’s characterization of the SEC disgorgement remedy in that case as punitive in nature was dispositive of the question of whether the court in Mr. Liu’s case could impose disgorgement as an equitable remedy under the statute. Specifically, the Court in *Liu* stated that:

> To be sure, the *Kokesh* Court evaluated a version of the SEC’s disgorgement remedy that seemed to exceed the bounds of traditional equitable principles. But that decision has no bearing on the SEC’s ability to conform future requests for a defendant’s profits to the limits outlined in common-law cases awarding a wrong-doer’s net gains.\(^\text{20}\)

Thus, the Court made clear in *Liu* that *Kokesh* does not support a blanket view that all disgorgement remedies in the context of SEC violations (much less in other contexts) are *per se* punitive or deterrent in nature, or (stated differently) that disgorgement remedies can never serve primarily as restitution to compensate allegedly harmed parties. Rather, the Court in *Liu* made clear that disgorgement under common law equity principles is not punitive, and implied that for courts to impose disgorgement


\(^{17}\) 743 F.3d 1350, 1354 (11th Cir. 2014).

\(^{18}\) 140 S. Ct. 1936 (2020).

\(^{19}\) *Id.* at 1942.

\(^{20}\) *Id.* at 1946.
under 15 U.S.C. § 78u(d)(5) they must follow the common law principles for equitable remedies that make such remedies “non-punitive.”21

In our view, Liu supports the view originally espoused by the Service in its internal memoranda that disgorgement may be primarily compensatory in certain cases. Although Liu makes this point in the context of SEC enforcement actions, it is clear that the point is equally valid in other contexts. For example, the Federal Energy Regulatory Commission (“FERC”) has described FERC-imposed disgorgement as a remedy wherein profits illegally obtained are distributed to those who were harmed by the violations. FERC notes that in this regard disgorgement is very different from penalties that “serve to provide just punishment, deterrence, and incentives for organizations to develop and maintain sufficient compliance measures.”22

We note that removing the presumption that disgorgement is, per se, not restitution or remediation or a cost of coming into compliance, would not mean that disgorgement always would qualify as one of the foregoing. Rather, it would replace a per se rule with a facts and circumstances test. Furthermore, the identification requirement would continue to apply. Thus, in a particular case where disgorgement served primarily a punitive or deterrent function, e.g., by being paid over to someone other than a harmed party, the disgorgement payment still would be nondeductible under the general definition of restitution, as well as, presumably, by virtue of failing the identification requirement.

c. Forfeiture

The preamble to the Proposed Regulations explains that the statutory language of amended section 162(f)(2)(A)(i)(I) focuses on restoration of the person or property harmed. This focus is demonstrated by the description of restitution in Prop. Treas. Reg. § 1.162-21(f)(3)(i). Forfeiture, the preamble asserts, focuses on the unjust enrichment of the wrongdoer, not the harm to the victim. The preamble cites Nacchio for the importance of the intent behind forfeiture, stating that “[w]hile restitution seeks to make victims whole by reimbursing them for their losses, forfeiture is meant to punish the defendant by transferring his ill-gotten gains to the United States Department of Justice.”23

We believe that the preamble, in citing only to Nacchio, takes an unduly restrictive view of forfeiture which is not consistent with how forfeiture can be applied in practice, or with the general rule in Prop. Treas. Reg. § 1.162-21(f)(3)(i), which says that

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21 Even the Kokesh opinion itself acknowledges that disgorgement historically has been regarded as a form of “[r]estitution measured by the defendant’s wrongful gain.” 137 S. Ct. at 1640 (citing Restatement (Third) of Restitution and Unjust Enrichment, § 51, Comment a, p. 204).


the proper inquiry is whether an amount paid as forfeiture is “paid or incurred . . . [to restore], in whole or in part, the person as defined in section 7701(a)(1); the government; the governmental entity; or property harmed by the violation or potential violation of a law.” We believe that forfeiture often is used for restorative purposes in practice, and that, consistent with the general rule, the use of a forfeiture should be the touchstone for determining whether it is excluded from section 162(f)(1), i.e., whether the amount paid serves to restore the person or property harmed. This lends itself to a facts-and-circumstances approach to determining whether an amount paid or incurred meets the description provided in Prop. Treas. Reg. § 1.162-21(f)(3)(i), rather than a blanket prohibition on deductibility.

As support for this, we note that, while forfeiture might be used as a tool to punish a wrongdoer, there also are many instances in which it restores the person or property harmed. For example, *United States v. Navarrete* involved a situation in which a convicted defendant had been ordered to forfeit money obtained by fraud as well as pay restitution to the victimized bank. The Seventh Circuit noted that the government planned to convey forfeited assets to the victim, and that the order of forfeiture and order of restitution would remain outstanding after the defendant was released from prison. Under the Proposed Regulations, had the defendant satisfied only one of the two orders, the victim would be restored, but the deductibility of the amount paid by the defendant would depend on which of the two orders had been satisfied. Under a functional approach that looks to whether the amount is used to restore, in whole or in part, a person or property harmed by a violation or potential violation of law, the forfeiture amount would be deductible if it was the only amount paid by the defendant because it would be conveyed to the victim. The forfeiture amount would rightfully not be deductible if the defendant satisfied both orders and the government kept the proceeds of the forfeiture.

We believe that this facts-and-circumstances approach also should take into account the various processes through which such restoration can occur. Such restoration might not in all circumstances be directly from the forfeiter to the person harmed, and amended section 162(f) does not require a direct payment to victims. Take, for example, the Department of Justice Asset Forfeiture Program (the “Program”). The Program provides that “[a] critical element of the forfeiture program is the return of [money and property derived from fraud or other theft-related offenses] to the victims of crime through the remission and restoration process.” Under the process of remission, following the forfeiture of property, the U.S. Attorney’s Office identifies potential victims and provides them an opportunity to petition for remission based on their

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24 667 F.3d 886 (7th Cir. 2012).


pecuniary losses.\(^{27}\) Under the process of restoration, a U.S. Attorney authorized by the Attorney General uses forfeited funds to pay restitution to the victim of a criminal offense.\(^{28}\) In other situations, forfeited amounts may be used to compensate a class of victims rather than the specific victim of a specific violation or potential violation. For example, in proposed settlements for public nuisance due to alleged marketing of drugs that caused injury to the public, defendants may be required to make settlement payments to a state government that in turn establishes funds for health treatment and education of injured individuals.

C. Terminology that Presumptively Satisfies Identification Requirement

1. Recommendation

We recommend that the Proposed Regulations, when finalized, broaden the scope of the terminology that presumptively satisfies the identification requirement to include, for example, synonymous terms such as “accounting” and “compensatory,” as well as other variations of restitution or remediation. We recommend that a similar approach apply to expand the terminology related to the costs of coming into compliance.

2. Discussion

Amended section 162(f)(2)(A)(ii) imposes an identification requirement on any taxpayer wishing to sustain a deduction under the exceptions for amounts constituting restitution, remediation, or paid to come into compliance with a law. Under the identification requirement, the court order or settlement agreement must identify the amount as restitution, remediation, or paid to come into compliance with a law by stating the nature of, or purpose for, each payment the taxpayer is obligated to pay and the amount of each payment identified.\(^ {29}\)

Prop. Treas. Reg. § 1.162-21(b)(2)(ii) would presume the identification requirement to be met if an order or agreement specifically identified a payment amount as restitution, remediation, or an amount paid to come into compliance with a law. It also would presume the identification requirement to be met if an order or agreement used a different form of the required words to identify a payment amount as meeting one of these exceptions, such as “remediate” or “comply with a law.”\(^ {30}\)

Prop. Treas. Reg. § 1.162-21(b)(2)(iv) would allow the Service to rebut the presumption under Prop. Treas. Reg. § 1.162-21(b)(2)(ii) by developing “sufficient contrary evidence that the amount paid or incurred was not for the purpose identified in the order or agreement.”

\(^{27}\) Id.

\(^{28}\) Id.

\(^{29}\) See also Prop. Treas. Reg. § 1.162-21(b)(2)(i).

We are concerned that the references in Prop. Treas. Reg. § 1.162-21(b)(2)(ii) to “remediate” or “comply with a law”—even though they are described as examples—are too limited and might result in the entire paragraph being interpreted too narrowly. The Supreme Court in *Liu* noted that courts and scholars have used various labels for stripping wrongdoers of their ill-gotten gains (i.e., restitution). The Court underscored its point by providing:

> Equity courts have routinely deprived wrongdoers of their net profits from unlawful activity, even though that remedy may have gone by different names. Compare, e.g., 1 D. Dobbs, Law of Remedies §4.3(5), p. 611 (1993) (“Accounting holds the defendant liable for his profits”), with id., §4.1(1), at 555 (referring to “restitution” as the relief that “measures the remedy by the defendant’s gain and seeks to force disgorgement of that gain”); see also Restatement (Third) of Restitution and Unjust Enrichment §51, Comment a, p. 204 (2010) (Restatement (Third)) (“Restitution measured by the defendant’s wrongful gain is frequently called ‘disgorgement.’ Other cases refer to an ‘accounting’ or an ‘accounting for profits’”); 1 J. Pomeroy, Equity Jurisprudence §101, p. 112 (4th ed. 1918) (describing an accounting as an equitable remedy for the violation of strictly legal primary rights). 31

Therefore, we recommend the Proposed Regulations, when finalized, include terms identified by the Supreme Court, as well as lower federal and state courts as applicable, that generally are synonymous with restitution, including but not limited to an “accounting,” an “accounting for profits,” and “disgorgement of improper profits.” Consistent with the Supreme Court’s point that restitution can go by many names, we recommend that other terms that could describe restitution, remediation, or amounts paid to come into compliance, such as “compensatory,” also should be included in the presumptive terminology to meet the identification requirement. An added benefit would be to extend the rule to foreign settlements that—because of differences in language or applicable law—do not use the terms restitution, remediation, or cost to come into compliance, or do not easily translate into those exact terms, but are synonymous with restitution, remediation, or cost to come into compliance.

We note that, because the Proposed Regulations allow the Service to challenge the presumption that the identification requirement has been met to ensure only amounts that actually constitute restitution, remediation, or paid to come into compliance are excepted from the denial of a deduction under amended section 162(f), the Service need not worry about taxpayers using these labels to circumvent the statute’s intent.

31 140 S. Ct. at 1942-43.
32 “In *Great-West*, the Court noted that an ‘accounting for profits’ was historically a ‘form of equitable restitution.’” *Id.* at 1943.
33 “In *Tull v. United States*, 481 U.S. 412 (1987), the Court described ‘disgorgement of improper profits’ as ‘traditionally considered an equitable remedy.’” *Id.*
D. Clarification of Documentation Requirement

1. Recommendation

We recommend that the Proposed Regulations, when finalized, expand the list of documents deemed to meet the establishment requirement under Prop. Treas. Reg. § 1.162-21(b)(3) as described below, clarify the requirement by including examples, described below, of situations in which the requirement has been met and situations in which it has not been met, and add a presumption that it has been met if a court order provides that a payment is restitution, remediation, or a cost to come into compliance.

2. Discussion

Amended section 162(f)(2)(A)(i) imposes an establishment requirement on any taxpayer wishing to sustain a deduction under the exceptions for amounts constituting restitution, remediation, or paid to come into compliance with a law. Prop. Treas. Reg. § 1.162-21(b)(3)(i) would require a taxpayer to substantiate, with documentary evidence, (i) its legal obligation, pursuant to the order or agreement, to pay the amount identified as restitution, remediation, or paid to come into compliance with a law, (ii) the amount paid, and (iii) the date the amount was paid or incurred, in order to satisfy that requirement. Under Prop. Treas. Reg. § 1.162-21(b)(3)(ii), documentary evidence that satisfies the establishment requirement would include, but not be limited to:

- receipts;
- the legal or regulatory provision related to the violation or potential violation of a law;
- documents issued by the government or governmental entity relating to the investigation or inquiry;
- documents describing how the amount to be paid was determined; and
- correspondence exchanged between the taxpayer and the government or governmental entity before the order or agreement became binding under applicable law.

We are concerned that the list of documentary evidence in Prop. Treas. Reg. § 1.162-21(b)(3)(ii)—even though the items are described as examples—is too limited and might result in the entire paragraph being interpreted too narrowly. Therefore, we recommend the Proposed Regulations, when finalized, supplement this list of documentary evidence to include, for example, court orders as well as other testamentary and objective support, such as witness statements and objective support for the positions.

We further recommend that the Proposed Regulations, when finalized, include examples of situations in which the documentary evidence has sufficiently demonstrated establishment and situations in which it has not. The Proposed Regulations are not clear as to whether this documentary evidence must support only (i) that the taxpayer had a binding obligation to pay the amount identified as restitution, remediation, or paid to comply with a law; (ii) actual payment of the amount; and (iii) the date the amount was paid; or whether the documentary evidence must also substantiate that the amount paid is, in substance, restitution, remediation, or a payment to comply with law, as defined in section 162(f)(2)(A)(i) and Prop. Treas. Reg. § 1.162-21(f)(3). Including examples of
situations that do and do not satisfy this standard would clarify what the documentary evidence is intended to support in order to meet the establishment requirement. We propose that the Proposed Regulations, when finalized, include the following examples, or similar examples of situations where the documentary evidence provided is and is not sufficient to satisfy the establishment requirement:

**Example 1.** Taxpayer is a chemical production company involved in negotiations to settle ongoing litigation with City regarding Taxpayer’s violation of the Clean Water Act by discharging pollutants directly into City’s river in the course of its trade or business without a permit. The parties entered into a final settlement agreement on 1/1/20XX with Taxpayer agreeing to pay a total of $20,000, $7,000 of which is identified as restitution and $5,000 of which is identified as paid to come into compliance with law. The evolution of the settlement and final agreement between the parties supports and is consistent with the settlement language identifying $7,000 as restitution and $5,000 as paid to come into compliance with the law. Further, the settlement agreement’s identification of the amounts as restitution and paid to come into compliance with the law are supported by and consistent with an origin of the claim analysis, including consideration of the evolution of the suit and negotiations between the parties. For example, the $7,000 identified as restitution was calculated as the cost to remove the discharged pollutants from the river and was paid into City’s Water Fund which services the river. Further, the $5,000 identified as paid to come into compliance with the law was calculated as the cost of a permit for discharging pollutants into City’s river as well as the cost of setting up the appropriate pipes to control such discharges. The amounts identified as restitution and paid to come into compliance with the law were paid by Taxpayer between 1/1/20XX and 6/1/20XX, and Taxpayer has invoices to support such payment on such dates. Taxpayer has met the documentary evidence standard to satisfy the establishment requirement because Taxpayer has a binding settlement agreement showing its obligation to pay $7,000 in restitution and $5,000 to come into compliance with the law, invoices to show actual payment and the date of payment of such amounts, and an origin of the claim analysis supports the classification of the $X and $Y amounts as restitution and paid to come into compliance, respectively.

**Example 2.** Taxpayer is an automobile manufacturer that was found to have violated 42 U.S.C. 1857f-2(a)(1) by selling a new motor vehicle that was not covered by the required certificate of conformity. Pursuant to 42 U.S.C. 1857f-4, Taxpayer was required to pay, and did pay, a civil penalty of $10,000. In addition, pursuant to 42 U.S.C. 1857f-5a(c)(1), Taxpayer was required to expend, and did expend, $500 in order to come into compliance with the law regarding the conformity of that motor vehicle. The Taxpayer was also required to pay, and did pay, an amount identified as restitution of $1,000 to a Vehicle Accident Victim Fund. While the Taxpayer has documentary evidence to support that it was obligated to pay $500 to come into compliance with the law and that it was obligated to pay $1,000 identified as restitution, it does not have documentary evidence sufficient to satisfy the establishment requirement with regard to the restitution payment without further proof that its violation of the law caused
$1,000 in harm which will be remedied by this payment to the Vehicle Accident Victim Fund.

Finally, we recommend that the Proposed Regulations, when finalized, include a presumption that if a court provides in its court order that a payment is restitution, remediation, or a cost to come into compliance, then the payment amount will be deemed to constitute restitution, remediation, or an amount paid to come into compliance. We believe that a court of competent jurisdiction can be relied on to describe properly and accurately the nature of the payment that it orders a defendant to make.

E. Application of Amended Section 162(f) to Revised Orders and Agreements

1. Recommendation

We recommend that the Proposed Regulations, when finalized, clarify that amended section 162(f) applies only to the amended portion of certain orders and agreements entered into prior to December 22, 2017, and provide a clearer and more narrowly delineated definition for “material change.” These recommendations are explained in more detail below.

2. Discussion

The Act’s amendments to section 162(f) generally are effective for amounts paid or incurred on or after December 22, 2017, unless the amount is paid or incurred under a binding order or agreement that was entered into before December 22, 2017.\textsuperscript{34}

Prop. Treas. Reg. § 1.162-21(e)(1) would provide that, if the parties to an order or agreement that was entered into before December 22, 2017, make a material change to the terms of the order or agreement on or after the effective date of the final regulations, the final regulations implementing the Act’s amendments to section 162(f) will apply to any amounts paid or incurred, or to any obligation to provide property or services, under the order or agreement subsequent to the date of the material change.

Prop. Treas. Reg. § 1.162-21(e)(2) would define a material change to the terms of an order or agreement broadly, stating that a material change “may include: changing the nature or purpose of a payment obligation; or changing, adding to, or removing a payment obligation, an obligation to provide services, or an obligation to provide property,” before confirming that “[a] material change does not include changing a payment date or changing the address of a party to the order or agreement.”\textsuperscript{35}

\textsuperscript{34} See note 8 supra. See also the discussion in Notice 2018-23, 2018-15 I.R.B. 474.

\textsuperscript{35} This definition of material change also applies for purposes of determining whether information reporting must be updated under Prop. Treas. Reg. § 1.6050X-1(f).
The preamble to the Proposed Regulations suggests that this provision was included to clarify that non-material amendments (i.e., amendments that do not change the nature or purpose of the payment obligation, or create a new payment obligation) to an order or agreement entered into prior to December 22, 2017, do not cause the order or agreement to be treated as entered into after December 22, 2017.

We are concerned that the reach of the proposed rule is much broader than its intended effect. As the Proposed Regulations are written, amended section 162(f) would apply not only to the new, added, or changed obligations resulting from the material change to an order or agreement entered into before December 22, 2017, but also to obligations that were determined and settled prior to December 22, 2017, but not yet paid as of the date of the material change. We believe this clearly was not the intended effect of the Act’s amendments to section 162(f), which were enacted to apply only to amounts paid or incurred under orders or agreements entered into on or after December 22, 2017. Therefore, we recommend that the Proposed Regulations, when finalized, clarify that amended section 162(f) applies only to new, added, or changed obligations within an order or agreement that was entered into prior to December 22, 2017, and not to any of the obligations within the original order or agreement entered into prior to December 22, 2017, that were not amended.

We also are concerned that the definition of “material change” in Prop. Treas. Reg. § 1.162-21(e)(2) is both broad and unclear. The use of the permissive word “may” suggests that what follows is not an all-inclusive list. Following such a broad definition with two narrowly carved-out exceptions suggests that a “material change” encompasses all changes that are not merely clerical. Specifically, under the language of the Proposed Regulations, any change other than to the payment date or the address of a party could constitute a material change triggering application of amended section 162(f). This language endorses a potentially very broad definition of “material change,” and we are concerned that the definition-by-example will create confusion and unpredictable outcomes for taxpayers determining whether amendments to their agreements trigger application of amended section 162(f). Therefore we recommend that the Proposed Regulations, when finalized, clearly delineate what constitutes a “material change” to allow taxpayers certainty in forecasting how the law will apply to their agreements and thereby eliminate potential causes for litigation. Specifically, we recommend that they clarify that a “material change” triggering application of amended section 162(f) includes only amendments that (i) modify the nature or purpose of the taxpayer’s existing obligations, or (ii) impose a new or different kind of obligation on the taxpayer (compared to the obligations in the original order or agreement).

F. Definition of “Governmental Entity”

1. Recommendation

We recommend that the Proposed Regulations, when finalized, clarify that the term “governmental entity” encompasses all local (e.g., city, town, municipal) governments and subdivisions thereof.
2. Discussion

Amended section 162(f) and Prop. Reg. § 1.162-21(a) provide that no deduction is allowed under chapter 1 of the Code for any amount paid or incurred by suit, settlement agreement, or otherwise to or at the direction of a government or governmental entity, in relation to the violation, or investigation or inquiry into the potential violation, of any civil or criminal law. Prop. Treas. Reg. § 1.162-21(f)(1) would define “government or governmental entity” as meaning:

(i) The government of the United States, a State, or the District of Columbia;

(ii) The government of a territory of the United States, including American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands;

(iii) The government of a foreign country;

(iv) An Indian tribal government, as defined in section 7701(a)(40), or a subdivision of an Indian tribal government, as determined in accordance with section 7871(d); or

(v) A political subdivision of (i), (ii), or (iii), or a corporation or other entity serving as an agency or instrumentality of any of paragraph (f)(1)(i)-(f)(iv) of this section.

We are concerned that this definition might be confusing to taxpayers trying to determine whether local governments or subdivisions of local governments constitute a government or governmental entity. Therefore, we recommend that the Proposed Regulations, when finalized, clarify the definition of “government or governmental entity” as stated above. This would remove uncertainty for taxpayers and provide for clear and consistent application of the Treasury Regulations under amended section 162(f).

II. Section 6050X

A. Background

Section 6050X generally requires the government or entity described in amended section 162(f)(5) to file information returns with respect to a suit or agreement subject to amended section 162(f) and furnish a written statement to each party to such suit or agreement if the reporting threshold is satisfied. The information return must include the amount to be paid as a result of the suit or agreement, any amount that constitutes restitution or remediation, and any amount to be paid to come into compliance with the law.

Under section 6050X(a)(2)(A)(ii), the reporting threshold is satisfied if the aggregate amount involved in all court orders and agreements with respect to the
violation, investigation, or inquiry is $600 or more. However, section 6050X(a)(B) provides that the threshold amount may be adjusted “as necessary in order to ensure the efficient administration of the internal revenue laws.”

Under section 6050X(a)(3), information returns must be filed with the Service at the time the agreement is entered into as determined by the Secretary. Under section 6050X(b), written statements must be furnished to each person who is a party to the suit or agreement at the same time the information return is filed with the Service.

Prop. Treas. Reg. § 1.6050X(h) provides that information reporting is applicable to orders and agreements that become binding under applicable law on or after January 1, 2022.

B. Reporting Threshold

1. Recommendation

We recommend that the Proposed Regulations, when finalized, increase the threshold amount under Prop. Treas. Reg. § 1.6050X-1(g)(5) to $1 million or more.

2. Discussion

Pursuant to the authority granted in section 6050X(a)(2)(B), Prop. Treas. Reg. § 1.6050X-1(g)(5) would increase the reporting threshold from $600 to $50,000. While we agree that there should be an increase in the $600 threshold, we are concerned that this increase does not reflect a tax risk commensurate with the increased burden of reporting that is being imposed on governments and other entities. This is especially important given the significant financial strain the pandemic has put on state and local governments.

We believe that raising the reporting threshold would not reduce benefits of the new law to the Service to any significant degree. That is because the operative rules under amended section 162(f), particularly the identification requirement, are still in effect regardless of whether the payor receives an information return.

We believe that, at a threshold of $1 million or more, state and local governments, boards, and commissions would not be subject to reporting for small matters, but the Service would have information reporting for the largest settlements where noncompliance could have a meaningful tax impact.

C. Rules for Aggregation

1. Recommendation

We recommend that the Proposed Regulations, when finalized, clarify that the reporting threshold under section 6050X applies on an order-by-order or agreement-by-agreement basis except where multiple settlements arise as a result of proceedings for the same violation or potential violation of law initiated by the same party or parties, and that
only the amounts required to be paid to the same government or entity, or group of governments or entities, that brought the proceeding resulting in the settlement need to be aggregated.

2. Discussion

Prop. Treas. Reg. § 1.6050X-1(a)(1) would provide that the reporting threshold is satisfied if the aggregate amount the payor is required to pay pursuant to all orders and agreements with respect to a violation, investigation, or inquiry equals or exceeds the threshold amount. The Proposed Regulations would not provide rules for what is meant by “all orders and agreements with respect to a violation, investigation, or inquiry.” We believe it would be useful to clarify that the reporting obligation applies on an order-by-order or agreement-by-agreement basis except where multiple settlements arise as a result of proceedings for the same violation or potential violation of law initiated by the same party or parties.

We also believe that only amounts required to be paid to the same government or entity, or group of governments or entities, that brought the proceeding resulting in the settlement should be aggregated for this purpose, and therefore that amounts paid for the same or similar violation or potential violation of law to a party that did not participate in the same proceeding as the filer should not be included. Without clarifying the identity of matter and parties, it will be difficult for filers to determine which amounts are taken into account to determine whether the threshold is satisfied.

D. Filing Date for Form 1098-F

1. Recommendation

We recommend that, to avoid future confusion, the Proposed Regulations, when finalized, make it clear that the date for filing the Form 1098-F (or any successor form) is not the date the settlement is entered into, but rather the due date determined by the Secretary.

2. Discussion

Under section 6050X(a)(3), the information return must be filed when the settlement is entered into as determined by the Secretary. Prop. Treas. Reg. § 1.6050X-1(b)(2) would provide that the information return, Form 1098-F, Fines, Penalties and Other Amounts, (or any successor form) must be filed with the Service on January 31 of the year following the calendar year in which the agreement becomes binding. This due date for filing the return is reasonable and consistent with other information reporting obligations. However, we are concerned that this might create confusion in view of the language of the statute.
E. Requirement to Provide Copy of Form 1098-F to Payor

1. Recommendation

We recommend that the Proposed Regulations, when finalized, include language to provide that if a payor asks for a copy of the Form 1098-F (or any successor form), the filer must provide the payor with a copy within ten days of the request.

2. Discussion

Prop. Treas. Reg. § 1.6050X-1(c)(3) would require a copy of the Form 1098-F to be furnished to the payor on or before the date filed with the Service. The Proposed Regulations would permit, but not require, the filer to furnish a copy of the information return to the payor earlier than January 31 of the year following the calendar year in which the agreement becomes binding.

We believe that payors will want to know what is being reported to the Service to ensure they are reporting consistently on their tax return. If there is a disagreement, a payor is going to want to try and resolve that prior to filing its return. If the payor is a fiscal year filer, it might be filing its return before the January 31 date. Although the payor can request that the filer furnish a copy of the Form 1098-F early, the payor has little leverage, particularly since the two parties were in an active dispute. We believe that including the recommendation described above would address the needs of the payor without imposing a significant burden on the filer.