Section 162(f), as Amended by the Tax Cuts and Jobs Act  
Panel Discussion in Anticipation of Forthcoming Proposed Regulations

The Tax Cuts and Jobs Act amended Section 162(f) and added new Section 6050X. Under amended Section 162(f)(1), taxpayers may not deduct amounts paid (whether by suit or agreement) to a government or governmental entity in relation to: (1) the violation of any law or (2) the investigation or inquiry by the government or entity into the potential violation of a law. Section 162(f)(2) contains an exception to Section 162(f)(1) under which a taxpayer may deduct an amount described in Section 162(f)(1), provided it is otherwise deductible under the Code and the taxpayer establishes that the amount paid or incurred: (1) is restitution (including remediation of property) for damage or harm that was or may be caused by violation of any law or the potential violation of the law, or (2) is paid to come into compliance with any law that was violated or otherwise involved in the investigation or inquiry into the potential violation of any law (the so-called “establishment requirement”) and is identified as such in the court order or settlement agreement (the “identification requirement”). Another exception under Section 162(f)(2)(A)(iii) also may apply. Under Section 162(f)(2)(A)(iii), in the case of any amount of restitution for failure to pay any tax imposed under the Code, the amount paid is treated as if it were the tax if it would have been allowed as a deduction had it been timely paid.

New Section 6050X(a)(1) requires an official of any government or nongovernmental entity described in Section 162(f)(5) that is involved in suits or agreements to complete a return, reporting any amount required to be paid as a result of: (1) a suit or agreement; (2) a suit or agreement that constitutes restitution or remediation of property; and (3) a suit or agreement for the purpose of coming into compliance with any law that was violated or involved in the investigation or inquiry. Amounts are required to be reported if the suit or agreement is a type described in Section 6050X(a)(2)(A)(i) and the dollar threshold in Section 6050X(a)(2)(A)(ii) is satisfied. The dollar threshold is $600 or more, but Section 6050A(a)(2)(B) allows the Secretary to adjust that amount to ensure the efficient administration of the internal revenue laws. The government or nongovernmental entity is required to file the return at the time the agreement is entered into with the taxpayer.

We understand that the Treasury Department and the IRS plan to issue proposed regulations under Sections 162(f) and 6050X in early 2020.

Section 6050X reporting

Notice 2018-23 provides transitional guidance under those sections. Under this guidance, the IRS will not require reporting under Section 6050X until the date specified in the proposed regulations. Notice 2018-23 does not require reporting for any amounts required to be paid or incurred under a binding court order or settlement agreement entered into before the specified date.

Identification requirement

Notice 2018-23 addresses, in part, the deductibility of amounts paid to a government as a result of a violation of a law or the investigation or inquiry by the government into the potential violation of a law under Section 162(f). Notice 2018-23 allows the identification requirement to be treated as satisfied for an amount if the settlement agreement or court order states that the amount is restitution, remediation, or for coming into compliance with the law. Notice 2018-23 indicates that even if the identification requirement is satisfied, taxpayers also must meet the establishment requirement to qualify for the exception under Section 162(f)(2).
Notice 2018-23 also provides guidance under new Section 6050X on reporting amounts paid as a result of a suit or agreement. Importantly, and as discussed herein, the Notice indicates that governmental and nongovernment entity reporting of an amount under Section 6050X is not required until a date specified in upcoming proposed regulations, with the date not to be earlier than January 1, 2019.

**Settlements paid in connection with sexual harassment or sexual abuse**

Section 162 permits a taxpayer to deduct eligible ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business. The TCJA enacted new Section 162(q), which denies an ordinary and necessary deduction under Section 162 for “any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or attorney’s fees related to such a settlement or payment.”

Issues include, for example, how broadly the statute will be applied (e.g., with regard to agreements that provide for a standard release of all claims), how will the attorney fee limitation on deductibility will be construed, and how taxpayers should parse settlement agreements that involve a variety of claims, only some of which entail sexual harassment or sexual abuse. We understand that specific guidance in the form of regulations, for instance, is not presently anticipated in the near term.