A. Overview of Provisions and Summary of Changes made to Section 162(f) and Section 162(q)

- Rayth Myers: Section 162(f)
- Connie Cheng: Section 162(q)
- Susan Grais: TCJA legislative history

B. Section 162(f) Draft Questions

1. Section 162(f) expressly addresses fines and penalties. The statute also refers to “other amounts”. Apart from fines and penalties, how do you currently interpret what is contemplated by this reference?

2. Post-TCJA, how might broadly might the IRS address what is restitution (i.e., generally, compensatory or remedial amounts) and amounts paid to come into compliance? Are there particular leading cases that the IRS has considered in this context?

3. If a lawsuit settlement amount is paid to a governmental entity, which will in turn use the funds at issue to establish programs to compensate victims of a violation of law, do you agree that section 162(f) should not preclude a deduction merely because the payment is not directly to the victims? For example, what are your thoughts regarding amounts paid to a government to come into compliance with the law that are used for public education related to the subject of the violation? One example for purposes of answering this question would be public education that a manufacturer of a defective product agrees to provide to ensure its improved products are properly utilized in a safe manner going forward. For another example, what about health treatment programs for the affected public (e.g., for substance abuse)? What about health education programs?

4. To qualify for characterization as restitution or amounts to come into compliance with any law, a court order or settlement agreement must identify the amount(s) as such. However, while this is a prerequisite to establishing the right to deductions, it is not conclusive or binding on the IRS under the statute. What other factors might the government, as a generalization, consider relevant to deductibility assuming this “identification” requirement is met? Will these other
factual considerations be addressed in forthcoming regulations as a non-exhaustive list of considerations?

5. The IRS can assert that amounts identified nevertheless do not qualify as a deduction for business expenses because the such amounts, for example, arguably may have a different nature or origin than identified. Is there any other basis on which you believe that taxpayers may be challenged (i.e., other than the amounts are identified inconsistent with the underlying facts (essentially, the evolution of the litigation))? What additional steps can a taxpayer take to document its entitlement to a deduction in this context, especially if the litigation evolves and the intent of the parties in the final settlement reflect the intent at the time of signing? For example, it generally is not uncommon for initial complaints to specify a wide variety of claims - - material and immaterial, some stronger than others.

6. Are there any specific industries that the IRS has considered factually in light of comments (formal or informal) received to date and, if so, what are the principal issues?

7. What issues has the government considered in the context of environmental remediation (e.g., when precise cost of remediation is not known at the time the settlement agreement finalized) and what are some of the alternatives considered to resolve such issues? For example, can a taxpayer use an estimate of the amount (e.g., approximately $10 million) to be incurred and what are the implications when the precise amount is known later? Can a taxpayer characterize “all amounts paid or incurred” as restitution (for example) and meet the identification requirement without specifying a dollar amount?

8. The IRS issued transitional guidance on reporting requirements under section 6050X in Notice 2018-23. Do you have an update on the status and nature these reporting requirements, which are not yet effective?

9. What are the implications for a compliant taxpayer if a governmental entity does not comply with its reporting requirement (e.g., due to lack of resources or some other factor not inconsistent with the intent of the statute)? Note that taxpayers in state and local settlements have expressed concern as to whether the non-federal entities will willingly (e.g., due to concern about providing information relevant federal tax law provisions) comply with section 6050X and whether the non-compliance will cause, a settlement otherwise not subject to Section 162(f), to become nondeductible under Section 162(f). With such background, can you provide your thoughts?

10. Our experience is that under prior policy, the Department of Justice often avoided taking any position regarding the tax treatment of settlement payments. We understand from publicly available information that the DOJ formed a working group that includes IRS representatives to determine the extent to which its approach should be modified in light of the TCJA. Do you have any update solely from an IRS perspective on these efforts?

11. Do you anticipate any clarification in the regulations regarding the definition and treatment of nongovernmental entities in light of section 162(f)(5)(A)?

C. Section 162(q) Draft Questions

1. The IRS issued an FAQ in 2019 confirming that recipients of settlement payments related to sexual abuse, where such settlement contain a nondisclosure agreement, are not precluded from deducting attorney’s fees. Section 162(q) as enacted does not distinguish between deductions by
the payer and deductions by the recipient of the settlement. The Joint Committee on Taxation previously had opined that “[a]ny attorney’s fees incurred by the beneficiary of the settlement or recipient of the payment are not subject to this rule”. What other issues does the IRS plan to address in any forthcoming guidance?

2. Has the government considered whether the attorney fee provision in the legislative history applies to both outside counsel as well as internal general counsel offices?

3. It is common practice for companies to hire legal firms to assist/lead internal investigations to investigate various claims of misconduct and advise the company or board on how to proceed. Are these the type of investigatory attorney fees envisioned as being subject to section 162(q), which refers to a “settlement or payment” as nondeductible? Will an allocation be permitted for payments that may address multiple claims? If so, what type of documentation would taxpayers need to prepare in order to substantiate deductible amounts?

4. What are the most common issues on which you are receiving inquiries regarding this new provision?

5. If a settlement payment is made pursuant to an agreement that releases all claims (including sexual harassment), but sexual harassment was not part of the initial complaint, will some/all of the payment be disallowed?

6. Does the IRS plan to issue guidance to elaborate on the term “nondisclosure” (confidentiality) agreement? Will a non-disparagement provision constitute a nondisclosure agreement?

7. Does the IRS plan to issue guidance as to what constitutes “related to sexual harassment or sexual abuse”? Does this apply only to payments arising out of an employer/employee relationship, or does it apply to all sexual harassment/sexual abuse claims?

8. Does Section 162(q) apply to claims that were settled before December 22, 2017, but paid after? What if the attorney’s fees were incurred before December 22, 2017 and the taxpayer is on the accrual method of accounting?