CHANGES TO THE TAX CODES THAT IMPACT AG SETTLEMENT NEGOTIATIONS

Paul Singer & Clayton S. Friedman
Overview of Relevant Tax Law Changes

- Tax Cuts and Jobs Act of 2017 (12/22/17)
  - Two Relevant Sections:
    - 26 U.S. Code § 162(f) – Applies to Defendants
    - 26 U.S. Code § 6050X – Applies to Attorneys General
    - Disclosure of key fact-no IRS Regulations yet
26 U.S. Code § 162(f) (Defendants)

- **Old Version**: “No deduction shall be allowed … for any fine or similar penalty paid to a government for the violation of any law.”
  - Compensatory damages were deductible, but civil penalties were not.
  - Question over whether unspecified payments were compensatory or “in lieu of” a penalty.
  - Restitution – Unclear if allowed as a deduction.
  - Attorneys Fees – Unclear if allowed as a deduction.
  - Note: Historically, the FTC, in certain cases, would specifically state certain payments were not deductible
26 U.S. Code § 162(f) (Cont’d)

- **New Version**: “[N]o deduction shall be allowed for *any amount* paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.”

- **Broad Application**:
  - Consumer Protection
  - Antitrust
  - Securities
  - Environmental
  - Etc.
**26 U.S. Code § 162(f) (Cont’d)**

- **EXCEPTIONS:**
  1. Restitution (including remediation of property) which was or may be caused by the violation or potential violation of any law; or
  2. Money paid to come into compliance with the law.

- Exceptions must be identified specifically in the court order or settlement agreement and the burden is on the defendant to establish the validity of the exception.

- Reimbursement of costs of investigation or litigation are **NOT** tax deductible.
  - E.g. Attorney’s Fees
Questions re: application of § 162(f)

- Impact if any, of the law if the target/parties decide to do restitution outside the scope of the settlement?
- How will payments to a State AG’s statutory funds be treated (revolving funds)?
- What happens when a company is required to pay a lump sum to the state(s) and the state(s) are given discretion on how to allocate the funds?
  - How will companies know how much they can deduct?
    - E.g. If only some of the funds are spent on restitution.
- What happens when a consumer gets restitution but gets to retain the product or service that has value – does it trigger a 1099?
Questions re: application of § 162(f) Cont’d

- How will the term “money to come into compliance with the law” be interpreted?
  - Does it include money spent on hiring a compliance monitor?
  - Does it include money spent to implement injunctive terms (e.g. cost to build new IT infrastructure for compliance)?
26 U.S. Code § 6050X (Applies to State AGs)

- Imposes the following reporting requirements on governmental entities.
  - Total amount paid by judgment or settlement;
  - Any amount which is restitution or remediation;
  - Any amount which is cost to come into compliance with the law.
26 U.S. Code § 6050X (Cont’d)

- The form must be sent to the IRS at the time of judgment or settlement.
  - If settlement requires court approval, may wait until court approval is obtained.
- A copy of the completed form must also be provided to the defendants.
- **NOTE:**
  - IRS is currently working on publishing regulations.
  - Reporting will not be required until regulations are published.
    - Unclear if forms will need to be completed for settlements executed prior to implementation of the regulations.
  - Uncertain who in the state has the responsibility to complete the form (e.g. Attorney General, Treasurer, Auditor)
Questions re: application of § 6050X

- What happens if companies disagree with the state’s allocations of the money in the 1098-F?
- Can companies challenge the allocations made by the state on the 1098-F?
- What is the purpose of the 1098-F? Is it to determine if the deductions are accurate or give states more visibility on how the money is being spent?
**Key Takeaways**

- Restitution—What is the reach of the exception?
- What is the scope of “an amount paid to come into compliance with [the] law”?
- How should discretionary payments be treated?
  - Where AG plans to use as restitution
  - Multistate payments
1,900 LAWYERS and 20 OFFICES located in commercial, financial and regulatory centers around the world